

Service Date: January 13, 1994

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER OF the Application) UTILITY DIVISION
of the US West Communications for)
Approval of Centrex Plus and) DOCKET NO. 92.9.58
Related Tariffs) ORDER NO. 5661b

FINAL ORDER

A proposed final order in this docket was issued on November 19, 1993. No exceptions, briefs or oral arguments to the proposed order were received or presented, therefore, the Commission adopts the following order as its final order in this matter.

I. Background.

1. On December 20, 1991, US West Communications (USWC) filed tariffs with the Montana Public Service Commission (Commission) for the introduction of its Centrex Plus product. On January 21, 1992, the Commission decided to consider the filing within the USWC general rate case (Docket No. 90.12.86). Testimony on Centrex Plus was filed by USWC on June 12, 1992. No other parties filed testimony on this issue.

2. On July 20, 1992, the Commission conducted the Phase III hearing in Docket No. 90.12.86, where USWC was cross examined by AT&T, MCI, and Commission staff regarding Centrex Plus. No parties raised any contested issues regarding Centrex Plus in their briefs and reply briefs.

3. On September 17, 1992, USWC filed a request for expedited consideration of the Centrex Plus filing. On October 20, 1992, the Commission separated the filing into the current docket and then granted interim approval to USWC's Centrex Plus filing. In its order, the Commission identified the following concerns regarding USWC's Centrex Plus pricing proposals:

1) USWC's deviation from cost-based pricing by implementing functionally equivalent based pricing (FEBP) of the Network Access Register (NAR);

2) USWC's use of distance sensitive, volume and contract discounts for Centrex Plus station lines; and

3) USWC's decision to discount its station line price floor below its calculated incremental costs in order to offset a portion of the Federal Communications Commission (FCC) mandated Customer Access Line Charge (CALC).

The interim order required USWC to supplement the filing with additional information to support its pricing of Centrex Plus (Interim Order No. 5661).

4. The next section of this order provides a description of Centrex Plus, and denotes some of the similarities and differences between Centrex Plus systems and Private Branch Exchange (PBX) systems, which compete with Centrex Plus. The remainder of the order describes the Commission's Centrex Plus pricing concerns, USWC's responses to these concerns, and the Commission's decisions.

II. Service description.

5. USWC's Centrex Plus product is a business communications system which competes with PBXs provided by vendors such as AT&T and others. Centrex Plus uses central office equipment to route internal calls from one extension to another, to route incoming calls directly to the appropriate extension, to handle direct dialing of outbound calls, and to provide many call-control and call-accounting features normally associated with PBXs.

6. A PBX provides a similar service except that the necessary hardware (essentially a switch) is generally located on-site at the customer's location, as opposed to Centrex Plus's hardware which is located at the central office. PBX systems gain access to the Public Switched Network (PSN) via trunks provided by USWC. The trunks run from the PBX switch to the central office switch. The number of PBX trunks chosen for a PBX system determines the number of simultaneous external calls that can be placed from the PBX end user stations (telephones). For example, if a PBX system included three end user stations and one PBX trunk, only one end user could place an external call at a time.

7. Centrex Plus service uses the following USWC network components:

1) lines (connections) to the central office through USWC facilities;

2) line termination and switching equipment in the USWC central office to route calls both within the customer's system and to the PSN; and

3) a partition of the USWC central office generic software to provide a group of station lines with the features purchased by the customer. (Exhibit No. USW-48, Docket No. 90.12.86, pp. 3-4.)

8. A customer wishing to obtain Centrex Plus service must purchase two elements: 1) access/usage, and 2) station lines. Customers have two options for access/usage, the NAR version, or the 100 percent access version. The NAR version limits the number of end user stations that can make external calls at any given time. Centrex Plus customers must select the number of NARS they want. This decision mimics a PBX customer's decision on the number of trunks desired. The 100 percent access version provides the capability for each Centrex Plus end user station to access the PSN at the same time.

9. Centrex Plus systems require separate dedicated lines called station lines for each end user station. Station lines connect each end user station at the customer's premises to the central office switch, and include the drop, loop, line termination, switching equipment, and standard features. A list of optional features is also available.

10. According to USWC, the Centrex Plus filing is intended to restructure the preexisting Centrex/Centron service so as to accomplish two goals: 1) to align prices between functionally equivalent services or service elements (the Centrex Plus NAR and the PBX trunk) and thereby avoid a violation of the non-discrimination provisions of the Modified Final Judgment (MFJ); and 2) to establish prices that are competitive with Private Branch Exchanges (PBXs) in the marketplace. (Jenson Testimony, p. 11, Docket 90.12.86.)

III. Supplemental Information Filing Requirements.

11. Interim Order No. 5661 directed USWC to file supplemental information addressing the following four items in regard to its Centrex Plus filing:

- 1) Economic and policy justification for the use of FEBP;
- 2) Information relating to the legal requirements which support the use of FEBP;
- 3) Costing and pricing information supporting volume, distance and length of contract discounts, and their inherent discrimination; and
- 4) Regulatory and economic justification for the use of the CALC offset in the pricing of the station line element.

12. The following sections review USWC's supplemental responses to the items listed above. The Commission's decisions conclude each section.

IV. Functionally-Equivalent Based Pricing.

13. The first supplemental information filing requirement, economic and policy justification for FEBP, pertains to USWC's decision to increase the price of the NAR to equal the rate USWC charges for a PBX trunk. According to USWC, a NAR and a PBX trunk function in relatively similar ways in that "each provide comparable customers with exchange access". (Keiter Testimony, Docket No. 90.12.86, p. 3.)

14. PBX end user stations are linked to a PBX switch which is located at the customer's premises. At least one USWC-provided PBX trunk is required to link a PBX switch to USWC's central office switch providing PBX end user stations access to the PSN. The number of trunks purchased from USWC by a PBX customer governs the number of PBX end users that can simultaneously access the PSN.

15. Each Centrex Plus end user station is physically connected to the central office switch via a separate dedicated line. Access to the PSN by Centrex Plus end users is governed by the NAR, which is not a physical circuit as is a PBX trunk. The NAR is purely computer code which limits the number of Centrex Plus end users that can simultaneously access the PSN. Thus, although a NAR and a PBX trunk can not functionally substitute for one another in a pure physical plant sense, they share one commonality: they both serve a bottleneck function which governs access to the PSN. USWC holds they are functionally equivalent.

16. USWC claims that aligning its NAR rate with its PBX trunk rate is an effort to comply with the requirements of the MFJ, and to avoid pricing arrangements which may discriminate by favoring USWC's service (Centrex Plus) over a competing service (PBXs).

17. USWC indicates that it was required by the U.S. Department of Justice to implement a formal review process of its business practices to ensure compliance with the non-discrimination provisions of the MFJ. According to USWC, as part of this review process, the potential discriminatory concerns with the pricing arrangements of its Centron/Centrex products were identified, which resulted in USWC's FEBP approach. USWC states that it was advised by the Justice Department that the FEBP approach was a reasonable way to respond to the discriminatory concerns. (Jenson Supplemental Testimony, p. 10, Docket 92.9.58.)

Commission Decision - FEBP.

18. The Commission approves USWC's pricing of the NAR in this case, but may revisit this issue in USWC's next cost of service/rate design docket. That the NAR is priced above its relevant cost is the Commission's chief concern. In this regard, relevant costs include what appears to be the imputation of the PBX price that USWC charges competitors into the NAR rate to assure USWC is not competitively disadvantaging those competitors. The record in this docket is insufficient regarding the proper imputation for Centrex Plus.

19. Although USWC asserts that NAR rates exceed relevant costs, confirmation is not possible for other than the apparent imputation of PBX trunk prices into NAR rates. USWC has indicated that it has not conducted any studies to determine the cost of a NAR. (USWC RDR No. PSC-026, Docket No. 90.12.86.)

V. Station Line Discounts

20. The third supplemental information filing requirement is costing and pricing information in support of discounts (volume, distance and length of contract), and their inherent discrimination. This refers to USWC's Centrex Plus station line pricing. Dedicated station lines connect the customer's end user stations to USWC's central office, and include the drop, loop, line termination, switching equipment, and standard features.

21. Discounts for Centrex Plus station line rates are tied to system size (the number of station lines), the length of the lines (only for systems with over 50 station lines), and the length of any customer signed contract. USWC notes that while the discounts to the Centrex Plus month to month prices do not track costs directly, the prices nevertheless exceed costs, "even at the deepest discount". (Jenson Supplemental Testimony, p. 4, Docket No. 92.9.58.)

22. USWC claims that its customers have come to expect volume and contract term discounts since such pricing structures are available in competitors' products, and in contracts for other services offered by USWC. According to USWC, similar pricing strategies are in place for WATS and toll calling plans which also utilize discounted price steps that do not follow a corresponding cost curve.
(Jenson Supplemental Testimony, p. 13, Docket 92.9.58.)

Commission Decision - Station Line Discounts.

23. The Commission approves USWC's Centrex Plus discounts based upon the following. As USWC noted, discounts are not unique to Centrex Plus, but have been approved by the Commission for other services as well. The discounts offered for Centrex Plus may enable USWC to retain existing customers, attract new customers, and make more efficient use of USWC's existing plant in service.

By offering these discounts, customers, who otherwise may choose an alternative (such as a PBX system), can be kept on the network. This is proper as long as the discounted prices exceed the relevant costs of serving the customers, and makes some contribution to USWC's common or overhead costs. Thus, discounts can help to curtail uneconomic bypass. USWC should be allowed to compete on economic grounds, which this order permits.

24. In approving the Centrex Plus discounts the Commission is cognizant that 69-3-807, MCA, requires that rates and tariffs for telecommunications services must be just, reasonable and nondiscriminatory. The term "discount" certainly raises the specter of discrimination and should be addressed. While there is no universal definition of unjust or undue discrimination, it is generally accepted that discrimination in rate making is premised on a disparity in prices for the same or similar service. In this particular case the Commission believes that the distinctions upon which the discounts are based (volume, mileage and length) mirrors distinctions in the character of service, such that any resulting discrimination in price is not undue or unjust.

VI. Justification of the CALC Offset.

25. The fourth supplemental information filing requirement is regulatory and economic justification for the use of the CALC offset in the pricing of the station line element. The CALC (\$6/month) was ordered by the FCC to be charged for each business line running into the central office in order to recover a portion of non-traffic sensitive costs. For Centrex Plus systems, a CALC is charged for each end user station line, while for a PBX system, a CALC is charged for each PBX trunk.

26. The stated justification for a CALC offset in Centrex Plus pricing stems from one of the functional differences between PBX systems and Centrex Plus systems. A PBX system can theoretically link a number of end user stations to the central office using a single trunk, while each end user station in

a Centrex Plus system has a dedicated line running to the central office. Therefore, while a PBX customer would pay a single \$6 CALC charge per trunk (which is shared by a number of end user stations), a similar Centrex Plus customer would pay a \$6 CALC charge for each end user station. USWC argues that a customer should not be driven to select a PBX system over a Centrex Plus system based solely upon the opportunity to pay lower CALC charges. (Jenson Supplemental Testimony, p. 13, Docket No. 92.9.58.)

27. To overcome this "artificial" competitive advantage, USWC included a CALC offset in the price floor formula for Centrex Plus station line rates. USWC's Centrex Plus Station Line Price Floor (CPSLPF) formula is computed using the following formula:

CPSLPF = Channel Connection Rate + Non-Traffic Sensitive Central Office Equipment Rate + Standard Feature Package Cost - CALC offset.

28. The actual magnitude of the CALC offset in the formula is a function of the number of station lines in a Centrex Plus system according to the following:

| Number of Station Lines | CALC Offset |
|-------------------------|-------------|
| 1-20 Lines | \$0 |
| 21-50 Lines | \$3 |
| 51+ Lines | \$5 |

29. USWC asserts that the inclusion of the CALC offset in the station line formula achieves equity in pricing between similarly sized Centrex Plus and PBX systems.

30. USWC argues that state commission action to keep Centrex Plus pricing competitive with PBX systems was suggested by the FCC in its order in FCC Docket 78-72. USWC provided the following quote from that order: ". . . the state can react to our decision (to impose CALC on Centrex station lines) in time to prevent the demise of Centrex-CO". (Jenson Supplemental Testimony, p. 14, Docket 92.9.58.)

31. USWC claims that in response to the FCC order, Centrex-type services have been priced using a CALC offset for several years. According to USWC, the Montana Commission has never explicitly approved a CALC offset for pricing purposes, but prices that included the offset were developed for the Centron Rate Stability tariff that was approved by the Commission in 1985. In addition, USWC contends that the CALC offset is being recognized in most other Bell

Operating Companies. (Jenson Supplemental Testimony, p. 14, Docket No. 92.9.58.)

Commission Decision - CALC Offset.

32. The Commission understands USWC's competitive concerns regarding the CALC advantage PBX systems hold over Centrex Plus systems, and agrees that an offset may be appropriate to mitigate USWC's disadvantage. Although a CALC offset may be justified, to avoid potential price signal distortions, the station line costing and rate design should be done independently of any offset. Placing the offset in the CPSLPF discounts the station line rates (for systems with over 20 station lines) below their calculated incremental costs, and recovers any shortfall from the CALC. In other words, although USWC still collects a CALC charge for each Centrex Plus station line, it discounts its station line rates below cost, and uses part of the CALC charge to cover the station line costs.

33. While the Commission has decided to approve USWC's CALC offset, it does not necessarily agree that the proper place for the offset is in the cost formula of the Centrex Plus Station Line element, and may revisit this issue in USWC's next cost of service/rate design docket.

CONCLUSIONS OF LAW

1. The Commission is charged with supervision and regulation of public utilities. 69-3-102, MCA.

2. US West Communications is a public utility providing regulated telecommunications service. 69-3-101, MCA.

3. Centrex Plus is a regulated telecommunications service as defined by 69-3-803 (3), MCA.

4. The Commission may establish specific rates, tariffs or fares for the provision of regulated telecommunications service. 69-3-807 (1), MCA.

ORDER

THEREFORE IT IS ORDERED that US West Communications' Centrex filing is approved.

Done and Dated this 10th day of January, 1994, by a 5 to 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ANDERSON, Chairman

BOB ROWE, Vice Chairman

DAVE FISHER, Commissioner

NANCY McCAFFREE, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.