

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INQUIRY INTO INTRALATA TOLL)
COMPETITION, AN APPROPRIATE) ADMINISTRATIVE
COMPENSATION SCHEME FOR COMPLETION) CASE NO. 323
OF INTRALATA CALLS BY INTEREXCHANGE) PHASE I
CARRIERS, AND WATS JURISDICTIONALITY)

O R D E R

On May 6, 1991, the Commission entered its decision. On May 28, 1991, GTE South Incorporated ("GTE South") filed a petition for clarification, the Independent Telephone Group¹ filed a motion for clarification, and South Central Bell Telephone Company ("South Central Bell") filed a petition for rehearing. On May 31, 1991, Alltel of Kentucky, Inc. ("Alltel") filed a motion for clarification. Responses were filed by AT&T Communications of the South Central States, Inc. ("AT&T"); MCI Telecommunications Corporation ("MCI"); and US Sprint Communications Company Limited Partnership ("US Sprint").

¹ Ballard Rural Telephone Cooperative Corporation, Inc.; Brandenburg Telephone Company, Inc.; Duo County Telephone Cooperative Corporation, Inc.; Foothills Rural Telephone Cooperative Corporation, Inc.; Harold Telephone Company, Inc.; Highland Telephone Cooperative, Inc.; Logan Telephone Cooperative, Inc.; Mountain Rural Telephone Cooperative Corporation, Inc.; North Central Telephone Cooperative, Inc.; Peoples Rural Telephone Cooperative Corporation, Inc.; South Central Rural Telephone Cooperative Corporation, Inc.; Thacker-Grigsby Telephone Company, Inc.; and West Kentucky Rural Telephone Cooperative Corporation, Inc.

On June 17, 1991, the Commission granted the motions of Alltel and the Independent Telephone Group to allow the intrastate use of the April 1, 1991 National Exchange Carrier Association interstate access services tariff filing for traffic sensitive and special access rates. The Commission also granted the motion of South Central Bell to allow a waiver of the requirement to mirror interstate special access rates, and granted the motions of GTE South and South Central Bell to allow rehearing on the issue of access charges imputation requirements. The following parties prefiled testimony:

1. On behalf of GTE South, Jeffrey C. Kissell, product management director -- intraLATA² services.

2. On behalf of South Central Bell, James C. Wilkerson, operations manager, regulatory department.

3. On behalf of AT&T, L. G. Sather, staff manager, state government affairs.

4. On behalf of US Sprint, Brooks B. Albery, regulatory policy and coordination manager. On motion by GTE South, the prefiled testimony of US Sprint was stricken from the record.³ Subsequently, upon motion by US Sprint, it was readmitted to the record as comment.⁴

5. On behalf of MCI, Don J. Wood, manager, economic analysis and regulatory affairs.

² Local Access and Transport Area.

³ Transcript of Evidence, pages 71-74.

⁴ Id., pages 234-235.

A public hearing was held on August 27, 1991. The Transcript of Evidence was filed on September 9, 1991. Post hearing briefs were filed by AT&T, US Sprint, GTE South, MCI, and South Central Bell.

On September 26, 1991, AmeriCall Systems of Louisville ("AmeriCall") filed comments in lieu of a brief. All information requested by the Commission and the parties through interrogatories and at the public hearing has been filed.

DISCUSSION

This rehearing centers on a requirement in the Commission's decision of May 6, 1991 that local exchange carriers impute access charges to the price of intraLATA toll. The relevant part of the decision reads as follows:

In Case No. 9889,⁵ the Commission allowed AT&T to reduce toll charges subject to the condition that no toll rate could be reduced below variable cost. Variable cost was defined in terms of access charges -- specifically, carrier common line charges, traffic sensitive rates, and billing and collection charges. The same standard should apply to South Central Bell and other local exchange carriers sponsoring toll tariffs in a competitive market. In the case of South Central Bell, rates for message toll service must fulfill the requirement of imputed access charges by rate band and time-of-day for calls of average distance and duration. Other toll services must stand a similar test. Moreover, since South Central Bell and the other local exchange carriers enjoy access arrangements at least equivalent to the premium access options available to interexchange carriers, imputation should reflect premium access rates.⁶

⁵ Case No. 9889, Adjustment of Rates of AT&T Communications of the South Central States, Inc.

⁶ Order in Administrative Case No. 323, Phase I, dated May 6, 1991, pages 46-47. Acronyms have been omitted and replaced with actual words here and in all other citations in this decision.

Positions of the Parties

South Central Bell contends that the imputation of access charges to the price of intraLATA toll is not necessary to prevent local exchange carriers from obtaining an unfair price advantage vis-a-vis interexchange carriers and is not appropriate from an economic standpoint.⁷ More specifically, South Central Bell contends that the practical effect of such imputation would be the creation of a "price umbrella" below which local exchange carriers could not price their toll services, thus denying consumers the benefits of any inherent network efficiencies and making local exchange carriers the highest-priced suppliers of service. South Central Bell likens this situation to its perception of events in the interLATA market "where AT&T's competitors price just below the 'AT&T umbrella.'"⁸ The result, according to South Central Bell, would be a reallocation of market share rather than true price competition.

Furthermore, South Central Bell contends that local exchange carriers do not use the same or equivalent facilities as interexchange carriers in the provision of toll services, citing the additional transport facilities and switching functions that may be required by interexchange carriers. South Central Bell concludes that "[i]t makes no economic sense, and would be patently unfair, for the cost of such non-used facilities to be

⁷ Prefiled Testimony of James C. Wilkerson, filed on July 8, 1991, pages 2-4 and Brief of South Central Bell, filed on September 25, 1991, pages 2-4.

⁸ Prefiled Testimony of James C. Wilkerson, page 3.

imputed as a part of the local exchange carrier's incremental cost of providing intraLATA toll service."⁹ According to South Central Bell, the imputation of such costs would obstruct achievement of a balanced and fair competitive environment, result in higher toll rates than are economically justified, and advantage interexchange carriers at the expense of consumers.

South Central Bell argues that:

[T]he goal of the local exchange carriers and the Commission should be to maximize the contribution available from intraLATA toll and access. As long as toll prices exceed incremental toll costs plus the contribution from access, the goal is being attained.¹⁰

South Central Bell also argues that since the services with which the local exchange carriers must compete may employ only one end rather than two ends of switched access, local exchange carrier toll rates should reflect only the incremental cost of toll service plus the contribution from one end of switched access.¹¹

These arguments notwithstanding, South Central Bell states that it "will continue to compete in the market if the level of imputation contained in the [May 6, 1991] Order is implemented as we understand it."¹² That is, that imputation requirements be implemented as they have applied to AT&T, including the imputation

⁹ Id.

¹⁰ Id., page 4, emphasis in original, and Brief of South Central Bell, pages 6-8.

¹¹ Id. and Brief of South Central Bell, pages 8-11.

¹² Id., page 5 and Brief of South Central Bell, pages 4-6.

of carrier common line charges, traffic sensitive rates, and billing and collection charges, but not including non-traffic sensitive charges billed on a flat rate basis. Even with this understanding, however, South Central Bell has "serious concerns with the provision of the [May 6, 1991] Order which directs the local exchange carriers to impute access charges by rate band and time-of-day for calls of average distance and duration."¹³

South Central Bell objects to the level of disaggregation imposed by the above requirement.¹⁴ Generally, South Central Bell argues that it does not permit sufficient pricing flexibility and will inhibit the ability of local exchange carriers to respond to price changes made by their competitors, and may require short haul and off-peak toll price increases. South Central Bell suggests that "[i]n order to allow the local exchange carriers more flexibility, while still ensuring fair pricing of local exchange carrier toll services, the Commission should only require toll service as a whole to pass the imputation test."¹⁵

GTE South contends that "[t]he current Order, if implemented 'as is,' could result in local exchange carrier toll prices that are not reflective of costs and would serve to obstruct, rather than facilitate, the intended benefits of competition."¹⁶ GTE

¹³ Id.

¹⁴ Id., pages 6-8.

¹⁵ Id., page 6, emphasis in original.

¹⁶ Prefiled Testimony of Jeffrey C. Kissell, filed on July 8, 1991, page 3.

South proposes an alternative imputation methodology based on "monopoly building blocks," which it defines as "[t]hose local exchange carrier tariffed services which competitors must subscribe to in the provision of competitive services, and which are designed to recover the costs of services/facilities utilized by the local exchange carrier in the provision of its own competitive services."¹⁷

Based on this definition, GTE South argues that imputation should be limited to monopoly building blocks that interexchange competitors cannot avoid and which local exchange carriers use. Additionally, GTE South suggests that non-monopoly building blocks should be imputed to the price of intraLATA toll based on direct costs rather than imputed costs, imputation requirements should be applied on a service-by-service rather than a rate element basis, and imputation requirements should apply to all toll carriers.¹⁸

Essentially, GTE South contends that there are no monopoly building blocks imputable across all local exchange carrier toll service offerings. Instead, GTE South examines each service offering and recommends imputation standards with reference to serving arrangements used by local exchange carriers vis-a-vis interexchange carriers and changing technology.

¹⁷ Id., page 4, emphasis in original, and Brief of GTE South, filed on September 25, 1991, pages 4-7.

¹⁸ Id.

GTE South suggests that a tariff filing should pass an imputation test if the proposed rate(s) or revenue stream is greater than or equal to:

1. All imputed access tariff rate elements, plus:
2. The direct cost of any network costs not included in (1) above, plus:
3. The direct costs of billing, sales, and advertising, less:
4. Any cost included in (1) above duplicated in (2) and (3) above.¹⁹

GTE South avows that the ratio of duplicated costs to total switched access revenue requirement can be determined and applied to the amount of imputed access charges to determine the amount of cost that should be eliminated from an imputation test.²⁰

In essence, GTE South argues that an imputation test should be applied on a service-by-service basis rather than on a rate element basis: "GTE South believes that as long as each toll service, in total, passes the imputation test, then no anti-competitive pricing has occurred."²¹ GTE South also argues that a rate element approach is a misapplication of imputation principles because carriers do not manage their toll products by rate element and have designed toll rates to maximize revenue. As

¹⁹ Id., page 13.

²⁰ Id., page 15.

²¹ Id.

an alternative, GTE South suggests that services be grouped as follows:

1. Message telephone service, including basic toll service, credit card, operator handled, and off-peak discount calling plans.
2. Intrastate wide area telephone service/800.
3. GTE South business line 800.²²

GTE South contends that imputation requirements should apply to all toll carriers.

[G]TE South believes that the local exchange carriers and the interexchange carriers face equivalent pricing decisions and will strive to reach the same profit maximization levels for their toll services. This does not assure that one or the other might not engage in below cost pricing, however, there is no stronger motivation for the local exchange carrier to engage in these practices than its interexchange carrier competitor. Accordingly, to the extent that imputation requirements apply to the local exchange carrier, these same requirements should also apply to the interexchange carrier's intraLATA offerings.²³

AT&T disputes the positions of South Central Bell and GTE South, and makes its own recommendations. AT&T contends that:

[S]outh Central Bell's proposal that the imputation test be applied to the totality of all toll services is inappropriate, administratively difficult, and would not protect the public or competitors from anti-competitive pricing activity. GTE's proposal incorporates more reasonable service disaggregation, however, it does not include the imputation of all access elements (monopoly building blocks) used by both local exchange carriers and interexchange carriers.²⁴

²² Id., pages 18-19.

²³ Id., page 22

²⁴ Prefiled Testimony of L. G. Sather, filed on July 22, 1991, page 3.

AT&T recommends that toll services be grouped as follows:

1. Direct dialed toll service.
2. Operator handled and assisted toll services.
3. Each uniquely tariffed wide area service offering.
4. Each uniquely tariffed 800 service offering.
5. Each uniquely tariffed optional calling plan.
6. Each special contract.²⁵

AT&T suggests that an imputation test be applied to these service categories based on average revenue and average access charges per conversation minute of use.²⁶ Average revenue per minute should be aggregated for all times of day and lengths of haul. Average access charges per minute should be computed using applicable access serving arrangements. Generally, average access charges per minute should be computed based on elements used to provide service: i.e., if one end of switched access is used, then one end should be included; if two ends of switched access are used, then two ends should be included; and if special access is used, then it should be imputed. AT&T represents its proposal as a compromise and adds that any proposal that is adopted should apply to all toll carriers.

According to AT&T, "[t]he rationale for requiring imputation of access charges is to assure that local exchange carriers do not

²⁵ Id., page 4

²⁶ Id., pages 4-5.

take unfair advantage of their unique position of providing both wholesale and retail services (i.e., access and toll) by imposing access costs on their competitors that they (the local exchange carriers) do not account for in the pricing of their similar competitive services."²⁷

In response to GTE South, AT&T contends that their effort to show differences in variable cost between local exchange carriers and interexchange carriers is "irrelevant and inappropriate," because imputation concerns pricing issues and not cost issues.²⁸ Furthermore, AT&T contends that if the cost characteristics of existing trunking arrangements are significantly different from applicable access charges, then GTE South should recommend a restructuring of transport rates.²⁹

In response to South Central Bell, AT&T contends that the imputation of access charges to the price of intraLATA toll creates a "price floor" rather than a price umbrella:

The imputation of access charges in the development of local exchange carrier toll prices creates a price floor for local exchange carrier toll rates. This is the same price floor that interexchange carriers are faced with given the access rates charged by the local exchange companies. Mr. Wilkerson implies that South Central Bell is willing to price below that price floor (the price of access). The effect of such pricing by the local exchange companies would be anti-competitive. The local exchange company would be using its advantage as the provider of a monopoly bottleneck service to gain

²⁷ Id., page 5.

²⁸ Id., page 6.

²⁹ Id.

market presence. The purpose of the imputation of access charges is to thwart such anti-competitive pricing activities. It is necessary to ensure fair competition.³⁰

MCI supports the Commission's decision of May 6, 1991. However, to the extent the decision may be modified, MCI recommends that any imputation standard should include the following elements:³¹

1. Each local exchange carrier tariffed toll service offering must be subject to an imputation standard based on average revenue per minute and variable cost as defined by the Commission. MCI would allow revenues and costs to be averaged across mileage bands and times of day.

2. Any uniquely tariffed service offering or special contract should meet the above standard.

3. Local exchange carriers should impute premium access charges to their toll services.

4. Local exchange carriers should impute the type of access used to provide service rather than the type of access that might be used by competitors.

The comments of AmeriCall and US Sprint are generally consistent with the positions represented by AT&T and MCI.

Analysis and Findings

It appears to the Commission that the imputation of access charges to the price of intraLATA toll is reasonable and necessary

³⁰ Id., page 7.

³¹ Prefiled Testimony of Don J. Wood, filed on July 29, 1991, pages 2-3.

to prevent anti-competitive behavior, and that the prior decision on this issue should be affirmed with limited modification.

Much discussion on the imputation issue centered on network serving arrangements used by local exchange carriers vis-a-vis interexchange carriers. On one hand, the focus was on the use of common lines by local exchange carriers in the provision of their toll services as compared to the use of dedicated or special access lines by interexchange carriers. On the other hand, the focus was on existence of transport facilities connecting local exchange carrier end offices and access tandems to interexchange carrier points of presence, and the lack of similar transport facilities and points of presence in the toll network of the local exchange carriers.

In the first area, GTE South and South Central Bell generally argued that they should be allowed to impute access elements used by their competitors in the provision of particular services rather than the access elements that otherwise might apply. For example, if competitors used special access to originate a message or wide area toll service and switched access to terminate it, then the local exchange carriers should be allowed to impute one end of switched access irrespective of the serving arrangement that might actually exist.

AT&T, MCI, and US Sprint argued that local exchange carriers should impute what they use. For example, if local exchange carriers used the equivalent of switched access to originate and terminate a message or wide area toll service, then they should

impute two ends of switched access regardless of the serving arrangement used by their competitors.

In the second area, GTE South and South Central Bell are correct that transport facilities are required to connect local exchange carrier end offices and access tandems to interexchange carrier points of presence. Further, at least in name, corresponding facilities do not exist in the toll network of the local exchange carriers. However, comparable facilities do exist in the form of interoffice and toll trunks that link end offices with one another directly or through toll tandems.³² Also, the functions that a local exchange carrier must perform in order to provide toll service are the same as the functions an interexchange carrier must perform: i.e., in general, a toll call must be switched, transported, and billed.³³ Moreover, the Commission notes that the Kentucky Restructured Settlement Plan, filed in this case and discussed in a related decision,³⁴ assumes Feature Group C access service and that a point of presence exists at the end office side of each toll tandem switch for each end office served by the switch.

The local exchange carriers should impute access elements to the price of their message and wide area toll services based on the access elements that would apply were they charged for access

³² Compare the illustrative diagrams in the prefiled testimony of Jeffrey C. Kissell, exhibit 3.

³³ Transcript of Evidence, pages 62-66 and 138-142.

³⁴ Administrative Case No. 323, Phase I, Order dated January 23, 1992.

as are interexchange carriers. In our view, contrary to the arguments of GTE South and South Central Bell, this action places all toll carriers on as equal a footing as is practical. It will avoid protracted investigations concerning the comparability of local exchange and interexchange carrier toll services as well as protracted investigations concerning the reasonableness of toll cost studies, either of which would be likely under the proposals made by GTE South and South Central Bell.

To the extent the local exchange carriers consider themselves disadvantaged vis-a-vis interexchange carriers due to existing toll serving arrangements, they are free to design future toll service offerings in ways that minimize imputation and, therefore, price. They are also free to reprice access services to more closely align rates with the economic costs of access within the constraints of overall revenue requirements and equity among customer classes. In fact, the Commission is addressing matters concerning toll and access price reductions in a related decision in Case No. 90-256³⁵ as well as another related decision in this case concerning local exchange carrier access services tariff filings and changes in toll settlement relationships among the local exchange carriers.³⁶

³⁵ Case No. 90-256, Phase II, A Review of the Rates and Charges and Incentive Regulation Plan of South Central Bell Telephone Company, Order dated January 23, 1992.

³⁶ Administrative Case No. 323, Phase I, Order dated January 23, 1992.

The Commission recognizes that some assumptions must be made in the imputation process. For example, as noted above, since local exchange carriers do not have points of presence, as such, it may be reasonable to assume toll tandems rather than end offices as points of presence for imputation purposes. As another example, it may be reasonable to view toll trunks as equivalent to transport facilities, not including interoffice trunks even though they may in fact be used to transport some toll traffic. As it has done with AT&T, the Commission will review toll rate tariff filings and accept reasonable assumptions. Of course, such tariff filings must be thoroughly documented.

Aside from arguing that the imputation of access charges is not necessary, South Central Bell indicates that it can accept the imputation test as ordered in the May 6, 1991 decision with some clarification and one modification. First, South Central Bell wants the treatment of non-traffic sensitive charges billed on a flat rate as opposed to a per minute basis clearly understood.

The Commission agrees and will clarify our prior holding. AT&T has not been required to impute non-traffic sensitive charges billed on a flat rate basis into the price of its toll services for reasons that have been thoroughly explained in several decisions in Case No. 8838³⁷ and which were touched upon at the

³⁷ Case No. 8838, An Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements for Telephone Utilities Pursuant to Changes to be Effective January 1, 1984.

rehearing.³⁸ For the same reasons, the local exchange carriers will not be required to impute non-traffic sensitive charges billed on a flat rate basis into the price of their toll services. They will be required to impute such charges billed on a per minute basis as AT&T is required to do.

Second, South Central Bell does not want to impute billing and collection rates to the price of its toll services based on the argument that interexchange carriers can obtain such services from other sources. GTE South also does not want to impute billing and collection rates for the same reason: i.e., billing and collection services are not monopoly building blocks. These arguments are without merit. The fact of the matter is that local exchange carriers bill their end-users for toll calls. Whether the billing agent is South Central Bell, GTE South, AT&T, MCI, or US Sprint is irrelevant in that each would charge any of the others for such services. Local exchange carriers should impute the rates they charge or would charge to other carriers for billing and collection services.

In addition to these issues, both South Central Bell and GTE South object to imputation by rate band and time-of-day. Various alternatives were advanced. For example, South Central Bell suggested an imputation test based on the aggregate of all toll services. GTE South suggested a service-by-service approach to imputation. The interexchange carriers suggested other

³⁸ Transcript of Evidence, pages 101-107.

alternatives. In each case, however, the parties were not able to affirm that their approach would prevent instances of anti-competitive pricing.³⁹ Therefore, the Commission finds that its prior decision should be affirmed: i.e., access charges should be imputed by rate band and time-of-day for calls of average distance and duration.

The Commission is aware that this decision links the price of access and the price of toll. Under past and current access charges, message toll rates in short haul bands and rates in discount periods would increase.⁴⁰ This has been the case as AT&T has repriced toll rates adopted from South Central Bell at divestiture under the constraints of an access charges imputation requirement.⁴¹ These rate changes, however, have occurred over time as AT&T has transitioned toward access-based toll prices and, at least in some instances, may be reversed as access charges decline. While affirming its prior decision, the Commission will allow local exchange carriers to transition toward access-based toll prices in cases where isolated rate elements fail to meet imputation requirements. At the same time, as with AT&T, the Commission will not allow local exchange carriers to reduce any rate or charge that fails to meet imputation requirements.

³⁹ Transcript of Evidence, pages 69-70, 142-145, 184-185, and 233.

⁴⁰ Prefiled Testimony of James C. Wilkerson, pages 7-8, Transcript of Evidence, page 12, and Brief of South Central Bell, pages 5-6.

⁴¹ Transcript of Evidence, pages 187-188.

South Central Bell reported an imputation requirement of 5.61 cents per minute of use,⁴² based on proposed access charges approved in a related decision.⁴³ At this level, except in the initial rate band, current intraLATA toll prices are high enough to permit substantial reductions without violating the imputation requirements outlined in this and the Commission's prior decision. Further reductions could be made. Thus, at present, there is no need to partition South Central Bell's intraLATA toll rate schedule between rate periods or change discounts applicable to rate periods, as AT&T has been required to do. Of course, this situation could change, depending on the level of access charges or an increase in imputation requirements.

South Central Bell pleads that the objectives of an imputation test should be equitable pricing among carriers and maximization of the contribution available from toll and access services.⁴⁴ In the context of the rehearing, maximization of contribution means that local exchange carriers should receive at least as much contribution from toll services as they receive from access services through pricing toll rates at or above the incremental cost of toll plus the contribution from access.⁴⁵ It

⁴² South Central Bell's response to the Commission's Order dated October 25, 1991, Item 10a.

⁴³ Administrative Case No. 323, Phase I, Order dated January 23, 1992.

⁴⁴ Prefiled Testimony of James C. Wilkerson, page 4, Transcript of Evidence, page 12, and brief of South Central Bell, pages 6-8.

⁴⁵ Transcript of Evidence, pages 23-24 and 67-68.

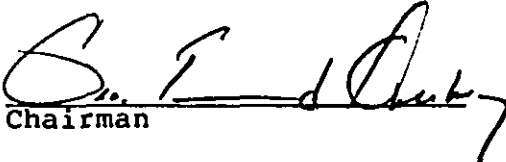
is obvious that the Commission believes that the imputation methodology it has adopted is reasonable and places all toll carriers on as equal a footing as is practical. As to the maximization of contribution from toll and access services, there is relatively little difference between the result of the imputation methodology adopted by the Commission and the method suggested by South Central Bell. As expressed at the rehearing, the sum of the incremental cost of toll plus the contribution from access and the price of access approximate one another.⁴⁶

ORDERS

The Commission HEREBY ORDERS that the decision of May 6, 1991 on the imputation of access charges to the price of intraLATA toll is affirmed.

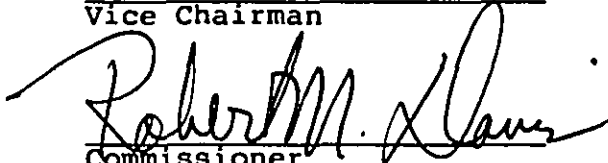
Done at Frankfort, Kentucky, this 23rd day of January, 1992.

PUBLIC SERVICE COMMISSION


Chairman

ATTEST:


Executive Director

Vice Chairman

Commissioner