Set 2

to offer customers attractive bundled service. This bundled service will probably include local, toll and long distance services. Pacific asserts that new carriers will not compete with the incumbent LECs for basic exchange service alone. Rather, new carriers will be competing on the basis of bundled service. Therefore, Pacific concludes that INP charges will only apply to ported numbers and will be a minor cost to the new carriers offering bundled service.

Pacific denies that number portability is a prerequisite to local competition, or that customers' ability to retain their phone number is the determining factor in their decision to change local providers. Pacific believes that customers will take several additional factors into consideration such as price, quality, reliability, and familiarity. Brand name recognition and the ability to get all services from one provider are additional factors customers would consider.

In support of its claim regarding the relative importance of number portability in a customer's willingness to change local providers, Pacific introduced a marketing study conducted by ConStat, Inc. an independent marketing research organization. The ConStat study was conducted during late 1994 and early 1995 and sought to determine the factors which customers consider important in deciding to change local providers and the relative value placed on retaining their current telephone number. Pacific interprets the study's findings to show that (1) the lack of service provider number portability is not a barrier to competition; and (2) price is a much more important factor than number portability in motivating a customer to change service providers.

The ConStat consultants concluded that for a discount of 15% off of their total Pacific charges, 36% of residential customers would consider switching to another provider whether they can keep their present phone number or not. Forty-nine percent of residential customers would switch only if able to retain their

phone number. In the case of large business customers (with over 100 lines), 59% would switch providers if their long distance company offers a 25% discount.

We shall first review the significance of the marketing studies offered by Pacific and MCI and then address more generally the validity of MCI's proposed $0.50 rate cap for INP service. We find that both the ConStat and the Gallup market studies have a number of limitations and caveats in terms of their evidentiary reliability. Both studies were offered only as hearsay evidence and accordingly carry less evidentiary weight than would be the case if a percipient witness had testified to the detailed statistical methodology and research techniques used to design, conduct, and interpret the results of the studies. To the extent we assign credibility to either of the studies, it is only in the form of broad corroboration of general trends regarding customer preferences. We do not rely upon the detailed statistical findings as precise measures of customer behavior.

Our hesitation to rely on these marketing studies is somewhat mitigated by the fact that opposing sides presented their own study. Thus, the results of one study can be used as a check against the credibility of its counterpart. While parties reach opposite conclusions regarding the significance of the market surveys offered into evidence, we find the surveys' results are really more alike than they are different.

Parties' differences in interpreting the surveys can be attributed more to the predetermined position each side sought to justify and the particular portions of the survey findings parties chose to emphasize. In contrast to its position in this proceeding regarding customers' willingness to change their phone numbers, Pacific argued previously in C.94-09-058/C.95-01-001 that customers in the 310 area code were strongly opposed to changing even the area code portion of their phone numbers in order to implement a geographic split of the 310 area code. Although in D.95-08-052 of

that proceeding we adopted a plan for a geographic split of the 310 area code, we acknowledged that customers react negatively to forced phone number changes.[30] It logically follows that CLCs would be at a competitive disadvantage if customers had to undergo a forced number change in order to switch local providers. Moreover, in Finding of Fact 90 of D.95-08-052, we noted that: "Some of the same reasons why a customer would be resistant to changing his or her area code due to an area code split would also make him or her resistant to changing his or her area code and number to receive service from a new competitor."

The focus on customers' responsiveness to price discounts obscures the measurement of how important number retention is to customers in considering a change in local service providers. The most meaningful part of the ConStat study for purposes of our inquiry is that which isolates customer sensitivity to number portability to the exclusion of other extraneous factors such as price discounts. Assuming zero price discounts, business customer willingness to switch providers increases from 10% to 21% and residential customer willingness increases from 19% to 32%, when number portability is offered, according to the ConStat findings.[31]

Both the ConStat and Gallup studies support the finding that as the price at which a competitor offers its service goes down relative to the incumbent LEC, the number of customers willing to switch carriers absent number portability goes up. Clearly -- and not surprisingly-- the overall price of a competitor's service

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30 Decision at 19-27.

31 Exh. 57,58.

has a significant bearing on the number of prospective customers who will be motivated to change local service providers. While the specific percentages of customers differ between the studies, both studies also support the finding that the ability to retain one's phone number has a bearing on the willingness of customers to change providers. As the price discount offered by a competitor goes down, the importance of retaining one's phone number becomes more important.

Such findings illustrate the importance to customers of retaining their phone number. They confirm that customers place a significant value on number retention and will only consider forfeiting their number if a significant price discount is offered. Both consumer surveys sponsored by opposing sides support the conclusion that a significant number of customers would require number portability as a prerequisite to changing local providers. If the only way a CLC can overcome a lack of number portability is to deeply discount its retail price below the LEC competitor, then the result would be an uneven playing field which would not be conducive to an efficient and competitive marketplace. Accordingly, we reaffirm our policy that service provider number portability is an essential feature that must be available to CLCs in order for competition to succeed. By adopting tariffed offerings of INP in this order we assure CLCs that their customers will have access to INP as needed.

We have no basis to conclude, however, that an INP wholesale charge in excess of $0.50 per month will preclude CLCs from offering a competitive price for local exchange services to its customers. There are several reasons to reject MCI's proposed $0.50-cap proposal. First, CLCs have the discretion to choose whether or not to establish an explicit retail charge for INP service. A CLC may decide not to pass through an explicit dollar-for-dollar charge to recover its wholesale INP costs. While the Coalition claims the $0.50 cap is necessary to allow a CLC a

reasonable opportunity to compete and still recover its costs, no evidence has been presented regarding the actual total service costs any CLC will incur relative to the LECs. Moreover, the CLCs oppose in principle any requirements for CLC cost studies to be submitted for Commission review. Without a showing as to the total costs each CLC will incur to provide local service, and being unable to compare such costs to the incumbent LECs', we cannot test the claim of MCI that CLCs will be unable to offer a competitive retail price unless INP charges are capped at $0.50 per month. The question of whether a CLC will absorb the cost of INP or raise its retail rates to recover the cost is a business decision based on the competitive constraints of the marketplace.

In addition, there are safeguards in place to ensure that the INP prices do not pose an unsurmountable competitive disadvantage for the CLCs. We will require Pacific and GTEC to impute the INP rates adopted in this decision on the price of basic exchange services offered under contract pursuant to our recent decision on resale issues, D.96-03-020. Moreover, we are setting current INP rates subject to a subsequent true up once TSLRIC-based rates are adopted. Thus, CLCs will implement INP service under the tariffs adopted in this decision knowing that today's adopted rates will be subject to refund for any charges which exceed the rate level ultimately adopted as a result of the OANAD proceeding.

We shall not prejudge the results of those cost studies nor assume that they will yield prices of no more than $0.50 per month. While we are interested in promoting a competitive marketplace, our pricing policies must be based on fairness and economic efficiency. There is no evidence that MCI's proposed $0.50 cap bears any relevant relationship to the determination of an economically efficient prices for INP services. We shall not

subsidize CLCs with artificially low INP prices merely to increase or accelerate the number of CLC entrants as an end in itself.

MCI has not produced any facts that would lead us to conclude that the INP rates we adopt in this order would foreclose CLCs from competing effectively against the LECs, and we reject their proposal. In our Phase II decision on hearing issues, we will address in a more comprehensive manner the competitive advantages that LECs and CLCs have relative to each other and what appropriate pricing policies should be adopted to promote an efficient and fairly balanced competitive marketplace. Now that we have established INP rates, we will take them into account as part of the total package of competitive features against which pricing rules should be evaluated and formulated.

V. Reasonableness of DEC-Based CLC-RCF Rate Elements

Since we have concluded that DEC is the appropriate basis upon which to establish INP rates and charges for purposes of this decision, we next consider the reasonableness of the parties' respective claims concerning the quantification of DEC for the relevant rate elements for CLC-RCF service. The rates and charges which we adopt for CLC-RCF service are summarized in Appendix B - Table 1. The adjustments we make to the LECs' proposed DEC rates are summarized in Appendix B - Table 2.

A. Monthly Usage Charges

1. Parties' Positions

Pacific has offered to waive usage charges for INP so long as the new carriers do not charge for terminating the CLC-RCF traffic. Pacific nonetheless identifies a usage cost of forwarding calls of $0.043. Pacific determined this cost as equivalent to the cost of a short-haul intraLATA call that originates in a different office from where the call is terminated, minus any terminating office costs. The subtraction of the terminating office costs

reflects the fact that the new carrier will use its switch to terminate the call. Since porting calls effectively results in the equivalent of two separate calls,[32] Pacific asserts that a usage charge may be appropriate if the Commission so determines in the OANAD proceeding.

GTEC does not propose to waive its usage charge. GTEC's proposed usage charge is intended to account for the cost of switching and transporting the call. GTEC has converted its estimated usage cost to a monthly flat rate of $2.70. GTEC asserts this rate is appropriate since GTEC will incur transport and switching costs, separate from interconnection usage costs, each time a call using CLC-RCF is forwarded. GTEC argues that under certain scenarios, it will incur switching and transport costs it will not recover. Its proposed flat rate, GTEC concludes, will therefore under-capture its actual usage costs.

The Coalition urges the Commission to reject GTEC's usage charge. It asserts GTEC's showing was inadequate and the resulting charges excessive and unsupported. Citizens also regards the usage costs as excessive. It asserts these costs more properly relate to interconnection charges rather than to the provision of CLC-RCF. The proposed usage rates, Citizens concludes, would act as a barrier to effective entry in the local exchange market.

DRA finds that GTEC failed to specify the dollar amount for its proposed usage charges. Therefore, DRA recommends that GTEC be required to concur in Pacific's proposed costs and charges for RCF-based INP service.

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32 The original call which is completed at the incumbent LEC's central office and the reoriginated call that forwards the call from the LEC's central office to the new carrier's switch.

2. Discussion

The usage rates which GTEC seeks to include to recover its cost of providing CLC-RCF were not well justified. GTEC did not provide any specific references to the IRD exhibits or workpapers to document its estimates of switching and transport costs underlying its proposed usage rate. GTEC witness Steele was unable to estimate the percentage of time that calls forwarded pursuant to INP routing arrangements would cause GTEC to incur the switching and transport costs which he described.[33] Thus, it is unclear how often the usage costs estimated by GTEC would actually apply to forwarded calls employing RCF. Accordingly, we find that GTEC has not met its burden of proof regarding the justification for its proposed $2.70 usage charge, and we decline to approve any usage charge at this time. GTEC will have the opportunity to justify the need for a separate usage charge for CLC-RCF through its OANAD cost studies. GTEC will be allowed to take into account any subsequently approved usage charges in the subsequent true-up of the INP memorandum account. In computing a true-up of the memorandum account for any subsequently authorized usage charges, GTEC should use the same average usage assumptions as were used to compute the usage charge proposed here.

Pacific has agreed to waive charges for usage until litigated in OANAD as long as CLCs do not charge for call termination. We shall not adopt any usage charges for Pacific at this time. INP traffic shall be subject to our previously adopted bill-and-keep procedure, and CLCs shall impose no call termination

33 RT 191.

charges for these calls.[34] We shall defer further discussion of Pacific's proposed usage charges to the OANAD proceeding.

In summary, we subtract the usage charge of $2.70 from GTEC's monthly charge of $6.50 to yield a residual DEC of $3.80 covering all other recurring charges. Since Pacific does not request cost recovery of usage, its DEC remains unadjusted at $3.25.

B. Line Termination Costs

1. Parties' Positions

MCI also takes exception to GTEC's inclusion of monthly line termination costs. MCI asserts that the $3.28 line termination element represents a piece of the interconnection facilities. Further, MCI suspects, but was unable to verify with certainty, that Pacific also inappropriately included line termination costs in its DEC calculation.[35] Interconnection facilities costs, MCI argues, are already included as a cost of interconnection and are not an additional cost of RCF functionality incurred by GTEC or Pacific in providing INP services.

GTEC counters MCI's claims that line termination costs were inappropriately included in the DEC calculation by stating that MCI's witness, Murray, is not an engineer and therefore not credible on this subject. GTEC's witness Steele testified that GTEC's switches do require the use of a line card separate from that which is used for interconnection. This view was corroborated, asserts GTEC, by Pacific's witness Scholl.

2. Discussion

We must weigh the testimony of MCI's witness Murray against that of Pacific, GTEC, and DRA witnesses who refuted her testimony regarding the exclusion of line termination costs from DEC. We reiterate that RCF is a functionality within the switch

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34 D.95-07-054, mimeo. at p. 38.

35 Murray Phase I Testimony, p. 12.

that enables the switch to identify that a particular call is not to be terminated at the dialed number but instead is to be terminated in the switch, and then regenerated as a new call to the forwarded number.[36]

Stone explained that two of the switches used by GTEC require the use of a line card separate from that which is used for interconnection.[37] He further explained that the interconnection of LEC and CLC networks is distinct from the provisioning of the CLC-RCF service. Further, the GTD-5 switch does have the capability to avoid the use of line termination cards 20% of the time.[38] GTEC properly accounted for this variance in the use of a line termination card by a weighting based on the requirement that the termination card be used only 80% of the time, thus reducing the line termination card costs.[39]

Pacific's costing witness Scholl also testified that Pacific's switch likewise requires a separate line termination card.[40] DRA's witness Abhulimen also testified that although he was not certain that a separate line card was required for the CLC-RCF function, he believed that such a card would be necessary if the forwarded call needed to be terminated at the LEC's switch and then regenerated as a new call to the CLC switch, rather than

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36 RT, p. 17, ll.17-25; p. 48, ll.17 - p. 49, ll.5; p. 232, ll.22 - p. 233, ll.7.

37 RT, p. 81, ll.13 - p. 82, ll.20; RT, p. 83, ll.14-21; p. 100, ll.1 - p. 101, ll.8; p. 318, ll.26 - p. 319, ll.3.

38 RT, p. 100, ll.1-28; p. 157, ll.10-27.

39 Id.

40 RT, p. 318, ll.26 - p. 319, ll.3.

merely "just going right to the [CLC] switch with that recognition."[41]

We are persuaded by the testimony of GTEC witness Steele that the line termination cost included in GTEC's MRC is proper. Accordingly, we decline to disallow its costs as proposed by MCI. Contrary to MCI's claim, GTEC showed that it cannot use the same line termination for interconnection and the RCF feature.

C. **Simultaneous Call Capabilities Usage Charge**

1. **Parties' Positions**

As described in item 3 of GTEC's cost components, GTEC asserts it incurs $2.70 for each call path when simultaneous call capability is employed. MCI's witness Murray asserts that there is no cost or dedicated facilities associated with additional call paths that allow a customer to receive multiple, simultaneous calls. MCI points out that Pacific's witness Scholl confirmed that there are no recurring monthly costs for simultaneous call capability.

Citizens reads GTEC's tariff to require that GTEC's CLC-RCF service charge be applied for each simultaneous call capability per number ordered, i.e., the CLC-RCF service charge would be applied 99 times if 99 simultaneous transfers to a single forwarded number were to be allowed. Citizens believes the CLC-RCF service charge should apply once per forwarded number, regardless of the number of simultaneous transfers allowed to that number.

Citizens notes that Pacific's proposed tariff provides that a CLC may order up to a maximum of 99 CLC-RCFs associated with the same CLC customer on a single INP order. Citizens suggests that this provision be clarified to read "A CLC may order up to a maximum of 99 call paths associated with the same CLC customer for

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41 RT, p. 612, ll.3 - p. 613, ll.4.

a single Directory-Number Call Forwarding number." Citizens believes this change would make it clear that the CLC will not be charged 99 times the call forwarding rate for a single call-forwarding number to which 99 simultaneous transfers can be made.

2. Discussion

Consistent with our denial of GTEC's proposed $2.70 usage charge as discussed above, we reject GTEC's proposal to impose a usage charge for "each simultaneous call capability per number forwarded." GTEC did not know whether physical hardware termination is required to support this feature. Moreover, Pacific's witness Scholl testified that there are no recurring monthly costs for simultaneous call capabilities, and that costs are incurred only once per number.[42] Scholl testified that there is a one-time cost to enter a setting into the switch software that determines the number of calls that will pass through to a single telephone number. This cost does not vary with the number of "call paths" selected.

D. Marketing, Customer Services, and General and Administrative Costs

We regard the INP services the incumbent LECs will be providing the new carriers as a wholesale service offering. As such, the charges for this services should be based on the costs related to providing this service to the wholesale markets. Thus, we must consider whether any further adjustments should be made to the $3.80 DEC covering GTEC's nonusage recurring costs for INP, or to the $3.25 DEC of Pacific's INP.

42 Tr. at 357.

1. **Parties' Positions**

Coalition

Although the Coalition objects to the use of DEC-based rates, it offered a critique of Pacific's and GTEC's DEC estimates. The Coalition argues that even if the Commission chose to adopt DEC-based rates over the Coalition's objections, it should disallow significant portions of Pacific's and GTEC's rates on the basis that they unreasonably overstate the true DEC for INP services.

Pacific and GTEC incorporated retail customer service and marketing expenses in its CLC-RCF DEC, which the Coalition asserts overstate the cost of providing wholesale CLC-RCF functionality. MCI's witness Murray testified that Pacific's cost support for its proposed rates inappropriately includes retail marketing and customer services expenses. Murray asserts this inclusion of retail costs overstates Pacific's true DEC for RCF capability to provide INP service by over 50%. It is inconceivable, MCI continues, that Pacific will expend any resources marketing a service that removes barriers to existing Pacific customers switching to a competing service provider.

The Coalition also objects to the inclusion of general and administrative expenses in Pacific's DEC study for CLC-RCF functionality. The Coalition asserts that general and administrative expenses are normally excluded from a DEC study. MCI and the Coalition further assert that the general and administrative expenses included in Pacific's DEC are indirect, overhead costs, including cost categories, such as "artwork repair expenses" and "general purpose computer expenses." The inclusion of such general and administrative expenses, by MCI's accounting, over-inflate Pacific's costs by more than 13%. Similarly, MCI asserts that upwards of $1 million of Pacific's $6.5 million annual costs for retail RCF are for customer services. MCI states it would not expect Pacific to incur an equal level of customer service costs for providing INP to carrier customers. After

accounting for the alleged overstatement, MCI asserts that the correct DEC for Pacific's RCF functionality cost component is $1.20 or less.[43]

Citizens

Lik he Coalition and MCI, Citizens asserts that GTEC's and Pacific's . s of RCF functionality are overstated. With respect to Pacific, Citizens states that company official expenses and average general and administrative overheads amount to fully 71% of Pacific's total recurring expenses, not just that attributable to RCF functionality. With regard to customer service costs, which include service commencement, billing, and responding to inquiries, Citizens asserts that the new carriers will assume most of these functions for their own customers. Citizens notes that Pacific includes company official expenses as 2% of the recurring costs, which assumes the unlikely proposition that Pacific will be offering its employees discounts or concession services if they choose a competing local carrier.

Taken together with its assessment of the retail costs improperly included in Pacific's recurring DEC, Citizens recommends the elimination of 90% of the marketing expenses, 50% of the customer services expenses, all of the company official expenses, but none of the general overhead costs. This would reduce Pacific's monthly recurring cost from $3.23 to $1.88. The effect of excluding these costs is to reduce the retail cost by 42% -- considerably less than the full 71% of the DEC Citizens regards as inappropriate when costing RCF as a wholesale service. Were the Commission to exclude Pacific's general and administrative costs on

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43 Murray, Phase I Testimony, Ex. 11, pp. 15-16.

the basis that they are indirect costs, Citizens argues the monthly recurring costs would drop to $1.44.

Citizens also believes GTEC's DEC is overstated by reflecting retail costs for RCF which could be avoided at the wholesale level. Citizens finds GTEC's cost data insufficient to develop a true wholesale rate. As a proxy value, Citizens' witness Montgomery developed factors based on the monthly and annual cost factors it used for RCF interim portability in contrast to the cost factors GTEC used in order to develop the central office equipment (COE) line-termination cost component for its business and residence access lines.

These COE line-termination costs are applicable themselves to GTEC's retail services, and do not reflect wholesale cost savings. Citizens believes that the cost factors do, however, reflect the fact that marketing and support costs are lower for access lines -- a nondiscretionary monopoly offering -- than are the costs incurred to promote and sell retail RCF service -- a highly optional product. Montgomery compared only the cost loadings used for recurring expenses, not for capital or asset-related items such as return, income tax and depreciation. The net charge factor applied by GTEC in the CLC-RCF DEC cost development was 0.1628, or about twice as high as the 0.0841 factor applicable to retail COE line termination costs in GTEC's study. Accepting the rest of GTEC's CLC-RCF cost study, Citizens computes a reduction in GTEC's $3.81 cost of $0.98 to a level of $2.83. Citizens' inspection of GTEC's cost data generally leads Citizens to believe the cost results for RCF reported in other jurisdictions, although GTEC's interim rate might be set somewhat above Pacific's rate.

Pacific and GTEC

Pacific and GTEC regard the retail RCF costs as reasonable proxies for developing the DEC of providing CLC-RCF. The specific retail RCF costs to which MCI, Citizens, ICG, and the

Coalition object are included in the incumbent LECs' recurring cost components.

Pacific claims that it appropriately included marketing, customer service, and general and administrative costs in its DEC for CLC-RCF.[44] Pacific used retail RCF marketing costs as a proxy for the marketing costs it will incur for CLC-RCF. Marketing costs account for 35% of Pacific's RCF-functionality recurring charge of $3.25 per month. Pacific states that the determining factor influencing the marketing costs is not the number of new carriers who will be ordering CLC-RCF, but the number of services the new carriers will order. The costs are incurred on a per-line-in-service basis, rather than per ordering customer.

For customer-service cost, Pacific again asserts that retail RCF customer cost is an appropriate surrogate for CLC-RCF customer-service cost. Customer service includes the costs associated with billing, business office costs, and billing inquiries. Pacific argues that it will still incur these costs since they are a function of the number of end-user lines being served.

General and administrative costs are appropriately included in the recurring RCF-functionality cost, Pacific argues, for they reflect the CLC-RCF costs associated with procurement expenses and employee-related costs. They are not, Pacific emphasizes, common overhead costs. In broad defense of its approach, Pacific asserts that since DEC studies allocate historical costs existing in the accounting records of the company, it is appropriate to allocate all such costs Pacific incurs to provide service.

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44 Pacific Brief, p. 17.

GTEC similarly asserts that marketing expenses associated with providing CLC-RCF are properly included in the recurring costs. Also, GTEC states that expenses for customer service are legitimate expenses of providing CLC-RCF. Among customer service costs, GTEC enumerates billing, billing inquiries, and business-office costs. GTEC asserts that Citizen's witness Montgomery concurred that properly identified CLC-RCF billing costs and certain bad debt costs should be recovered by the incumbent LECs. GTEC criticizes Citizens' adjustments to its retail RCF costs to attempt to account for avoided marketing and customer costs. GTEC objects to Citizens' reduction in its annual charge factor for CLC-RCF, for no explanation is provided as to why this is a proper method nor how much of an adjustment would be appropriate. GTEC identifies the total monthly cost of its retail RCF customer operations as being only $0.$2. Accordingly, GTEC challenges the validity of Citizens' adjustment to reduce its costs for CLC-RCF. GTEC takes exception to MCI's claim that the amount of customer-service and marketing expenses will be less for CLC-RCF because the incumbent LECs will be providing the service only to CLCs, and not to tens of thousands of customers. GTEC counters that behind each CLC order there will be potentially tens of thousands of individual customers for which the LEC must still process an order, provide customer service, and generate billing records for each telephone number.

2. <u>Discussion</u>

While it is appropriate to develop a wholesale cost assessment from the readily available actual costs of the most equivalent retail offering as a starting point, the LECs have overstated their costs by assuming the DEC for CLC-RCF equals the DEC of retail RCF. The appropriate adjustments to convert the incumbent LECs' proposed DECs are discussed below.

Downward adjustments to the proposed DEC for CLC-RCF service are appropriate to reflect the wholesale nature of the INP

service offering. The disputed recurring cost components with the greatest effect on the ultimate recurring charge are marketing and customer services costs. For example, for Pacific, marketing costs account for approximately 35% of its recurring cost calculation, and customer services costs for 17%. Of lesser impact, but disputed are the general and administrative costs, and the official company costs.

We find MCI's argument that the incumbent LECs have little incentive to expend a lot of resources marketing INP service -- a service they are being directed to offer as a means of reducing barriers to competition -- quite persuasive. Unlike retail RCF which is a purely discretionary service requiring marketing resources to stimulate demand, wholesale RCF service will be purchased by CLCs who do not view the service as discretionary, but are highly motivated to purchase the service without any substantial marketing support by the LECs. However, we also recognize that the incumbent LECs may need to dedicate some limited marketing resources for CLC-RCF services. Therefore, not all marketing costs associated with providing retail RCF are necessarily avoided.

In defending the inclusion of customer services costs in the DEC of CLC-RCF services, the incumbent LECs argue that focusing on the fact that the service will be provided to fewer customers or to wholesale to new carriers only misses the point. Each LEC asserts that it is the number of new services ordered that is determinative of LEC wholesale costs. While this argument has merit, Citizens' argument that CLCs will assume responsibility for many of the customer service functions is also persuasive. Billing and service inquiries, for example, will be largely fielded by the new carrier without need for a follow-up call from the new carrier to the incumbent LEC.

Since no party presented an actual DEC-based cost study regarding the difference between retail and wholesale marketing and

customer service costs, we are forced to use a degree of subjective judgment in arriving at an appropriate adjustment. We make these adjustments with the understanding that they will be subject to a true up once INP prices have been finalized in OANAD, as discussed elsewhere in this decision. Based on the conclusion that the vast majority, but not all, marketing costs will be avoided in marketing INP to CLCs, Citizens recommends that 90% of Pacific's recurring costs attributable to retail RCF marketing be eliminated. In the absence of an actual cost study to provide a more accurate measure, we adopt Citizens' recommendation as a reasonable approximation of Pacific's wholesale marketing costs for INP. Likewise, we find that retail RCF customer service costs, like retail RCF marketing costs, are partially avoided. Citizens suggests approximately 50% of the customer service costs associated with retail RCF would be avoided in the offering of CLC-RCF. This approximation of the customer-service costs the incumbent LECs will avoid in providing CLC-RCF is reasonable in the absence of any more precise data, and we shall adopt it.

We reject Citizen's proposed adjustment to disallow the costs identified as "Official Company Services" (OCS). Citizens proposed to disallow this cost on the assumption that it represented employee discounts off personal phone bills, and that Pacific would not be likely to offer its employees discounts off their personal phone bills if the employee selects a new carrier. Yet Pacific witness Scholl testified that the OCS costs reflect the "use of telephones and telephone facilities in the providing of the [RCF] service."[45] Since the OCS costs are incurred for the use of company telephones by employees doing the job of providing RCF service while they are on the job, these costs are properly

45 RT 267.

included in the DEC of CLC-RCF. The OCS cost adjustment represents $0.06 out of Citizens total proposed disallowance of $1.37. This yields a final wholesale INP DEC of $1.94, which we shall adopt as the wholesale recurring charge for INP. The adopted price is 60 percent of the retail DEC of RCF.

Consistent with our adjustment of Pacific's DEC to reflect avoided retail marketing and customer service costs, a similar adjustment should be made to GTEC's DEC. Since GTEC did not report its RCF costs in a similar fashion to that of Pacific, we cannot precisely quantify the same adjustment for GTEC.

We do not accept Citizens' proposed adjustment of GTEC's RCF costs of $0.98, i.e., $3.81-$2.83, because this adjustment to the net charge factor is a refinement inconsistent with the gross accounting categories of GTEC's records. The examination of GTEC's cost categories as summarized in Exhibit 2 makes clear that the accounting conventions that they are following cannot be consistent with those of Pacific, even though both the service and technology are similar. In particular, we are not persuaded that the $0.52 identified as total retail RCF recurring customer costs by GTEC is analogous to the $1.62 of retail RCF recurring customer and marketing costs identified by Pacific. It is untenable to conclude that only 15% of GTEC's DEC represents customer and marketing costs while they represent 50% of Pacific's DEC.

In the absence of more precise disaggregated data on GTEC's costs, we shall apply the same percentage adjustment representing avoided retail costs to GTEC's DEC for RCF as we applied to Pacific As calculated above, the Pacific's wholesale INP is approximately 60 percent of the DEC of the retail RCF. Applying this same percentage to GTEC's retail DEC of $3.81 for RCF yields a wholesale INP rate of $2.29. Accordingly, GTEC's monthly recurring charge for INP shall be reduced from $3.81 to $2.29.

Pacific argues that general and administrative costs reflect procurement expenses and employee related costs associated with employees working on CLC-RCF. We are not persuaded by MCI's arguments that these costs should be excluded as overhead costs. As explained by Pacific, only the directly related general and administrative costs were included in the study. The inclusion of such direct costs are consistent with the DEC methodology we used in IRD and are appropriate here. Pacific did not include indirect general and administrative costs in its DEC charges. The inclusion of Pacific's direct general and administrative costs in the CLC-RCF DEC cost calculation is reasonable.

As a result of these adjustments, the MRC for RCF for Pacific is reduced by $1.31 and for GTEC is reduced by $1.52. We note that the resulting INP rates of $1.94 for Pacific and $2.29 for GTEC are consistent with comparable rates in NY and MI.[46]

E. Nonrecurring Charge (NRC)

1. Parties' Positions

Pacific's nonrecurring charge (NRC) is intended to recover the costs of ordering, provisioning, and ultimately disconnecting CLC-RCF. The costs were identified through the nonrecurring cost identification approach used in presenting IRD costs. The work activity times were estimated and multiplied by 1995 labor rates.

As noted above in the description of cost components, Pacific offers a third option for pricing and recovering the nonrecurring costs associated with ordering and provisioning CLC-RCF. In it, the ordering and provisioning of nonrecurring charges for CLC-RCF would be recorded in a balancing account and recovered by a surcharge on all California customers. The amount

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46 Exhibit 25, Table 1.

recorded in the account would be either the actual accounting cost of installing CLC-RCF, or alternatively, the number of CLC-RCF service installations multiplied by the TSLRIC of installing CLC-RCF as established in the OANAD proceeding. The balancing account, as proposed by Pacific, would also record the actual costs of NXX code openings for new carriers and the costs associated with accelerated area code exhaust, issues being addressed in Phase III.

GTEC used the nonrecurring costs for ordering and provisioning switched access services as a proxy for the CLC-RCF nonrecurring costs. GTEC asserts this proxy is reasonable since both services use common transport facilities and the access service request process.

The Coalition, MCI, and Citizens all assert that the incumbent LECs have not adequately documented the nonrecurring costs of CLC-RCF. GTEC, the Coalition states, concedes that it conducted no study of the nonrecurring costs of CLC-RCF. The Coalition argues that Pacific's estimates were poorly documented. They recommend, therefore, that the incumbent LECs not be allowed to charge for nonrecurring costs.

While accepting Pacific's assessment of nonrecurring costs, DRA finds that GTEC failed to specify the dollar amount for its proposed nonrecurring charges in its originally filed tariff. Therefore, DRA recommends that GTEC be required to concur in Pacific's proposed NRC charges.

2. <u>Discussion</u>

We conclude that the LECs do incur nonrecurring costs relating to ordering, provisioning, and ultimately disconnecting the INP service. Accordingly, carriers providing INP service should receive fair compensation for such costs. As noted by both the Coalition and Citizens, however, Pacific failed to provide a description of the work activities or labor hours assumed necessary to establish INP service. Moreover, the available cost data for

retail RCF service has not been updated since it was first introduced in the mid-1970s.[47]

As to GTEC, the company filed a proposed INP tariff on September 18, 1995, it did not quantify a proposed rate for NRC costs, but merely stated that the ordering procedures would be pursuant to an access service request (ASR) format. In a September 25, 1995, supplemental tariff filing, GTEC stated that "appropriate nonrecurring charges are applicable," but did not quantify them. It was not until November 1, 1995 that GTEC filed an additional supplement to its proposed tariff expressly referencing its "Switched Access Service Ordering Charges" which provides that the NRC is $228.94 per ASR. Because GTEC did not timely provide NRC rates, DRA recommended that GTEC be required to concur in Pacific's proposed rates and charges for CLC-RCF services.[48] Because parties did not have a timely opportunity to review GTEC's proposed NRC rates in advance of the evidentiary hearings, we shall reject the evidentiary showing regarding GTEC's NRC. We further find that the evidentiary showing of GTEC with respect to nonrecurring charges, such as it is, fails to justify the use of the ASR as a valid proxy for CLC-INP nonrecurring charges.

Having found fault with the incumbent LECs' showings, we must decide on the appropriate NRC for CLC-RCF based on a limited record, for no other party presented an alternative cost study that provided more reliable figures as a basis for setting interim NRC levels. To this end, we will take official notice of the existing retail RCF tariffed NRCs for Pacific and GTEC.

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47 Scholl/Tr. at 354.

48 Exh. 14; p. 6-2.

In Pacific tariff schedule A5.4.4, the NRC for RCF is $5 for residents and $6 for business customers. These rates contrast greatly with the proposed wholesale NRC of $31.75 per number to install CLC-RCF. In addition, Pacific has proposed a $31.25 NRC to install number referral upon disconnect, a charge that has no counterpart in the retail tariff.[49] Essentially, Pacific's NRCs amount to as much as $63 per number, or more than ten times the existing retail NRCs.

We shall also take official notice of the existing price floor for Pacific's retail RCF. This information is proprietary, so we shall not disclose it here. We note that these price floors are based on the LRIC studies presented in the IRD proceeding. Although we have refused in this decision to set prices for INP services based on these LRIC studies as recommended by MCI, the results of those studies are instructive as a reference point. Additionally, the LRIC-based price floors filed by Pacific purportedly recover recurring and non-recurring costs.

We have already determined that, in the interim, the recurring monthly charge for Pacific, less avoided costs, is a fully compensatory charge for recurring DEC. We shall reject the NRCs proposed by Pacific for CLC-RCF, since these charges were not justified properly. Further, we find that demanding up to $63 per ported number, including a termination charge, represents a significant competitive barrier for facilities-based competitors. CLC-RCF already presents technical limitations that would only be

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49 Pacific submitted a different pricing scheme for the CLC-RCF service that varies in accordance with the numbers that will need to be ported. Since the per-unit NRC varies depending on the amount of numbers in an order under this alternate scheme, it is not possible to compare the per-unit prices in the alternate wholesale pricing scheme with the retail, per-line NRCs for RCF.