

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

A REVIEW OF THE RATES AND CHARGES)
AND INCENTIVE REGULATION PLAN OF) CASE NO. 90-256
SOUTH CENTRAL BELL TELEPHONE) PHASE II
COMPANY)

O R D E R

INTRODUCTION

On April 3, 1991, the Commission adopted a revised incentive regulation plan for South Central Bell Telephone Company ("South Central Bell"), but deferred rate design priorities to be implemented outside and within the incentive regulation plan.

The following parties prefiled testimony:

1. On behalf of the Attorney General of the Commonwealth of Kentucky, by and through his Utility and Rate Intervention Division ("Attorney General"), the prefiled testimony of Dr. Marvin H. Kahn, Exeter Associates, Inc., consultant to the Attorney General.

2. On behalf of AT&T Communications of the South Central States, Inc. ("AT&T"), the prefiled testimony of L. G. Sather, staff manager, state government affairs. AT&T also filed additional comments.

3. On behalf of Contel of Kentucky, Inc. ("Contel"), the prefiled testimony of O. Douglas Fulp, manager, revenue requirements and pricing, Contel Service Corporation. Inasmuch as

Mr. Fulp did not appear at the public hearing, his prefiled testimony will be considered as comments.

4. On behalf of GTE South Incorporated ("GTE South"), the prefiled testimony of Jeffrey C. Kissell, product management director -- intraLATA¹ services, GTE Service Corporation. The Commission granted GTE South's motion to consider Mr. Kissell's prefiled testimony as comments.

5. On behalf of the Independent Telephone Group,² the prefiled testimony of James K. Sharpe, Utility and Economic Consulting, Inc., consultant to the Independent Telephone Group.

6. On behalf of MCI Telecommunications Corporation ("MCI"), the prefiled testimony of Randy R. Klaus, senior staff member, regulatory and economic analysis.

7. On behalf of South Central Bell, the prefiled testimony of Leo B. Shoemaker, industry relations manager, and the prefiled testimony, as amended, of James C. Wilkerson, operations manager, regulatory department.

¹ Local Access and Transport Area.

² 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; 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.

A public hearing was held on July 16, 1991. Post hearing briefs were filed by the Attorney General, AT&T, MCI, and South Central Bell. South Central Bell also filed a reply brief.

All information sought through interrogatories and at the public hearing has been filed.

DISCUSSION

In its decision of April 3, 1991, the Commission found that funds available from the expiration of embedded inside wire amortization expense and depreciation reserve deficiency amortization expense should be treated outside the incentive regulation plan, and should not be used to offset increased depreciation expense.³ The disposition of funds available outside the incentive regulation plan generated considerable and somewhat confusing testimony, given the overall context of the inquiry. Therefore, the positions of the parties on rate design priorities outside the incentive regulation plan will be discussed apart from their more general positions on rate design priorities under the incentive regulation plan. In the end, the distinction as to whether funds are treated outside or under the incentive regulation plan is coincidental to rate design priorities. The distinction is not really a matter of rate design priorities at all, but a matter of determining the amount of funds available for rate reductions.

³ Case No. 90-256, Phase I, pages 20-22.

Rate Design Proposals for Funds Available From the Expiration of Embedded Inside Wire Amortization Expense and Depreciation Reserve Deficiency Expense

As a result of the expiration of embedded inside wire amortization expense, \$6,900,000 is available for rate reductions. Of this amount, South Central Bell proposes that \$4,600,000 be applied to reduce intraLATA toll rates and \$2,300,000 be applied to reduce switched access charges. As a result of the expiration of depreciation reserve deficiency amortization expense, an additional \$18,000,000 is available for rate reductions. Of this amount, South Central Bell proposes that \$12,000,000 be applied to reduce intraLATA toll rates and \$6,000,000 be applied to reduce switched access charges. In summary, South Central Bell proposes that \$16,600,000 be applied to reduce intraLATA toll rates and \$8,300,000 be applied to reduce switched access rates, for a total rate reduction of \$24,900,000.⁴

⁴ South Central Bell's original proposal was that \$5,000,000 be applied to offset increased depreciation expense; \$11,600,000 be applied to reduce intraLATA toll rates; \$7,300,000 be applied to reduce switched access charges; and \$1,000,000 be applied to offset an expected revenue loss from the implementation of universal access lines for wide area telecommunications service ("UWALs"). However, as indicated above, the Commission denied a depreciation expense offset. Also, South Central Bell revised its estimate of revenue loss associated with UWAL implementation to zero. Including these adjustments, South Central Bell proposed that \$17,600,000 be applied to reduce intraLATA toll rates. Compare the prefiled and amended prefiled testimony of James C. Wilkerson, filed on April 22 and July 15, 1991, respectively, pages 2-4 and Transcript of Evidence, filed on July 31, 1991, pages 30-34. Where the prefiled testimonies of Mr. Wilkerson differ, the reader is invited to compare the two versions. Otherwise, his amended prefiled testimony is cited.

Under the Attorney General's proposal, none of these funds would be assigned to intraLATA toll rates or switched access charges. Instead, the entire amount would be allocated to zone charges, touch tone charges, and exchange access line charges.⁵ The Attorney General recommends that zone charges be reduced by \$4,800,000,⁶ based on the argument that cost savings associated with local loop distance sensitivity should be recognized in lower rates.

The Attorney General recommends that touch tone charges be reduced by \$12,000,000,⁷ based on the argument that touch tone has become integral to network architecture rather than an optional

⁵ Prefiled Testimony of Dr. Marvin H. Kahn, filed on June 14, 1991, pages 6-8 and exhibit MHK-1.

⁶ Specifically, the Attorney General recommends that the charge in zone 1 for one-party service be reduced from \$2.20 to \$2.00 and that charges in all other zones for one-party service be reduced to the two-party level. The Attorney General represents this proposal as consistent with South Central Bell's proposal on rate design priorities under the incentive regulation plan. It appears to be consistent when combined with the Attorney General's own proposal on rate design priorities under the incentive regulation plan. Compare the prefiled testimony of Dr. Marvin H. Kahn, pages 7-8 and exhibit MHK-1; the amended prefiled testimony of James C. Wilkerson, pages 9-11 and revised exhibit 1 schedule 3; and Transcript of Evidence, pages 177-178.

⁷ Specifically, the Attorney General recommends that touch tone charges be reduced for all subscribers by \$1.50, eliminating the charge to residence customers and reducing it by 50 percent to business customers. The Attorney General further recommends elimination of touch tone charges, available funds permitting. Elimination of touch tone charges is consistent with South Central Bell's proposal on rate design priorities under the incentive regulation plan. Compare the prefiled testimony of Dr. Marvin H. Kahn, page 7 and exhibit MHK-1; the amended prefiled testimony of James C. Wilkerson, page 11 and exhibit 1 schedule 3; and Transcript of Evidence, page 177.

feature with an identifiable incremental cost. In fact, due to the deployment of digital switching technology, the cost function may be inverse to the rate structure. The Attorney General recommends that exchange access line charges be reduced by \$8,100,000,⁸ based on the argument that basic exchange service subscribers should benefit from reduced rates independent of their subscription to other services. The sum of these recommendations is \$24,900,000.

Among its general rate design recommendations, AT&T contends that funds available for rate reductions should be allocated between intraLATA toll rates and access charges based on relative minutes of use. As it relates to funds available from the expiration of embedded inside wire amortization expense and depreciation reserve deficiency expense, this approach would result in a \$15,100,000 allocation to intraLATA toll rates and a \$9,800,000 allocation to access charges, or a total allocation of \$24,900,000.⁹

Consistent with its general rate design recommendations, MCI contends that all funds available from the expiration of embedded inside wire amortization expense and depreciation reserve deficiency expense should be allocated between intraLATA toll

⁸ The Attorney General's total recommendation is \$11,000,000, including funds available both outside and under the incentive regulation plan. See the prefiled testimony of Dr. Marvin H. Kahn, page 8 and exhibit MBK-1.

⁹ Prefiled Testimony of L. G. Sather, filed on June 14, 1991, pages 5-7 and Sather exhibit 1.

rates and switched access charges on a 1:1 ratio, until the total rate reductions targeted to these services are achieved.¹⁰

The actual disposition of funds available from the expiration of embedded inside wire amortization expense and depreciation reserve deficiency expense is best gleaned from the following.

Rate Design Proposals for Funds Available Under the Incentive Regulation Plan

South Central Bell contends that toll rates and switched access charges must be "rebalanced" at "market prices" to prepare for intraLATA competition. In both cases, South Central Bell contends that market prices are interstate rate levels.¹¹ On the subject of switched access charges, South Central Bell contends that "[u]ntil intrastate switched access charges are brought in line with interstate switched access rates, interexchange carriers and resellers will have every incentive to tariff shop, to mis-report percent interstate usage, to leverage interstate rates against intrastate rates, and bypass switched access altogether."¹²

South Central Bell estimates that a switched access rate reduction of \$21,055,000 is required to mirror interstate rates. This amount includes the elimination of ULAS¹³ revenue

¹⁰ Prefiled Testimony of Randy R. Klaus, filed on June 14, 1991, pages 2-3.

¹¹ Transcript of Evidence, pages 35-38, 72-75, and 85-86.

¹² Amended prefiled testimony of James C. Wilkerson, page 5. Acronyms have been omitted from this and all other quotations.

¹³ Universal Local Access Service.

requirement.¹⁴ South Central Bell contends that if its proposal concerning disposition of funds available from the expiration of embedded inside wire amortization expense and depreciation reserve deficiency amortization expense were accepted, this amount would be reduced to \$12,755,000.¹⁵

On the subject of intraLATA toll rates, South Central Bell contends that "as intrastate switched access rates mirror interstate levels, the interexchange carriers' intrastate toll rates will approximate their interstate toll rates, as switched access payments are the major cost inputs into interexchange carrier toll rates."¹⁶ South Central Bell estimates that an intraLATA toll rate reduction of \$52,063,000 is required to achieve market prices.¹⁷ This amount includes reducing intraLATA

¹⁴ Originally, South Central Bell provided an estimate of \$16,000,000, which did not include the elimination of ULAS revenue requirement. Compare the prefiled and amended prefiled testimony of James C. Wilkerson, page 5 and Transcript of Evidence, pages 34-36.

¹⁵ Compare the prefiled and amended prefiled testimony of James C. Wilkerson, pages 7-8.

¹⁶ Amended prefiled testimony of James C. Wilkerson, page 5.

¹⁷ Compare the amended prefiled testimony of James C. Wilkerson, page 6 and revised exhibit 1 schedule 3; South Central Bell's response to Items 4(b) and 11 of the Commission's Order dated May 2, 1991; Transcript of Evidence, pages 34-35; and South Central Bell cross-examination exhibit 2. Estimates appear throughout the record at various levels, depending on the context and whether the estimate is specific to South Central Bell or an industry-wide estimate. This decision cites estimates on an industry-wide basis from the Item 11 price-out, including both message and wide area telecommunications service, unless otherwise noted. Given approval of the Kentucky Restructured Settlement Plan, the appropriate South Central Bell estimate is the same as the industry-wide estimate.

toll rates to an interstate "benchmark" level and an additional discount to adjust for the disadvantage of being limited to the intraLATA market. The benchmark level is MCI's interstate rates and the additional discount is approximately 12 percent.¹⁸ South Central Bell contends that if its proposal were accepted, this amount would be reduced to \$35,463,000.¹⁹

Going forward from its proposals for initial toll and switched access rate reductions, South Central Bell recommends that rates be reduced using a ratio of 2.8:1 at each point of test over the duration of the incentive regulation plan until total reduction targets are achieved.²⁰ The ratio is based on the relative amount of reductions targeted to toll and switched access services. Of course, the ratio changes as relative amounts and revenue targets change, which has occurred several times in the course of this investigation.

In addition to toll and switched access as rate reduction priorities, South Central Bell proposes that zone charges, grouping charges, touch tone charges, and exchange access line

¹⁸ Originally, South Central Bell proposed US Sprint's interstate rates as the benchmark. Compare the amended prefilled testimony of James C. Wilkerson, page 7; South Central Bell's response to Item 4(a) of the Commission's Order dated May 2, 1991; and Transcript of Evidence, pages 43-45, 49-51, 54-55, 57-59, 88-89, and 108-109.

¹⁹ Compare the prefilled and amended prefilled testimony of James C. Wilkerson, pages 7-8.

²⁰ Id.; South Central Bell cross-examination exhibit 2; and Transcript of Evidence, pages 35, 49, and 65-71.

charges be included as rate reduction priorities.²¹ South Central Bell recommends that zone charges be reduced toward complete elimination because the distance sensitivity and maintenance cost of the local loop has declined, the existing rate structure may inhibit demand for vertical services such as custom calling features, and the existing rate structure may inhibit telephone subscription by making rural service unaffordable.²² Rate reductions to zone charges totaling \$17,507,000 are proposed.

South Central Bell recommends that grouping charges be reduced because existing rates reflect value of service rather than cost of service distinctions. A statewide flat rate for grouping service and rate reductions totaling \$5,600,000 are proposed. South Central Bell recommends that touch tone charges be reduced toward complete elimination because they may inhibit demand for enhanced services. Rate reductions to touch tone charges totaling \$11,000,000 are proposed. Finally, South Central Bell recommends that exchange access line charges be reduced on a residual basis, assuming that all other rate design priorities are achieved.

In the event of rate increases, South Central Bell proposes that late payment charges, directory assistance charges,

²¹ Amended prefiled testimony of James C. Wilkerson, pages 9-12 and revised exhibit 1 schedule 3 and Transcript of Evidence, page 32.

²² Id. and Transcript of Evidence, pages 46-48 and 81-83.

miscellaneous charges, and exchange access line charges be included as rate design priorities.²³ South Central Bell contends that these charges should be increased consistent with cost causation principles.

The Attorney General opposes South Central Bell's emphasis on rate reductions involving intraLATA toll rates and switched access charges.²⁴ The Attorney General alleges that South Central Bell's proposals are premised on the Intrastate Toll Contribution Study filed in Administrative Case No. 323, Phase I, the findings of which were rejected by the Commission.²⁵ The Attorney General concludes that "[r]eductions in toll rates and switched access charges may be justified, but not as precipitously as South Central Bell suggests or on such a large scale."²⁶

In the alternative, the Attorney General proposes reductions to exchange access line charges as his first rate design priority under the incentive regulation plan.²⁷ Here, he proposes \$2,900,000 in rate reductions, for a total of \$11,000,000 when

²³ Id., page 13 and exhibit 2 schedule 4 and Transcript of Evidence, page 32.

²⁴ Transcript of Evidence, pages 151-156.

²⁵ Administrative Case No. 323, Phase I, An Inquiry Into IntraLATA Toll Competition, An Appropriate Compensation Scheme for Completion of IntraLATA Calls by Interexchange Carriers, and WATS Jurisdictionality, Order dated May 6, 1991, pages 17-25. WATS is an acronym for wide area telecommunications service.

²⁶ Prefiled Testimony of Dr. Marvin H. Kahn, page 5.

²⁷ Id., pages 8-13 and exhibit MHK-1 and Transcript of Evidence, pages 178-180.

combined with his recommendation on disposition of funds available from the expiration of embedded inside wire amortization expense and depreciation reserve deficiency expense. The Attorney General's second rate design priority under the incentive regulation plan is service initiation charges, which he proposes to reduce by \$2,000,000. The Attorney General's third and fifth rate design priorities concern intraLATA toll rates and switched access charges. In the initial step, the Attorney General proposes intraLATA toll rate reductions sufficient to move South Central Bell's rates to par with AT&T's, an amount totaling \$20,800,000. In the second step, the Attorney General proposes intraLATA toll and switched access rate reductions totaling \$16,000,000. In this area, the Attorney General's primary concern is to prevent a "price squeeze," where intraLATA toll rates are set too low relative to switched access rates.

The Attorney General's fourth and sixth rate design priority is grouping charges, which he proposes to reduce by \$5,600,000. This is consistent with South Central Bell's proposal. Finally, the Attorney General proposes reductions to zone charges as a residual rate design category.

In the event of rate increases, the Attorney General recommends that rates that have been most recently decreased be the first to be increased. According to the Attorney General, because recommended rate reductions are in areas where South Central Bell would most like to reduce rates, this approach "will contribute to the Company's incentive to increase operating

efficiencies and improve earnings."²⁸ It should be noted that this approach is generally consistent with a recommendation contained in a report on incentive regulation prepared by Theodore Barry & Associates for the Commission.²⁹

Unlike the Attorney General, AT&T contends that rate design priorities under the incentive regulation plan should be limited to intraLATA toll rate reductions and access charges reductions, and not include any local service rate reductions.³⁰ AT&T does not specifically designate switched access charges. According to AT&T, exchange access line rates should not be reduced, as proposed by South Central Bell, because South Central Bell has introduced evidence in different proceedings before the Commission that these rates are below cost and should be increased rather than decreased. Also, reducing exchange access line rates would be inconsistent with recommendations contained in the Theodore Barry & Associates report on incentive regulation, which recommended that intraLATA toll rates and access charges be targeted for rate increases and decreases. In any event, according to AT&T, given the sharing mechanism contained in the incentive regulation plan, it is unlikely that available funds

²⁸ Id., pages 13-14.

²⁹ A Review of the Incentive Regulation Plan of South Central Bell Telephone Company, filed September 4, 1990, page III-8.

³⁰ Prefiled Testimony of L. G. Sather, pages 1-4 and Transcript of Evidence, pages 122-125.

will be sufficient to address South Central Bell's proposed reductions to intraLATA toll rates and switched access charges.

AT&T does not oppose South Central Bell's proposed reductions to zone charges and grouping charges.³¹ However, AT&T contends that these reductions should not be made through incentive regulation plan rate design priorities. Instead, AT&T suggests that these reductions be made through revenue neutral tariff filings that offset such reductions with increases to other categories of local exchange service.

Finally, AT&T contends that funds available for rate reductions should be allocated between intraLATA toll rates and access charges based on relative minutes of use, which it perceives to be the most appropriate and equitable approach.³²

MCI proposes that intraLATA toll rates and switched access charges receive priority over all other services for rate reductions under the incentive regulation plan, until the total rate reductions proposed by South Central Bell are achieved -- i.e., \$48,100,000, net of funds available from the expiration of embedded inside wire amortization expense and depreciation reserve deficiency expense.³³

³¹ Id., pages 4-5.

³² Id., pages 1-2 and 5-6 and Transcript of Evidence, pages 129-132.

³³ Prefiled Testimony of Randy R. Klaus, pages 2-3.

According to MCI, these rate reductions should be made based on a 1:1 ratio, until rate parity is achieved between South Central Bell's interstate and intrastate access services tariffs.³⁴ After rate parity is achieved, switched access charges should be reduced as necessary to maintain rate parity. Additional reductions to intraLATA toll rates should be made consistent with the imputation of access charges and other relevant costs.

After rate reductions targeted to intraLATA toll rates and switched access charges have been achieved, MCI recommends that any other available funds be targeted to zone charges and regrouping charges as proposed by South Central Bell. In the event of rate increases, MCI concurs with South Central Bell's proposals.

MCI advocates intraLATA toll rates and switched access charges as primary rate design priorities in order to move switched access charges toward cost, alleviate South Central Bell's concerns about bypass, tariff shopping, and usage misreporting, and accommodate intraLATA competition.³⁵ MCI advocates an allocation of funds available for rate reductions on a 1:1 ratio rather than a 2.8:1 or any other ratio because incentives to bypass access charges exist. According to MCI, such bypass is detrimental to both local exchange carriers and access services users. Also, according to MCI, the phase-in approach to

³⁴ Id., and Transcript of Evidence, page 114.

³⁵ Id., pages 5-7.

intraLATA competition adopted by the Commission makes intraLATA toll rate reductions less pressing than suggested by South Central Bell.

MCI opposes South Central Bell's proposals to include exchange access line charges and touch tone charges as rate reduction priorities under the incentive regulation plan.³⁶ MCI opposes the former proposal because South Central Bell's exchange access line charges compare favorably with the national average and subscriber penetration rates in Kentucky have steadily increased over the past several years. MCI opposes the latter proposal because touch tone is an optional feature that customers can enjoy without additional cost through the use of dual tone multi-frequency station sets and is not necessary to access enhanced services.

Rate design priorities for the incentive regulation plan are discussed below.

IntraLATA Toll Settlement Issues

At the time South Central Bell prefiled its testimony, the status of existing intraLATA toll pool settlement arrangements was unclear, except that changes might be desirable and even necessary. South Central Bell addressed the issue, stating its belief that "the current intraLATA toll revenue distribution fund

³⁶ Id., pages 3-5.

arrangements are not appropriate in competitive markets and under incentive regulation. . . ."37

Based on administrative ease and equity in revenue distribution among the local exchange carriers, South Central Bell concedes that the intraLATA toll pool settlement arrangement adopted in Case No. 8838³⁸ "has been working to the general satisfaction of the local exchange carriers."³⁹ However, South Central Bell points to recent events that have caused dissatisfaction among the pool partners and a need for alternative settlement arrangements.⁴⁰ Among these events, South Central Bell first cites its proposals for intraLATA toll rate reductions, which would also impact other local exchange carriers, unless a "make-whole" provision were required. South Central Bell avows that while other local exchange carriers recognize the need to reduce intraLATA toll rates, they are unwilling to share in any reduced revenue streams triggered by the incentive regulation plan. At the same time, if a make-whole provision were required, then the customers of other local exchange carriers would benefit from lower intraLATA toll rates without a corresponding change in pool settlements. As a result, "one of the principal features of

37 Prefiled Testimony of Leo B. Shoemaker, filed on April 22, 1991, page 2.

38 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.

39 Prefiled Testimony of Leo B. Shoemaker, page 5.

40 Id., pages 5-7 and Transcript of Evidence, pages 8-9.

a pool, that is the proportionate sharing of benefits and costs, is thwarted. . . ."41

South Central Bell next cites the Commission's decision of May 6, 1991 in Administrative Case No. 323, Phase I, finding intraLATA competition in the public interest. Obviously, as a result of that decision, the relative monopoly that local exchange carriers have enjoyed in the intraLATA market will give way to increased competition. According to South Central Bell, such competition will force local exchange carriers to reduce intraLATA toll rates. However, the perceived need to reduce intraLATA toll rates will vary among local exchange carriers as a function of their vulnerability to competition, making the likelihood of a single pricing strategy unrealistic and suggesting the need for more autonomy and flexibility in rate decisions. Indeed, South Central Bell points out that some local exchange carriers do not agree that reduced toll rates are necessary with the advent of intraLATA competition. South Central Bell concludes that:

This shows that there is fundamental disunity among the local exchange carriers in the matter of appropriate intraLATA toll schedules that are commonly applied by the participants in the pool. Thus, the underlying foundation of the present pool, that is a common toll pricing strategy, cannot be maintained in a competitive market.⁴²

South Central Bell then cites the possibility that local exchange carriers could be competing among themselves for

41 Id., page 5.

42 Prefiled Testimony of Leo B. Shoemaker, page 6.

intraLATA toll traffic, which would be contrary to the spirit of "partnership" reflected under existing toll pool settlement arrangements. In summary, "[b]ased on these factors," South Central Bell concludes, "it should be clear that the present intraLATA toll revenue pooling plan is no longer suitable for use in Kentucky and should be replaced."⁴³

Although South Central Bell recommends that existing intraLATA toll pool settlement arrangements should be replaced, it does not make a specific proposal in this docket. Instead, South Central Bell notes that it has been conducting discussions with other local exchange carriers on a new settlement plan and outlines the basic components it believes any new settlement plan should have. These components include flexibility in toll pricing and market participation; bill and keep relationships for both toll and access revenues, with at least one local exchange carrier responsible for end-to-end service in each LATA; equalization of interLATA and intraLATA access charges; and revenue neutrality at the starting point.⁴⁴ South Central Bell moves the Commission to allow discussions among the local exchange carriers on a new intraLATA toll settlement plan to continue, stating:

Historically, the local exchange carriers in Kentucky have negotiated satisfactory toll settlement arrangements among themselves. I believe that they should be permitted to continue this very satisfactory

⁴³ Id., page 7.

⁴⁴ Id., pages 7-9.

tradition. Following this negotiation, the local exchange carriers should report to the Commission the results of their deliberations. If they are unable to reach an agreement the Commission should then review the issues outstanding and assist in their resolution.⁴⁵

The Independent Telephone Group does not oppose continuation of South Central Bell's incentive regulation plan. It does oppose any action the Commission might take concerning intraLATA toll rates that would negatively affect the earnings of its members. The Independent Telephone Group states:

South Central Bell Telephone Company has proposed reductions in intraLATA message telecommunications service rates without a comparable reduction in their intraLATA pool compensation. This would reduce the revenues for the other local exchange carriers in the intraLATA pool without regard to their current financial position. This case is a review of the rates, charges and Incentive Regulation Plan of South Central Bell Telephone Company. The revenue requirements of the other local exchange carriers have not been at issue in this proceeding and they shouldn't be.⁴⁶

The Independent Telephone Group contends that intraLATA toll rate reductions should be implemented so that the revenue streams of other local exchange carriers are not affected.⁴⁷ Without preference, the Independent Telephone Group suggests that revenue neutrality could be accomplished by reducing either the network compensation or non-traffic sensitive compensation that South Central Bell receives from the settlement pool in an amount equal

⁴⁵ Id., page 9 and Transcript of Evidence, pages 9-11.

⁴⁶ Prefiled Testimony of James K. Sharpe, filed on June 14, 1991, page 2 and Transcript of Evidence, pages 19 and 22-23.

⁴⁷ Id., pages 3-8, generally.

to any intraLATA toll rate reductions. The Independent Telephone Group observes that failure to insulate the other local exchange carriers from the impact of intraLATA toll rate reductions could generate unnecessary rate case activity. Conversely, a make-whole mechanism would not prevent intraLATA toll rate reductions.

Finally, the Independent Telephone Group indicates its willingness to negotiate a new intraLATA toll settlement plan, as suggested by South Central Bell.⁴⁸

The comments of Contel and GTE South are consistent with the position of the Independent Telephone Group.

In a related decision, the Commission ruled on revised access services tariff filings and other matters.⁴⁹ In that decision, the Commission described the revenue neutral nature of the tariff filings and related price-outs. Also, subject to certain conditions, the Commission approved a new intraLATA toll settlement plan proposed by the local exchange carriers. Under that plan, in effect, local exchange carriers other than South Central Bell become providers of access services rather than partners in a toll pool arrangement. South Central Bell becomes the intraLATA toll service provider. This plan, in conjunction

⁴⁸ Id., pages 3-4 and Transcript of Evidence, page 20.

⁴⁹ Administrative Case No. 323, Phase I, Order dated January 23, 1992.

with the mechanics of the Joint Motion,⁵⁰ insulates the other local exchange carriers from any negative revenue impact that might occur as a result of the implementation of intraLATA competition and intraLATA toll rate reductions. Therefore, the concerns expressed by South Central Bell, Contel, GTE South, and the Independent Telephone Group about intraLATA toll settlement arrangements have been fully addressed and do not require further analysis or discussion in this decision.

Total Funds Available for Rate Reductions

As discussed above, as a result of the expiration of embedded inside wire amortization expense, \$6,891,000 is available for rate reductions. This amortization expense expired on December 31, 1990. On December 31, 1991, an additional \$813,000 became available and, on December 31, 1992, an additional \$404,000 will become available for rate reductions as a result of expired embedded inside wire amortization expense. These funds should be treated consistent with the Commission's decision on the original expense expiration -- i.e., they should not flow through the sharing mechanism contained in the incentive regulation plan -- and will be applied to rate reductions in this decision.

Also, as discussed above, as a result of the expiration of depreciation reserve deficiency expense, \$17,923,000 is available

⁵⁰ Joint Motion of a Coalition of Local Exchange Companies and Interexchange Carriers. The Joint Motion, both as originally filed and later supplemented, was attached to and incorporated in the Commission's decision of May 6, 1991 in Administrative Case No. 323, Phase I.

for rate reductions. This amortization expense expired on September 30, 1991.

Due to the timing of these expense expirations relative to this decision, funds have accumulated that are owed to ratepayers with interest. Interest is based on the average rate for 3-month commercial paper. The Commission must determine whether these funds should be refunded to subscribers through a credit or cash payment, or discounted for application to rates on a recurring basis. South Central Bell proposed a discount plan over a 40 year period at a discount rate of 9.25 percent.⁵¹ Comments from other parties on this point were very limited. The Commission finds that these funds should be discounted and applied to rate reductions. This will give ratepayers ongoing rather than one-time rate relief.

The Commission also finds that a 3 year discount period is reasonable. This is consistent with the term of the incentive regulation plan and a reasonable approximation of the life of rate changes. The Commission will use the discount rate of 9.25 percent, as it reflects South Central Bell's cost of debt. As of March 3, 1992, this results in an additional \$6,126,000 available for rate reductions, which should not flow through the sharing mechanism contained in the incentive regulation plan.

Under the incentive regulation plan, the February 1991 point-of-test results were filed on May 1, 1991. Exhibits filed

⁵¹ Response of South Central Bell to the Commission's Order dated May 2, 1991, Item 2 and Transcript of Evidence, pages 93-98.

at this point-of-test show \$5,067,000 available for rate reductions. The August 1991 point-of-test results were filed on November 1, 1991. Exhibits filed at this point-of-test show \$4,012,000 available for rate reductions. Again, due to the timing of these points-of-test relative to this decision, funds have accumulated that are owed to ratepayers with interest. In keeping with our earlier holdings, the Commission will discount these funds over a 3 year period at a discount rate of 9.25 percent. As of March 3, 1992, this results in an additional \$1,911,000 available for rate reductions, which should not flow through the sharing mechanism contained in the incentive regulation plan.

In a related decision in Administrative Case No. 323, Phase I,⁵² the Commission ruled on revised access service tariff filings and other matters. In that decision, the Commission described a shift in non-traffic sensitive revenue requirement that will reduce South Central Bell's operating expenses, which would result in a revenue and earnings windfall not attributable to management efficiency absent regulatory action. Consequently, the Commission found that these funds should not flow through the sharing mechanism contained in the incentive regulation plan and ordered that \$9,817,000 be applied to rate reductions in this case.

In summary, total funds available for rate reductions at this time are \$52,966,000.

⁵² Order dated January 23, 1992.

In another decision, the Commission found that residual disbursements from the intraLATA toll settlement pool should cease upon implementation of the decision on intraLATA competition.⁵³ That event will occur on March 3, 1992. Therefore, the Commission will require that South Central Bell include disposition of these funds as part of its February 1992 point-of-test, the results of which are to be filed on May 1, 1992. Moreover, these funds should not flow through the sharing mechanism contained in the incentive regulation plan, as their availability for rate reductions is a result of regulatory action and not management efficiency.

Rate Design Priorities

First, this caveat. As some parties have noted, this record is peppered with revenue calculations that can be both confusing and elusive, due to the variety of rate design proposals that have been sponsored and changing rate and revenue targets. Therefore, all parties should be advised that the revenue calculations discussed below may change as rate targets and, especially, demand quantities change.

The Commission finds that intraLATA toll rates and access charges should be the basic rate design priority, both outside and under the incentive regulation plan. As South Central Bell argued:

⁵³ Id., Order dated May 6, 1991, pages 32-33 and Transcript of Evidence, pages 107-108.

[A]ll of the parties, except the Attorney General, agree that toll and access services should be the first priority for reductions. There is general agreement that the reduction of switched access charges to the interstate level is appropriate. All parties seem to recognize that interstate access is a direct substitute for intrastate access. To discourage the misreporting of percentage interstate use factors and to permit comparable services to be comparably priced, intrastate access charges should be reduced to interstate levels.⁵⁴

Along the same lines:

Local exchange carrier toll rates must be reduced. Consumers are understandably confused when they receive bills for toll calls within Kentucky that are higher than the charges for making calls to more distant interstate locations. In addition, local exchange carrier toll rates are higher in some bands than that of their interexchange carrier competitors. Because the interexchange carrier competitors will soon complete intraLATA message telecommunications service calls as well as interLATA message telecommunications service calls, local exchange carriers must respond to their lower prices.⁵⁵

AT&T and MCI also support intraLATA toll and access rate reductions, although there is disagreement as to specific amounts and implementation ratios. The only party that opposes intraLATA toll and access rate reductions as the basic rate design priority is the Attorney General. However, even the Attorney General provides for intraLATA toll and access rate reductions, supra. While the reasons for the Attorney General's priority structure may have merit in other circumstances, in this instance, the Commission has the rare opportunity to make significant intraLATA toll and access rate reductions without the need to offset such

⁵⁴ Brief of South Central Bell, filed on August 5, 1991, pages 4-5, citations omitted.

⁵⁵ Id., page 5, citations omitted.

reductions with increases to local exchange access or other local exchange rates.⁵⁶ It is an opportunity that should be taken and maximized.

South Central Bell proposed to reduce intraLATA toll rates in the amount of \$52,063,000. This includes both message and wide area telecommunications services. Also, South Central Bell proposed to reduce intrastate access charges in the amount \$21,055,000. Total proposed rate reductions are \$73,118,000.⁵⁷ According to calculations based on price-out information provided by South Central Bell, there is \$6,629,000 included in proposed message toll rate reductions that is designed to produce a 12 percent discount from MCI's interstate message toll rates.⁵⁸ However, South Central Bell provided insufficient evidence to support the discount. Otherwise, the Commission finds that the amounts targeted to intraLATA toll and access rate reductions are reasonable. This action reduces proposed intraLATA toll rate

56 Compare Transcript of Evidence, pages 183-187.

57 $\$52,063,000 + \$21,055,000 = \$73,118,000$.

58 A price-out of South Central Bell's message toll demand at MCI's current interstate message toll rates yields a revenue reduction of \$42,770,000. Therefore, $\$49,399,000 - \$42,770,000 = \$6,629,000$. The \$49,399,000 is the message toll revenue reduction computed by South Central Bell. See South Central Bell's response to the Commission's Order dated May 2, 1991, Item 11. Adding wide area telecommunications service to the calculation will not substantially change the result.

reductions to \$45,434,000.⁵⁹ Accordingly, total proposed rate reductions are changed to \$66,489,000.⁶⁰

Clearly, the market restrictions under which South Central Bell operates as a result of the divestiture decree place South Central Bell at a competitive disadvantage vis-a-vis other interexchange carriers not subject to the same restrictions. However, as South Central Bell admits, at least at this point, placing a quantitative value on the disadvantage is a matter of judgement.⁶¹ Moreover, as the Attorney General and other parties argued, South Central Bell's vulnerability to competition will be generally limited to "10XXX" dialing until intraLATA "1+" dialing is implemented on a presubscribed equal access basis. This argument is not as persuasive as the lack of concrete evidence supporting a discount, since "autodialers" and other features available in customer premises equipment make the 10XXX dialing pattern transparent to end-users. The lack of concrete evidence on price sensitivity, consumer preference, or expected changes in market share that might support a discount suggests a course of prudence and reconsideration when such evidence becomes available.

The Commission will not implement intraLATA toll and access rate reductions as proposed by any party, although there is some

⁵⁹ $\$52,063,000 - \$6,629,000 = \$45,434,000.$

⁶⁰ $\$45,434,000 + \$21,055,000 = \$66,489,000.$

⁶¹ See South Central Bell's response to the Commission's Order dated May 2, 1991, Item 4(a).

overlap with various positions. Instead, the Commission will implement these rate reductions consistent with the Joint Motion and related decisions in Administrative Case No. 323, Phase I, except as specified below.⁶²

Consequently, some initial observations are in order. First, the Joint Motion and related decisions require that rates for access services apply equally to all interexchange carriers, both interLATA and intraLATA. Therefore, the rate reductions authorized in this decision should be implemented consistent with the standard of equal rates per unit of traffic. Second, also as a result of the Joint Motion and related decisions, intrastate switched access charges will mirror interstate switched access charges, upon approval of pending tariff filings. Thus, reductions to switched access charges in this decision would result in interstate rates higher than intrastate rates. While such an outcome might be desirable for any number of reasons, no request for it has been made and no need for it has been demonstrated in this investigation. Therefore, the rate reductions authorized in this case should be applied to non-traffic sensitive revenue requirement, which is recovered through charges to terminating switched access minutes of use. Third, the Commission has required South Central Bell to impute the price of access in setting intraLATA toll rates. Therefore,

⁶² Orders dated May 6, 1991 and January 23, 1992.

the rate reductions authorized in this decision should be implemented consistent with imputation requirements.

In Administrative Case No. 323, Phase I, South Central Bell reported interLATA terminating switched access minutes of use of 282,858,000 and intraLATA terminating switched access minutes of use of 346,319,000 or an intrastate total of 629,177,000.⁶³ South Central Bell reported a non-traffic sensitive revenue requirement of \$83,620,000.⁶⁴ Calculations yield a rate of 13.29 cents per minute of use to recover non-traffic sensitive revenue requirement.⁶⁵ In this case, South Central Bell reported an imputation requirement of 5.61 cents per minute of use, based on the Commission's decision of May 6, 1991 in Administrative Case No. 323, Phase I.⁶⁶ Further calculations yield an average intraLATA toll revenue of 27.52 cents per minute of use.⁶⁷

63 Id. See South Central Bell's price-out filed on August 15, 1991. $282,858,000 + 346,319,000 = 629,177,000$.

64 Id.

65 $\$83,620,000 / 629,177,000 = \0.1329 .

66 See South Central Bell's response to the Commission's Order dated October 25, 1991, Item 10(a).

67 $\$169,294,000 / 152,667,000 = \1.1089 . Also, $\$1.1089 / 4.03 = \0.2752 . Toll revenues and messages in the first calculation were derived from South Central Bell's response to the Commission's Order dated May 2, 1991, Item 11. The average length of call in the second calculation was derived from South Central Bell's response to the Commission's Order dated October 25, 1991, Item 10(a).

Accordingly, in the case of South Central Bell,⁶⁸ revenue associated with intraLATA toll usage equals \$95,307,000.⁶⁹ Against that revenue stream, South Central Bell must impute an access cost of \$19,428,000⁷⁰ and recover another \$46,026,000⁷¹ in non-traffic sensitive revenue requirement, or recover a total cost of \$65,454,000.⁷² Based on this analysis, from an access charges perspective, toll revenue in excess of total cost is \$29,853,000.⁷³

The Commission finds that an initial reduction to intraLATA toll rates should be made in this amount, which leaves \$23,113,000⁷⁴ in current funds available for further rate

68 An argument could be made that this analysis should include values representing all intraLATA toll pool participants. It does not for several reasons. First, as the result of a related decision in Administrative Case No. 323, Phase I, the intraLATA toll pool will be replaced by a new settlement agreement that ends the prior toll pool partnership. Second, South Central Bell is not responsible for recovering either the traffic or non-traffic sensitive revenue requirements of other local exchange carriers. Third, proposed intraLATA toll rate reductions are based on industry-wide estimates. Therefore, generally, industry-wide affects should be embedded in them.

69 $346,319,000 \times \$0.2752 = \$95,306,989$. This amount compares favorably with the price-out in South Central Bell's response to the Commission's Order dated May 2, 1991, Item 11.

70 $346,319,000 \times \$0.0561 = \$19,428,496$.

71 $346,319,000 \times \$0.1329 = \$46,025,795$.

72 $\$19,428,000 + \$46,026,000 = \$65,454,000$.

73 $\$95,307,000 - \$65,454,000 = \$29,853,000$.

74 $\$52,966,000 - \$29,853,000 = \$23,113,000$.

reductions. This amount should be applied to non-traffic sensitive revenue requirement. Accordingly, South Central Bell's non-traffic sensitive revenue requirement is reduced from \$83,620,000 to \$60,507,000.⁷⁵ The Commission finds that the remaining \$23,113,000 in current funds available for further rate reductions should be split between intraLATA toll rates and access charges paid by other interexchange carriers, in such a way that intended rate reductions are achieved and the equal rate per unit of traffic standard is maintained.

Additional reductions to intraLATA toll rates cannot be made without reducing non-traffic sensitive revenue requirement. This is due to the intrastate mirroring of interstate switched access services rates and the initial rate reduction discussed above. However, reducing non-traffic sensitive revenue requirement poses a problem. The problem is assuring that the equal rate per unit of traffic standard is not violated. The problem arises as a result of the relative terminating switched access minutes of use carried by South Central Bell vis-a-vis the other interexchange carriers and the recovery of non-traffic sensitive revenue requirement through both intraLATA toll rates and access charges paid by other interexchange carriers. For example, simple application of \$23,113,000 to non-traffic sensitive revenue requirement would not result in an equivalent cost reduction to other interexchange carriers or an equivalent revenue reduction to

⁷⁵ \$83,620,000 - \$23,113,000 = \$60,507,000.

South Central Bell. Only that portion captured through usage generated by other interexchange carriers would appear as a cost reduction to them and a revenue reduction to South Central Bell. In effect, absent a corresponding reduction to intraLATA toll rates, South Central Bell would be capturing too much non-traffic sensitive revenue, through a higher effective rate than charged to other interexchange carriers.

Based on the ratio of terminating switched access minutes of use reported in Administrative Case No. 323, Phase I, at the starting point of intraLATA competition, non-traffic sensitive revenue requirement attributable to South Central Bell is 55.04⁷⁶ percent of the total requirement. Inversely, the amount attributable to other interexchange carriers is 44.96⁷⁷ percent of the total requirement. Accordingly, intraLATA toll rates should be reduced an additional \$12,721,000.⁷⁸ Access charges paid by other interexchange carriers should be reduced by \$10,392,000.⁷⁹ This results in an equal rate per unit of traffic at the starting point of intraLATA competition.

The total reduction to intraLATA toll rates made is \$42,574,000.⁸⁰ This revenue reduction will allow South Central

⁷⁶ $346,319,000 / 629,177,000 = 0.5504\%$.

⁷⁷ $282,858,000 / 629,177,000 = 0.4496\%$.

⁷⁸ $\$23,113,000 \times 0.5504\% = \$12,721,395.$

⁷⁹ $\$23,113,000 \times 0.4496\% = \$10,391,605.$

⁸⁰ $\$29,853,000 + \$12,721,000 = \$42,574,000.$

Bell to approximate MCI's current interstate message toll rates. At the same time, it allows for equitable reductions to access charges based on market characteristics, actual rate application, and imputation requirements. The total reduction made to access charges in the form of non-traffic sensitive revenue requirement is \$23,113,000.⁸¹ As previously mentioned, this amount is split between South Central Bell and the other interexchange carriers. The rates resulting from these revenue reductions are specified in Appendices A and B.

The revenue reductions made leave further authorized reductions of \$2,860,000⁸² to intraLATA toll rates, allowing South Central Bell to match MCI's current interstate message toll rates, and \$10,663,000⁸³ to access charges, or a total of \$13,523,000 in further authorized reductions⁸⁴ and a toll to access ratio of 0.27:1.⁸⁵ In order to maintain the equal rate per unit of traffic standard, further rate reductions should be allocated at each point-of-test based on the market shares discussed above, which is the same as a 1.22:1 ratio.⁸⁶

⁸¹ $\$12,721,000 + \$10,392,000 = \$23,113,000.$

⁸² $\$45,434,000 - \$42,574,000 = \$2,860,000.$

⁸³ $\$21,055,000 - \$10,392,000 = \$10,663,000.$

⁸⁴ $\$2,860,000 + \$10,663,000 = \$13,523,000.$

⁸⁵ $\$2,860,000 / \$10,663,000 = 0.2682.$

⁸⁶ $0.5504\% / 0.4496\% = 1.2242.$

However, going forward from the starting point of intraLATA competition, undoubtedly, market shares will change. In fact, all other things equal, it is likely that South Central Bell's market share will decrease as the market share of the other interexchange carriers increases. Also, use of the 1.22:1 ratio would not permit rate reduction objectives to be accomplished at the same time and would result in lower allocations to access charges at each point-of-test than could otherwise be obtained. Given the relative proximity of each amount to targeted rate reductions, the Commission will require that further rate reductions at each point-of-test be made between intraLATA toll rates and access charges at a 0.27:1 ratio, even though it conflicts with the equal rate per unit of traffic standard. The Commission expects that this effect will be short-term in nature and should not cause a competitive disadvantage to any interexchange carrier.

The second rate design priority should be zone charges, both outside and under the incentive regulation plan. As the distance sensitivity and maintenance cost of the local loop has declined, the existing rate structure may inhibit demand for vertical services such as custom calling features, and the existing rate structure may inhibit telephone subscription by making rural service unaffordable, supra. The cost and demand arguments notwithstanding, it is clear that zone charges impose a financial burden that may inhibit telephone subscription. Such an effect is not desirable and should be corrected as funds become available.

The end objective should be the elimination of zone charges, which will require approximately \$17,507,000.⁸⁷

The Commission will allow South Central Bell to reduce zone charges essentially as proposed. That is, first, eliminate rate differentials for party line service by reducing zone charges for 1-party service to 2-party levels, except zone 1 1-party charges, where the rate is \$2.20 per month. This requires \$4,628,000. Second, consolidate zones 4 and 5 into zone 3. This requires \$2,288,000. Third, reduce all zone charges to \$2.00, except zone 1 2-party charges, where the rate is \$1.30 per month. This requires \$4,973,000. Lastly, eliminate zone charges. This requires \$5,618,000.

The third rate design priority should be touch tone charges, both outside and under the incentive regulation plan. Touch tone charges should be reduced because they may inhibit demand for enhanced services such as voice mail, supra. They should also be reduced because touch tone technology has become integral to network architecture and may be inappropriate in a digital switching environment. The objective should be elimination of touch tone charges.

South Central Bell's evidence indicates that \$11,000,000 is required to eliminate touch tone charges for both business and

⁸⁷ For this and other calculations related to zone charges in the following paragraph, see South Central Bell's response to the Attorney General's information request dated May 2, 1991, Item 1(b).

residence customers.⁸⁸ However, price-out information furnished to the Attorney General shows that \$14,599,000 is required.⁸⁹ The Commission will use the latter estimate because the support for it is more complete. Of this amount, \$9,521,000 is needed to eliminate residence touch tone charges and \$5,077,000 is needed to eliminate business touch tone charges. Available funds should be applied to residence touch tone charges until eliminated and then applied to business touch tone charges until eliminated. As with zone charges, this approach to the reduction and eventual elimination of touch tone charges should encourage telephone subscription.

The fourth rate design priority should be grouping charges. Grouping charges should be reduced because the current rate structure reflects value-of-service rather than cost-of-service distinctions, supra.

South Central Bell proposed to reduce grouping charges from 55 percent of applicable individual line exchange access rates to a statewide flat rate of \$15.00 for business customers and \$5.00 for residence customers. South Central Bell's evidence indicates that this proposal requires \$4,600,000.⁹⁰ However, price-out

⁸⁸ For example, amended prefiled testimony of James C. Wilkerson, revised exhibit 1 schedule 3.

⁸⁹ South Central Bell's response to the Attorney General's information request dated May 2, 1991, Item 1(d).

⁹⁰ For example, amended prefiled testimony of James C. Wilkerson, revised exhibit 1 schedule 3.

information furnished to the Attorney General shows that \$5,738,000 is required.⁹¹ As with touch tone charges, the Commission will use the latter estimate because the support for it is more complete. Of this amount, \$11,000 is needed to accomplish the residence target and \$5,727,000 is needed to accomplish the business target. Total revenue associated with residence grouping charges is \$28,000. Given these circumstances, residence grouping charges should be eliminated before available funds are applied to the business target for grouping charges. The total requirement is changed to \$5,755,000.

Finally, there is established exchange access line rates as a residual category for rate reductions in the unlikely event that all other objectives are accomplished.

Though not anticipated, in the event of rate increases resulting from the incentive regulation plan, late payment charges may be increased by \$2,000,000; directory assistance charges by \$2,000,000; miscellaneous charges by \$1,000,000; and exchange access line rates on a residual basis.

The Attorney General objected to South Central Bell's menu of proposed rate increases. His position is that rates that have been decreased should be the first subject to rate increases, based on the theory that such linkage will encourage management efficiency. Arguably, this may be true. However, the countervailing risk is to undo rate design objectives that have

⁹¹ South Central Bell's response to the Attorney General's information request dated May 2, 1991, Item 1(c).

merit independent of one's view as to whether management is acting efficiently or inefficiently. The sharing mechanism contained in the incentive regulation plan should be sufficient to encourage management efficiency.

The above rate design priorities are summarized in Appendices C and D.

Miscellaneous Issues

AT&T asks that the Commission convene a generic proceeding to determine appropriate rate design methodologies for South Central Bell's service offerings.⁹² According to AT&T, a generic proceeding is necessary to define appropriate price relationships and contribution levels among South Central Bell's service offerings.

The Commission will not docket a case to investigate and determine a specific and unbending rate design methodology. Although reasonable cost documentation, price relationships, and contribution levels are always desirable, subject to the constraints of applicable protective agreements, the same information is generally open to the scrutiny of intervenors in any given case. Moreover, flexibility in pricing decisions is equally desirable, since service offerings may not share interchangeable cost components or demand characteristics.

Lastly, AT&T filed comments concerning access imputation requirements, noting that the greater the level of aggregation

⁹² Prefiled Testimony of L. G. Sather, pages 1-2 and 8-11, generally.

used for imputation purposes, the lower the imputed cost of access. These comments are more appropriate to a related decision in Administrative Case No. 323, Phase I and need not be addressed here, except to say that this and the other decision are compatible.

ORDERS

Having considered the evidence of record and being otherwise sufficiently advised, the Commission HEREBY ORDERS that:

1. South Central Bell shall include disposition of residual funds from the expired intraLATA pool settlement arrangement as part of its February 1992 point-of-test under the incentive regulation plan, the results of which are to be filed on May 1, 1992. These funds shall not flow through the sharing mechanism contained in the incentive regulation plan.

2. Funds available for rate reductions at this time are \$52,966,000.

3. IntraLATA toll rates shall be reduced in the amount of \$42,574,000, as specified in Appendix A, effective March 3, 1992.

4. Access charges in the form of non-traffic sensitive revenue requirement shall be reduced \$23,113,000, as specified in Appendix B, effective March 3, 1992.


5. South Central Bell shall file revised tariff pages showing the rates and charges authorized herein on or before February 3, 1992.

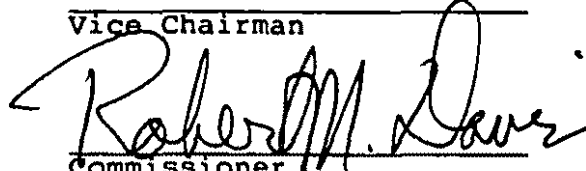
6. Funds available outside and under the incentive regulation plan shall be applied to rate reductions at each point-of-test as discussed herein and specified in Appendix C.

7. Priorities for rate increases under the incentive regulation plan shall be as discussed herein and specified in Appendix D.

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

PUBLIC SERVICE COMMISSION


Chairman

Vice Chairman

Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 90-256, PHASE II, DATED 1/23/92

The following rates and charges are prescribed for the customers in the area served by South Central Bell Telephone Company and other common carriers concurring in its message and wide area telecommunications service tariffs, effective February 1, 1992. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

GENERAL SUBSCRIBER SERVICES TARIFF

A18. LONG DISTANCE MESSAGE TELECOMMUNICATIONS SERVICE

A18.3 Two-Point Service

A18.3.1 Service Between Lane Wire Telephones

B. Rates and Charges

2. Basic Rate Schedule

b. Basic Rate Schedule (Day Rate Period)

(1) Rate Mileage

	<u>Initial Minute</u>	<u>Additional Minutes, Each or Fraction Thereof</u>
(a) 0-10 miles	\$.1775	\$.1400
(b) 11-16 miles	.1875	.1875
(c) 17-22 miles	.1875	.1875
(d) 23-30 miles	.1975	.1975
(e) 31-40 miles	.1975	.1975
(f) 41-55 miles	.1975	.1975
(g) 56-70 miles	.2155	.2155
(h) 71-85 miles	.2155	.2155
(i) 86-100 miles	.2155	.2155
(j) 101-124 miles	.2155	.2155
(k) 125-148 miles	.2155	.2155
(l) 149 + miles	.2155	.2155

A19. WIDE AREA TELECOMMUNICATIONS SERVICE

A19.5 Rate and Charges

A19.5.4 Monthly Rates and Charges

A. Hourly Rates

The following hourly rates apply to the average use of each access line in a service group or total Option 800 Service (IntraLATA Only 800 Service) usage terminating on an exchange line(s). These rates are applied according to the method specified in A19.5.5 following.

1. Combined Outward WATS and Outward WATS - IntraLATA Service (Average hours of use per line)

	<u>Rate Per Hour</u>
(a) 0-15 Hours	\$10.20
(b) 15.1 - 40 Hours	8.90
(c) 40.1 - 80 Hours	6.95
(d) 80.1 - 140 Hours	5.00
(e) 140.1 - 200 Hours	5.00
(f) Over 200 Hours	5.00

2. Combined 800 Service (Inward WATS) and Option 800 Service (IntraLATA only 800 Service (Average hours of use per line)

	<u>Rate Per Hour</u>
(a) 0-15 Hours	\$11.50
(b) 15.1 - 40 Hours	9.95
(c) 40.1 - 80 Hours	8.95
(d) 80.1 - 140 Hours	7.95
(e) 140.1 - 200 Hours	6.95
(f) Over 200 Hours	5.95

B. Monthly Access Line Rates

2. The following rates apply for each access line per month (in addition to the monthly usage charges specified in A19.5.5. following):

	<u>Monthly Rate</u>
(a) Outward WATS - IntraLATA Service only	\$25.00
(b) Combined Outward WATS	25.00
(e) Combined 800 Service	25.00
(f) Option 800 Service (IntraLATA Only 800 Service)	25.00

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 90-256, PHASE II, DATED 1/23/92

The following rates and charges are prescribed for the customers in the area served by South Central Bell Telephone Company, effective March 3, 1992. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Non Traffic Sensitive Revenue Requirement

1991 Non-Traffic Revenue Requirement as Reported in Administrative Case No. 323, Phase I	\$83,620,000
Less	<u>23,113,000</u>
Revised 1991 Non-Traffic Sensitive Revenue Requirement	<u>\$60,507,000</u>

Non-Traffic Sensitive Revenue Requirement per Access Line (\$60,507,000 / 901,283 / 12)	\$ 5.5945
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Non-Traffic Sensitive Revenue Requirement per Terminating Switched Access Minute of Use (\$60,507,000 / 629,177,000)	\$ 0.0962
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APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 90-256, PHASE II, DATED 1/23/92

The following schedule of rate reduction priorities is prescribed for the customers in the area served by South Central Bell Telephone Company and other common carriers concurring in any affected tariff. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Rate Reduction Priorities

1. IntraLATA toll rates shall be reduced a total of \$2,860,000 and access charges in the form of non-traffic sensitive revenue requirement shall be reduced a total of \$10,663,000 at a ratio of 0.27:1 at each point-of-test until this objective is achieved.
2. Zone charges shall be reduced a total of \$4,628,000 or the amount necessary to eliminate rate differentials for party line service by reducing zone charges for 1-party service to 2-party levels, except zone 1 1-party charges, at each point-of-test until this objective is achieved.
3. Zone charges shall be reduced a total of \$2,288,000 or the amount necessary to consolidate zones 4 and 5 into zone 3 at each point-of-test until this objective is achieved.
4. Zone charges shall be reduced a total of \$4,973,000 or the amount necessary to reduce all zone charges to \$2.00, except zone 1 2-party charges, at each point-of-test until this objective is achieved.
5. Zone charges shall be reduced a total of \$5,618,000 or the amount necessary to eliminate zone charges at each point-of-test until this objective is achieved.
6. Touch tone charges shall be reduced a total of \$9,521,000 or the amount necessary to eliminate residence touch tone charges at each point-of-test until this objective is achieved.

7. Touch tone charges shall be reduced a total of \$5,077,000 or the amount necessary to eliminate business touch tone charges at each point-of-test until this objective is achieved.
8. Grouping charges shall be reduced a total of \$28,000 of the amount necessary to eliminate residence grouping charges at each point-of-test until this objective is achieved.
9. Grouping charges shall be reduced a total of \$5,727,000 of the amount necessary to reduce business grouping charges to a statewide flat rate of \$15.00 at each point-of-test until this objective is achieved.
10. Exchange access line rates shall be reduced in the amount of any residual funds available at each point-of-test after all of the above objectives have been achieved.

APPENDIX D

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 90-256, PHASE II, DATED 1/23/92

The following schedule of rate increase priorities is prescribed for the customers in the area served by South Central Bell Telephone Company and other common carriers concerning in any affected tariff. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

Rate Increase Priorities

1. Late payment charges shall be increased a total of \$2,000,000 at each point-of-test until this objective is achieved.
2. Directory assistance charges shall be increased a total of \$2,000,000 or the amount necessary to eliminate call allowances at each point-of-test until this objective is achieved.
3. Miscellaneous charges shall be increased a total of \$1,000,000 through across-the-board rate adjustments at each point-of-test until this objective is achieved.
4. Exchange access line rates shall be increased in the amount of any residual requirement at each point-of-test after all of the above objectives are achieved.