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Decision 01-02-018 February 8, 2001

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Application for Approval of Settlement Transition Agreement and Implementation of Replacement Funding for Small Local Exchange Carriers.	Application 99-09-044 (Filed September 21, 1999)

Beck & Ackerman, by Jeffrey F. Beck and Jillisa Bronfman, Attorneys at Law, for the following Small LECs: Evans Telephone Company, Happy Valley Telephone Company; Hornitos Telephone Company; Kerman Telephone Company, Pinnacles Telephone Company, The Siskiyou Telephone Company, and The Volcano Telephone Company; Cooper, White & Cooper by E. Garth Black, Alvin H. Pelavin, Mark P. Schreiber, and Sean P. Beatty, Attorneys at Law, for the following Small LECs: Calaveras Telephone Company, Cal-Ore Telephone Company, Ducor Telephone Company; Foresthill Telephone Company, The Ponderosa Telephone Company, and Sierra Telephone Company, Inc.; and Colleen O'Grady, Attorney at Law, for Pacific Bell Telephone Company, applicants.

Jason J. Zeller and Laura J. Tudisco, Attorneys at Law, for the Office of Ratepayer Advocates, protestant.

Randolph Deutsch, Attorney at Law, for AT&T Communications of California, Inc.; Tony DiTirro, Attorney at Law, for MCI WorldCom; Patrick McMahon, Attorney at Law, at the Law Office of Patrick McMahon, for Sprint Communications Company, L.P.; and Thomas Long, Attorney at Law, for The Utility Reform Network, intervenors.

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1. Summary

In this decision, we approve, with modifications, the Settlement Transition Agreements (STAs) which Pacific Bell (Pacific) negotiated with each of 13 Small Local Exchange Carriers (LECs)[1] We grant applicants' proposal that replacement funding for the Small LECs come from the California High Cost Fund-A (CHCF-A). However, we deny applicants' request that the CHCF-A draws by the small companies not be subject to the means test, waterfall, and rate increase requirements, as required by the rules governing the CHCF-A.

We authorize Pacific and each Small LEC to discontinue offering intraLATA toll service if at least one interexchange carrier (IXC) is willing to provide the service on a presubscribed basis. If no IXC offers presubscribed intraLATA toll service in a particular Small LEC's service territory, the Small LEC will provide service as the Carrier of Last Resort (COLR). Pacific is not required to serve as COLR for intraLATA toll service in the Small LECs' service territories. We also require the Small LECs to implement intraLATA presubscription (ILP) and set an implementation schedule.

We adopt the Small LECs' National Exchange Carrier Association (NECA) switched access rates, with one modification. We eliminate the Carrier Common

[1] The Small LECs include: Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Evans Telephone Company, Foresthill Telephone Co., Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., The Siskiyou Telephone Company, and The Volcano Telephone Company.

Line Charge (CCLC) rate element from the NECA rates, and the Small LECs are instructed to apply to the CHCF-A for recovery of the revenue shortfall which results from elimination of the CCLC.

We determine that Pacific is not required to reduce its rates by the approximately $37.2 million it currently makes in STA payments to the Small LECs, once it discontinues making its payments to the Small LECs.

2. Procedural History

Thirteen small Local Exchange Carriers (Small LECs) and Pacific (together referred to as the "Joint Applicants") filed their application on September 21, 1999, asking the Commission to approve the STAs which Pacific negotiated with each of the companies. The agreements terminate the applicants' existing toll, access and, if applicable, Extended Area Service (EAS) inter-company arrangements, upon the condition that the Commission approve and implement a permanent alternative funding mechanism. The permanent funding source, coupled with increases in access charges, will replace the net settlement revenues that will be lost to all of the Small LECs upon termination of the current inter-company settlement arrangements for toll, access and EAS services.

The Office of Ratepayer Advocates (ORA) protested the application and was opposed to approval of the Settlement on several grounds.

A Prehearing Conference (PHC) was held on December 3, 1999, to determine the scope of issues to be addressed, the schedule for resolving the issues identified, and to determine whether or not evidentiary hearings were required. The Ruling which set the PHC was mailed to all interexchange carriers (IXCs) since Joint Applicants requested that they not be required to provide intraLATA toll service. Assigned Commissioner Carl Wood issued a

Scoping Memo on January 11, 2000, which set the schedule and scope for the proceeding.[2] As required in the Scoping Memo, the Joint Applicants filed a First Amendment to Joint Application on February 9, 2000, indicating that they had amended the agreements to state that the applications would incorporate the issue of the intrastate access charges to be adopted for the small companies. On March 2, 2000, the applicants filed amendments to keep the STAs effective until the Commission acts to establish a permanent funding source.

On January 3, 2000, The Utility Reform Network (TURN) filed a Notice of Intent to seek intervenor compensation for participating in the proceeding. TURN was found eligible for compensation in the proceeding in an Administrative Law Judge (ALJ) Ruling issued on January 31, 2000.[3]

The Commission's preliminary determination in Resolution ALJ 176-3024, issued on October 7, 1999, was that the category for the proceeding was ratesetting. The preliminary determination was that hearings would not be necessary. However, following the PHC, the Assigned Commissioner determined that hearings would be necessary. The Commission issued an order on March 2, 2000, changing the hearing designation.[4]

The parties held informal settlement discussions on March 6, 2000 which were continued on May 31, 2000. Beginning April 21, 2000, bill inserts were mailed to all customers of Small LEC applicants whose basic rates are not

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[2] The Assigned Commissioner issued a second Ruling on February 18, 2000, amending the Scoping Memo to add an issue which was inadvertently omitted from the list of issues to be included in the scope of the proceeding.

[3] The issue of compensation is moot since TURN did not actively participate in the proceeding after the PHC.

[4] Decision (D.) 00-03-003.

already capped at 150% of Pacific's rates so that those customers were aware that they may experience a rate increase as a result of this proceeding. Opening Testimony was filed on April 4, 2000, and Rebuttal Testimony, on April 28, 2000. Evidentiary hearings were held June 12-14, 2000. On June 16, 2000, ORA filed a motion pursuant to Rule 45 of the Commission's Rules of Practice and Procedure, requesting that corrections be made to several sections of the transcript of the June 12-14 hearings. ORA's motion was not opposed by other parties. Concurrent opening briefs were filed on July 17, 2000, with concurrent reply briefs, on July 31, 2000.

3. The History of Inter-company Settlements

The inter-company settlements process between Pacific and the Small LECs dates back to the 1960's and has permitted all telephone companies that participate in the process to charge the same basic toll rate for a similar call of a given duration over the same distance. Prior to implementation of the intraLATA toll settlement pools, small telephone companies established additional charges to cover their own cost of receiving and sending toll messages. For example, on a call from a Pacific customer to a Small LEC customer, the Small LEC would add an increment of about 20 cents to a typical three minute call, whether the call was initiated in its service area or Pacific's.

For the past 30 years, intraLATA toll rates of all LECs that participate in the pooling arrangement have been uniform. The term "Settlements" refers to an accounting procedure based on a LEC's total investment in telephone equipment used to provide intrastate telephone service. Under the inter-company settlements process, all participating companies place all of their intrastate toll facilities and expenses into a common pool and charge the same toll rates, even though their individual costs for provisioning toll service vary widely.

The basic concepts underlying pooling arrangements are: 1) a single uniform rate for a service, b) the revenues billed at this uniform rate are not "kept" by the billing LEC, but rather are reported to the administrator of the pool (Pacific) who has the responsibility of collecting the billed revenues of every participating LEC, and c) the billed revenues are then redistributed to the participating LECs, based on each LEC's costs and the pool rate of return.

Within each specific pool, each LEC, including Pacific, will receive its cost of providing the intrastate service plus an amount based on its investment allocated to providing the service. This rate of return on investment is common to all LECs in the pool and is known as the "settlement ratio" or "pool" rate of return.

The excess revenues derived from the pooling arrangements were used by the Small LECs to subsidize local exchange rates. Thus, the inter-company settlements process has helped keep toll and access rates uniform and has also kept basic telephone rates reasonable by using contributions from statewide toll rates of all participating carriers.

4. Should the Commission Approve the STAs and Implement the Pool Termination Procedures Negotiated by the Applicants?

4.1. Small LECs' Position

In mid-1998, Pacific approached the Small LECs with a request that the parties enter into negotiations to terminate the inter-company settlement pools for toll, access, and EAS services. Pacific's belief was that with the advent of a competitive telecommunications market, it was no longer appropriate for support payments to be made entirely by one company.

As requested by Pacific, the parties entered into negotiations for a transition from pooling to a replacement funding mechanism. The negotiations

extended over a period of fifteen months, and the resulting agreement, reflected in the STAs, provided for fixed transition payments from Pacific to each Small LEC, based on continuation of the most recent level of pool revenue flows, followed by transition to a permanent, Commission-administered funding source based on the same fixed payment levels.

The Small LECs state the STA transition plan provides for revenue neutrality in connection with the implementation of the permanent replacement funding by adjusting the level of transition payments on a dollar-for-dollar basis to account for the changes in billed revenues and specific expense items that will occur in the post-pooling environment.

According to the Small LECs, the principle of revenue neutrality as reflected in the STAs neither harms nor benefits the Small LECs in connection with pool termination. The process set forth in the STAs was specifically designed to maintain the existing level of settlement revenue flows, net of pool termination impacts. In his Opening Testimony, Small LEC witness Tutt tracks the individual company settlement payments through the process of adjustment for pool termination-related revenue and expense changes.

The Small LECs assert no party took issue with any of Tutt's data or calculations or presented any other evidence on the subject. The other participating parties each presented rate design proposals that would impact the post-pooling revenues of the Small LECs, but each of those rate design changes was proposed to be offset by a corresponding increase or decrease in the level of the affected company's permanent replacement funding.

One important aspect of the replacement revenue methodology set forth in the STAs is that the payments will be fixed in amount, subject to change only in connection with Commission General Rate Cases (GRCs) for each Small LEC. In this respect, the replacement funding would be unlike pool revenues

which typically increase between Commission rate reviews due to increases in operating costs. (Exh. 1, Bishop Opening Testimony at 6-7.)

According to the Small LECs, the pool transition plan set forth in the STAs is a balanced proposal that addresses each subject that is directly impacted by pool termination without wandering off into a "wish list" of proposals affecting general ratemaking methodology for Small LECs. It corresponds closely with the pool termination plans adopted in many other states that have addressed the subject. (Exh. 5, Peters Opening Testimony, at 4-7.) With respect to the revenue aspects of the pool exit plan, Pacific and the Small LECs negotiated as adverse parties. The plan advances the Commission's goals of replacing hidden subsidies with explicit payments, while maintaining reasonable local rates and the ability of the Small LECs to continue to provide high quality service to their customers.

4.2. Pacific's Position

Pacific asserts the STAs which end the pooling arrangement between Pacific and the Small LECs should be approved. According to Pacific, the intervenors' major objections to the STAs have either been abrogated or are without merit.

4.3. ORA's Position

While ORA concurs that an examination of the Commission's existing toll, EAS and access pooling agreements is overdue, ORA asserts the Small LECs' and Pacific's joint proposal is not acceptable in its current form. What the Small LECs and Pacific propose is to replace the existing toll, EAS and access pooling agreements with an explicit subsidy that has few of the consumer protections the existing pooling arrangements contain.

4.4. AT&T Communications of California, Inc. (AT&T); WorldCom, Inc. (WorldCom); and Sprint Communications Company L.P. (Sprint) (the IXCs') Position

The IXCs do not oppose the basic request of applicants to eliminate the access, toll and EAS pools. However, the IXCs assert applicants must bear the consequences of these changes. They cannot be allowed to exit these pools while demanding that IXC intervenors guarantee applicants' financial positions and, in the case of Pacific, obtain an unfair competitive advantage.

The IXCs' analysis of the applicants' proposal reveals that it is structured in a manner that is not in the public interest and is clearly unfair and discriminatory to IXCs. The IXCs point to various failings in the application which must be corrected by the Commission in order for the application to be in the public interest.[5]

4.5. Discussion

We support the end of the historical system of inter-company settlements between Pacific and the Small LECs. Continuation of this regime is not sustainable in a competitive telecommunications environment. Therefore, we will approve the STAs negotiated between the parties, with some adjustments, which are described in sections below. Section 6 of each STA, "Regulatory Approval and Review" was amended on March 2, 2000, in response to the Scoping Memo and Ruling of Assigned Commissioner, which ordered the applicants to amend their STAs to keep them effective until the Commission acts to establish a permanent funding source. The revised Section 6 in each STA reads as follows:

[5] The specific points raised by the IXCs will be discussed in subsequent portions of this decision.

> Except for Section 3b of the Agreement as amended, this Agreement shall not be effective until it has been approved by the CPUC and shall remain subject to the jurisdiction of the CPUC to the extent provided by law. By making this Agreement neither Party waives any rights to seek review or appeal of the decision of the CPUC in A.99-09-044. Insofar as such decision may affect Pacific's pool funding obligations, the Parties agree to be bound by such terms of such decision and any review or appeal thereof. (STAs, Section 6.)

In other words, the applicants state their willingness to abide by the decision of this Commission, while maintaining their review/appeal rights. The Commission has the authority to modify agreements which are submitted to it for approval. We therefore approve the STAs, subject to the modifications adopted below.

5. Use of CHCF-A for Replacement Funding

5.1. History of CHCF-A

The CHCF-A was originally adopted by the Commission in Decision (D.) 85-06-115 as a means of subsidizing reasonable basic exchange rates for the customers of smaller LECs that concurred in Pacific's statewide average toll, toll private line, and access rates. The Small LECs typically have higher costs than Pacific so rates set at Pacific's levels are insufficient to generate the Small LECs' revenue requirement, including a reasonable rate of return for provisioning these services (i.e. toll, access, toll private line). The rationale provided for the introduction of the CHCF-A was to provide customers of smaller independent LECs with the systemwide rate averaging benefits afforded to Pacific's rural customers by virtue of Pacific having the same rates systemwide within its serving areas.

The CHCF-A rules currently in effect require the Small LECs to comply with a means test and waterfall provision if they request funding from the CHCF-A. The means test ensures that draws from the fund do not result in intrastate rates of return in excess of those authorized by the Commission. The waterfall provision provides the Small LECs with the incentive to file a GRC while funding levels are still high. Appendix A to D.91-09-042 describes the waterfall as follows:

> The issuance of a Commission decision in a general rate proceeding of an independent company will have the effect of a "fresh start" for that company under the HCF [High Cost Fund] plan. Specifically, the phase-down of funding shall be reinitiated effective January 1 following the utility's first subsequent annual October advice letter filing after resolution or decision is rendered in the utility's general rate review proceeding. The phase-down cycle under this reinitiation will be six years: three years at 100% funding level followed by three succeeding years at 80%, 50% and 0% respectively, if a local exchange company has not initiated a general rate review proceeding by December 31st of the previous year."

In addition, draws from the CHCF-A also require that a Small LEC's basic rates shall be increased, the increased rate not to exceed 150% of comparable California urban rates.[6] The revenue from this required basic rate increase is taken into account in determining the amount to be drawn from the CHCF-A. The 150% ceiling on rates was established by the Commission following the enactment of P U Code Section 739.3(a). The Legislature's goal in enacting Section 739.3(a) was to ensure that the rates of rural telephone

[6] D.91-09-042, Appendix [41 CPUC 2d, 326, 330.]

customers would be at a reasonable level, compared to the rates of urban customers.

5.2. Small LECs' Position

The Small LECs assert the Commission should authorize replacement funding through the CHCF-A. According to the Small LECs, the CHCF-A is the most sensible mechanism to be used to replace settlements payments from Pacific. The CHCF-A is already in existence with a functioning administration, an established billing base, and a positive balance. Using it to provide replacement funding for the Small LECs would be the most expeditious way to proceed.

According to the Small LECs, no party has disagreed with the proposal to utilize the CHCF-A for the proposed purpose. ORA does disagree with the Small LECs' proposal in that ORA recommends retaining the waterfall and means test that today are applied only to the Small LECs' current draws from the fund. It also proposes that the Small LECs be required to raise their basic rate to 150% of Pacific's basic rates, which is a precondition for receipt of existing draws. However, ORA's testimony endorses the general proposition that the CHCF-A is the appropriate funding source to use.

The Small LECs propose that the waterfall and means test procedures that are applied to existing funding not be applied to replacement funding incorporated in the CHCF-A. There are many reasons the Small LECs take this position. First, there are no such mechanisms applied to inter-company settlements revenues today. Instead, when the Commission reviews the rates of the Small LECs, it simply applies those revenues to meeting the Small LECs' overall revenue requirement in order to keep their overall rates reasonable. Inasmuch as the replacement revenues will not grow, there is no compelling reason to change this process at this time.

In addition, the existing waterfall and means test are manageable with respect to existing CHCF-A draws because the amounts they are applied to are relatively small. However, if the replacement revenues are provided via the CHCF-A, the replacement funding will encompass from 30% to 80% of the small companies' intrastate revenues. (Exh. 1, p. 6, Opening Testimony, Bishop for Small LECs). Application of the means test to such a large proportion of a company's revenues essentially means that the company is having a rate case every year. And because the means test is a retrospective review of earnings rather than a forward looking review, it is an inappropriate and unrealistic rate case that will not account for even known changes that will be taking place.

According to the Small LECs, another serious drawback of the means test is the perverse incentive it creates for a Small LEC with respect to investment. If a Small LEC is effectively brought back to its authorized rate of return every year by application of the means test, it has no incentive to pursue efficiencies in its operations. The fruits of these efficiencies are taken away every year. It is a fact of rate-base regulation that a period of time between rate cases where efficiencies realized can be kept by the companies provides the necessary incentive to pursue the efficiencies.

The waterfall is also unreasonable when it is applied to 30% to 80% of a Small LEC's revenues. Suppliers of capital are likely to view the automatic loss of such a large portion of revenue as being too risky, and this may inhibit investment or the availability of loans. Furthermore, rate cases are extremely expensive for Small LECs, and the necessity of filing a rate case to arrest the waterfall could create unreasonable expense that ratepayers would ultimately be required to bear.

Also, both the means test and waterfall are designed to achieve a single objective that can be realized with more appropriate tools. They are

designed to ensure that any company's CHCF-A draw does not lead to windfall earnings. However, this is unlikely given the nature of the transition payments and the ability of the Commission to subject the Small LECs to earnings reviews on whatever basis it desires. The payments as proposed are fixed, and, unlike settlements revenues, will not grow as operations expand. This fact will exert a natural pressure on the Small LECs to seek rate relief from the Commission as operations and costs expand, while the transition payment, which makes up a very large portion of small company revenues, remains the same.

Finally, this Commission has the power to order a comprehensive rate review for any or all of the Small LECs at any time to address any perceived earnings issue. This power is flexible, and can be exercised at any time based on an individual company's circumstances. This stands in contrast to a waterfall provision which will require periodic and frequent filings by all Small LECs, regardless of size, resources, and earnings. A pre-scheduled, automatic rate case proceeding is an unnecessary and expensive waste of resources for a company that may be earning at or less than its authorized rate of return.

The Small LECs state that ORA recommends that any CHCF-A draw to replace inter-company settlements payments be reduced for any Small LEC whose rate of return, as calculated by ORA, exceeds the 10% authorized by the Commission in the last round of rate cases. According to the Small LECs, ORA's recommendation is based upon insufficient data. Its calculated rates of return are based upon 1998 recorded data and partial year 1999 recorded data with no ratemaking adjustments. It is not appropriate for the Commission to engage in ratemaking for what now appears to be year 2001 based upon such incomplete, out-of-date, and unadjusted data. As was demonstrated during cross examination of ORA witness Phillips and is evident from Table 1 of Exh. 14, very small swings in small company revenues or expenses can dramatically affect a

recorded rate of return. Even relatively small errors or poor data can create an incorrect picture of Small LEC earnings and cause improper reductions in funding.

In their Reply Brief, the Small LECs state that ORA's brief cites data in the record that illustrates the potential for unfair results if the means test is applied for the first time to this major portion of Small LEC revenue streams. ORA notes that Small LEC earnings are erratic and vary widely from year to year. The means test, however, operates to determine the support revenues to be received in a given year based on the recorded results of operations for the first seven months of the preceding year. This is an unsound methodology when earnings fluctuate widely from year to year. The means test is a "one way" adjustment. It is used to reduce revenues when earnings are above a benchmark, but it does not increase revenues or earnings when they are below the benchmark. Over a stretch of time, this bias guarantees that Small LECs will not earn their authorized rates of return. The years when they under-earn will never be offset by comparable years when they over-earn. With the volatility of earnings that ORA points out, the under-earnings years are inevitable.

The illegal nature of such a one-way system was explained in American Tel. & Tel. Co. v. F.C.C., (D.C. Cir. 1988) 836F.2d 1386. In that case the FCC rules at issue limited AT&T's revenues to target rates of return on an annual basis. However it did not adjust revenues upward in the event of a shortfall. The Court of Appeals vacated the rule, stating:

> [a] carrier cannot be expected to receive earnings each year at precisely the prescribed rate of return, and from one two year period to the next it must forfeit any excess in earnings while absorbing any deficiency. Thus, over the long run the carrier is virtually guaranteed to fall short of earning its required target rate of return on its

> combined operations for all such periods viewed together." (Id. at 1390.)

This is precisely the problem with the means test if it is applied to such a large proportion of Small LEC revenues. It will virtually guarantee that the Small LECs do not earn their cost of capital over the long run. Such a situation can be expected to damage them economically and jeopardize service in rural areas.

It is better that Small LEC earnings be evaluated by reviewing information across more than one year, which the Commission can do under the existing ratemaking and reporting structure. This allows for rate cases to be required by the Commission when circumstances actually warrant and avoids the waste of money and other resources that would result from requiring rate cases to be filed even when they are not needed.

5.3. Pacific's Position

Pacific states the CHCF-A is an existing and operating fund which will allow the Small LECs to draw revenue replacement quickly. The fund was established for small companies. It is the appropriate source for permanent replacement funding.

According to Pacific, a waterfall or means test for replacement funding is not necessary. Pool revenues were not traditionally subject to reduction through a means or waterfall test. The Small LECs' earnings are subject to the normal rate review process. Since the Commission has the power to set or adjust replacement funding during the regular course of a periodic rate case, a rate case is the most comprehensive and thus best method to determine future permanent funding reductions or increases.

In its Reply Brief, Pacific asserts that no party disagreed with the proposal to use the CHCF-A as the source of replacement funding for the Small

LECs. The only disagreement stems from the IXCs' and ORA's opposition to the elimination of a means test and waterfall provision for this portion of the Small LECs' CHCF-A withdrawals. The IXCs' objections are based on their misconception that the Small LECs are seeking guaranteed CHCF-A funding. The ORA's objections are based on a similar misconception that this would "lower the level of Commission scrutiny over their operations." (ORA's Opening Brief at 8.) According to Pacific, both objections are misplaced.

Pacific states the Small LECs are actually proposing a declining source of outside funding as compared to the current pooling process. This occurs due to the fact that the replacement funding amount is being capped at the current level whereas, under the old pooling process, the Small LECs were receiving increased funding amounts. In fact, between 1995 and 1999, the Small LECs' funding through the pooling process increased by 46%, which is an average annual rate of increase of 10%. This cap on funding, in and of itself, is actually acting as an annual 10% waterfall provision versus their previous funding plan and will require the Small LECs to significantly change their operations to cope with the decline in funding. Due to the fact that this funding source represents 30%-80% of the Small LECs' intrastate revenues[7] and has been growing at an annual rate of 10% per year, this funding source is completely different than the funding requirements previously placed in the CHCF-A and, therefore, should be treated in a different manner. Pacific concludes it is not appropriate to place additional waterfall provisions over and above that which is already inherent in the process, due to the fact that the amount will be capped.

[7] Small LECs Opening Brief, p. 9.

5.4. ORA's Position

ORA asserts the Small LECs would like to use the instant application to lower the level of Commission scrutiny over their operations by eliminating both the means test and the waterfall provision. ORA recommends that the Commission retain both types of Commission oversight. A quick review of Table 1 from ORA's Direct Testimony, (Ex. 14, p. 2-5), reveals that for calendar year 1999, six of the 13 Small LECs were earning above their Commission authorized rate of return (of 10%) for their intrastate operations, however, all of these companies received funds from the pooling agreements. ORA points out that one firm, Happy Valley Telephone Company, earned a 27.1% rate of return for its intrastate operations for 1999. While the earnings of the Small LECs over the past three years have been erratic, and no firm has earned in excess of 10% all three of the years covered by the table, this erratic earnings pattern is strong evidence of the need for continuing Commission scrutiny over Small LEC operations. A firm such as Happy Valley obviously had a diminished need for pooling revenues in 1999 than it did in previous years, however, under the Small LECs' proposal, payments from the CHCF-A would be essentially an entitlement with no Commission oversight.

According to ORA, reducing Commission oversight over payments from the CHCF-A to the Small LECs runs contrary to the long-term goal of the Commission to eliminate or reduce subsidy payments to the Small LECs and to ensure that local telephone services more closely reflect actual costs.

ORA asserts that continued Commission oversight in the form of the means test and the waterfall provision is important to ensure the Small LECs are not allowed to use the CHCF-A as a source of earnings (for one company) as high as 17.1% above the Commission's authorized rate of return. It should also be noted that if the Small LECs are allowed to increase their access charges to

NECA-Tariff 5 level rates, over time the need for continuing subsidies from the CHCF-A should diminish. Similarly, as the Small LECs increase their basic exchange rates up to 150% of Pacific's rates, the need for continuing CHCF-A subsidies should diminish.

In its Reply Brief, ORA rebuts the Small LECs' contention in their Opening Brief that it is not appropriate for the Commission to engage in ratemaking for what appears to be year 2001 based upon incomplete, out-of-date, and unadjusted data. ORA responds that in mid-2000, 1999 data can hardly be dismissed as being out of date. Earlier accounting data from 1997 forward is clearly relevant to reflect revenue and expense trends. Further, ORA asserts, nothing precluded the Small LECs from updating the annualized 1999 information to account for any inaccurate estimates the use of annualized numbers might have created.

ORA further notes that the Small LECs have relied on the same "incomplete, out of date, and unadjusted data" to support their position that Small LECs' revenues fluctuate from year to year. If this data is relevant to support the Small LECs' position, it is similarly relevant to debunk it. ORA demonstrated in Exh. 14 that, absent Commission scrutiny (via a means test and the waterfall provision), the Small LECs' proposal to use the CHCF-A as the source of replacement revenues for the toll pooling agreements is likely to lead to continued windfalls for some of the Small LECs.

In its Reply Brief, ORA states that despite the Small LECs' contention to the contrary, there is no evidence in the record of this case to equate a means test with a GRC. The Small LECs themselves acknowledge that a rate case is far more burdensome on their limited staffs than an annual means test. The Commission and the Small LECs have been performing the means test for a number of years.

ORA rebuts another argument promoted by the Small LECs that suppliers of capital are likely to view the loss of between 30-80% of the Small LECs' intrastate revenues as being too risky, which may inhibit investment. According to ORA, the argument is flawed in that the Small LECs' position is based on an unsupported assumption: that the loss of revenues is automatic. According to ORA, the reality is quite different.

The loss of revenue posited by the Small LECs is anything but automatic. What the means test and waterfall provision represent are prudent measures that the Commission can take to stabilize Small LEC finances, assure the investment community of the safety of investments in the Small LECs' service territories and to provide a degree of consumer protection to the ratepayers of the Small LECs that the companies are not over-earning, at ratepayers' expense. Speculative opportunities for excess earnings are not what attracts the investment community to a given utility, but rather a stable revenue stream and consistent earnings. Viewed properly, the Small LECs' proposal to eliminate the means test and waterfall provision is simply a poorly disguised attempt to limit Commission oversight at a time when approximately half of the Small LECs are already earning in excess of Commission-authorized levels. The public interest demands continued Commission vigilance in light of this record.

5.5. The IXCs' Position

The IXCs assert the Small LECs' proposal for guaranteed CHCF-A relief is not in the public interest. First, the Commission has a responsibility to ensure just and reasonable rates for ratepayers, in this instance by protecting ratepayers from overearnings and unreasonable expenses on the part of the Small LECs.

Second, Small LEC witness Bishop stated that the Small LECs' "expense levels are all over the place from year to year. They're not very

consistent like you would see in a larger LEC." (1 R.T. 39.) According to the IXCs, this statement is not consistent with the Small LECs' request for guaranteed payments from the CHCF-A. Because the Small LECs have failed to provide cost studies in support of their application, the Commission lacks sufficient evidence to determine whether the guaranteed funding levels requested by the Small LECs support a relatively low or relatively high level of expenses. The concern to ratepayers would be that some Small LECs may be requesting funding based on an unusually high level of expenses, and that these LECs will over-earn at ratepayers' expense in years in which they have more typical, and relatively lower, expenses.

According to the IXCs, the Commission's prime objective is to ensure just and reasonable rates for ratepayers, not guaranteed revenue flows for incumbent LECs. A better solution to protect ratepayers, instead of the guaranteed payments that the Small LECs propose, would be to maintain the safeguards and review of the CHCF-A and have the Small LECs petition the Commission when they have a legitimate emergency. The Small LECs admit that they "have the ability to come and petition the Commission for rate increases if they have an emergency so that they can cover unusual expenses." (1 R.T. 58.)

Finally, the IXCs state that while the Small LECs may have received from Pacific in previous years the amounts they are requesting in this application, that is not a sufficient reason for them to receive those amounts in the future. Evidence presented in this proceeding indicates that a number of the Small LECs earned in excess of their authorized rate of return within the period

from 1997 to 1999,[8] and that several Small LECs appear to have had unreasonably high corporate operations expenses when compared to other Small LECs of the same size, during this same time period.[9] For all the above reasons, the IXCs say the Commission should reject the Small LECs' proposal for guaranteed funding and should instead apply the current safeguards of the CHCF-A to the Small LECs' new draws of replacement funding.

In their Reply Brief, the IXCs rebut several statements the Small LECs made in their Opening Brief. The Small LECs state that it is unlikely that their draws of replacement funding will lead to windfall earnings. ORA has shown, however, that a number of Small LECs did over-earn during the period from 1997 to 1999, and hence, such overearnings are far from "unlikely."

The IXCs assert the Small LECs seek to reargue the Commission's authorized rate of return of 10%, claiming that:

> If a Small LEC is effectively brought back to its authorized rate of return every year by application of the means test, it has no incentive to pursue efficiencies in its operations…[A] period of time between rate cases where efficiencies realized can be kept by the companies provides the necessary incentive to pursue the efficiencies. (Small LEC Brief, p. 9.)

According to the IXCs, in this statement the Small LECs falsely imply that the means test completely prevents them from earning above the Commission's authorized rate of return. Neither the waterfall nor the means test, however, takes away overearnings from completed rate years. Thus, these earnings are, in fact, kept by the Small LECs.

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[8] Exh. 14, ORA Testimony, ¶22 and p. 2-5, Table 1.

[9] Exh. 10, p. 10 and Attachment 2; Exh. 11, Reply Testimony of Kong for AT&T, p. 8.

While it may be true that periods between earnings reviews provide LECs with incentives to economize, it is also true that ratepayers pay the additional costs during these periods. The Commission must continually balance efficiency with equity in these situations. For Small LECs, the Commission has already ruled on the proper balance between these two forces, adopting the waterfall and means tests as appropriate regulatory mechanisms for the years between rate cases. Applicants present no new evidence or argument to justify the Commission altering its previous decisions.

The Small LECs also imply that they should be allowed to overearn because "very small swings in small company revenues or expense can dramatically affect a recorded rate of return." (Small LECs Opening Brief at 10.) The Small LECs cite a hypothetical change of $18,000 for Pinnacles Telephone Company, which is by far the smallest LEC. (Id. at 10.) According to the IXCs, this one example, however, only shows that there is much diversity among the Small LECs and does not justify weakening the safeguards of the CHCF-A to benefit all Small LECs. If a particular Small LEC has unusual expenses, it bears the burden to petition the Commission for relief.

In their Reply Brief, the IXCs assert that, although the Small LECs attempt to argue otherwise, the means test actually encourages efficiencies in operations by providing an incentive for the Small LECs to hold down unnecessary costs so that they can achieve the full authorized rate of return of 10%. Similarly, by inducing them to return to the Commission for regular rate reviews, the waterfall provides the Small LECs with an incentive to manage their costs efficiently on a continuing basis.

5.6. Discussion

We find that the CHCF-A is the appropriate source of revenue recovery for the inter-company settlement payments currently made by Pacific.

However, the Small LECs and Pacific have not provided compelling reasons why the Small LECs should not be subject to the means test, waterfall, and rate increase requirements associated with draws from the CHCF-A. We created the rules governing the CHCF-A over the past two decades of experience with the fund, and have developed a workable system to maintain reasonable basic exchange rates for customers of small rural telephone companies to further our goal of universal service in rural areas. However, the requirements of the waterfall and means test, and the rate increase requirement, assure us that the companies that draw from the fund are submitting themselves periodically to Commission scrutiny of their operations and are not over-earning. In other words, all California ratepayers should not be funding inefficiencies and excessive earnings by the Small LECs.

While the Small LECs appear to find this a punitive process, we see it as our obligation to protect ratepayer interests, since all ratepayers are subject to the CHCF-A surcharge. The applicants are correct that the current settlement payments from Pacific are not subject to a waterfall and means test, but that begs the issue. Once the payments come from the CHCF-A, instead of from Pacific, we have an obligation to ensure that ratepayer interests are preserved.

The Small LECs try to make the annual CHCF-A filing sound as involved as a GRC, but as ORA points out, the annual means test included in the CHCF-A process in no way equates to a full-blown GRC. The Commission and the Small LECs have been performing this calculation for a number of years.

The Small LECs complain that the means test is a "one way" adjustment which is used to reduce revenues when earnings are above a benchmark, but it does not increase revenues or earning when they are below a benchmark. We disagree. The Small LECs ignore two important facts: 1) If a Small LEC is found to be over-earning in a particular year, no adjustment is

made to earnings for that base year. The Small LEC is allowed to keep those over earnings. The Small LEC's revenues are adjusted for the following year to eliminate the over-earning. Therefore, there is no penalty associated with the over earnings in a particular year; and 2) The Small LECs always have the option of coming to the Commission by filing a GRC if their earnings slip to a level which could impair their ability to provide telephone service, or if they incur unanticipated expenses.

The Small LECs' claim that investment companies will be discouraged from investing in the small companies if a large percentage of their revenue could be eliminated when that revenue is subject to the CHCF-A rules. We dispute that conclusion and agree with ORA's and the IXCs' assertion that the investment community will applaud the CHCF-A subsidy which virtually guarantees that the Small LECs will earn their authorized rate of return. This guaranteed subsidy will provide stability for the Small LECs, which should encourage investment.

Five of the Small LEC applicants currently do not have their rates set at 150% of Pacific's, as required by the CHCF-A rules. In the Scoping Memo and Ruling of Assigned Commissioner issued in this proceeding, those Small LECs were required to provide a notice to their customers of a potential rate increase.[10]

We have determined that the Small LECs' replacement funding for the STAs shall be subject to the same rules that apply to current draws from the CHCF-A, namely, both the means test and the waterfall provisions will apply. In addition, CHCF-A draws are conditioned on a Small LEC's basic rates being

[10] One of the five companies, Cal-Ore Telephone Company, notified its customers that they could experience a rate decrease as a result of this proceeding.

increased up to 150% of Pacific's residential flat rate. Since we are applying the same rules to these draws, we will utilize the same process in place for the current draws.

Small LECs shall be required to make their CHCF-A Advice Letter filings on October 1 of each year, and the Commission will approve those requests by Resolution. This process will commence with the annual filings required October 1, 2001. The Small LECs have already made their October 1, 2000, filings for calendar year 2001, but the Commission has not yet issued a Resolution approving those advice letters. Therefore, the results of this decision will be incorporated into the current process. Within 15 days of the effective date of this Decision, each Small LEC shall supplement its CHCF-A Advice Letter to reflect the results of this Decision.

The Telecommunications Division (TD) is directed to take these supplements into account in processing the Small LECs' 2001 CHCF-A Advice Letter filings. Those Advice Letter filings will be approved by Commission Resolution. Pacific shall be responsible for making its monthly STA payments through the month in which that Resolution is approved, and will have 60 days from the end of that month to complete its payments. The CHCF-A Administrative Committee is directed to begin making the monthly payments to each Small LEC, based on the Commission Resolution approving the Small LECs' Advice Letter filings, beginning the month following the month in which the Resolution is approved. TD will recommend the appropriate surcharge[11] rate level for the CHCF-A for calendar year 2001 as part of TD's processing of the

[11] The CHCF-A surcharge is currently set at 0% because there were adequate funds to meet the previously anticipated draws by Small LECs. Including the results of this decision in draws from the CHCF-A will necessitate reactivation of the surcharge.

Small LECs' Advice Letters. In the Resolution approving the Advice Letters, we will approve or modify TD's recommended surcharge rate level. Within 30 days of the effective date of the Resolution, the CHCF-A surcharge shall be reactivated at a level sufficient to cover the Small LECs' draws. At that time the total amount necessary for 2001 draws from the Fund will be known, which will allow us to reactivate the surcharge at the appropriate level to cover the necessary draws.

Since D.00-09-072 granted the applicants' request to extend the waterfall at the 100% level for one additional year, applicants' 2001 draws will not be subject to the waterfall provision. The issues raised in OP 2 of D.00-09-072 will be addressed in a subsequent decision in this docket.

6. Provision of IntraLATA Toll Service

6.1. Background

IntraLATA toll service is currently jointly provided by the Small LECs and Pacific. At the present time, intraLATA presubscription (ILP) has not been implemented in the territories of 12 of the Small LEC applicants of this proceeding[12] so IXCs are not authorized to provide presubscribed or "One Plus" intraLATA toll service in the Small LEC territories.

On March 23, 1999, the Federal Communications Commission (FCC) released an order setting an implementation schedule for intraLATA dialing parity.[13] According to the FCC order, all LECs were required to submit a dialing parity implementation plan to the appropriate state commission by April 22,

[12] Sierra Telephone Company, Inc. (Sierra) has already implemented intraLATA presubscription effective May 4, 1999.

[13] Implementation of Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, FCC 99-54 (released March 23, 1999).

1999. The FCC order set a deadline of June 22, 1999, by which time the Commission was to have approved each of the small telephone company filings.

Twelve of the parties to the instant proceeding concluded that the timing of the FCC order could create customer confusion and complicate revenue flows between Pacific and the small telephone companies. In June 1999, the 12 Small LECs filed applications, A.99-06-004/A.99-06-009 seeking additional time in which to implement intraLATA equal access. In D.00-01-004, the Commission granted a temporary suspension of the Small LECs' dialing parity requirement for intraLATA toll calls. The date for compliance with the dialing parity requirement was set for 30 days after the Commission's decision in the instant proceeding.

6.2. Small LECs' Position

Paragraph 2 of each of the STAs provides that neither Pacific nor the Small LEC is to be responsible for the provision of intraLATA toll services upon approval of the STAs. The parties agreed to this provision because they realized that intraLATA equal access would soon be required in all of the service areas of the Small LECs, and they anticipated that there would be many carriers interested in providing intraLATA toll services in those areas.[14] The Small LECs took this position because most of them are not well situated to provide these services in a competitive market. The Small LECs assert that most of them do not have the necessary facilities and administrative and customer service support in place. Those companies that want to provide these services to their customers (e.g., Sierra and Kerman at this time) have established Commission-

[14] The Small LECs point to Exh. 16 and 17, which are intraLATA Access Service Requests (ASRs). These include requests by AT&T, Sprint, and WorldCom, and there is no evidence that any of these requests have been withdrawn.

certificated long distance affiliates to do so. Other Small LECs may choose to do so in the future, but most of the other Small LECs are reluctant to offer intraLATA toll services and perceive problems associated with the provision of such services.

Despite the position of the Small LECs in this regard, they are cognizant of the concern expressed in the Assigned Commissioner's Scoping Memo and Ruling that customers of the Small LECs not be left without intraLATA toll service. While the Small LECs believe that such an eventuality is unlikely in view of the interest that other carriers have expressed in providing intraLATA toll services in their service areas, they recognize that it would be an unacceptable regulatory outcome. Therefore, the Small LECs have modified their position on this issue in order to address the Assigned Commissioner's stated concerns. Their position is now that they are willing to do the following:

1. The Small LECs which choose to provide intraLATA toll service through an affiliate would transition their toll services to the affiliate in connection with implementation of intraLATA presubscription. Customers would be notified of ILP options under existing ILP notification procedures, with the LEC affiliate serving as the default toll provider for non-responding customers.

2. Small LECs that have not chosen to provide toll service through an affiliate would not be required to offer intraLATA toll service if there is at least one interexchange carrier willing to provide the service. These companies would notify customers of available intraLATA toll carriers at the time of ILP implementation. Non-responding customers would be assigned to their interLATA carrier if that carrier is participating in ILP for the Small LEC. If the customer's interLATA carrier does not participate in ILP, the customer will be required to make an affirmative choice from

among participating carriers or to utilize 101XXXX dialing for intraLATA traffic.

3. In the event that there are no interexchange carriers willing to provide intraLATA toll service at the time of ILP implementation, the Small LEC would continue to provide the service following ILP. This puts the risk of IXC non-participation on the Small LEC.

This revised position is described in Exh. 3 and in Bishop's further direct testimony at the hearing. (1 R.T. 9-10.)

The Small LECs emphasize that the Commission should not require them to provide service where there are other carriers willing to do so. Thus, they should not be named as "default carrier" in an intraLATA equal access balloting or any other carrier selection process, even though they are willing to accept carrier of last resort (COLR) responsibilities for intraLATA toll. There is a difference between a default carrier and a COLR, as explained by Small LEC witness Bishop.[15] A "default" carrier is the carrier designated to serve customers who do not respond to a notice or ballot giving them the opportunity to select from among a list of interested carriers. A COLR is the carrier designated to provide a service because there are no other carriers willing to provide that service. Obviously, if service is required to be provided by a COLR, there is no notice or balloting, because there are no interested carriers willing to provide the service on a voluntary basis.

If a Small LEC is required to offer intraLATA toll service as a stand-alone service, the result will likely be high toll rates for end users and the risk of losses that will be part of its fully-regulated costs of operation. For rate-base

[15] 1 R.T. 32.

regulated carriers such as the Small LECs, such losses would be borne directly by ratepayers. If there are other carriers willing to serve, exposing ratepayers to this risk is completely unnecessary.

Under alternative 2 in the Small LECs' proposal above, the Small LECs have also proposed to default non-responding customers to each customer's participating interLATA carrier. They believe that this proposal is most likely to coincide with customer preference. After all, the customer has already chosen that carrier to provide interLATA service. It is difficult to imagine customer objection to being assigned to the same carrier for intraLATA toll service. Customers of non-participating carriers would be required to choose a new carrier, just as all new customers are required to choose their IXC or IXCs in the service area of any LEC offering equal access.

In their Reply Brief, the Small LECs rebut ORA's contention that the Small LECs have offered insufficient assurances that adequate intraLATA toll service will be available to customers of the Small LECs under their ILP proposal described in Exh. 3. According to the Small LECs, ORA's argument fails to acknowledge the Commission's clear statement of the ILP issue in the Scoping Memo for this proceeding:

> Before authorizing the proposed discontinuance of toll service, the Commission must be assured that customers of the Small LECs will continue to receive intraLATA toll service from one or more certificated carriers. (Scoping Memo, p. 6.)

The Small LECs assert they have provided the assurance required by the Commission by stating their unequivocal willingness to become the COLR for intraLATA toll service if there are no other carriers willing to provide the

service on a one-plus basis.[16] The record further contains convincing evidence that there will be IXCs willing to serve Small LEC customers.

The Small LECs rebut ORA's hypothetical scenario that the only IXC willing to serve a Small LEC's customers might charge those customers an intraLATA toll rate of 25 cents per minute. This possibility was suggested by ORA during the cross-examination of the Small LECs' witness Bishop. On redirect, however, Bishop testified that the Commission's policy on statewide rate averaging requires an IXC to offer the Small LEC customers the same rates that are applied to that IXC's customers in the urban areas of the states. The policies of this Commission expressly prohibit a 25-cent "Small LEC only" rate. No carrier could charge 25 cents per minute across the state and be competitive. Therefore, the Commission's policies effectively guarantee that no customer will face 25 cent per minute toll rates as the only option anywhere in the state.

ORA's response to the requirement of statewide rate averaging is to suggest that there might possibly be an IXC which was planning to provide intraLATA toll service only in Small LEC territories instead of statewide. Neither ORA nor any other party has presented any evidence that such a hypothetical carrier actually exists.

In their Reply Brief, the Small LECs indicate that while they cannot guarantee IXC participation in their future ILP process, the evidence in the record strongly supports the conclusion that multiple IXC participation will, in fact, occur. The only evidence in the record of a carrier that might not participate

[16] "Presubscription" or "One Plus" dialing means that once a customer selects a carrier for intraLATA or interLATA toll, that information is stored in the switch that serves the customer. When the customer picks up the phone to make a toll call, the switch automatically routes the customer's call to the customer's pre-selected carrier.

in the ILP process in California comes from AT&T, which says it has not yet determined whether it will provide the service. (2 R.T. 139, Reardon for Sprint.) Sprint admits that its tariffs do not permit it to decline to serve specific areas of the state (3 R.T. 242.) Further, Sprint has participated in every intraLATA presubscription opportunity presented to it across the country. (Id. at 239.)

In addition, the Small LECs state that ORA's Opening Brief ignores Exhibits 16 and 17, which are Access Service Requests (ASRs) submitted by IXCs to Calaveras and Evans, including orders by AT&T, Sprint, and WorldCom. These orders are evidence of strong interest on the part of many IXCs in serving the territories of these two Small LECs. Significantly, Calaveras is one of the smallest LECs in California. If such a large number of carriers are interested in serving Calaveras' customers, it strongly indicates that there will be keen interest in serving the customers of the other Small LECs.

In their Reply Brief, the Small LECs point out that ORA's brief also makes a confusing reference to 10XXX[17] dialing which is based on a misconstruction of Bishop's testimony. At page 4 of ORA's Opening Brief, Bishop's testimony at 1 R.T. at 33 is cited in support of ORA's claim that Small LEC customers might have to resort to 10XXX dialing in order to obtain intraLATA toll service. Bishop made no such statement. In fact, the Small LEC position on ILP guarantees that all customers will have available to them one-plus presubscribed intraLATA toll service, either from an IXC or from the Small LEC. What Bishop actually said when asked by ORA about 10XXX service was that under the FCC's rules, a new customer signing up for local service with the

[17] 10XXX or 101XXXX dialing means that the customer has to dial an access code to reach a carrier to make a toll call.

LEC must choose a toll carrier and may not be assigned by a LEC to itself or an affiliate or to any IXC. Thus, a new customer must either affirmatively choose a toll carrier or rely on 10 XXX dialing for toll calls.

6.3. Pacific's Position

The Small LECs modified their original proposal and expressed a willingness to serve as the COLR for intraLATA toll services in the event that no IXC is willing to provide such services to their customers. This modification removes the risk that there will be no carriers willing to serve in the Small LECs' territories. Pacific asserts that the willingness of the Small LECs to carry this traffic also renders moot many of the objections raised by intervenors. It completely negates any argument that Pacific be designated a COLR in the Small LEC territories. Additionally, the modification complies with the universal service order requiring incumbent LECs to assume the role of COLR.[18]

In its Reply Brief, Pacific asserts that AT&T's request that Pacific be the COLR in the Small LECs' service areas is inconsistent with previous Commission decisions stating that the incumbent LEC should be the COLR. According to Pacific, AT&T relies on incorrect factual assumptions to buttress its arguments that Pacific be the COLR. For example, AT&T claims that Pacific is a carrier of intraLATA toll service throughout the entire state,[19] even though Pacific is not providing intraLATA toll service in Verizon California, Inc.'s (formerly GTEC) or any other independent company's service territory, except on a very limited basis through its CLEC operations. Also, AT&T attempts to establish that Pacific has existing physical facilities in the Small LECs' service areas to provide intraLATA toll service. AT&T contends that Pacific is a COLR

[18] D.97-01-020 [70Cal. PUC2d] 588, 596, Appendix A, O.P. 11(e).

[19] IXCs' Opening Brief, p. 9.

in the Small LECs' service areas by stating, " because Pacific is now and has always been the COLR for intraLATA toll service, it is best equipped to continue providing those services, having its lines and system in place…" (IXCs' Opening Brief, p. 24.) Pacific asserts that it jointly provides intraLATA toll service and access service with all of the LECs in California and many of the CLECs. It does not own all the facilities to provide such services.

In any event, Pacific asserts that AT&T's request to have Pacific assume COLR status is not even necessary. The Small LECs have agreed that they will be the COLR for intraLATA toll in their service areas. This complies with ORA's position that the Small LECs have been, by previous Commission order, designated to be the COLR for intraLATA toll.

6.4. ORA's Position

As part of this application, the Small LECs are seeking Commission authorization to decline to offer intraLATA toll service if there is at least one IXC willing to provide intraLATA toll service in their respective territories. While the Small LECs have offered assurances that such services will be offered, both AT&T and Sprint have been unwilling to guarantee that they will offer such services in the Small LECs' service territories.[20] According to AT&T, the decision on whether AT&T will be willing to offer intraLATA toll service on a statewide basis will depend upon the costs and the effective rates customers pay. Sprint similarly states in its direct testimony that it is unable to commit to becoming a presubscribed intraLATA carrier in the service territories of the Small LECs under the terms they have proposed in their application. (Exh. 18 at 7.)

[20] 2 R.T. 139-140, Kong for AT&T.

Further, ORA states, there is no requirement that a prospective IXC that is willing to provide intraLATA toll service in the service territories of the Small LECs must be willing to offer this service on a statewide basis or even be available on a continuing basis in a Small LEC's service territory. According to ORA, the sole guarantee the Small LECs are offering to their customers is that as long as one IXC is willing to provide service (at whatever price) the Small LECs would no longer be the COLR for intraLATA toll. Given the importance of telephone service in rural areas, and the relatively small service territories of the Small LECs, access to reasonably priced intraLATA toll service is of vital importance to these rural areas because many of the calls are predominately toll-related.

ORA has determined that none of the existing IXCs are under any legal requirement to participate in equal access balloting in any part of the state (according to the Commission's Telecommunications Division and both AT&T and Sprint). Given this situation, what the Small LECs propose is unacceptable to ORA. The risk of having no reasonably priced intraLATA toll service available to Small LEC customers is simply too great.

Another important concern is the possibility is that customers of the Small LECs might have to resort to 10XXX dialing to obtain intraLATA toll service, something that even the Small LECs acknowledge is not the same quality of service that currently exists in their service territories. (1 R.T. 33, Bishop for Small LECs.) Absent some express Commission determination to the contrary, the customers of the Small LECs run a distinct risk of having to resort to 10XXX dialing to obtain intraLATA toll service if the Small LECs are allowed to abandon their former role as default providers.

ORA expresses concern that if the Commission does not require the Small LECs to continue to serve as default providers, some LEC customers may

have only extremely high priced service available. ORA raised the hypothetical situation of a carrier which charged 25 cent per minute rates in the Small LEC territories. Not only does the Small LECs' and Pacific's application represent poor public policy, states ORA, it also runs contrary to the express provisions of Decision (D.) 97-04-083 and the Scoping Memo in this proceeding. Both of these documents reiterate the Commission's interest in having assurances that customers of the Small LECs must be able to access both intraLATA and interLATA toll services. According to ORA, nothing has been presented in this proceeding to justify modification of D.97-04-083 to allow the Small LECs to abandon their role as default provider.

In its Reply Brief, ORA rebuts Pacific's contention that during cross examination AT&T's witness committed the company to providing intraLATA toll service in the Small LECs' service territories. According to ORA, Pacific is distorting the actual testimony of AT&T's witness who stated that "AT&T hasn't made its mind up yet." (Kong, AT&T, 2 R.T. 139.) AT&T's witness later clarified his statement saying that AT&T's marketing department would have to undergo a complex evaluation to determine if it would offer intraLATA toll service in the Small LECs' service territories. (Id. 139-140.)

Despite Pacific's contention to the contrary, Sprint similarly did not make a specific commitment to provide intraLATA toll service in the Small LECs' service territories. Instead, Sprint's witness merely stated that Sprint has historically participated in all intraLATA presubscription opportunities in the past. (3 R.T. 240, Rearden for Sprint.)

ORA criticizes Exhibits 16 and 17 which Pacific offered in support of its contention that many IXCs have offered to provide intraLATA toll service in the Small LECs' service territories. According to ORA, the two exhibits include copies of ASRs that are over a year old. While these agreements purport to show

a willingness on the part of several IXCs to provide intraLATA toll service in the Small LECs' service areas, they are generally not current and were based on the intraLATA access rates in effect at the time they were submitted, which are far lower than the rates the Small LECs propose. Neither of these exhibits has any probative value in predicting how these same IXCs would react to the Small LECs proposed access rates. Because these documents are not timely and because they reflect an entirely different access regime than what the Small LECs propose, they should be disregarded.

6.5. The IXCs' Position

The IXCs assert that the COLR proposals in the application are confusing and fail to protect the public interest. Both the Small LECs and Pacific originally proposed to withdraw from the provision of intraLATA toll service in the Small LECs' territories. However, the Small LECs modified their position with a complicated proposal, which the IXCs find to be somewhat unclear. (Exh. 3.)

The IXCs state that the applicants' proposal to reduce their responsibility as COLR is not in the public interest. The applicants presented no support for modifying previous Commission decisions designating the ILEC as the COLR. Furthermore, any concern that customers of Small LECs lack intraLATA toll alternatives stems from the access rate levels and rate design proposed by the Small LECs themselves.

According to the IXCs, Pacific's refusal to provide intraLATA toll service in the Small LECs' territories is further evidence of the flaws in the Small LECs' access proposal. As a carrier of intraLATA toll service throughout the entire state, Pacific must charge statewide uniform rates. That is, it must charge the same toll rates in the Small LECs' territories as in its own exchanges. Applicants admit that Pacific physically provides intraLATA toll service in the

Small LECs' territories jointly with each Small LEC. (1 R.T. 20.) Pacific's proposal to withdraw from exchanges where it currently provides service is evidence that Pacific does not believe it can profitably serve the Small LECs' territories with statewide uniform toll rates and National Exchange Carrier Association (NECA) level access rates. The IXCs face fundamentally the same situation. It is completely unreasonable for Pacific and the Small LECs to fashion an application that, in effect, transfers an unprofitable service and subsidy burden to IXCs.

The IXCs assert that the Small LECs' complicated proposal is similar to that created in other states when the incumbent LECs withdrew from the intraLATA toll markets in those states. Under this arrangement, IXCs that participate in intraLATA equal access balloting would serve as default providers for some of their customers, while other Small LEC customers would have to dial around to receive service. (Exh. 3.) The IXCs assert the Small LECs' revised proposal still places inappropriate obligations on IXCs and fails to guarantee an adequate level of service quality for consumers.

The Commission can approve a solution that is equitable to consumers, IXCs, and applicants alike. First, the Commission should approve an efficient access rate structure that will promote competition in the intraLATA toll market in the Small LECs' territories.[21] An efficient rate structure will encourage IXCs to participate in the intraLATA toll markets in the Small LECs' territories and to compete actively for customers, thereby minimizing the number of customers who will default to the incumbent LECs in their capacity as COLRs.

[21] Parties' specific proposals regarding access charges are discussed in the following section.

Second, the Commission should reject applicants' de facto request to modify the provisions of D.97-04-083 and require them to continue to serve as COLRs, as set forth in that decision. The active competition of IXCs described above will minimize the burden on the incumbent LECs that are serving as COLRs. Conversely, the requirement for these LECs to serve as COLRs will provide the Commission with the assurance it seeks to have a guaranteed intraLATA toll service provider and a high level of service quality for Small LEC customers.

6.6. Discussion

6.6.1. Provision of intraLATA Toll Service

Before we rule on how intraLATA toll service should be provided in the Small LEC service territories, we need to address ORA's three major concerns: (1) Small LEC customers could be subject to 25 cent intraLATA toll rates, (2) Small LEC customers could have to dial extra digits to make an intraLATA toll telephone call, and (3) IXCs may discontinue intraLATA toll service in Small LEC territories. ORA raises valid concerns so we will evaluate each in detail, as we are not willing to have Small LEC customers subjected to inferior intraLATA service.

First, we address the potential problem of Small LEC customers paying 25 cent rates. In previous Commission orders, we found that carriers cannot charge lower rates in the competitive urban areas, and higher rates in the less competitive rural areas. That policy precludes a carrier from charging Small LEC customers 25 cent rates, while charging lower rates to its urban customers.

We have reiterated this policy in Commission orders as far back as 1984, when we first addressed the issue of interLATA competition. In that decision we found as follows:

> Another issue that stimulated substantial discussion is the problem of deaveraged rates. The notion is that 'cream skimming' will force down rates in competitive markets and force up rates on noncompetitive routes. We find there is no foreseeable danger that deaveraging will occur spontaneously in the near future, in light of the access charges that we adopted; however, in order to further diminish the probability, we will require that each applicant file rates that are uniform on a distance basis. (D. 84-06-113, 15CPUC2d, 426, 474.)

The issue of deaveraged rates was raised in a subsequent rulemaking, as the Commission established tariff filing rules for nondominant interexchange carriers (NDIECs). We decided to leave the current requirement for average rates in place, pending further investigation. We concluded as follows: "NDIEC rates should remain uniform on a distance basis until the Commission considers this issue in Phase III of I.87-11-033." (D.90-08-032, Conclusion of Law 8, 37 CPUC2d, 130, 157.)

In Phase III of our New Regulatory Framework (NRF) investigation, we looked at the issue of statewide average toll rates in conjunction with our efforts to open the intraLATA market to competition. We found there was no economically sound reason to adopt a different structure for Message Telecommunications Service (MTS) intraLATA calls than exists for interLATA toll calls. While we allowed different carriers to adopt their own intraLATA toll rates, we required that those rates be effective throughout the carrier's service territory. We concluded as follows: "All individual LECs and IECs should … be required to maintain uniform MTS rate schedules within their respective service areas." (D.91-07-044, CoL 23, 41 CPUC2d, 1, 35-36.)

The mandate in D.91-07-044 remains in effect today. That means that an IXC that provides service in various parts of California cannot

decide to charge different rates in Small LEC territories than it charges in urban areas. Thus, there is no danger of those carriers offering a 25 cent rate in the Small LEC territories because they would then have to offer that rate statewide, and at 25 cents per minute, those carriers would not be able to compete against carriers charging far less than 25 cents per minute.

The only instances where Small LEC customers would be subjected to a 25 cent rate would be in one of two cases: (a) An IXC with 25 cent intraLATA toll rates elects to serve only Small LEC customers, or (b) the Small LEC serves as COLR in its service territory because no IXC indicates an interest in providing service there. We will address each instance in turn.

It is not likely that an IXC will choose to serve only Small LEC territories, when the state's urban areas provide more lucrative areas to serve. We conclude that ORA's first issue does not have merit, because they have raised an eventuality that is unlikely to occur.

However, ORA's concern raises a companion issue, namely, since the Small LECs do not want to provide intraLATA toll service, there is nothing in the record of this proceeding to indicate what intraLATA toll rates they would charge if they were required to offer the service. However, each Small LEC did agree to be the COLR, if no IXC were to choose to provide service in its territory. In that case, the Small LEC would presumably be the monopoly provider of intraLATA toll service. In the event that a Small LEC does offer intraLATA toll service in its area as a result of this decision, that Small LEC shall, at least initially, charge rates no higher than Pacific's intraLATA toll rates (the ceiling rates for residential intraLATA toll and the maximum rates for business intraLATA toll service). Also, the Small LECs should continue to offer any toll discount plans which they currently offer today. That will ensure that Small LEC customers are not paying high rates as a result of having only a single provider.

Any Small LEC which serves as COLR for intraLATA toll service may apply to the Commission to increase its intraLATA toll rates in its next GRC.

Second, we address ORA's concern that Small LEC customers will have to dial extra digits to make intraLATA toll calls. While this issue will be discussed further below, we state unequivocally that we intend to provide Small LEC customers with presubscribed intraLATA toll service. That does not mean that a Small LEC customer would never have to dial 10XXX or 101XXXX to reach an intraLATA carrier, but 101XXXX dialing will not be the only option available to Small LEC customers.

Third, ORA expresses concern that IXCs may discontinue offering intraLATA toll service in the Small LECs' territories. Here we offer the protections afforded by General Order 96-A. Once an IXC begins to offer service in a Small LEC's territory, it cannot withdraw from service without Commission approval. General Order 96-A which governs the filing and posting of rate schedules for various types of public utilities includes a section relating to withdrawal of service.

> Section XIV. Withdrawal of Service: No public utility of a class specified herein shall, unless authority has been obtained from the Commission, either withdraw entirely from public service or withdraw from public service in any portion of the territory served.

This requirement for Commission approval prior to withdrawal of service alleviates ORA's concern that an IXC which begins to offer service in a Small LEC's territory might not be available on a continuing basis. We will closely scrutinize any requests for withdrawal of intraLATA toll service in the Small LEC territories to assure ourselves that the ongoing interests of Small LEC customers are preserved.

The next issue relates to whether Pacific and the Small LECs should be authorized to discontinue provisioning intraLATA toll service, as requested by the applicants. Service is currently jointly provided, with each carrier using its own facilities. The Small LECs assert they are not well-situated to provide intraLATA toll services in a competitive market, since most of them do not have the necessary facilities and administrative customer service support in place.

AT&T asks that Pacific continue to be the COLR in the Small LEC territories. However, as Pacific correctly states, previous Commission decisions (D.96-10-066, D. 97-01-020 and D.97-04-083) require the incumbent LEC to be the COLR, and Pacific is not incumbent LEC in the Small LEC territories, and there is no reason why Pacific should be required to perform the role of COLR. Contrary to the IXCs' allegation in their Brief, Pacific is not the COLR for intraLATA toll service in the Small LEC service territories, and currently provides service jointly with each Small LEC. Pacific does not own all of the facilities used to provide those services. We conclude that Pacific should not be required to serve as COLR outside of its own service territory, and therefore will not be required to serve as COLR for intraLATA toll service in the Small LEC territories.

Next we address whether a Small LEC should be authorized to discontinue providing intraLATA toll service if at least one IXC is offering presubscribed intraLATA toll service in its territory. We have assured ourselves that Small LEC customers will have at least one presubscribed intraLATA toll carrier—either the LEC itself or an IXC. Also, our requirement for statewide average rates will ensure that Small LEC customers will not be subject to extremely high intraLATA toll rates. This negates many of the objections raised by intervenors. While the IXCs claim that the Small LEC proposal places an

unfair service burden on them, that claim does not have merit. We do not require that IXCs provide intraLATA toll service, so it is unclear that any obligation or burden is being placed on the IXCs. Each IXC will make its own determination, without Commission intervention, as to whether it will provide intraLATA toll service in each Small LEC's service territory.

At this point, we do not know whether IXCs will step forward to participate in the presubscription process, or not. The intraLATA toll market in California is competitive, and IXCs cannot be required to provide that service in the Small LEC territories. ORA indicates that it has confirmed that existing IXCs are not under any legal requirement to participate in intraLATA equal access in any part of the state. As ORA points out, the ASRs in Exh. 16 and 17 are over a year old, and may not indicate various IXCs' willingness to provide intraLATA toll service pursuant to the access rates, and other policies adopted in this decision. Each IXC will make that business decision after analyzing the access charges adopted in this decision and other factors which could affect its business plan.

Even if no IXC steps forward to provide intraLATA toll service in a particular Small LEC's service territory, the LECs themselves have expressed willingness to serve as COLR. This will ensure that Small LEC customers have intraLATA service on a presubscribed or "1+" basis at reasonable rates. We have indicated that for the present time, any Small LEC which serves as COLR shall charge no more than Pacific's current intraLATA toll rates (the ceiling rates for residential service and the maximum rates for business service). Any proposed increases in those toll rates should be raised by the small company in its next GRC. Therefore, we conclude that the Small LECs will be required to provide intraLATA toll service as COLR, only if no IXC provides presubscribed service in its service territory. Once an IXC provides the service,

the LEC is not required to continue to provide service, since under the terms of GO 96-A, the IXC will not be allowed to suspend service without Commission approval.

We adopt the Small LEC proposal for provision of intraLATA service cited above as Exh. 3, with some modifications. Item 1 provides that the Small LEC which has an IXC affiliate will transition its toll service to the affiliate in connection with implementation of ILP. The Small LECs also propose that the IXC affiliate will serve as the default provider for non-responding customers. That is satisfactory only if no other IXC offers service in the Small LEC's territory. If other IXCs are offering service in competition with the Small LEC's affiliate, the affiliate cannot serve as default provider. Rather, the IXC affiliate must be treated the same as any other IXC.

Under Section 2, the LEC is relieved of its obligation to provide intraLATA service if at least one IXC is willing to provide the service. Item 2 indicates the LECs will notify customers of available toll carriers. In their Opening Comments on the Proposed Decision (PD), the Small LECs suggest that a notification process be implemented, in lieu of the balloting ordered in the PD. According to the Small LECs, the primary distinction between the balloting process described in the PD and the proposed notification process is the method of customer response. With notification, the customer is provided with contact information for all available intraLATA toll service providers and is invited to contact the IXCs directly for information on rates and terms of service and to sign up for the service from the customer's preferred provider. The balloting procedure requires the customer to return the ballot to the LEC rather than contacting the IXC directly. The balloting procedure could lead to a customer selecting a particular IXC without the opportunity to choose from among the IXC's service alternatives that would best serve the customer's needs.

In its Reply Comments, ORA indicates that it has no preference for balloting over notification, but recommends that whatever option the Commission chooses should be implemented with an eye toward providing customers with the opportunity to gather enough information to make informed choices. ORA recommends that the use of direct mail be required and that phone numbers of the IXCs willing to provide service be included in the direct mail notification. ORA also recommends that the Small LECs should send a second direct mail notice to customers 30 days after the first one is sent to minimize the possibility that a customer will be assigned to an IXC by default.

The Small LECs and ORA have both made convincing arguments that a process of notification is superior to a system of balloting since it gives customers a better opportunity to make an informed choice as to which IXC provides the best plan for their calling patterns. We will adopt the notification process, as proposed by ORA. The notices must be sent by direct mail, and must include the names and telephone numbers of all IXCs which have indicated an interest in providing service. In addition, we shall require the Small LECs to send a second notice 30 days after the first notice. Both notices need to make clear what the default process is, with an explanation of how 10XXX dialing works.

The Small LEC proposal includes a policy for those customers who do not respond to the notice. We agree that non-responding customers should be assigned to their interLATA carrier, as long as that carrier is participating in ILP for the Small LEC. If the interLATA carrier is not participating in ILP, those customers who do not make an affirmative choice will be required to utilize 101XXXX dialing for intraLATA toll calls. We reiterate that this option applies only to those customers who decline to make a selection of intraLATA toll provider.

6.6.2. Implementation of IntraLATA Presubscription

The policies adopted above will require the 12 Small LECs to implement intraLATA equal access in a different way than the larger LECs in the state. The Small LECs will need to ascertain the interest of IXCs to participate in intraLATA presubscription. Since the Small LECs will not serve as the default provider of intraLATA toll service, if at least one IXC expresses interest in providing service, the Small LEC will have to provide notice to its customers. The following schedule will be adopted for implementation of intraLATA equal access. All dates are based on the date of approval of this decision.

+15 days	Each Small LEC will send a notice to all IXCs authorized to provide intraLATA service in California of the availability of intraLATA presubscription in the Small LEC's service territory.
+40 days	Deadline for interested IXCs to return form relating to intraLATA equal access and to order associated access facilities.
+60 days	Initial notice mailed to customers. If only one carrier (either an IXC or the LEC) will provide service, notice shall inform customers as to which carrier will be the COLR for intraLATA service. Customer notices are subject to review and approval by the Public Advisor and TD. Small LECs implement customer intraLATA presubscribed carrier preferences as orders are received from IXCs and as related access

	facilities are available.
+90 days	Second notice mailed to customers.
+120 days	Customer response period ends. Service for non-responding customers is defaulted to their interLATA carriers or to 10XXX dialing if the customer's interexchange carrier does not participate in presubscription.

This action requires us to modify prior Commission orders. Our intraLATA presubscription decision D.97-04-083 set the basic ground rules for implementing intraLATA equal access, and among other things, established that each LEC would be the default provider of intraLATA toll service. However, in the Scoping Memo to this proceeding we indicated that we might need to make changes to that decision, and we served the ruling on the service list for the intraLATA presubscription proceeding so interested parties were given notice, pursuant to Public Utilities Code Section 1708, of the potential change in a Commission order.

Several Ordering Paragraphs adopted in D.97-04-083 shall be modified for the 12 Small LEC parties to this proceeding which have not yet implemented ILP, to reflect the following changes which result from this decision:

a. OP 3: The "full 2-PIC methodology" which permits a customer to presubscribe to different carriers for interLATA and intraLATA service will be modified to eliminate the requirement that the customer's LEC be one of the options for intraLATA service, unless the Small LEC serves as COLR.

b. OP 5: The Small LEC will not be required to provide intraLATA service as long at least one

IXC offers presubscribed service. Therefore, we eliminate the requirement that existing customers who do not elect to change their intraLATA toll provide shall continue to receive intraLATA toll service from their LEC.

c. OP 8: The notification timeframes are modified. We retain the requirement that all proposed customer notices be submitted to the Telecommunications Division for review.

d. OP 13(a): The neutral business office procedures do not apply to the extent that the LEC itself will not be offering intraLATA toll service if at least one IXC is willing to offer the service.

e. OP 14: The review of scripts is only required if one of the options for intraLATA toll service is service provided by an affiliate of the LEC.

f. OP 17: Small LECs will be required to use direct mail to notify customers as to their options for intraLATA toll service.

One other Commission decision is impacted by the policies adopted above, D.00-01-004. That decision, which grants a temporary suspension of the dialing parity requirement for 12 of the Small LECs which are parties to this proceeding (excluding Sierra which has already implemented ILP), set a date for compliance with the dialing parity requirement for 30 days after the Commission's decision in this proceeding. (D.00-01-004 at 6, OP 1.)

However, if parties to proceeding A.99-06-004/A.99-06-009 believe that 30 days is not enough time to perform all the steps ordered in this decision, they should send a letter to the Executive Director requesting an extension of time under Rule 48(b) to comply with the implementation of dialing parity requirements beyond the 30 days established in D.00-01-004. Such letter shall include a reason why 30 days is not sufficient. In any event, any extension granted will be no longer than the implementation schedule adopted in this

decision. If parties believe the 30-day deadline is realistic, they should include that statement in their comments on this PD, along with a proposed 30-day implementation schedule, based on the implementation process adopted in this decision. This PD will be mailed to the service list for A.99-06/004/A.99-06-009 to ensure that all interested parties are aware of the implementation schedule in this PD and its impact on D.00-01-004.

In their Opening Comments, the Small LECs note that the PD correctly exempts Sierra from the implementation process because Sierra has already implemented ILP and numerous IXCs currently offer intraLATA toll to Sierra's subscribers. However, notwithstanding the prior ILP implementation, Sierra, through its intraLATA toll pooling arrangement with Pacific, continues to provide intraLATA toll service to several thousand subscribers. For this reason, the Commission needs to outline procedures for transitioning those subscribers into the new environment where neither Sierra nor Pacific will provide intraLATA toll to Sierra's customers.

We have reviewed the process proposed by the Small LECs in their Opening Comments, and adopt it with some minor modifications:

+15 days	Notice mailed to IXCs providing interLATA service to customers currently receiving intraLATA toll from Sierra advising those IXCs of the possibility that their existing interLATA customers may be defaulted to them for intraLATA service.
+60 days	Notices mailed to customers receiving intraLATA toll from Sierra. Customer notices are

	subject to review and approval by the Public Advisor and TD. Sierra implements customer preferences as orders are received from IXCs.
+90 days	Second notice mailed to customers.
+120 days	Customer response period ends. Service for non-responding customers is defaulted to their interLATA carriers or to 10XXX dialing if the customer's interexchange carrier does not participate in presubscription.

In its Opening Comments, ORA indicates that a group of Small LECs filed a request for delay of their duty to implement intraLATA equal access until this proceeding was decided. (A.99-06-009.) In that application, Foresthill and Ducor stated that they had not yet implemented interLATA presubscription and requested that they be permitted to delay implementation of interLATA equal access until they implement intraLATA equal access, citing cost efficiencies and reduced customer confusion.

The Commission subsequently granted Foresthill and Ducor a delay for implementation of the dialing parity requirements until 30 days after a final decision was made in A.99-09-044 (D. 00-01-004, Ordering Paragraph 1.) As ORA indicates, that decision closed A.99-06-009. Therefore, ORA states that the Commission must explicitly establish an interLATA equal access implementation schedule for Foresthill and Ducor in this docket and this decision.

We decline to adopt ORA's recommendation that we order interLATA equal access for Foresthill and Ducor in this proceeding. We find we have no record before us in A.99-09-044 which would allow us to address the issue. The issue was not within the scope of this proceeding, no testimony was heard on the issue, and the first time the issue was raised was in ORA's comments on the PD. However, O.P. 1 to D.00-01-044, clearly requires the applicants to implement the dialing parity requirements of 47 U.S.C. § 251 within 30 days after a final decision in this docket. Section 251(b)(3) includes a requirement to implement dialing parity for "telephone toll service" which would include both intraLATA and interLATA toll service. Therefore, our earlier decision already places the requirement on Foresthill and Ducor to

implement interLATA equal access. Nothing in this decision overturns our earlier order.

In their Reply Comments, the Small LECs support ORA's proposal and suggest that the two companies be allowed to implement interLATA and intraLATA equal access simultaneously and adhere to federal rules for implementation of interLATA equal access. We deny the Small LECs' request because we are not willing to further defer implementation of intraLATA equal access for Foresthill and Ducor. The Small LECs do not provide any information on how or when implementation would take place. We suggest that the two companies use the schedule adopted here for implementation of intraLATA equal access to implement interLATA equal access as well.

7. Access Charge Rates and Structure

7.1. Small LECs' Position

The Small LECs propose adoption of intrastate access charges based on the interstate access charge rate structure of the National Exchange Carrier Association (NECA). According to the Small LECs, they currently charge Pacific's access rates, which are far below the Small LECs' relevant costs. Use of NECA rates moves the Small LEC intrastate access rates closer to their own costs, but the rates would still remain within a reasonable range, as evidenced by the fact that NECA rates have been applied to interstate access traffic for many years. The NECA access tariff structure is also well-established and understood within the industry, and use of the same structure for intrastate services will simplify carrier access billing.

The Small LECs assert that the proposed rates filed with the Amendment to the Joint Application will move the access charges of the Small LECs closer to the relevant access costs of the Small LECs, but there will be a substantial balance of access-related costs in excess of access revenues. The $31

million in permanent replacement funding represents this balance of access costs, since it is a company-by-company total of the amount of costs reported to the pools, less the total access revenues that each company will receive using the access rates it has filed. According to the Small LECs, the access rates are calculated to generate $18.3 million in access revenues. When added to the $31 million balance represented by the permanent funding, the total of the access-related costs for the Small LECs is $49 million. The costs reported to the pools by each company are determined by application of the accounting, separations and cost allocation rules adopted by the FCC and this Commission.

The Small LEC proposal to use NECA-based access rates was supported in the opening testimony of ORA and AT&T, except both those parties opposed adoption of the Carrier Common Line Charge (CCLC) rate element.[22] Sprint, however, took the position that the access rates of the Small LECs should not be set in relation to Small LEC costs. Sprint proposed, instead, that the Small LEC access rates should be based on a statewide average of the access rates of other California companies, which in effect would mean that the primary determinant of Small LEC access rates would be Pacific's operating costs.

The Small LECs state that Sprint attempted to justify its position by referring to the regulatory requirement that toll service providers charge statewide averaged toll rates. According to the Small LECs, Sprint's argument ignores the reason for requiring that carriers charge statewide averaged toll rates. Regulators require that toll service providers charge averaged toll rates because they realize that low-density areas are more expensive to serve than high-density

[22] The Carrier Common Line Charge (CCLC or CCL) is a per-minute rate element intended to recover a portion of the nontraffic-sensitive costs of the access line connection to the public switched network.

areas. Based on the consumer-oriented public policy determinations by this Commission, IXCs are prohibited from recognizing these location-specific cost differences by adopting location-specific pricing. Sprint's proposal turns this policy on its head by suggesting that since IXCs are being required to charge averaged toll rates that do not vary with locality-specific service costs, the regulator is therefore obliged to eliminate the service cost disparities between high and low cost areas.

The Small LECs assert that Sprint's position that the Small LEC access rates would be too high is further undermined by the fact that Sprint's own incumbent LEC operations in several other states charge access rates as high as 13 cents to 22 cents per minute.[23] This is far in excess of the approximately 5.5 cent per minute rates proposed by the Small LECs.

According to the Small LECs, the suggestion of ORA, AT&T and Sprint that the CCLC should be eliminated is primarily based on a philosophical opposition to CCLCs in general and is not supported by the record in this proceeding. The elimination of the CCLC by the FCC has only applied to some of the larger price cap companies. Rate-of-return LECs, including the NECA companies, continue to have a CCLC access rate element in their FCC-approved tariffs. Further, when the FCC eliminated the CCLC for price cap carriers, it adopted a charge on presubscribed lines as a replacement for the CCLC revenues.

The proposal to eliminate the CCLC also fails to address the fact that even with the CCLC rate element, the access rates proposed by the Small LECs are below their access-related costs. (Bishop Reply Testimony, Exh. 2, p. 4.)

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[23] Rearden Cross-examination, 3 R.T. at 248-252.

Further, as demonstrated by Peters' testimony, Pacific's willingness to pay access rates which include the CCLC is based in part on Pacific's acknowledgement that the 5.5 cent access rates are below the 6.5 cent "traffic sensitive" portion of Small LEC access costs.

The Small LECs rebut the IXCs' argument that the proposed 5.5 cent Small LEC access rate would lead to an unprofitable toll market for IXCs serving Small LEC customers. There is no credible evidence in the record that can support such a conclusion. According to the Small LECs, there is no evidence of the cost and revenue factors that serve as a measure of toll service profitability. The only evidence presented by the IXCs that even remotely approached the subject of toll service profitability was in the prefiled testimony of Rearden that the "most competitive" toll rates were five cents per minute. (Rearden Opening Testimony, Exh. 18, p. 5.) Under cross-examination, however, Rearden was unable to provide any evidence whatsoever when asked about (1) the "least competitive" toll rates in the state; (2) the upper range of toll rates for Sprint customers who were not on a specific rate plan; (3) the rates for Sprint's interstate calling services; (4) whether in order to get the five-cent per-minute rate a customer had to pay $6.99 per month; and (5) whether a customer on a five-cent rate plan with a $6.99 monthly charge who used 100 minutes of toll service in a month would have an effective 12-cent per minute rate. (Rearden cross-examination, 3 R.T. 236-238.) Under cross-examination, Kong acknowledged that AT&T's basic intrastate toll rate was 13 cents per minute and that the interstate basic rate was 26 cents per minute, (2 R.T. 134.) but he did not know what AT&T's average revenue per minute was, inclusive of monthly minimum charges for rate plans.

The Small LECs assert the IXCs cannot have it both ways. Their failure to be forthcoming with hard information on toll service profitability

eliminates the credibility of their claim that they cannot provide profitable toll services to Small LEC customers if the Commission approves the requested 5.5 cent per minute access rate. Furthermore, their argument completely ignores the policy basis for both California and federal requirements of toll rate averaging among high and low cost areas. The relevant costs for setting statewide toll rates are obviously statewide operating and access costs. The object of the policy is not to promote service redlining; it is, instead, to eliminate geographic price discrimination by IXCs, despite the existence of high and low cost service areas.

In their Reply Brief, the Small LECs indicate that ORA misunderstood the Small LEC access charge proposal. ORA states that the Small LECs' purpose in proposing to include the CCLC is to generate "additional" revenues for the Small LECs, in order to avoid revenue neutrality. That is not the case. All CCLC revenues are expressly included in witness Tutt's calculation of the settlements replacement funding, as a reduction to the funding requirement.

According to the Small LECs, the IXCs ignore two facts relating to access charges: (1) Small LECs have higher costs of providing access than large LECs, and (2) Replacement funding must come from somewhere, and the Commission has expressed a preference that costs be recovered through a carrier's own rates where reasonable.

The IXC brief also reiterates the unsupported claim that the CCLC is somehow unlawful or illegal. According to the Small LECs, this assertion is pure fabrication. According to the Small LECs, both the FCC and the CPUC have approved access tariffs that include a CCLC at various times since passage of the

1996 Act.[24] Also, the FCC has been able to eliminate CCLC charges for larger LECs by creating other forms of access charges to replace the CCLC revenues. (Exh. 2 at 4.) In the case of the Small LECs, however, no party has suggested an increase to local rates that are already at the maximum level under CHCF-A rules or the creation of a charge on presubscribed lines or some other charge to be assessed against IXCs as a replacement for CCLC revenues.

7.2. Pacific's Position

Pacific sees the access charge issue as a red herring. AT&T and Sprint ostensibly object to the proposed adoption of the NECA rates for the Small LECs to the extent that it introduces CCL charges into the Small LECs' intrastate rate structure. At least one other party, ORA, was left with the impression that AT&T and Sprint would not provide intraLATA toll service in the Small LECs' territories because of the proposed access charges. (Exh. 15, ORA Rebuttal Testimony, p. 10.)

ORA's impression regarding AT&T and Sprint's unwillingness to serve was contradicted by AT&T and Sprint. According to Pacific, AT&T and Sprint both stated they would provide intraLATA service in the Small LEC territories.[25] While it is clear that AT&T and Sprint would like lower access rates, Pacific asserts that allowing the Small LECs to raise their access rate to NECA levels (with CCLC) will not create a barrier to entry for the intraLATA toll market. Pacific believes that the claim that there will not be enough carriers for

[24] See Kong for AT&T, Cross-examination, 2 R.T. 119-122; 1997 CPUC Resolutions T-16008 and 16000, adopted access tariffs with CCLC for Winterhaven Telephone Company and GTE West Coast. These California access tariffs remain in effect today.

[25] Kong for AT&T, 2 R.T. 139; Rearden for Sprint, 3 R.T. 240.

presubscription because of access charges is a scare tactic conjured up by AT&T and Sprint in their quest for lower access fees.

Likewise, Pacific states that AT&T's claims that the Small LECs' access charges may be too high for it to be profitable should also be disregarded. The incremental increase in access charges AT&T will pay on a statewide basis is negligible. (Exhibit 13-C Confidential.) Additionally, AT&T's access costs will be further significantly reduced on the interstate side as a result of the recent FCC CALLS Order.[26] The net result will reduce, not raise, the access charges that AT&T pays.

According to Pacific, Sprint's witness admitted that Sprint's incumbent LEC's access charges range from a low of 9 cents per minute to a high of 22 cents per minute. (Rearden for Sprint, 3 R.T. 251.) The proposed rate of about five and a half cents is lower than that charged by Sprint's incumbent LEC, and lower than the access charges both Sprint and AT&T pay in other states where they provide intraLATA toll service. (Id.)

Finally, Pacific concludes that AT&T and Sprint's claims regarding access charges are disingenuous given that Pacific, through the pooling process, has been subsidizing AT&T, Sprint and other IXCs for years. (Exh. 5, Testimony of Peters for Pacific, p. 4.) AT&T and Sprint have been paying Pacific's lower access rates (now less than one cent in the Small LECs' territories) while the Small LECs have been withdrawing their total costs to provide access from the

[26] In Re Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-volume Long Distance Users, Federal-State Joint Board on Universal Service, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, FCC No. 00-193 (released May 31, 2000).

pools. Pacific, in essence, has been paying the true cost of access while AT&T and Sprint were enjoying a free ride.

In its Reply Brief, Pacific rebuts the assertions by ORA and the IXCs that the Small LECs have not justified their access rates with cost studies. According to Pacific, the Small LECs have been producing access, intraLATA toll and EAS cost studies on an annual basis for the pools. Pacific paid the Small LECs their access, intraLATA toll and EAS costs that resulted from these studies through the pooling process. This process resulted in Pacific paying the Small LECs approximately 11 cents per access minute. (1 R.T. 67, Peters for Pacific.)

7.3. ORA's Position

The Small LECs should not receive a CCLC. Not only is such a charge inconsistent with Pacific's access rates (which the Small LECs currently use for their access rates), CCLC charges are inconsistent with the Commission's philosophy of trying to make telephone rates cost-based. The Commission eliminated the CCLC for both Pacific and GTEC. D.94-09-065 [56 CPUC 2d, 117, 191.]

According to ORA, nothing in the proposal to eliminate pooling arrangements justifies the re-imposition of this charge. The Commission should strive to be consistent in gradually eliminating the structure of subsidies and payments that has developed over the years. Re-imposing a CCLC, as the Small LECs have proposed, is a move in the opposite direction.

It is important to keep the purpose of the instant proceeding in mind in considering the CCLC question: to find a source of replacement revenues for the existing pooling agreements. During cross-examination, the Small LECs' witness acknowledged that establishing a CCLC in the context of this proceeding is really a device for generating additional revenues for the Small LECs. (Bishop for Small LECs, 1 R.T. 38.) Thus, establishing a CCLC for the Small LECs in the

context of this application is inappropriate since the replacement source of revenue for the pooling agreements was supposed to be revenue neutral.

AT&T's witness Kong noted that the FCC is moving away from rate structures such as the CCLC because it is not cost-based. Kong also noted that, as a general matter, the FCC supports the replacement of implicit subsidies such as the CCLC with explicit subsidies. The Commission should follow the lead of its federal counterpart and not allow the Small LECs to use this application to re-impose this non-cost-based rate.

In its Reply Brief, ORA asserts the Small LECs have distorted the policies and actions of the FCC regarding the CCLC. The IXCs' Opening Brief makes it clear that the FCC intends to eliminate the CCLC and other similar non-cost-based charges. According to ORA, the Small LECs have failed to provide a compelling reason to retain this type of subsidy. Given that both the FCC and this Commission have stated their intention to move from implicit subsidies to explicit ones, it would be counterproductive for the Commission to sanction the Small LECs' attempt to bootstrap the CCLC into their rates.

7.4. The IXCs' Position

The Small LECs should not be allowed to increase their traffic-sensitive access charges without a cost showing. Without cost studies from the Small LECs, the Commission has no way of verifying that the proposed NECA rates correctly recover each Small LEC's access revenue requirement. Similarly, without these studies, the Commission cannot verify that the CHCF-A replacement funding requested by the Small LECs will not result in overearnings for any individual Small LEC.

The IXCs assert that CCL charges should not be included in the Small LECs' access charge structure. As AT&T explained in its opening testimony, CCL charges do not follow the principles of cost causation, and they

recover the non-traffic sensitive (NTS) costs of the local loop via a per-minute rate. (Exh. 10, Kong for AT&T at 4.) The Commission eliminated the CCL charges for a number of LECs, including applicants, and neither Pacific nor the Small LECs have intrastate CCL charges in their tariffs at the present time. (1 R.T. 49.) The Small LECs imply that the CCLC is an appropriate rate element because the FCC continues to approve interstate tariffs of smaller LECs which contain CCL charges, even after passage of the Telecommunications Act of 1996 (the Act). According to the IXCs, this misrepresents the full picture of the FCC's policies relating to the CCLC. As AT&T witness Kong stated, the FCC has instituted access reform proceedings for both price cap LECs and rate-of-return LECs in which it has proposed to phase out the interstate CCLC, and it has done so for a number of price cap LECs. Contrary to the Small LECs' implied argument, the fact that the FCC has not yet issued its order eliminating the interstate CCL charge for smaller LECs, there is no doubt as to the FCC's policy and intent regarding this subsidy.

According to the IXCs, new implicit subsidies are prohibited by the Act. As the FCC noted in its Universal Service Order, "Congress intended that, to the extent possible, 'any support mechanisms continued or created under new section 254 should be explicit, rather than implicit as many support mechanisms are today."[27] Thus, the IXCs assert the Commission may not now approve an implicit subsidy for the Small LECs in the form of CCL charges.

The IXCs state that any individual Small LEC's fixed loop costs which are not fully recovered via its basic exchange rates, must be recovered via

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[27] *Report and Order*, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, FCC 97-157, ¶ 9, ("Universal Service Order") citing the *Joint*

Footnote continued on next page

an explicit subsidy from the CHCF-A. Because the CHCF-A does not afford the Small LECs guaranteed revenues, they seek to establish an implicit subsidy in a misguided attempt to guarantee a certain amount of revenues from IXCs. This is bad public policy. An implicit subsidy does not guarantee any particular level of funding because customer calling patterns cannot be relied upon to generate a guaranteed level of toll revenues. By contrast, the Commission can ensure that the CHCF-A is funded sufficiently to provide the Small LECs with the subsidies they require.

In their Reply Brief, the IXCs rebut applicants' argument that the proposed NECA level access rates are affordable because IXCs pay higher access charges in several other states. The IXCs assert those access rates levels are simply not applicable to California. In other states, the Small LECs' access charges generally contain implicit subsidies that the state commissions have not yet migrated to an explicit universal service fund in accordance with the Act. In California, by contrast, an explicit High Cost Fund has already been established, and access rates that contain implicit subsidies such as CCL charges may not now be approved by this Commission.

The IXCs also refute Pacific's allegation that it has been subsidizing IXCs through the pooling process. According to the IXCs there has been no subsidy to IXCs due to the pooling process, because IXCs have been paying the implicit subsidies to Pacific, which, in turn, forwarded the subsidies to the actual recipients via its payments to the Small LECs. The proposition that Pacific's per-minute access rate is lower than the Small LECs' access costs is not the issue here. The fact remains that IXCs have been paying the entire access subsidy to the

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Explanatory Statement of the Committee of the Conference, H.R. Rep. No. 458, 104th Cong., 2d Sess., at 131.

Small LECs—an amount of approximately $16.9 million—implicitly as part of Pacific's access rates. The Commission should remove this subsidy from Pacific's rates once Pacific stops paying it to the Small LECs.

7.5. Discussion

The major dispute centers on whether the access charges adopted for the Small LECs should include the CCLC rate element. ORA and the IXCs are correct that this Commission previously eliminated this rate element, as not-cost based. In our Implementation Rate Design proceeding, we eliminated the CCLC and mandated recovery of the revenue through other rates. We dispute the IXCs' contention, however, that the Act prohibits adoption of a new implicit subsidy in the form of a CCLC for the Small LECs. While the FCC did eliminate the CCLC for price cap LECs, the interstate CCLC is still in place for rate-of-return LECs. As the Small LECs state, since passage of the Act, both the FCC and CPUC have adopted access charge rate structures that included a CCLC rate element. Therefore, we believe we have the discretion to determine whether or not the Small LECs switched access rate design includes a CCLC.

Given that we have the discretion to make that decision, we make our determination on policy grounds. According to the record in this proceeding, the Small LECs' access rate including the CCLC is about 5.5 cents per minute. According to the First Amendment to the Joint Application, which the applicants filed on February 9, 2000, in response to the Scoping Memo and Ruling of Assigned Commissioner, the CCLC rate element accounts for about 1 cent per minute. Therefore, the switched access rate for the Small LECs without the CCLC would be about 4.5 cents per minute.

The IXCs have stated strong opposition to inclusion of a CCLC in the Small LECs' switched access rates. We recognize that the access rates in the Small LEC territories will be significantly higher than Pacific's rates, and would

like to take the steps necessary to see that a competitive market develops in the Small LEC areas. We believe that elimination of the CCLC rate element will encourage IXCs to enter the market and will assist in the development of that competitive market.

By eliminating the CCLC rate element, we are ensuring that Small LECs will receive a reduced amount in revenues from their switched access rates. The Small LECs calculated that they would receive about $18.3 million in switched access revenues, with the CCLC. Without the CCLC, that amount will drop down to about $15 million. However, that does not mean that the Small LECs' revenue stream will be reduced by $3 million. It simply means that the anticipated draw from the CHCF-A will be increased by that amount.

We recognize that billing would be easier for the Small LECs if the interstate and intrastate access charges were the same. However, we feel we have good reason to eliminate the CCLC from intrastate rates, and are confident that the Small LECs will be able to adjust their billing systems to reflect the differing rates.

Therefore, for each of the Small LEC applicants we adopt the switched access rate structure in First Amendment to the Joint Application, with the exception of the CCLC rate element. The Small LECs should reflect these revenue effects in their CHCF-A Supplemental Advice Letter filings.

8. Should Pacific be Required to Reduce its Rates to Reflect the Elimination of the Pooling Payments?

8.1. Pacific's Position

The intervenors proposed that Pacific's rates be reduced to account for elimination of the payments to the Small LECs. Pacific asserts, however, that the Commission has eliminated this cost change as a Z-factor or Limited Exogenous (LE) factor. Pacific states that even if the Commission had not

already put this issue to rest, Pacific has refunded more than it received in start-up revenue under NRF for pooling payments to Small LECs such that there is nothing in Pacific's rates recovering these amounts, rather Pacific is suffering a significant shortfall in recovering these costs.

Adjustments made to Pacific's rates in the past, when pooling payments were terminated, were made under the Z-factor mechanism of NRF, before the Commission eliminated Z-factors in D.98-10-026.[28] In that decision, the Z-factor mechanism was replaced by the LE factor which allows adjustments only for cost increases or decreases resulting from: (1) matters mandated by the Commission; and (2) changes in total intrastate cost recovery resulting from changes between federal and state jurisdictions. Further, in D.98-10-026, the Commission stated that:

> Z-factor recovery shall be continued until fully implemented only for the following adjustments: (1) $200 to $500 capital to expense shift, (2) merger refund authorized in D.97-03-067, (3) gain on sale of land, (4) other billing and collections jurisdictional cost shift, (5) results of Order Instituting Investigation 92-03-052 regarding property taxes, (6) a $99.5 million annual reduction in Pacific's rates for post retirement benefits other than pensions (PBOP) and a $24.025 million annual reduction in GTE's rates for PBOPs, and (7) a $12.656 million reduction in GTE's customer notification and education program costs. (Id. at 93.)

The Commission added, "All other Z-factor recovery and adjustments shall be permanently eliminated effective immediately. (Id. at O.P. 1.f.) Changes in intraLATA toll pooling costs was not one of the issues that the

[28] Rulemaking on the Commission's Own Motion into the Third Triennial Review of the Regulatory Framework Adopted in Decision 89-10-031 for GTE California Incorporated and Pacific Bell, mimeo, (October 8, 1998).

Commission deemed appropriate to continue to consider as either a Z-factor or an LE-factor. In fact, D.98-10-026 specifically noted that changes in intraLATA toll pooling costs were excluded from LE-factor treatment.

> Our elimination of new Z-factor adjustments means we will no longer authorize recovery for exogenous cost changes, such as Commission-adopted financial Accounting Standards Board accounting changes, changes in intraLATA toll pooling, or changes in federal or state tax laws. (Id. at 61.)

According to Pacific, the Commission put any risks associated with cost changes, formerly borne by California ratepayers, squarely on Pacific's shoulders. The risks of cost changes can either raise or lower Pacific's net income. The intervenors should not be able to selectively mete out cost changes to Pacific's detriment and treat these changes differently. This outcome destroys the intent of putting risk and reward for costs on Pacific's shoulders.

Also, Pacific asserts it proved that it has given back more in pooling payments than what is reflected in its rates through the startup revenue adjustment implemented by the Commission in D. 89-12-048. Pacific provided the Commission with the pooling payments made to each company for the period 1989 to 1999, and the costs included in the startup revenue requirement. Pacific asserts that simple calculations provide a reasonable demonstration that Pacific has paid substantially more than the costs reflected in the startup revenue requirement.

Pacific rebuts ORA's assertion that Pacific should refund pooling payments even if such payments are not reflected in Pacific's rates. ORA's original position, as stated in its prehearing conference statement, was that Pacific should only be required to refund EAS payments if those payments were reflected in Pacific's rates. (PHC Statement of ORA, at 4-5.) According to Pacific,

requiring the company to refund money it is not collecting in rates amounts to a taking, and is unconstitutional.

ORA and AT&T contend the Commission did not intend to eliminate Z-factor treatment for changes in intraLATA toll pooling in D.98-10-026. In its Reply Brief, Pacific criticizes AT&T's argument that the elimination of intraLATA toll pooling is not a "change" and therefore this exclusion does not apply in the present circumstances. Pacific contends that the elimination of intraLATA toll pooling that is occurring through this application fits within the plain meaning of the word "change." In any event, the only previous Z-factors recognized by the Commission were for elimination of pooling payments and, in fact, never recognized year-to-year pooling changes. Thus, elimination of pooling payments is exactly what the Commission must have meant by using the world "changes," and exclusion from Z-factor treatment does apply to the present circumstances.

Pacific asserts that ORA and AT&T mistakenly argue that an LE factor could be applied here under the chimera that this is a matter mandated by the Commission. Their contention is illogical because the Commission specifically eliminated intraLATA toll pooling as one of its Z factors and did not include it as one of the six types of adjustments that would continue to have the potential for Z-factor recovery. Pacific states that if the Commission intended for intraLATA toll pooling to continue to be subject to a recovery mechanism, it would have included it as one of the adjustments that remained subject to Z-factor recovery. It did not do so. Accordingly, the elimination of intraLATA toll pooling is not subject to either Z-factor or LE-factor recovery.

Pacific defends its Exh. EGB-2 presented by witness Borsodi, and says Borsodi explained the difference between EGB-2 and Appendix C, p. C-1 of D.94-09-065. As he explained, Appendix C is a "sources and uses" document

which was designed to achieve a zero result when all items on the page are totaled. In contrast, EGB-2 is a listing of the rate increases or rate reductions resulting from a series of Commissions orders and resolutions over a period of almost 10 years. The underlying decisions and resolutions cited in EGB-2 support the positive and negative nature of numbers listed in that Exhibit. According to Pacific, comparing the two exhibits in the manner ORA proposes is like comparing apples and oranges.

8.2. ORA's Position

ORA asserts that Pacific has failed to justify the retention of funds it will no longer be paying into the various settlements pools. Pacific contends that the termination of Pacific's payments to the Small LECs does not qualify for LE factor treatment. In support of this position, Pacific's witness Borsodi attached a chart (Exh. EGB-2) to Exh. 8 that purports to show a cumulative shortfall of $279 million and a current annual shortfall of approximately $31.6 million as a result of various Commission decisions affecting settlement payments to small carriers by Pacific. However, when questioned about this figure, Pacific's witness characterized page C-1 of Appendix C of D.94-09-065, as a "sources-and-uses" statement of cash flow that has the effect of returning everything to zero. Further, under cross examination, Pacific's witness was unable to provide an adequate explanation of why Exh. EGB-2 reverses the signs that appear in Appendix C.

According to ORA, Pacific's alleged loss of $279 million is a chimera. ORA notes that Pacific's witness acknowledged that his employer had sought Z-factor rate adjustment for a number of items that are far smaller than $25 million. It strains credulity for Pacific to contend that until November 1999, Pacific had no knowledge that it was losing between $25 to $30 million per year and had made no effort to recover this loss from the Commission. (1 R.T. 93.)

ORA also notes that D.98-10-026 provides that the Commission can provide LE-factor treatment for (1) matters mandated by the Commission. Changing the source of settlement payments from direct payments from Pacific to the CHCF-A is precisely the type of regulatory mandate the Commission had in mind when it promulgated the LE-factor criteria in D.98-10-026. The Commission should order LE-factor treatment for the funds to ensure that the monies do not become a windfall for Pacific.

In its Reply Brief, ORA notes that the language of D.98-10-026 proscribing LE treatment for "changes" in intraLATA toll, access and EAS pooling costs, does not bar the Commission from affording such treatment to the outright termination of the toll, access and EAS pools. Termination of the pools is more than a mere change, but rather is something mandated by the Commission, and therefore eligible for LE treatment.

8.3. The IXCs' Position

Applicants have confirmed that the toll, access and EAS pools are operated separately and are governed by separate contractual agreements. The amount of the subsidy that Pacific currently pays to the Small LECs is approximately $37.2 million annually for all the pools, including approximately $16.9 million for the access pool. (Exh. 10, AT&T Testimony, Attachment 4.) If this application is approved, the Small LECs will increase their access charges and CHCF-A draws to recover this amount, while Pacific will not reduce its rates. As the IXCs and ORA have pointed out, applicants' proposal clearly leads to double payment of this $16.9 million by ratepayers. To prevent this double payment, the Commission should remove the entire subsidy from Pacific's access charges, effective with Pacific's termination of settlement payments to the Small LECs.

Pacific claims that it should not have to reduce its rates because it has already given back a larger amount related to inter-company settlements than it received in its start-up revenue requirement. Pacific argues that it has been using shareholder funds to make its settlement payments to the Small LECs under the pools (1 R.T. 90.) This claim is contradicted by the history and operation of the pools. Small LEC witness Tutt explained how the pooling process works. He stated that he had never seen the pools earn a negative rate of return (1 R.T. 49.). In other words, the pooled revenues for access service have always been sufficient to pay access costs of both Pacific and the Small LECs. Thus, Pacific has always made its settlement payments out of its revenues for access service, and has never needed to contribute additional funds of its own to the access pool to pay the Small LECs.

During hearings, Pacific's witness Borsodi explained Pacific's analysis entitled "Post-NRF Rate Reductions Associated with Settlements," which is Exh. EGB-1 to his rebuttal testimony. In this document, Pacific purports to show that the Commission allotted approximately $292 million for inter-company settlements in Pacific's start-up revenue requirement, but that the Commission subsequently made a series of settlement-related adjustments, which reduced Pacific's rates by a total of approximately $317 million. According to Pacific, this left it with a shortfall of approximately $25 million related to inter-company settlements. (Exh. 8, Borsodi for Pacific at 5, A6.)

The IXCs assert that although Exh. EGB-1 was prepared under Borsodi's direction, he was unable to explain key aspects of Pacific's analysis. Pacific claims that Borsodi obtained all of the adjustments shown in its analysis directly from Commission decisions and resolutions listed on Exh. EGB-1, but that is not true. In fact, Pacific reversed the effects of all eight adjustments it took from D. 94-09-065 Appendix C. Table C-1, such that positive revenue amounts

listed in Table C-1 are shown as revenue reductions in Pacific's Exh. EGB-1, and vice versa. (Exh. 9.) Also, Borsodi was unable to explain why two adjustments that are revenue reductions in Table C-1—line 21 for PB/GTEC ZUM Access Charges and line 22 for PB/Roseville DCP MTS Billings—are shown as rate increases in Pacific's analysis.

Finally, during evidentiary hearings, Borsodi explained some clerical errors in his analysis. One of those related to IRD-adjustments where "somebody got the signs backwards or something." (1 R.T. 88.) This statement contradicts Pacific's contention that it has simply taken the revenue adjustments listed in its Exh. EGB-1 directly from Commission decisions and resolutions. If the amounts were the same as those ordered by the Commission, there would be no need for Pacific to change the signs on any of the adjustments. According to the IXCs, the minor clerical errors, combined with Borsodi's explanation, indicates that Pacific is playing with the numbers in order to arrive at its alleged shortfall. The IXCs state that Exhibit EGB-1 should be ignored by the Commission.

The IXCs assert that Pacific's claim that it only recently realized that it lost nearly $279 million in inter-company settlement payments to Small LECs during the period 1990-1999 is simply not credible. Prior to the filing of rebuttal testimony on April 28, 2000, Pacific had never mentioned these alleged losses in this proceeding. Also, Borsodi admitted that Pacific never filed for Z-factor recovery of any of these amounts, even though it had the right to do so for many years, and even though it filed for recovery of a number of other, much smaller amounts. (1 R.T. 90.) As administrator of the pools, Pacific has been well aware of the revenues, costs, and rates of return associated with Pacific's own contributions to the pools.

Because the pools have never earned a negative rate of return, it is clear that Pacific has never contributed its own funds to the pools. Thus, contrary to its claims, Pacific has experienced no shortfalls related to settlements.

The IXCs assert that Pacific's claim that the NRF decision exempts it from reducing its rates in this proceeding is an erroneous reading of D.98-10-026. The section of the NRF decision to which Pacific refers states, "Our elimination of new Z factor adjustments means we will no longer authorize recovery for exogenous cost changes, such as…changes in intraLATA toll pooling." In Borsodi's opening testimony, Pacific attempted to seize on the word "changes", characterizing the termination of its contractual agreements with the Small LECs – and the accompanying termination of approximately $37.2 million in settlement payments—as mere "payment changes," in order to rely on the Commission phrase, "changes in intraLATA pooling," in the citation above. (Exh. 7 at 4-5.) According to the IXCs, this is an erroneous reading of the NRF decision. The elimination of Pacific's settlement payments to the Small LECs is neither a change in the amount of those payments nor a change in the way intraLATA toll pooling operates. Nor is the elimination of a process a "large change" in that process, as Pacific attempts to imply in Borsodi's rebuttal testimony. (Exh. 8 at 3.)

More importantly, the IXCs state, Borsodi admitted in his opening testimony that the NRF decision states that LE factors may be ordered for "matters mandated by the Commission." (Exh. 7 at 3-4, citing D.98-10-026 at 61.) Because this application clearly involves the elimination of Pacific's pooling and settlement processes with the Small LECs, rather than "changes" in those processes, the Commission has full authority to order Pacific to reduce its rates via an LE factor adjustment to remove the implicit subsidies Pacific will no longer be paying to the Small LECs. (Exh. 11 at 10-11.)

As AT&T noted, the Commission correctly required Pacific to reduce its rates previously when Pacific similarly terminated settlement payments to GTE, Contel, Citizens and Roseville. (Id.) The termination of settlement payments to the Small LECs is no different than these other cases and merits similar treatment, via LE factor adjustment, by the Commission.

8.4. Discussion

The resolution of this issue turns on parties' varying interpretations of D.98-10-026. We will clarify our intent in that decision, but to place our discussion in context, we must first summarize the history of exogenous factors in NRF. When we first adopted the NRF framework for Pacific in D.89-10-031, we included changes in IntraLATA Toll Pooling as one of the initial Z-factors:

> As a starting point, we accept the following factors: changes in federal and state tax laws to the extent they affect the local exchange carriers disproportionately, mandated jurisdictional separations, changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission, changes in regulatory amortizations such as expensing of station connections, and reflection of tax benefits resulting from premature retirements of high coupon bonds pursuant to D.88-12-094.[29]

In other words, changes in intraLATA toll pooling arrangements were clearly delineated as an allowable exogenous factor. And in fact, as the IXCs point out, when Pacific terminated settlements payments to Contel, Citizens, Roseville and GTEC, the elimination of those inter-company settlement payments was reflected in Pacific's rates.

[29] D.89-10-031, [33 CPUC2d 43, 137-138].

At the end of 1998, after we approved Z-factor treatment for those settlements adjustments, we issued D.98-10-026. That decision in the Third Triennial Review of our NRF program for Pacific & GTEC made substantial changes in the treatment of exogenous factors. We eliminated consideration of any new Z-factor adjustments. (D.98-10-026 at 60.) We also examined all existing Z-factors, including intraLATA toll pooling, and determined which Z-factors should be phased out over time. We developed a list of seven items which would be allowed continued Z-factor treatment on a limited time basis. IntraLATA toll pooling was not included on that list of allowable Z-factors. To the contrary, we specifically excluded changes in intraLATA toll pooling, as Pacific cited above, as follows:

> Our elimination of new Z-factor adjustments means we will no longer authorize recovery for exogenous cost changes, such as Commission-adopted Financial Accounting Standards Board accounting changes, changes in intraLATA toll pooling, or changes in federal or state tax laws. (Id. at 61.)

In other words, we made it clear that intraLATA toll pooling would no longer be included among allowable Z-factor adjustments.

According to ORA and the IXCs, while we eliminated intraLATA toll pooling as a Z-factor, it could be treated as an LE factor, under the new criteria adopted in D.98-10-026. In order to clarify our intent in that decision, we need to review the entire relevant portion of the text, including the portion cited above:

> Our elimination of new Z-factor adjustments means we will no longer authorize recovery for exogenous cost changes, such as Commission-adopted Financial Accounting Standards Board accounting changes, changes in intraLATA toll pooling, or changes in federal or state tax laws. We will, however, allow continuation

> of a streamlined process for requests in two narrow areas: requests for recovery of cost increases or decreases resulting from (1) matters mandated by the Commission and (2) changes in total intrastate cost recovery resulting from changes between federal and state jurisdictions. (Ibid.)

The IXCs assert the inter-company settlement payments should be included as an LE-factor because it fits the criteria of number (1) "matters mandated by the Commission." We agree that we have the authority to mandate the termination of the inter-company settlements payments from Pacific to the Small LECs, and are doing so in this order. However, ORA's and the IXCs' interpretation of our intent is not correct. As cited above, we eliminated recovery for exogenous cost changes for intraLATA toll pooling for Pacific and GTEC. Our former Z-factor and the LE-factor we adopted in D.98-10-026 both relate to "exogenous cost changes" so we clearly intended that intraLATA toll pooling would be exempt from either Z-factor *or* LE-factor treatment when we said that we would not authorize recovery for exogenous cost changes for changes in intraLATA toll pooling.

Both ORA and the IXCs have provided a strained interpretation of the phrase "changes in intraLATA toll pooling" cited above from D.98-10-026 and have concluded that the elimination of pooling does not constitute a "change." We disagree with this interpretation of our decision. We agree with Pacific that the elimination of intraLATA toll pooling that is occurring through this application fits within the plain meaning of the word "change." As Pacific points out, previous Z-factors recognized by the Commission were for elimination of pooling payments and never for year-to-year pooling changes.

ORA's and the IXCs' proposal that Pacific reduce its rates by the approximately $37.2 million in payments it no longer makes to the Small LECS is rejected, as it is inconsistent with our directive in D.98-10-026 that intraLATA toll

changes not be treated as exogenous factors. Therefore, the analysis of whether or not Pacific has paid more than its start-up revenue requirement is moot, and will not be addressed.

9. Comments on Proposed Decision

The Proposed Decision of Administrative Law Judge Karen Jones in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on January 18, 2001 and reply comments were filed on January 23, 2001. We have taken the comments into account in finalizing this order.

Findings of Fact

1. Continuation of the inter-company settlements system is not sustainable in a competitive telecommunications environment.

2. The CHCF-A waterfall and means test assure us that the companies that draw from the CHCF-A are submitting themselves periodically to Commission scrutiny of their operations and are not over-earning.

3. The current inter-company settlement payments from Pacific to the Small LECs are not subject to a waterfall and means test.

4. The annual means test included in the annual CHCF-A process does not equate to a full-blown GRC.

5. The Commission and Small LECs have been performing the annual CHCF-A means test calculation for a number of years.

6. If a Small LEC is found to be over-earning in a particular year, no adjustment is made to the earnings for that base year. The Small LEC is allowed to keep those over earnings.

7. The Small LEC's revenues are adjusted for the following year to eliminate the over-earning indicated in FOF 6.

8. The Small LECs have the option of coming to the Commission if their earnings slip to a level which could impair their ability to provide telephone service, or if they incur unanticipated expenses.

9. Five of the Small LEC applicants currently do not have their rates set at 150% of Pacific's, as required by CHCF-A rules.

10. The five Small LECs provided notice to their customers of a potential rate increase/decrease as a result of this proceeding.

11. Commission policy prohibits interexchange carriers from charging lower rates in the competitive urban areas, and higher rates in the less competitive rural areas.

12. There is no danger that interexchange carriers will charge a 25 cent rate in the Small LEC territories because they would have to offer that rate statewide and would not be able to compete against carriers charging far less than 25 cents per minute.

13. The Small LECs have agreed to be the COLR for intraLATA toll service, if no IXC chooses to provide service in their territories.

14. Small LEC customers will have at least one carrier which provides presubscribed intraLATA toll service.

15. The Small LECs are not well-situated to provide intraLATA toll services in a competitive market, since most do not have the necessary facilities and administrative customer service support in place.

16. Pacific does not own all of the facilities used to provide intraLATA toll service with the Small LECs.

17. The Small LECs' proposal does not place an unfair burden on the IXCs.

18. IXCs are not required to provide intraLATA toll service in any of the Small LEC service territories.

19. At the present time, it is impossible to determine whether IXCs will participate in intraLATA presubscsription in the Small LEC territories.

20. In D. 94-09-065 the Commission eliminated the Carrier Common Line Charge (CCLC) because it is not a cost-based rate.

21. While the FCC did eliminate the CCLC for price cap LECs, the interstate CCLC is still in place for rate-of-return LECs.

22. The Small LECs' access rates, including the CCLC, is about 5.5 cents per minute.

23. The CCLC rate element accounts for about 1 cent per minute.

24. The switched access rate for the Small LECs without the CCLC is about 4.5 cents per minute.

25. The access rates in the Small LEC territories will be significantly higher than Pacific's switched access rates.

26. Changes in intraLATA toll pooling arrangements were clearly delineated as an allowable Z-factor in D.89-10-031.

27. Changes in intraLATA toll pooling were not included on the list of allowable Z-factors in D. 98-10-026.

Conclusions of Law

1. The historical system of inter-company settlements between Pacific and the Small LECs should be terminated.

2. All California ratepayers should not be funding inefficiencies and excessive earnings by Small LECs.

3. The guaranteed CHCF-A subsidy ensures that the Small LECs will have the opportunity to earn their authorized rate of return.

4. This guaranteed subsidy will provide stability for the Small LECs which should encourage investment.

5. The Small LECs' replacement funding for the STAs should be subject to the same rules that apply to current draws from the CHCF-A, namely rates shall be increased to a ceiling as necessary and both the means test and the waterfall provisions should apply.

6. Since the same rules are being applied to the replacement of the settlement payments as for current CHCF-A draws, requests for replacement funding should be incorporated into the advice letter process used for current draws.

7. Decision 00-09-072 granted applicants' request to extend the waterfall at the 100% level for one additional year so the 2001 draws will not be subject to waterfall provisions.

8. Small LEC customers should not be subjected to inferior intraLATA toll service.

9. Small LEC customers should not pay excessive intraLATA toll rates as a result of having only the Small LEC to provide intraLATA toll service as the COLR.

10. If a Small LEC is required, under the terms of this decision, to serve as COLR for intraLATA toll service, the Small LEC should not charge rates higher than Pacific's intraLATA toll rates (ceiling rates for residential intraLATA toll and the maximum rates for business intraLATA toll).

11. The Small LEC which is required to serve as COLR may petition the Commission to increase its intraLATA toll rates in its next GRC.

12. Once an IXC begins to offer service in a Small LEC's territory, the IXC cannot withdraw from service without Commission approval.

13. The Commission should closely scrutinize any requests for IXC withdrawal of intraLATA toll service in the Small LEC territories to ensure that the ongoing interests of Small LEC customers are preserved.

14. Pacific should not be required to serve as the COLR outside of its own service territory.

15. IXCs are not under any legal requirement to participate in the intraLATA equal access process in any part of the state.

16. A Small LEC should be required to provide intraLATA toll service as COLR, if no IXC provides presubscribed service in its service territory.

17. If an IXC provides intraLATA toll service in the Small LEC's service territory, the Small LEC should not be required to continue to provide intraLATA toll service.

18. The Small LEC's IXC affiliate cannot serve as default provider for intraLATA toll service if other IXCs offer intraLATA service in competition with the affiliate.

19. If customers do not respond to notices regarding the need to choose an intraLATA toll carrier, they should be assigned to their interLATA carrier, as long as that carrier is participating in ILP for the Small LEC.

20. If the customer's interLATA carrier is not participating in ILP, those customers which do not make an affirmative choice will be required to utilize 101XXXX dialing for intraLATA calls.

21. Pursuant to Public Utilities Code Section 1708, parties of record were notified that this proceeding could result in modification to our presubscription decision, D. 97-04-083.

22. If parties to proceeding A.99-06-004/A.99-06-009 believe that 30 days is not enough time to perform all the steps ordered in this decision to implement intraLATA presubscription, they should send a letter to the Executive Director requesting an extension of time under Rule 48(b).

23. At the present time, the FCC does not preclude this Commission from establishing an intrastate CCLC rate element.

24. Elimination of the CCLC rate element should encourage IXCs to enter the market and assist in the development of a competitive intraLATA toll market in the Small LECs' service territories.

25. Elimination of the CCLC from the Small LECs' rates means that the anticipated draw from the CHCF-A will be increased by the amount of revenues expected to be received from the CCLC.

26. Changes in intraLATA toll pooling are no longer included among allowable Z-factor adjustments.

27. IntraLATA toll pooling is exempt from either Z-factor or LE-factor treatment.

O R D E R

IT IS ORDERED that:

1. The Settlement Transition Agreements (STAs) negotiated between Pacific Bell (Pacific) and each of the 13 Small Local Exchange Carriers shall be approved, with some adjustments, as outlined in this order.

2. Within 15 days of the effective date of this decision, each Small LEC shall supplement its CHCF-A Advice Letter to reflect the results of this decision.

3. The Advice Letter Supplements filed by the Small LECs shall include as a starting point, the amount of the Transition Contract Payment from Pacific in its STA with the Small LEC. That amount shall be adjusted by the net change in billed revenues reflecting the transition from the billed revenue reported to Pacific to the new bill and keep access revenues (excluding the CCLC) and shall show the revenue effect of any customer rate increases.

4. The Telecommunications Division (TD) shall take those advice letter supplements into account in processing the Small LECs' 2001 CHCF-A Advice Letter filings. Those Advice Letters shall be approved by Commission Resolution.

5. Pacific shall be responsible for making its monthly STA payments through the month in which that Resolution is signed, and will have 60 days from the end of that month to complete its payments.

6. The California High Cost Fund – A (CHCF-A) Administrative Committee shall begin making the monthly payments to each Small LEC, based on the Commission Resolution, beginning the month following the month in which the Resolution is approved. The initial month's payment to companies which qualify for CHCF-A funding under their October 1, 2000, advice letter filings shall include the unpaid monthly amounts of such funding due those companies beginning with the month of January 2001, plus interest equal to the 3 month commercial paper rate.

7. The CHCF-A Administrative Committee shall make those payments within 30 days of the close of each calendar month.

8. TD shall recommend the appropriate surcharge rate level for the CHCF-A for calendar year 2001 as part of TD's processing of the Small LECs' 2001 Advice Letter filings. The Commission will set the final surcharge level when it adopts the Resolution approving the CHCF-A Advice Letters.

9. In the event that a Small LEC is required to serve as COLR for intraLATA toll service in its territory, that Small LEC shall charge rates no higher than Pacific's intraLATA toll rates, until further order of the Commission.

10. Any Small LEC that serves as COLR shall continue to offer any toll discount plans in effect as of the date of this decision, until further order of the Commission.

11. If customers have more than one choice for intraLATA toll provider, each Small LEC, with the exception of Sierra Telephone Company, Inc. (Sierra) shall send direct mail notices to customers which include the name and phone

numbers of the interexchange carriers (IXCs) which have indicated their intention to provide intraLATA service in the Small LEC's territory.

12. Sierra shall only provide notice to those subscribers who continued to receive intraLATA toll services from Sierra after it implemented ILP.

13. Prior to mailing notices to customers, each Small LEC, with the exception of Sierra, shall provide the assigned Administrative Law Judge and TD Director with a list of the interexchange carriers which have asked to participate in intraLATA presubscription in the Small LEC's service territory.

14. The Small LECs, other than Sierra, shall implement intraLATA presubscription on the following schedule. The start date shall be the date this decision is approved by the Commission:

+15 days	Each Small LEC will send a notice to all IXCs authorized to provide intraLATA service in California of the availability of intraLATA presubscription in the Small LEC's service territory.
+40 days	Deadline for interested IXCs to return form relating to intraLATA equal access and to order associated access facilities.
+60 days	Initial notice mailed to customers. If only one carrier (either an IXC or the LEC) will provide service, notice shall inform customers as to which carrier will be the COLR for intraLATA service. Customer notices are subject to review and approval by the Public Advisor and TD. Small LECs implement customer intraLATA presubscribed carrier

	preferences as orders are received from IXCs and as related access facilities are available.
+90 days	Second notice mailed to customers.
+120 days	Customer response period ends. Service for non-responding customers is defaulted to their interLATA carriers or to 10XXX dialing if the customer's interexchange carrier does not participate in presubscription.

15. Because Sierra Telephone Company, Inc. (Sierra) has already implemented ILP, Sierra shall transition its existing intraLATA toll subscribers on the following schedule without assessing a charge for the change in presubscribed carrier for intraLATA toll. The procedural requirements of D. 97-04-083 do not apply to this transition process because Sierra has already implemented ILP. The start date shall be the date this decision is approved by the Commission:

+15 days	Notice mailed to IXCs providing interLATA service to customers currently receiving intraLATA toll from Sierra advising those IXCs of the possibility that their existing interLATA customers may be defaulted to them for intraLATA service.
+60 days	Notices mailed to customers receiving intraLATA toll from Sierra. Customer notices are subject to review and approval by

	the Public Advisor and TD. Sierra implements customer preferences as orders are received from IXCs.
+90 days	Second notice mailed to customers.
+120 days	Customer response period ends. Service for non-responding customers is defaulted to their interLATA carriers or to 10XXX dialing if the customer's interexchange carrier does not participate in presubscription.

16. The Ordering Paragraphs in Decision 97-04-083 shall be modified for the 12 Small LEC parties to this proceeding which have not yet implemented intraLATA presubscription, to reflect the following changes which result from this decision:

a. OP 3: The "full 2-PIC methodology" which permits a customer to presubscribe to different carriers for interLATA and intraLATA service will be modified to eliminate the requirement that the customer's LEC be one of the options for intraLATA service, unless the Small LEC serves as COLR.

b. OP 5: The Small LEC will not be required to provide intraLATA service as long at least one IXC offers presubscribed service. Therefore, the requirement is eliminated that existing customers who do not elect to change their intraLATA toll provide shall continue to receive intraLATA toll service from their LEC.

c. OP 8: The notification timeframes are modified. The requirement that all proposed customer notices be submitted to the Telecommunications Division for review is retained.

d. OP 13(a): The neutral business office procedures do not apply to the extent that the LEC itself will not be offering intraLATA toll service if at least one IXC is willing to offer the service.

e. OP 14: The review of scripts is only required if one of the options for intraLATA toll service is service provided by an affiliate of the LEC.

f. OP 17: Small LECs will be required to use direct mail to notify customers as to their options for intraLATA toll service.

17. The Small LECs shall implement the switched access rate structure in the Amendment to the Joint Application, with the exception of the CCLC rate element, which shall be eliminated from the switched access tariff.

18. Within 15 days of the effective date of this decision, the Small LECs shall file Advice Letters with the switched access rates adopted in this decision. Those compliance filings will not be subject to protest and shall become effective on the first day of the month in which the monthly payments specified in Ordering Paragraph 6 commence.

19. ORA's June 16, 2000, motion to correct the hearing transcript is hereby granted.

This order is effective today.

Dated February 8, 2001, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners