

"THE CENTREX PRODUCT LINE"

FEBRUARY 27-28, 1986

MAYFLOWER HOTEL
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CENTREX SERVICE IS A MATTER OF EXTREME IMPORTANCE IN THE DISTRICT OF COLUMBIA. AS OF DECEMBER, 1985 C&P HAD APPROXIMATELY 300,000 CENTREX MAINSTATION LINES IN SERVICE. THESE CENTREX LINES ACCOUNT FOR 43% OF C&P'S TOTAL ACCESS LINES IN SERVICE, AND FOR APPROXIMATELY 21% OF C&P'S INTRASTATE REVENUES. THIS LARGE DEPENDENCE ON CENTREX REVENUES BY C&P IS UNIQUE AMONG LOCAL EXCHANGE CARRIERS. 1/

ALSO UNIQUE IS C&P'S HEAVY RELIANCE ON THE FEDERAL GOVERNMENT AS A CENTREX CUSTOMER. GSA IS C&P'S LARGEST CUSTOMER USING APPROXIMATELY 2/3 OF THE CENTREX LINES IN SERVICE.

UNTIL RECENTLY, CENTREX HAD A VIRTUAL MONOPOLY ON THE SWITCHING MARKET FOR SYSTEMS IN EXCESS OF 2,000 LINES. AS YOU KNOW, TECHNOLOGICAL ADVANCES IN THE LATE 1970'S AND EARLY 1980'S PERMITTED PBX TO EFFECTIVELY COMPETE WITH CENTREX. 2/

THE COMPANY RESPONDED TO THE INCREASED COMPETITION BY FILING AN APPLICATION TO AMEND ITS GENERAL SERVICES TARIFF IN MARCH OF 1983. THE APPLICATION PROPOSED A RATE STABILITY

PLAN, UNDER WHICH CUSTOMERS COULD PROTECT THEMSELVES FROM COMPANY INITIATED RATE INCREASES FOR A THREE YEAR PERIOD. THE COMMISSION GRANTED FULL APPROVAL IN EARLY 1984 (Order No. 7954). CUSTOMER RESPONSE TO THE PLAN WAS APPARENTLY ENTHUSIASTIC, WITH APPROXIMATELY 70% OF ALL CENTREX LINES BEING COVERED BY THE THREE YEAR PLAN. 3/

HOWEVER, WHILE THE D.C. COMMISSION WAS ATTEMPTING TO RESPOND TO THE CHANGING REGULATORY ENVIRONMENT, AN ADDITIONAL BURDEN WAS PLACED ON THE SERVICE BY THE FCC IN ITS ACCESS CHARGE DECISION 4/ ISSUED IN MID 1983. INITIALLY, THE FCC RULING SUBJECTED CENTREX TO THE FLAT-RATE PER LINE BUSINESS ACCESS CHARGE OF \$6.00. BECAUSE THERE ARE APPROXIMATELY 6.25 CENTREX LINES FOR EACH SINGLE PBX TRUNK, THIS RULING SUBSTANTIALLY ALTERED CENTREX'S ECONOMIC VIABILITY.

OUR COMMISSION, IN ITS PETITION FOR RECONSIDERATION, ARGUED TO THE FCC THAT LEVYING THE FULL COMMON-LINE ACCESS CHARGE ON EACH CENTREX LINE WOULD LEAD TO THE DEMISE OF THE SERVICE OFFERING, AND ULTIMATELY TO A SUBSTANTIAL INCREASE IN RATES FOR THE REMAINING D.C. CUSTOMERS. THE FCC, SOMEWHAT PERSUADED BY OUR ARGUMENTS, MODIFIED ITS EARLIER ORDER BY PROVIDING A MULTIYEAR TRANSITION FOR CENTREX LINES WHICH WERE ALREADY IN PLACE OR ON ORDER ON JULY 27, 1983. IN SUCH INSTANCES, FOR EACH YEAR FROM 1984 UNTIL AND INCLUDING 1989, THESE EMBEDDED CENTREX LINES WOULD

BE ASSESSED A MONTHLY PER LINE END USER CHARGE EQUAL TO THAT OF THE RESIDENTIAL CUSTOMER. NEWLY LAID CENTREX LINES WOULD THUS FEEL THE BRUNT OF THE FULL MULTI-LINE BUSINESS RATE WHICH IN THE DISTRICT IS \$4.40. THE FCC EXPLAINED THAT THIS TEMPORARY PARTIAL EXEMPTION WAS MADE TO PROVIDE STATE COMMISSIONS WITH ADDITIONAL TIME TO REEVALUATE INTRASTATE RATES IN LIGHT OF THE NEWLY INITIATED END USER CHARGES, AND ALSO TO ALLOW FOR ADDITIONAL RECOVERY OF CENTREX INVESTMENTS FROM CENTREX CUSTOMERS. 5/

THE D.C. COMMISSION WAS STILL DISSATISFIED WITH THE FCC DECISION AND APPEALED ITS RECONSIDERATION ORDER, ARGUING THAT THE APPROPRIATE RATE FOR CENTREX WAS A FLAT CHARGE FOR EACH LINE EQUAL TO 16% OF THE SINGLE BUSINESS LINE RATE. THE APPEALS COURT UPHELD THE FCC'S DECISION IN ITS ENTIRETY.

APPROXIMATELY TWO MONTHS LATER, C&P FILED AN APPLICATION WITH OUR COMMISSION TO REVISE ITS CENTREX TARIFF, ALLEGING THAT THE COMPETITION FOR CENTREX CUSTOMERS FROM PBX SYSTEMS HAD INCREASED DRASTICALLY AND THAT IF THE COMPANY CONTINUED TO OFFER CENTREX AT CURRENT RATES, COMPETITION FROM PBX VENDORS WOULD REPLACE ALL BUT 16.6% OF THE CENTREX LINES THEN IN SERVICE BY 1989.

THE APPLICATION PROPOSED RENAMING THE EXISTING CENTREX PLAN AS RSP-A AND LIMITING IT TO EXISTING CUSTOMERS, ESTABLISHING A

NEW, OPTIONAL RATE STABILITY PLAN-B WHICH CONTAINED SUBSTANTIAL PRICING REVISIONS FOR SERVICE CATEGORIES RANGING FROM REDUCTIONS OF 10% TO 95%, FOR ESTABLISHING A "NEW CENTREX-99 SERVICE" TO BE OFFERED TO CUSTOMERS WHO REQUIRED LESS THAN 100 CENTREX LINES. THE APPLICATION ALSO CONTAINED A PROPOSAL TO IMPLEMENT A FULL CALC CREDIT OF \$2.00 TO ENSURE CONTINUED COMPARABILITY WITH PBX SYSTEMS. THE COMMISSION GRANTED PRELIMINARY APPROVAL OF THE PROPOSED TARIFF IN NOVEMBER OF 1984, SUBJECT TO FULL INVESTIGATION IN A FUTURE PROCEEDING. THE INVESTIGATION COMMENCED THE FOLLOWING MONTH WITH INTERVENTION BY THE OFFICE OF PEOPLE'S COUNSEL (OPC), THE DISTRICT OF COLUMBIA GOVERNMENT, (D.C.) AND THE FEDERAL GOVERNMENT, REPRESENTED BY THE GENERAL SERVICES ADMINISTRATION (GSA).

OPC UTTERLY OPPOSED THE COMPANY'S PROPOSAL ARGUING THAT THE REDUCED RATES WOULD RESULT IN RESIDENTIAL CUSTOMERS SUBSIDIZING THE FEDERAL GOVERNMENT. INSTEAD, OPC URGED A SUBSTANTIAL INCREASE IN RATES BEFORE PRESENT CENTREX CUSTOMERS WERE ABLE TO LEAVE THE SERVICE. AS AN ALTERNATIVE, OPC SUGGESTED THAT CENTREX BE PLACED IN A SEPERATE SERVICE CATEGORY WITH AN IMPUTED REVENUE REQUIREMENT UNDER WHICH C&P WOULD HAVE COMPLETE PRICE FLEXIBILITY.

THE FEDERAL GOVERNMENT ARGUED THAT EVEN LOWER RATES WERE REQUIRED AND SUCH REDUCED RATES SHOULD BE MADE AVAILABLE TO BOTH

PLAN A AND B CUSTOMERS. GSA ALSO SUPPORTED THE FULL CALC ALLOW-
ANCE.

STAFF ARGUED THAT THE PROPOSED REDUCTIONS WERE MORE DRASTIC
THAN THE SITUATION REQUIRED AND SUGGESTED 50% REDUCTION IN
EXISTING CENTREX RATES.

THE COMPANY'S ARGUMENTS FOCUSED SOLELY ON THE LOSS OF
CENTREX REVENUES AND THE EFFECTS OF PBX GAINS IN THE D.C. MARKET.

ACCORDING TO C&P, THE PROPOSED RATES WOULD PROVIDE \$29
MILLION MORE IN REVENUE THAN IF THE ORIGINAL RSP-A RATES AND
CENTREX-50 RATES REMAINED IN EFFECT. 6/ FURTHER, IT ALLEGED THAT
IF RSP-B AND CENTREX-99 RATES WERE APPROVED, C&P WOULD RETAIN
APPROXIMATELY 69% OF ITS 1984 LEVEL OF INSTALLED CENTREX LINES
BY YEAR END 1989, COMPARED TO 17% OF INSTALLED CENTREX IF RSP-B
AND CENTREX-99 RATES ARE DISCONTINUED. 7/ THE COMPANY ALSO
IDENTIFIED POTENTIAL NEW REVENUE OPPORTUNITIES WHICH WOULD BE
ADVERSELY AFFECTED BY LOSSES OF CENTREX. THESE INCLUDED CENTRAL
OFFICE BASED LOCAL AREA DATA TRANSPORT, PACKET SWITCHED DATA
SERVICE, AND INTRASYSTEM DATA TRANSMISSION LINES, ALL OF WHICH
C&P SAID COULD GENERATE SUBSTANTIAL REVENUES.

C&P ALSO THEORIZED THAT A DECLINE IN THE DEMAND FOR CENTREX
LINES WOULD RESULT IN A CORRESPONDING GROWTH IN OTHER SERVICES,
SUCH AS PBX AND DID TRUNKS. ACCORDING TO C&P, WITHOUT RSP-B AND

CENTREX-99 RATES, CENTREX WOULD LOSE 83% OF ITS 1984 INSTALLED LINES IN SERVICE BY THE END OF 1989, CAUSING A DROP OF CENTREX REVENUES FROM \$43.7 MILLION IN 1984 TO \$8.7 MILLION IN 1989, WHILE PBX TRUNK REVENUES WOULD RISE FROM \$500,000 IN 1984 TO \$13.2 MILLION IN 1989. With RSP-B AND CENTREX-99 IN PLACE, C&P ESTIMATED THAT CENTREX WOULD LOSE 31% OF ITS 1984 LEVEL OF INSTALLED LINES BY THE END OF 1989, WITH A DROP IN CENTREX REVENUES TO \$26.5 MILLION IN 1989, WHILE PBX TRUNK REVENUES WOULD GROW TO 6.7 MILLION IN 1989.

AS I STATED EARLIER, CENTREX COMPRISES MORE THAN 40% OF C&P ACCESS LINES AND 21% OF C&P'S INTRASTATE REVENUES. THEREFORE, THIS COMMISSION IS COMPELLED TO BE CONCERNED ABOUT THE IMPLICATIONS FOR ALL RATEPAYERS IN THE DISTRICT OF COLUMBIA CAUSED BY THE COMPETITIVE THREATS TO CENTREX WHICH MAY LEAVE MUCH OF THE INVESTMENT IN THIS SERVICE STRANDED. WE WERE NOT, HOWEVER, PERSUADED THAT THE PLAN, AS PROPOSED BY C&P, WAS AN ADEQUATE RESPONSE TO THE COMPETITIVE ENVIRONMENT. WE THEREFORE ADOPTED THE C&P PROPOSED REDUCTIONS IN CENTREX SERVICES, BUT FOUND THAT THE RSP-B PLAN AS PROPOSED WAS LACKING. WE EMBRACED A CREATIVE AND FORWARDING LOOKING APPROACH TO THE COMPETITIVE MARKET. WE REASONED THAT THE CUSTOMERS WITH 10,000 LINES OR MORE COULD NOT SOLICIT BIDS FROM VENDORS, AWARD A CONTRACT AND COMPLETELY INSTALL A PBX SYSTEM IN LESS THAN THREE YEARS. THEREFORE, THE PLAN AS PROPOSED BY THE COMPANY WOULD HAVE NO IMPACT UPON THE

PROCUREMENT DECISIONS OF ITS LARGE CUSTOMERS - AND THUS FAILED IN PROVIDING THE INDUCEMENT TO RETAIN CENTREX SERVICE. WE THEREFORE ORDERED THAT LARGE CUSTOMERS COULD ONLY ELECT PLAN-B, WITH THE PROPOSED RATE REDUCTIONS, IF THE CUSTOMER SIGNED-UP FOR A FIVE YEAR PERIOD. IN ORDER TO FURTHER INDUCE CUSTOMER COMMITMENT, WE AGREED THAT ON JANUARY 1, 1988, 1989 AND 1990, THE RATE STABILITY PLAN B RATES WOULD BE ADJUSTED UPWARD TO REFLECT ANY INCREASE IN C&P'S APPLICABLE COSTS ABOVE ITS ESTIMATED 1987 COSTS BY AN AMOUNT NOT TO EXCEED THE PERCENTAGE INCREASE IN THE CONSUMER PRICE INDEX DURING THE PREVIOUS TWELVE MONTHS. WE ALSO AGREED NOT TO ENTERTAIN ANY REQUESTS FOR AN INCREASE DURING THE FINAL TWENTY-SEVEN MONTHS OF THE FIVE YEAR PERIOD, EXCEPT FOR THE COST ADJUSTMENTS WITH THE CPI CAP. WE ALSO ALLOWED C&P TO OFFER THE REDUCED RATES CONTAINED IN RSP-B FOR CUSTOMERS WITH LESS THAN 10,000 LINES FOR A THREE YEAR PERIOD WITH THE SAME COMMISSION RESTRAINTS ON RATE INCREASES. THE COMMISSION WAS SO IMPRESSED WITH THE POTENTIAL REVENUE LOSSES ASSOCIATED WITH CENTREX THAT WE ALSO GRANTED C&P'S REQUEST FOR A FULL CALC CREDIT ON THE INTERCOM RATE.

THE FINAL PORTION OF C&P'S RSP PROPOSAL WAS THAT IT BE ALLOWED TO PRESENT CUSTOMERS WITH INDIVIDUALIZED TARIFFS, SUBJECT TO PSC APPROVAL IN ORDER FOR THE COMPANY TO BE ABLE TO EFFECTIVELY BID ON GOVERNMENT RFPs. HOWEVER, THE COMMISSION WAS CONCERNED WITH THE AMOUNT OF TIME REQUIRED FOR IT TO APPROVE SUCH TARIFFS

AND THAT SAID TARIFFS COULD LEAD TO UNJUST DISCRIMINATION AMONG SIMILARLY SITUATED CUSTOMERS. THUS, WE CONCLUDED THAT IT WAS FAR MORE APPROPRIATE FOR C&P TO USE A FACILITIES- BASED TARIFF FOR CALCULATING ITS CENTREX COMPETITIVE BIDS AND PROPOSALS TO INDIVIDUAL CUSTOMERS. SUCH A TARIFF WOULD BE ON THE ACTUAL FACILITIES USED TO PROVIDE THE SERVICE, AND COULD BE CUSTOMER SPECIFIC WITH CERTAIN LIMITS. IT WOULD INCLUDE OPTIONS RELATING TO SYSTEM SIZE, CONFIGURATION, FEATURES, LOCATION AND LENGTH OF COMMITMENT, AND THE RATES WOULD BE TIED TO THE COST EFFICIENCIES REALIZABLE WITH EACH PARTICULAR ARRANGEMENT. THE TARIFF WOULD SPECIFY RATE ELEMENTS IN TERMS OF INCREMENTAL "BLOCK OF SERVICES, SUCH AS CAPACITY, CONTRACT LENGTH, DISTANCE FROM THE CENTRAL OFFICE AND SO FORTH". 8/

PETER K. PITSCHE, CHIEF OF THE FCC'S OFFICE OF PLANS AND POLICY IN A RECENT NORTHERN TELECOM INC. SYMPOSIUM IN SAN FRANCISCO (JANUARY 13, 1986) DISCUSSED THE CENTREX SERVICE. THE TITLE OF HIS PRESENTATION WAS "GOOD OLD CENTREX IS BACK: PHOENIX OR FICTION?".

WHAT MR. PITSCHE SHARED WITH HIS AUDIENCE WAS HIS PERCEPTION THAT CENTREX APPEARS TO BE ALIVE AND WELL WITH THE TECHNOLOGICAL ABILITY TO BE CONTINUALLY UPDATED. HE CONTINUED HOWEVER THAT EVEN THOUGH CENTREX PROVIDES THE FLEXIBILITY TO INCREASE OR DECREASE USAGE, BECAUSE OF THE REGULATORY CONSTRAINTS THE SERVICE

LACKED PRICE STABILITY. HE STATED, "THE REGULATORY ENVIRONMENT CANNOT PROVIDE THE SAME PRICE CERTAINTY AS CAN LONG TERM BUSINESS CONTRACTS. STATE PUCs MIGHT INITIATE A PRICE INCREASE EVEN THOUGH COMPANIES DO NOT WANT ONE." (AT PAGE 3) BECAUSE OF THIS PERCEIVED PROBLEM, MR. PITSCH RECOMMENDED THAT THE STATES ALLOW CENTREX RATES TO BE "CUT IN THE AMOUNT NECESSARY TO OFFSET THE LINE CHARGES" - WHATEVER THE AMOUNT. HE ALSO RECOMMENDED THAT CENTREX COSTS BE TAKEN FROM THE RATE BASE TO GIVE THE COMPANIES THE FLEXIBILITY AND PROFIT INCENTIVE TO MAKE CENTREX ATTRACTIVE TO CONSUMERS FOR WHOM IT IS COST-EFFECTIVE. (THE IOWA PLAN).

THERE IS MERIT, IN MY OPINION, TO SOME OF MR. PITSCH'S COMMENTS - AS EVIDENCED BY THE ACTIONS TAKEN BY OUR COMMISSION. HOWEVER, DEREGULATION OF THE SERVICE WAS REVIEWED BY OUR COMMISSION IN THE CENTREX DOCKET. INTERESTINGLY, IT WAS NOT EMBRACED BY THE COMPANY AND MORE IMPORTANTLY WAS REJECTED BY THE COMMISSION BECAUSE WE THOUGHT IT IMPRUDENT TO RELINQUISH REGULATORY AUTHORITY OVER A SERVICE WHICH MAKES SUCH SUBSTANTIAL USE OF COMMON CENTRAL OFFICE FACILITIES AND OUTSIDE PLANT.

I WHOLEHEARTEDLY AGREE THAT CENTREX IS ALIVE AND DOING WELL - IT IS MY OPINION THAT WITH APPROPRIATE REGULATORY OVERSIGHT IT CAN STAY THAT WAY. HOWEVER, IT CAN ONLY WORK IF THE COMPANIES DEMONSTRATE AN INNOVATIVE APPROACH TO ENHANCING THE SERVICE AND EMBRACE THE CORPORATE MENTALITY OF A COMPETITIVE

BUSINESS, THAT IS ONE WHICH IS SENSITIVE TO BOTH CUSTOMERS' NEEDS
AND DRIVEN BY QUALITY OF SERVICE CONCERNS.

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FOOTNOTES

1. Comments of the D.C. Public Service Commission In the Matter of the Bell Atlantic Telephone Companies Waiver of Section 64.702 of the FCC's Rules and Regulations to Permit Provision of Centrex Service on a Prime Contractor Basis, June 28, 1985 at page 3.
2. F.C. 828, Order #8230, April 15, 1985, page 7
3. F.C. 798, Order #7954, January 5, 1984, page 27
4. MTS and WATS Market Structure: Third Report and Order, 93 FCC 2d 241 (1983)
5. NARUC v. FCC, 737 F2d 1095 (1984)
6. F.C. 828, Order #8230, page 11
7. Id. at 13
8. Id. at 33