ORDER NO. 99-753

ENTERED 12/12/99

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 909/UT147

In the Matter of the Investigation into Centrex-Related Issues.	))	ORDER

DISPOSITION: TARIFF ADOPTED AS FILED

Background. This proceeding originated as a complaint by Shared Communications Service, Inc. (SCS) against U S WEST Communications, Inc. (USWC), docketed as UC 335. SCS alleged that the monthly $5.40 per line surcharge on Centrex type service purchased for resale from USWC was discriminatory under federal and state law. In particular, SCS alleged that the surcharge violated the Telecommunications Act of 1996. Subsequently, Frontier Telemanagement Inc. (FTI) and American Telephone Technology Inc. (ATTI) intervened as complainants. SCS, FTI, and ATTI will be referred to as Resellers.

The surcharge itself originated in 1990, when the Commission determined to abolish the resale of Centrex type service. To accomplish its goal, the Commission directed USWC to impose a series of rate increases over 3 years for Centrex type services. The increases were tailored to eliminate opportunities for resellers to exercise rate arbitrage. Immediately before the last scheduled rate increase, Resellers, USWC, and Staff executed a stipulation that permitted the continued resale of Centrex lines. The stipulation allowed USWC to impose a $5.40 per line surcharge on all resold Centrex lines. Order No. 94-1055.

By Order No. 98-372, in UC 335, the Commission found the surcharge lawful in its context and opened the present docket to “consider all Centrex related issues.” Order No. 98-372 at 6. Resellers petitioned for rehearing and clarification of Order No. 98-372. In Order No. 98-541, the Commission determined that USWC should file a tariff eliminating the $5.40 surcharge and should “balance other Centrex related rates to make the outcome revenue neutral to USWC.” The Commission further noted that the tariff rates would be interim, and that UM 909 would not be a docket in which to address “any overall redesign of rates for Centrex related services.” Such overall rate redesign would be taken up in the rate design portion of UT 125, USWC’s general rate case, or in a successor docket. Order No. 98-541 at 4.

On February 23, 1999, USWC filed Advice No. 1756, with Supplements 1 (April 1, 1999) and 2 (April 27, 1999) (the Tariff). The Tariff recovers the surcharge revenue from the 1-20 station line cohort of Centrex Plus service. Centrex Plus is a business multi-line communications system consisting of common switching equipment (also known as a "common block") and station lines. The common block is a dedicated section of memory in a USWC central office. The common block provides the Centrex Plus user with intrasystem calling, a number of system features, and access to the public switched network. USWC offers Centrex Plus to its retail customers and to resellers. The rates for Centrex Plus service are discounted based on the quantity of station lines ordered and by term of the contract. Station lines are divided into three groups or cohorts: 1-20 lines, 21-50 lines, and 50+ lines.

The Tariff increases the monthly recurring rates for month to month and contract rate options for 1-20 station lines; increases the nonrecurring charge (NRC) for additions or changes to standard or optional features to a station line; and increases the rates associated with Digital Facility Interface (DFI) common equipment and circuit connections. USWC's proposed changes represent a reduction of about five percent in annual gross revenues from Centrex Plus resale surcharges.

This filing increases the station line rates for 72 percent of the company's Centrex Plus customers, those who subscribe to 20 or fewer lines at one location, by $3.52 per month per line. This is a 16 to 21 percent increase in station line rates for these customers but represents a smaller increase (8 to 12 percent) in total Centrex Plus charges per line. Approximately half the charges paid by customers who subscribe to 1-20 station lines cover other facilities, e.g., Network Access Facilities and Common Blocks. The increase represents 89 percent of the revenue changes that would result from this filing.

The filing also proposes a 12 percent per line increase in the recurring monthly charges for five DFI services. These services provide digital interfaces for high capacity (1.544 MBPS) facilities that terminate to a customer's central office based switching system. This service provides for the connectivity of 24 circuits within the Centrex Plus system. The 12 percent increase in the recurring monthly charges for the DFI represents 2 percent of the revenue changes that would result from this filing.

In addition, this filing proposes to increase the nonrecurring charge from $6.25 to $15.00 for "additions or changes for subsequent installation of one or more standard or optional features to a Centrex Plus station line," an $8.75 increase. This represents 4 percent of the revenue changes.

The parties filed testimony on the Tariff. Staff and USWC support the Tariff. The Resellers oppose the Tariff on several grounds. They argue that the Tariff is anticompetitive because it recovers the lost surcharge revenue only from the Centrex Plus 1-20 station line cohort. They also argue that the Tariff is not revenue neutral. Parties determined that cross-examination was not required, so the case became ready for decision on October 26, 1999, when parties filed their closing briefs.

Positions of the Parties. ***Resellers*** argue that the Tariff: 1) is anticompetitive and 2) will collect more revenue than would be appropriate in a rate case. Resellers propose an alternative plan under which the Centrex Plus surcharge revenue loss would be spread across all Centrex Plus lines as well as all Centrex 21 lines. 3) Resellers also contend that the proposed NRC increase to $15 for Centrex Plus customers is anticompetitive.

1) Resellers argue that the Tariff is anticompetitive because USWC wants the increase to fall on the service primarily purchased for resale, the Centrex Plus 1-20 station line cohort. Resellers contend that the price increase should apply to other Centrex services as well, especially those Centrex services that are designed to appeal to the end users to whom both USWC and the resellers provide service in competition. According to Resellers, USWC should include Centrex 21[1] and the Centrex Plus 21-50 and 50+ station line groups in the price increase.

According to the Resellers, the surcharge puts them at a serious competitive disadvantage. Under USWC's proposed Tariff, the surcharge disappears but a $3.52 per line cost is imposed. Resellers maintain that reducing but not eliminating that disadvantage does not result in fair rates. Resellers argue that under state and federal law, the price increase must be equitably distributed amongst all Centrex services. Any other distribution is discriminatory, according to Resellers. Resellers also argue that the Commission's Order No. 98-541, at 3, requires that the price increase be spread across all Centrex services named in the preceding paragraph.[2]

Instead, according to Resellers, USWC's proposal increases the retail price for the part of Centrex Plus that Resellers primarily wish to buy. The USWC rate design proposal places offsetting increases mainly on the Centrex resellers, instead of spreading the increases to all Centrex customers. Resellers point out that almost 94 percent of the price increases proposed by USWC fall on customers buying lines in the 1-20 line group. Centrex resellers buy more of those lines than do other Centrex product customers. Approximately 92 percent of the Centrex Plus station lines purchased by resellers fall in the 1-20 line group. By contrast, Resellers note that Centrex 21 customers face no proposed increase and only about 50 percent of the Centrex Plus station lines purchased by Centrex Plus customers other than resellers are in the 1-20 line

[1] The parties do not agree whether Centrex 21 is a Centrex service. Resellers contend that it is; Staff and USWC dispute that contention. Because we resolve the case on different grounds, it is not necessary for us to reach a decision on the question.

[2] There are two older Centrex services that are grandfathered in, Centron II and Centraflex. The surcharge did not apply to those services. The number of sales units attributable to these services has declined for several years; they represent less than three percent of USWC's total Centrex sales units (excluding Centrex 21). No party argues that the rates for these two services should increase to contribute to surcharge recovery.

group. In sum, Resellers argue that USWC's proposed price increase burdens them but does not impose a corresponding burden on other Centrex customers.

In the alternative, Resellers propose that the line rate for all Centrex Plus and Centrex 21 lines should be increased by $2.43. This recommendation is based on spreading the dollars USWC has proposed be collected from price increases in station lines bought by customers in the Centrex Plus 1-20 line group and spreading those over all Centrex Plus and Centrex 21 lines.

2) Resellers argue that the Tariff is not revenue neutral. Continued charges for the station line and the carrier access line charge (CALC) are held constant during the period of Centrex Plus contracts. This is achieved by lowering the effective rate for the station line to offset any CALC increase. According to Resellers, when current contracts expire and customers sign new ones, those customers will pay the full station line and CALC rates; USWC will receive more than $490,000 per year in new revenues. This additional revenue would be recognized in a general rate case, and Resellers argue that the Commission should recognize this revenue to ensure that the Tariff is revenue neutral.

Resellers recommend instead that the dollar increase USWC proposes be spread across all Centrex Plus customers, including Centrex 21 customers but excluding the grandfathered Centrex type services. Under this plan, the maximum price increase would be $2.43 per line per month. But, Resellers argue, even this is not a truly revenue neutral approach. USWC's proposed tariff revisions fail to take into account significant annual revenues from the elimination of line rate stability when three and five-year contract holders renew their service contracts. Therefore, Resellers propose a $1.96 per line per month increase.

3) Resellers also recommend that Centrex 21 customers be required to pay the same $15 NRC for subsequent installations that USWC has proposed for Centrex Plus customers. Resellers argue that the NRC increase is anticompetitive unless USWC requires the same increase of Centrex 21 customers. Resellers further recommend that the Commission reject the price increases USWC has proposed for DFI.

Commission Staff and USWC are in substantial agreement with each other's positions. They argue that the Tariff complies with Order No. 98-541. They take the position that the Tariff eliminates the $5.40 surcharge on Centrex services, is revenue neutral to USWC,[3] and confines changes to Centrex related rates. They contend that the Tariff, unlike Resellers' proposal, does not attempt any overall redesign of rates.

1) Staff and USWC contend that the Tariff reasonably recovers the surcharge from the Centrex Plus 1-20 line cohort. The fact that other approaches may also comply with the Order does not detract from the reasonableness of this Tariff, they

[3] The Tariff in fact reduces USWC's annual gross revenues by about $137,000. Such reduction is lawful because USWC proposed it.

assert. In support of the Tariff's reasonableness, these parties point out that Centrex resellers are the major source of Centrex Plus revenue. Resellers also currently contribute more than 80 percent of Centrex Plus total revenues and currently account for all Centrex Plus revenue growth. Staff and USWC argue that rebalancing Centrex Plus rates should reasonably result in most of the surcharge related cost shifting to fall on the 1-20 station line cohort, because that is where most of the revenues are.

Staff notes that 97 percent of USWC's Centrex revenue in Oregon comes from Centrex Plus. The 1-20 line cohort represents 72 percent of USWC's Centrex Plus customers and accounts for 89 percent of USWC's Centrex Plus revenues. That cohort also represents by far the fastest growing of the three Centrex Plus cohorts.[4] According to Staff and USWC, any reasonable plan would recover most of the surcharge revenue from the 1-20 line cohort.

Approximately 92 percent of the Centrex Plus station lines purchased by resellers fall in the 1-20 line group and thus face the proposed increase. While the underlying rate for 1-20 Centrex lines increases under the Tariff, USWC points out that the net effect to Centrex resellers of eliminating the surcharge and rebalancing rates is a decrease of $1.88 per line. To USWC customers in the same cohort, the effect will be an increase of $3.52 per line. About half the Centrex Plus 1-20 line cohort is sold to USWC end customers. Thus Staff and USWC contend that this effect cannot be called anticompetitive.

Staff and USWC argue that Centrex 21 should not be included in the surcharge recovery plan because it is not, strictly speaking, a Centrex service. They argue that it is provisioned differently from Centrex Plus and that if the Commission includes Centrex 21 in its recovery plan, there is no clear way to draw a line between that and other USWC business services.

2) Resellers contend that the Tariff is not revenue neutral, because USWC can expect to see more than $490,000 per year in new intrastate revenues. When a new Centrex Plus contract is signed, interstate revenues will stay the same but intrastate revenues will increase by the amount the federal CALC charges have increased since the old contract was signed. Even assuming that Resellers can demonstrate how they arrived at their conclusions, USWC and Staff contend that their analysis suffers from a faulty premise: the assumption that all customers who currently have a Centrex Plus contract will migrate to a new USWC contract when the old contract expires. Resellers have not taken into account the likelihood that USWC will lose Centrex customers to competitors on expiration of current contracts, particularly in view of the elimination of the resale surcharge.

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[4] USWC reports that in a recent 18-month period, the number of subscriber lines in the 1-20 cohort had increased by 70 percent, while the number of lines in the two larger cohorts had decreased by 40 percent. More than 80 percent of Centrex Plus revenues in Oregon are generated by the 1-20 line cohort. The Tariff will recover about 90 percent of surcharge from that same cohort. Surcharge recovery will thus come from the service that accounts for most of Centrex revenues.

Resellers' analysis is also flawed, according to Staff and USWC, in that it tries to capture future trends in the context of a revenue neutral filing. Neither out-of-period differences nor growth trends are typically considered in revenue neutral filings; instead, such filings are based on a financial snapshot. Finally, USWC argues that the Resellers fail to reconcile their claimed revenue increase with the fact that USWC's proposed tariffs are designed to recapture only 95 percent of the surcharge revenues to be eliminated.

3) Resellers object to the Tariff's NRC increases. Resellers propose that Centrex 21 customers pay the same $15 NRC for subsequent installations that USWC proposes for Centrex Plus customers. Resellers do not provide a rationale for their proposal. According to USWC, the Tariff proposes a $31 per line NRC for Centrex Plus station line installations. USWC argues that this is the same rate all other USWC business customers pay for line installations. USWC previously applied an incorrect NRC of $15 to Centrex resellers. Thus, according to USWC, the Tariff does not impose a new charge but corrects a previously erroneous NRC applied to Centrex resellers only. To apply the increase to Centrex 21 customers would compound the mistake.

Resolution. Our intent in this docket was not to redesign rates. That will take place in the rate design phase of UT 125, USWC's general rate case, for which a schedule was set on November 29, 1999. The intent was to eliminate the surcharge and rebalance Centrex rates on an interim basis. In Order No. 98-541, at 4, we noted that the rebalanced Centrex rates would be subject to refund and revision in UT 125 or a successor docket.

We agree with USWC and Commission Staff that USWC's Tariff complies with the directives of Order No. 98-541. In that order, at 4, we mandated that USWC file a tariff rebalancing *other* Centrex rates, not *all* Centrex rates. Moreover, we subscribe to the reasoning USWC and Staff advance in support of the Tariff. USWC has presented a reasonable plan for rebalancing Centrex rates while eliminating the surcharge. USWC's plan concentrates the surcharge recovery on the segment of the Centrex market that benefits from the elimination of the surcharge. Resellers present another plan, which may or may not also be reasonable. The existence of more than one possible way of rebalancing Centrex rates does not vitiate the reasonableness of USWC's proposal.

Because we consider USWC's Tariff reasonable, and in compliance with Order No. 98-541, we do not address the question of whether Centrex 21 is a Centrex service.

Contrary to Resellers' contention, USWC's Tariff is not anticompetitive. The increase in line prices will affect USWC customers in the Centrex Plus 1-20 line cohort. It need not affect current Centrex Plus customers who take service from Resellers. If Resellers pass on the price decrease, their customers will benefit from the price decrease and their resold service will be more attractive than service purchased directly from USWC. We also point out that these rates are interim and subject to revision and refund in UT 125.

Resellers challenge the revenue neutrality of USWC's Tariff. Resellers' figure of a $490,000 increase in Centrex revenue per year is based on assumptions about the Centrex market and renewal of Centrex contracts that may not prove out. Moreover, as Staff witness Sloan points out, in rate rebalancing it is customary to take as a starting point a financial snapshot. That is, rebalancing typically deals with a fixed moment rather than making projections. We concur with USWC and Staff that Resellers' figures are too speculative to rely on, and that projection, even with a firmer evidentiary basis, is not appropriate in a rate rebalancing. We agree with USWC and Staff that the Tariff is revenue neutral or represents a reduction in Centrex related revenue, because USWC has chosen to recover only 95 percent of current revenue.

As to the increased NRC charges, USWC and Staff point out that they correct an earlier mistake. It would make no sense to apply them to services that were not involved in the mistake. Resellers make no serious argument with respect to the imposition of the DFI charges.

In summary, we conclude that USWC's Tariff complies with the directives of Order No. 98-541 in that it eliminates the surcharge and rebalances Centrex rates in a revenue neutral way. The Tariff should be approved as filed. The Tariff is interim and subject to revision or refund in UT 125.

ORDER

IT IS ORDERED that the Tariff filed by U S WEST Communications, Inc., Advice No. 1756, is approved.

Made, entered, and effective ____________________________.

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Ron Eachus
Chairman

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Roger Hamilton
Commissioner

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Joan H. Smith
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order to a court pursuant to applicable law.