COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

INTERIM ORDER

INTRODUCTION

In Administrative Case No. 261,[1] the Commission found that the resale of intrastate WATS[2] was in the public interest. In Administrative Case No. 273,[3] the Commission found that interLATA[4] facilities-based toll competition was in the public interest, but found that intraLATA facilities-based toll competition was not in the public interest because the evidence was not sufficient to conclude that such competition was viable and sustainable and because such competition could threaten universal service and the financial viability of local exchange carriers.[5] However, the

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1 Administrative Case No. 261, An Inquiry Into the Resale of Interstate Wide Area Telecommunications Service.

2 Wide Area Telecommunications Service.

3 Administrative Case No. 273, An Inquiry Into Inter- and IntraLATA Intrastate Competition in Toll and Related Services Markets in Kentucky.

4 Local Access and Transport Area.

5 Administrative Case No. 273, Order dated May 25, 1984, pages 11-17.

Commission indicated that it would monitor the evolution and growth of competition in the interstate and interLATA markets and reconsider the issue at a later time. The issue has been reconsidered through this investigation.

In determining whether, and to what extent, intraLATA competition is in the public interest, it is critical to consider matters of federal and state law.

The federal court case associated with the Modified Final Judgment (the divestiture of AT&T), U. S. v. American Telephone and Telegraph Company, 552 F.Supp. 131 (1982), reserved to the state regulatory commissions the decision of whether intraLATA competition should be permitted or whether a monopoly should be maintained.

> Nothing in the proposed decree would require a State to replace its regulatory system with a system of competition: it may continue to require a regulated monopoly in, say, local telephone service or intrastate toll service.

552 F.Supp. at 159, fn. 117.

Thus, there is no federal mandate requiring or prohibiting intraLATA competition. The court-created system of LATA's was a means to contain the recently divested "Baby Bells," not a protection for exclusive rights to serve. The public interest determination should be based on state law.

South Central Bell argues that as long as it provides adequate service, it has a legal right to exclusively provide service. South Central Bell cites Brandenburg Telephone Company v. South Central Bell Telephone Co., 506 S.W.2d 513 (Ky., 1974), for the proposition that another utility cannot be authorized to

serve an area which a utility has certificated authority to serve in the absence of a showing of substantial inadequacy of existing service. However, this case dealt not with intraLATA competition but rather with the provision of local telephone service as between two companies desiring to provide that service.

South Central Bell asserts that under the traditional "compact" theory, it has a right to serve exclusively so long as meets its obligations. This compact theory is especially reflected in KRS 278.030 (1) and (2) which states:

> (1) Every utility may demand, collect and receive fair, just and reasonable rates for the services rendered or to be rendered by it to any person.
>
> (2) Every utility shall furnish adequate, efficient and reasonable service, and may establish reasonable rules governing the conduct of its business and the conditions under which it shall be required to render service.

But, the statutory standards of KRS 278.030 must be upheld whether intraLATA toll service is provided by a monopoly or on a competitive basis.

It is clear from Kentucky case law that, "[w]hether, in the overall public interest, competition has advantages that offset those of a monopoly is a question our legislature has chosen to leave to the decision of the Public Service Commission." Kentucky Utilities Company v. Public Service Commission, 390 S.W.2d. 168, 174 (Ky., 1965). In that case, the Commission granted a certificate to construct facilities to a "newcomer" utility after finding the existing facilities were inadequate. Further, the court stated:

> [T]here is no suggestion that this will result in any serious rate disadvantage to the consumers of the existing utilities. In substance the argument is that competition is bad in the public power field and that the public interest is best served through a large regulated monopoly. While it may be conceded that a large monopoly is in theory capable of rendering cheaper and more efficient service, there are other considerations that enter into the question of whether the monopoly system best serves the public interest. There has been no declaration of public policy of this state that the type of ownership that will provide the lowest rates is the only type of ownership that will be permitted to operate a utility service. (citation omitted)
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> As we view it, if the newcomer's proposal is feasible (capable of supplying adequate service at reasonable rates) and will not result in wasteful duplication, the Public Service Commission is authorized to grant a certificate to the newcomer. The Commission is not restricted to making a close comparison of whose rates will be lowest and whose service will be most efficient. Cf. Public Service Commission v. Cities of Southgate, etc., Ky., 268 S.W.2d 19. The existing utilities have no absolute right to supply the inadequacy. East Kentucky [Kentucky Utilities Company v. Public Service Commission, 252 S.W.2d 885]. Nor do they have any right to be free of competition. Tennessee Electric Power Company v. Tennessee Valley Authority, 306 U.S 118, 59 S.Ct. 366, 83 L.Ed. 543.

390 S.W.2d at 174, 175.

Accordingly, the Commission is authorized to determine that intraLATA toll competition is in the public interest and to proceed toward its implementation.

As in Administrative Case No. 273, the basic question before the Commission is whether intraLATA facilities-based toll competition is in the public interest. In other words, is such competition viable and sustainable and do the economic benefits of such competition outweigh any impact on universal service and the financial viability of local exchange carriers? The Commission

has studied information in the record of evidence and pondered the testimony of expert witnesses, and finds that a prima facie case exists that intraLATA facilities-based toll competition will be viable, sustainable, and is in the public interest.

Generally, the parties agree that effective competition exists in the interstate and interLATA markets, and that effective competition can exist in the intraLATA market, especially with appropriate regulatory oversight. As evidence of effective competition, AT&T, for example, cites (1) the large number of firms that purchase access from local exchange carriers nationwide and in Kentucky, (2) the ample supply of transmission capacity available to interexchange carriers, and (3) the presence of price sensitive consumers in the market.

Furthermore, the Commission finds that a prima facie case exists that allowing intraLATA facilities-based toll competition will not materially impact either universal service or the financial viability of local exchange carriers. A number of factors should mitigate any negative impact as a result of lost toll contribution. First, any negative impact can be mitigated through implementation plans to be developed later, as well as through cases to adjust earnings and/or restructure rates, or through consolidation of exchange boundaries. Second, the earnings of most local exchange carriers are robust and, generally, the earnings impact will be negligible. Third, stimulation of demand for access services will offset some lost toll contribution. Lastly, assuming that South Central Bell's maximum estimate of lost toll contribution is accurate and that

the entire amount must be recovered through local service rates, the impact per access line would not materially affect the number of access lines in service, because demand for local exchange service is price inelastic in the zone of likely impact.

The Commission is of the opinion that the benefits of intra-LATA facilities-based toll competition will likely outweigh any threat to universal service or the financial viability of local exchange carriers. These benefits include (1) increased production efficiency, (2) lower toll prices, (3) more rapid deployment of new technology, and (4) increased consumer choices.

In order to fully exploit the benefits of competition, it should extend to equal access on a presubscribed basis and include intraLATA interexchange private line service, intraLATA interexchange message toll services, and intraLATA interexchange operator services. Equal access conversion and presubscription balloting will result in some expense to local exchange carriers. The evidence indicates that such expense will be relatively minor. The Commission will consider an expense recovery mechanism in the implementation portion of this investigation.

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that:

1. A prima facie case exists that intraLATA facilities-based toll competition will be in the public interest; and

2. Such competition should extend to equal access on a presubscribed basis and include intraLATA interexchange private line service, intraLATA interexchange message toll services, and intraLATA interexchange operator services.

IT IS THEREFORE ORDERED that the implementation phase of this case shall proceed apace.

This is an Interim Order, not final and appealable.

Done at Frankfort, Kentucky, this 29th day of March, 1990.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director