

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PROPOSED SPECIAL CONTRACT OF SOUTH)
CENTRAL BELL TELEPHONE COMPANY ON)
BEHALF OF THE LOCAL EXCHANGE CARRIER) CASE NO. 95-151
TELEPHONE GROUP FOR THE KENTUCKY)
INFORMATION HIGHWAY RFP ET-41-95)

O R D E R

On March 17, 1995, South Central Bell Telephone Company ("South Central Bell"), on behalf of the Local Exchange Carrier Telephone Group ("LECTG"), filed with the Commission the special contract awarded to it by the Commonwealth of Kentucky. On March 30, 1995, AT&T Communications of the South Central States ("AT&T") sought full intervention and a hearing. AT&T was granted intervention on April 6, 1995, and a hearing was set for May 22, 1995. MCI Telecommunications Corporation ("MCI") subsequently intervened on April 14, 1995. On May 22, 1995, in response to motions of the intervenors, the Commission granted certain representatives of AT&T and MCI access to confidential information pertaining to the special contract and continued the hearing to May 30, 1995.

The intervenors contend that the contract should be rejected.¹ They allege, inter alia, that the contract rates are

¹ AT&T has suggested that, in the alternative, the Commission should require South Central Bell to take its revenues and costs associated with the contract out of regulated rate base and to offer the service "below the line." See, e.g., Prefiled Testimony of L.G. Sather, at 20.

discriminatory, that South Central Bell has failed to observe the Commission-mandated imputation standard, and that the contract rates will be subsidized by other Kentucky ratepayers.

In Administrative Case 323, Order dated January 23, 1992, the Commission stated that 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 as are interexchange carriers."² AT&T points out that the message telephone service ("MTS" or toll) imputation requirement of \$0.561 as calculated by South Central Bell in response to a Commission data request in Case No. 90-256³ is higher than the \$0.045 MTS rate offered in the special contract for the majority of LECTG traffic.⁴ In addition, the \$0.045 rate is lower than all of the other local exchange carriers' access charges to interexchange carriers.⁵ AT&T concludes that South Central Bell has failed to impute to itself the appropriate access charges for

² Administrative Case No. 323, An Inquiry Into IntraLATA Toll Competition, An Appropriate Compensation Scheme For Completion Of IntraLATA Calls By Interexchange Carriers, And WATS Jurisdictionality, Order dated January 23, 1992, at 14-15.

³ Case No. 90-256, A Review of the Rates and Charges and Incentive Regulation Plan of South Central Bell Telephone Company: South Central Bell Telephone Company's Response to Request No. 10 and Supplemental Response to Request No. 2 of Commission Order dated September 30, 1991, Item Nos. 10(a) and 10(b).

⁴ Motions of AT&T for Full Intervention and a Hearing, filed March 30, 1995, at 7.

⁵ Id., Attachment A.

switched traffic, and has instead developed its rates using only its costs for originating and terminating switched access.⁶

In response, South Central Bell explained that the contract prices are based upon projections and calculations that have enabled it to arrive at appropriate statewide rates that include the rate elements required by Administrative Case 323. The voice network has both dedicated and switched network components.⁷ The dedicated portion of the network is an Electronic Tandem Network ("ETN") made up of various ETN nodes throughout the state. These nodes facilitate the interconnection of various state government Private Branch Exchanges ("PBXs") or ESSX/CentraNet locations. The PBX or ESSX/CentraNet locations are connected to ETN nodes through dedicated, private-line based facilities.

Administrative Case 323 does not require LECs to impute access charges for private line services. Instead, it requires them to impute to themselves access elements that would apply "were they charged for access as are interexchange carriers."⁸ As South Central Bell states, imputation for dedicated services is unnecessary because interexchange carriers may use alternatives to LEC access services such as competitive access providers.⁹

⁶ Post-Hearing Brief of AT&T, filed June 8, 1995, at 4-5.

⁷ Prefiled Testimony of South Central Bell Witness Steve Rausch, at 2.

⁸ Order dated January 23, 1992, at 14-15.

⁹ Brief of BellSouth Telecommunications, Inc., d/b/a South Central Bell Telephone Company, For Itself and On Behalf of The Local Exchange Carrier Telephone Group, filed June 8, 1995, at 8. See also Transcript, at 100.

Accordingly, the imputation requirement applies only to switched MTS, which includes only traffic from the point that it enters the public switched network. On-network calls, since they are carried on dedicated facilities, do not have an imputation standard.

South Central Bell's pricing formulas are based upon call origination. Those calls originating on the network are referred to as Category A traffic; those originating off the network are referred to as Category B traffic.¹⁰ The two categories are priced differently. Moreover, South Central Bell's pricing formulas take into account the fact that not all state government calls will be pure (originating and terminating) network calls or ordinary toll calls (off-network originating calls). Some will consist of a mixture using a combination of private and public switched networks. Any state government call originating from network dedicated equipment is an on-network call, and only when a call goes onto the public switched network does imputation apply.

For "off network" calls (Category "B" calls), which are subject to the imputation requirement, South Central Bell's contract rate is \$0.076 per conversation minute. The \$0.076 rate was developed by analyzing the contribution as if the LECTG had not won the contract for the voice network, compared to what it would receive from the Category B rate if it were awarded the bid.¹¹ This analysis was based on what South Central Bell considered a

¹⁰ Transcript, at 140.

¹¹ Prefiled Testimony of South Central Bell Witness Steve Rausch, at 6.

realistic assessment of where an IXC would use its special and switched access, billing and collection services, and South Central Bell's and GTE's costs of providing high volume toll service. It also took into account the access payments made to other LECs.¹² The off-network rate appears reasonable and meets the imputation standard. It is significantly higher than the \$.0561 MTS rate imputation in Case No. 90-256. Furthermore, it incorporates the access charges of the other LECs.

The network price of \$0.045 per minute is a blended rate based upon a weighted average of pure network calls, on-network originating and off-network terminating calls, and calls crossing a LATA boundary. Estimated call demand in each of these categories is the basis for the weights. The demand figures are, of necessity, estimates. However, the Commission finds that the reasoning and estimates employed by South Central Bell in developing its contract rates are sound and that the necessary rate elements are covered.

It also does not appear that the rates in the special contract are discriminatory. KRS 278.170(1) prohibits utilities from charging customers differently for "a like and contemporaneous service under the same or substantially the same conditions." South Central Bell maintains that the prices offered pursuant to the special contract would be available to any customer who

¹² Id.

requests the same services as those offered in the contract,¹³ and that the same methodology is used by South Central Bell to develop pricing for any customer who requests services that are not covered in South Central Bell's tariffs.¹⁴ The prices in the special contract are unique, South Central Bell contends, because they are based on a unique network design.¹⁵

AT&T alleges that South Central Bell stated it offered AT&T its tariffed rates, which are higher than the special rates used in the contract pricing formula. In a letter to South Central Bell dated July 28, 1994 AT&T asked South Central Bell to provide "the minimum cost at which you are prepared to provide the required access connections to the proposed state network."¹⁶ By letter dated August 18, 1994,¹⁷ South Central Bell informed AT&T that it could purchase access connections to the proposed Kentucky State network at tariffed rates. However, at the hearing, South Central Bell's policy witnesses repeatedly testified that under the same terms and conditions, the same service rates would be available to

¹³ See, e.g., Prefiled Testimony of South Central Bell Witness Sheri Rose, at 6.

¹⁴ Transcript, at 9.

¹⁵ Prefiled Testimony of South Central Bell Witness Sheri Rose, at 4.

¹⁶ Local Exchange Carrier Telephone Group's Responses to AT&T's Data Requests, filed May 1, 1995, Attachment to Item No. 4 at 1 of 14.

¹⁷ Id. at 2 of 14.

any customer.¹⁸ When questioned about the August 18, 1994 letter, South Central Bell witness Rausch cited the last sentence of the letter, which says "Our Interexchange Carrier Account Team is available to discuss details or answer any further questions you may have." Mr. Rausch stated that South Central Bell's account teams would have worked with its pricing organization to develop special prices for a particular contract.¹⁹

There is no evidence that there was any attempt by AT&T or MCI to secure reduced prices based on specific contract terms. Furthermore, it is unclear whether AT&T would have needed or desired to purchase the same types of services under the same terms and conditions from South Central Bell as those in the special contract. Finally, South Central Bell offered its Director of Pricing for cross examination on the issue of discriminatory pricing. Both AT&T and MCI declined the opportunity to question the proffered witness.²⁰

The Commission is aware that South Central Bell is a monopoly provider of local exchange services and is aware of the danger of self dealing. However, AT&T and MCI have not shown that South Central Bell has discriminated against any of its customers. Nor

¹⁸ For example, when questioned by AT&T Attorney Holland McTyeire, South Central Bell witness Sheri Rose testified, "If you gave us the same demand, if you gave us the same jurisdiction of services, if you gave us the same contract period we would have given you the same rate. And that's what we mean by a common pricing methodology." Transcript at 15.

¹⁹ Transcript at 136.

²⁰ Transcript at 168.

have they refuted South Central Bell's contention that it has not discriminated in its pricing. Accordingly, the Commission finds that the special contract rates are not discriminatory.

Finally, there has been no showing that South Central Bell's other customers will subsidize the contract. South Central Bell's contribution analysis indicates that the \$0.045 rate is above its variable cost and that the contract is profitable. The contribution analysis does show that, on certain calls, South Central Bell will pay another local exchange carrier a rate which is greater than the \$0.076 rate for an off-network (Category B) call. However, South Central Bell's profit will more than cover any loss attributable to the relatively few calls on which it will lose money. The intervenors are incorrect in their contention that contract services will be provided below cost. South Central Bell's contribution analysis shows that profit will occur in the aggregate. AT&T argues that subsidization will occur if the special contract rates do not include the Non-Traffic Sensitive Revenue Requirement Rate ("NTSRRR").²¹ However, the Commission does not require South Central Bell to impute NTSRRR in services it markets to end-use customers. Furthermore, South Central Bell states it anticipated, and covered, the impact of the special contract on NTSRRR.²² There has been no showing that South Central Bell's other customers will subsidize the special contract.

²¹ AT&T Post-Hearing Brief, at 8-9.

²² Transcript, at 138-39.

South Central Bell has demonstrated that its special contract with the Commonwealth of Kentucky is nondiscriminatory, that its other customers will not subsidize the special contract, and that all necessary elements have been included in the rates offered under the special contract. However, the contract prices were developed based on the terms, conditions, quantities, and demand projections for specified participants: agencies of the Commonwealth of Kentucky, the Commonwealth's political subdivisions, and state licensed, nonprofit institutions of higher education. Accordingly, only these entities should have access to and use of the backbone network at the prices specified in this special contract.

IT IS THEREFORE ORDERED that:

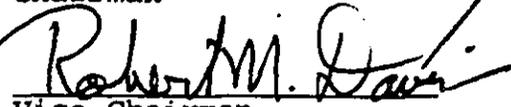
1. The special contract filed by South Central Bell on behalf of the Local Exchange Carrier Telephone Group to provide telecommunications services to the Commonwealth of Kentucky is hereby approved.

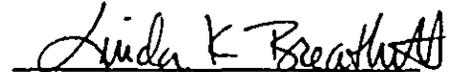
2. The prices specified in the special contract shall be available only to Kentucky's state agencies, political subdivisions, and state licensed, nonprofit institutions of higher education.

Done at Frankfort, Kentucky, this 16th day of June, 1995.

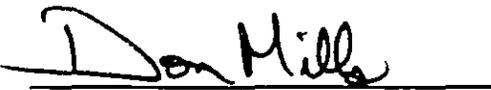
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