

Exhibit :
Issue : Intercompany Compensation
Witness : Taylor
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Sponsoring Party : Southwestern Bell Telephone Co.
Company : Southwestern Bell Telephone Co.
Case No. : TW-97-333

SOUTHWESTERN BELL TELEPHONE COMPANY

CASE NO. TW-97-333

DIRECT TESTIMONY

OF

RICHARD L. TAYLOR

FILED

APR 11 1997

**MISSOURI
PUBLIC SERVICE COMMISSION**

St. Louis, Missouri

April 1997

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

IN THE MATTER OF AN INVESTIGATION INTO)
THE PROVISION OF COMMUNITY OPTIONAL)
CALLING SERVICE IN MISSOURI)

Case No. TW-97-333

AFFIDAVIT OF RICHARD L. TAYLOR

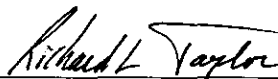
STATE OF MISSOURI)
) SS
CITY OF ST. LOUIS)

I, Richard L. Taylor, of lawful age, being duly sworn, depose and state:

1. My name is Richard L. Taylor. I am presently Director-Regulatory and Industry Relations for Southwestern Bell Telephone Company.

2. Attached hereto and made a part hereof for all purposes is my direct testimony consisting of pages 1 through 15 and schedules 1 and 2.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.



Richard L. Taylor

Subscribed and sworn to before me this 10th day of April 1997.


Notary Public

My Commission Expires:

Jan 5, 2000

MARYANN PURCELL
Notary Public - Notary Seal
STATE OF MISSOURI
ST. LOUIS COUNTY
MY COMMISSION EXP JAN 5, 2000

DIRECT TESTIMONY OF RICHARD L. TAYLOR

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Richard L. Taylor. My business address is 100 North Tucker Blvd.,
St. Louis, Missouri 63101.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Southwestern Bell Telephone Company (SWBT) as Director-
Regulatory and Industry Relations. In that capacity I am Southwestern Bell's liaison with all
incumbent independent local exchange telephone companies in Missouri on matters including
intercompany compensation and the joint provisioning of services to customers.

**Q. HAVE YOU PREPARED A SCHEDULE DESCRIBING YOUR
EDUCATIONAL BACKGROUND AND EXPERIENCE?**

A. Yes, it is attached as Schedule No. 1

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will address the intercompany compensation issues associated with the existing
COS arrangement as well as for those COS arrangements proposed in SWBT witness Debbie
Bourneuf's Direct Testimony. Specifically, I will provide SWBT's position on the
intercompany compensation aspects of the two straw COS proposals posed in the
Commission's March 7, 1997 Order in this case [Issue (B) and questions No. 3 and 6].

Southwestern Bell's position in response to the other issues and questions posed in the Order are addressed in Ms. Bourneuf's testimony.

I. Issue (B) Compensation Mechanism for the Straw COS Proposals

Q. WHAT IS THE CURRENT COMPENSATION MECHANISM FOR COS?

A. Under the Commission's Order of December 23, 1996 in Case No. TO-92-306, COS is tariffed as a toll service by the respective Primary Toll Carrier (PTC) for each COS route. The PTC receives the COS end-user revenue based on the Commission-ordered tariff rates. The PTC pays minutes-of-use originating and terminating Switched Access charges to the Local Exchange Company (LEC) for the Petitioning and Target exchanges.

Q. HAS THE CURRENT COMPENSATION MECHANISM FOR COS BEEN A SATISFACTORY ARRANGEMENT TO DATE?

A. No. From SWBT's perspective, this has been a very unsatisfactory plan because it forces SWBT to pay out substantially larger amounts in Access payments than we receive in COS revenue.

Q. CAN YOU QUANTIFY THE REVENUE AND ACCESS EXPENSE RELATIONSHIPS?

A. Yes, in part. I've sent Data Requests to the Secondary Carriers (SCs) requesting the data which will allow me to quantify the revenue and access expense relationships for all COS routes in which SWBT is a participant. That process could not be completed for

1 inclusion in this testimony. However, I do have the data for 18 COS routes involving four
2 Secondary Carriers and SWBT and have completed some analysis of that data. The eighteen
3 routes represent 27% of the 67 COS routes where SWB is the PTC and one of its SCs serves
4 the Petitioning exchange.

5
6 **Q. WHAT INFORMATION HAVE YOU REVIEWED?**

7 **A.** I've examined the COS revenue, usage, number of subscribers and Access
8 payments for 18 COS routes which were in service for all of 1996. For each of these routes
9 one of SWBT's Secondary Carriers serves the petitioning COS exchange and SWBT serves
10 the Target COS exchange. SWBT is also the PTC on each of the routes. The four SCs
11 involved are Mark Twain Rural Telephone Company (seven routes), Green Hills Telephone
12 Corporation (eight routes), Goodman Telephone Company, Inc. (one route) and KLM
13 Telephone Company (two routes). The eighteen routes are identified on Schedule No. 2,
14 attached.

15
16 **Q. PLEASE EXPLAIN THE ANALYSIS YOU'VE COMPLETED.**

17 **A.** For this presentation I will display Goodman and KLM data combined to avoid
18 displaying route specific data. Since Mark Twain and Green Hills each have several COS
19 routes, I will use the respective company total for all of its routes. The relationship between
20 COS revenue received by SWBT compared to the Access payments made by SWBT to the
21 SCs for calendar year 1996 is as follows:

	<u>SC</u>	SWBT COS <u>Revenue</u>	SWBT Access <u>Paid to SC</u>	SWBT Net <u>Cash Flow</u>	Payout Ratio <u>(Access:Revenue)</u>
4	Mark Twain	\$ 42,832	\$434,936	(\$392,104)	10.15 : 1
5	Green Hills	145,441	376,970	(231,529)	2.59 : 1
6	Goodman/KLM	<u>34,207</u>	<u>89,132</u>	<u>(54,925)</u>	2.61 : 1
7	Total	\$222,480	\$901,038	(\$678,558)	4.05 : 1

For every one dollar of COS revenue SWBT received on these routes, we paid out \$4.05 in Access payments to Secondary Carriers.

Q. DOES THE NEGATIVE CASH FLOW DISPLAYED REFLECT SWBT'S TOTAL COST OR TOTAL LOSS ASSOCIATED WITH PROVIDING COS ON THESE 18 ROUTES?

A. No. SWBT had its own network and administrative cost associated with this COS traffic which would increase SWBT's losses on this service.

Q. CAN YOU PROVIDE AN ANALYSIS OF THE IMPACT OF COS RELATED ACCESS PAYMENTS ON THESE SECONDARY CARRIERS?

A. Yes. The following information is useful in assessing the dependence on COS related Access by the SCs:

		<u>COS Access Revenue Per COS Subscriber Per Month</u>	<u>COS Access Revenue Per Access Line Per Month</u>
1			
2			
3			
4	Mark Twain	\$151.02	8.84
5	Green Hills	62.95	9.33
6	Goodman/KLM	33.46 (avg.)	2.41 (avg.)
7	Simple Average	70.22	5.75

8

9 **Q. HOW DOES SWB COS REVENUE PER COS SUBSCRIBER COMPARE**
10 **TO THE SC's COS ACCESS REVENUE?**

11 **A.** The weighted average monthly COS revenue for the 869 residence and 21
12 business COS subscribers on these 18 routes in 1996 was \$16.41. Therefore, on average, for
13 every SC customer who paid SWB \$16.41 for COS, SWB paid a secondary carrier \$70.22.

14

15 **Q. WHAT CONCLUSIONS DO YOU RECOMMEND THE COMMISSION**
16 **DRAW FROM THIS ANALYSIS?**

17 **A.** There are several. First, it is clear that COS, as it is currently configured, is a
18 highly subsidized service. The COS revenue falls dramatically short of covering even the
19 direct cost of access paid out by the PTC (SWBT in this analysis). Second, the current
20 compensation mechanism should be terminated no matter what decision the Commission
21 makes as to the definition of the future COS retail product.

22

23 **Q. CAN YOU QUANTITATIVELY SUPPORT THIS CONCLUSION?**

1 A. Yes. This illustration is based on the same 18 COS routes I've been discussing
2 and their 1996 usage and subscription levels.

3 Assumptions:

4 1. COS is converted to one-way only service from the Petitioning exchange to the
5 Target exchange.

6 2A. One-way only COS is priced at 50 percent of the current two-way price.

7 2B. One-way only COS is priced at 100 percent of the current two-way price.

8 3A. The SC is the COS provider and pays terminating access only to the
9 terminating LEC (SWBT on these routes).

10 3B. SWBT (as PTC) is the COS provider and pays the SCs originating access only.

11 Results:

	<u>Annual COS Revenue</u>	<u>Annual Access Payments (3A)</u>	<u>Annual Access Payments (3B)</u>
12 2A	\$111,240	\$225,517	\$385,058
13 2B	\$222,480	\$225,517	\$385,058

14
15
16
17 The 2B assumption should not be interpreted as a pricing recommendation. Rather, it
18 is intended only to reveal that even if COS is converted to a one-way only service but the
19 price remains at the current two-way price, the COS revenue will still fall short of covering
20 even SWBT's terminating access rates, which are the lowest in the state.

21
22 **Q. WHAT FACTORS CONTRIBUTE TO THIS UNACCEPTABLE RESULT?**

23 A. It is simply a matter of having usage sensitive compensation at full access rates

1 which significantly exceed the average revenue per minute of the flat rate priced COS service.
2 Based on the COS usage for these 18 routes and assuming the Target exchange to Petitioning
3 exchange usage equals the Petitioning exchange to Target exchange use, the average revenue
4 per minute of COS use is approximately .017. If you ignore the return calling and ascribe all
5 COS revenue to the usage from the Petitioning exchange to the Target exchange, the revenue
6 per minute of COS use would be approximately .034, still below even SWBT's terminating
7 access rates. SWBT's terminating switched access rate per minute is .034313 compared to an
8 average of approximately .083558 for the four SCs in this analysis.

9
10 **Q. DOES THAT MEAN YOU SHOULD NEVER HAVE USAGE SENSITIVE**
11 **COMPENSATION COUPLED WITH FLAT RATED RETAIL SERVICES?**

12 **A.** Not necessarily, but it does point out that the retail price and the compensation
13 mechanism should be better coordinated than what we have with the current COS
14 arrangement. If COS (or any like service) is intended by the Commission to be subsidized or
15 "socially priced", then compensation based on rates which themselves incorporate implicit
16 subsidies is not practical.

17
18 **Q. WHAT IS YOUR RECOMMENDATION FOR A REVISED**
19 **COMPENSATION MECHANISM?**

20 **A.** Assuming the Commission will convert COS to a one-way only service or a one-
21 way reciprocally available service and that the service will be considered local, I recommend
22 the following:

1 The LEC of the petitioning COS exchange should be the provider of local one-way
2 only COS to the customers in the Petitioning exchange. That LEC should pay terminating
3 compensation to any other LEC whose network is used to terminate the Petitioning exchange
4 to Target exchange traffic. The terminating compensation should be at Terminating Switched
5 Access rates, less the Carrier Common Line (CCL) element.

6 Should the Commission mandate one-way reciprocally available COS, then for the
7 reciprocal route (Target exchange to Petitioning exchange) the LEC of the Target exchange
8 should be the COS provider and the terminating compensation mechanism should work the
9 same as for the petitioned route, including that the Target exchange LEC would pay the
10 Petitioning exchange LEC its Terminating Switched Access rates, less CCL. In each case, the
11 COS provider would receive the COS revenue.

12
13 **Q. WHAT WOULD THE COS REVENUE/COMPENSATION**
14 **RELATIONSHIPS HAVE BEEN IN 1996 FOR THE 18 ROUTES HAD YOUR**
15 **RECOMMENDATION BEEN IN PLACE?**

16 **A.** Figure No. 1 following reflects the results if COS was one-way only. If the
17 service was one-way reciprocally available, both Figures No. 1 and No. 2 would have
18 occurred. This analysis assumes the usage and subscription in the Target exchange would be
19 equal to that of the Petitioning exchange.

1	1.	Percent One-Way		Terminating Compensation
2		COS Rates of	Petitioning Exchange	Payments from SCs to
3		<u>Two-Way Rates</u>	<u>COS Revenue to SCs</u>	<u>SWBT at .01618 per MOU</u>
4				
5		50%	\$111,240	\$106,341
6		75%	\$166,860	\$106,341
7		100%	\$222,480	\$106,341
8	2.			Terminating Compensation
9			Target Exchange COS	Payments from SWBT
10			<u>Revenue to SWBT</u>	<u>to SCs at .037725 per MOU</u>
11				
12		50%	\$111,240	\$247,942
13		75%	\$166,860	\$247,942
14		100%	\$222,480	\$247,942

15 **Q. TO THIS POINT, YOUR TESTIMONY HAS ADDRESSED ONE-WAY**
16 **AND ONE-WAY RECIPROCAL COS. WHAT ARE YOUR SUGGESTIONS FOR**
17 **INTERCOMPANY COMPENSATION SHOULD THE COMMISSION REQUIRE**
18 **THE RETENTION OF TWO-WAY COS USING THE 800 NUMBER-BASED**
19 **ALTERNATIVE?**

20 **A.** I would encourage the Commission not to make that decision. The 800 number
21 form of two-way COS, while the best of the two-way alternatives, is still problem laden, as
22 discussed in Ms. Bourneuf's testimony. However, if the Commission adopts the two-way
23 COS proposal, as I indicated earlier, the present intercompany compensation mechanism
24 should be terminated. Under a two-way, 800 number-based serving arrangement the LEC of
25 the Petitioning exchange should be the COS provider. That LEC should receive the COS
26 revenue and pay terminating switched access, less CCL as previously described to the LEC of

1 the Target exchange. In addition, the COS provider should pay the LEC of the Target
2 exchange originating switched access, less CCL for the origination of the Target exchange to
3 Petitioning exchange traffic.

4
5 **Q. UNDER YOUR ONE-WAY RECIPROCAL PROPOSAL THE TARGET**
6 **EXCHANGE LEC WOULD PAY TERMINATING COMPENSATION ON THAT**
7 **TRAFFIC TO THE PETITIONING LEC. WHY, FOR TWO-WAY SERVICE,**
8 **SHOULD THE PETITIONING EXCHANGE LEC PAY ORIGINATING**
9 **COMPENSATION FOR THE RETURN TRAFFIC?**

10 **A.** Because for two-way COS the Petitioning LEC will receive all of the COS
11 revenue (for bi-directional traffic), whereas for one-way reciprocal COS both the Petitioning
12 and Target exchange LECs will receive one-way COS revenue from their respective
13 subscribers.

14
15 **II. Question No. 3**

16 **What, if any, change must be made in the Primary Toll Carrier (PTC) plan to**
17 **accommodate or accomplish the proposed COS changes here?**

18 **Q. WHAT PTC PLAN CHANGES ARE REQUIRED IF THE COMMISSION**
19 **MODIFIES COS TO EITHER ONE-WAY ONLY OR ONE-WAY RECIPROCALLY**
20 **AVAILABLE COS?**

21 **A.** If the Commission changes COS to one-way only or one-way reciprocally
22 available Local service with the intercompany compensation mechanism I have proposed,

1 little if any change will have to be made to the PTC plan for this purpose (of course, there are
2 other reasons to change it). If a LEC, for technical or other reasons, determined to provide
3 COS on a 1+ basis rather than on a local dialed basis, the PTC/SC Agreements might have to
4 be amended to reflect that 1+ COS traffic is not the responsibility or property of the PTC.
5 The only other change I have identified is more of a process change than a PTC plan change.
6 It is that COS usage and compensation will have to be segregated from other intercompany
7 compensation due to the difference in who pays who and the compensation rate differential.
8 Given that COS traffic already has to be segregated and handled differently for customer
9 billing purposes, that should not be a significant administrative issue.

10
11 **Q. WHAT PTC PLAN CHANGES ARE REQUIRED IF THE COMMISSION**
12 **MODIFIES COS TO AN 800 NUMBER-BASED TWO-WAY SERVICE?**

13 **A.** If the Commission changes COS to an 800 number-based two-way service
14 including the recommendations I have made concerning the responsible service provider
15 (Petitioning LEC) and the intercompany compensation mechanism I have proposed, the PTC
16 plan changes required would be limited and much the same as discussed concerning one-way
17 COS.

18
19 **Q. WHAT PTC PLAN CHANGES WOULD BE REQUIRED IF THE**
20 **COMMISSION MODIFIES COS TO 800 NUMBER-BASED TWO-WAY SERVICE**
21 **BUT CLASSIFIES IT AS TOLL, MAKES THE PTC THE PROVIDER AND LEAVES**
22 **COMPENSATION AT FULL ACCESS?**

1 A. To date, I have not identified any changes required to the PTC plan per se under
2 this scenario. However, the LECs would have to establish joint methods and procedures for
3 establishing the 800 number services in a fashion that would accommodate the unique
4 requirement to establish the 800 number service with presumably no billing. However, it is
5 SWBT's position that the PTC plan, on the whole, is fundamentally inconsistent with
6 intraLATA presubscription and should be replaced. We will ask the Commission to do that in
7 the appropriate docket and expect some other parties will agree. Therefore, if the
8 Commission decides in this case to retain COS as a toll service under the PTC plan, there
9 seems little doubt the issue will be revisited in the case that determines the future of the PTC
10 plan.

11
12 **III. Question No. 6**

13 **The participants should offer their assessments as to whether a LATAwide or**
14 **statewide flat-rate calling scope might be a viable substitute for the current**
15 **COS arrangements.**

16
17 **Q. DOES SWBT BELIEVE THAT A LATAWIDE OR STATEWIDE COS-**
18 **TYPE SERVICE IS A VIABLE ALTERNATIVE FOR THE CURRENT COS**
19 **ARRANGEMENT?**

20 A. As explained more fully in SWBT witness Debbie Bourneuf's Direct Testimony,
21 SWBT believes that a one-way LATAwide flat-rate COS plan is viable and is willing to
22 consider offering such a service to its own customers under certain circumstances. Ms.

1 Bourneuf's testimony delineates the necessary circumstances except for the intercompany
2 compensation issue which I will address.

3
4 **Q. DOES SWBT ACKNOWLEDGE THAT IF IT PROVIDES A LATAWIDE**
5 **COS THAT SOME OF THE USAGE WILL TERMINATE IN NON-SWBT**
6 **EXCHANGES?**

7 A. Yes. SWBT serves approximately 75% of the access lines in Missouri, so it is a
8 certainty that some LATAwide traffic would terminate in other LEC exchanges. SWBT
9 would, of course, compensate those LECs for terminating the traffic.

10
11 **Q. WHAT LEVEL OF COMPENSATION DO YOU PROPOSE?**

12 A. SWBT would be willing to offer the service as discussed with compensation at the
13 respective LEC's Terminating Switched Access rates.

14
15 **Q. IF ANOTHER LEC OFFERED LATAWIDE COS TO ITS CUSTOMER,**
16 **HOW WOULD SWBT PROPOSE IT BE COMPENSATED TO TERMINATE SUCH**
17 **TRAFFIC?**

18 A. SWBT would charge its Terminating Switched Access rates consistent with my
19 proposal to compensate others.

20
21 **Q. IF AN ENTITY OFFERED STATEWIDE COS TO CUSTOMERS, WHAT**
22 **COMPENSATION SHOULD BE PAID FOR THAT TRAFFIC?**

1 A. The Switched Access rates of each respective LEC handling the traffic.

2
3 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

4 A. I have demonstrated that COS, as presently configured, is a highly subsidized
5 service due largely to the intercompany compensation mechanism. I have explained
6 that the current intercompany compensation mechanism is not satisfactory because it
7 causes COS providers like SWBT to payout substantially greater amounts in access
8 payments than they receives in COS revenue.

9 I have proposed that COS intercompany compensation should be changed
10 to a mechanism where the Petitioning exchange LEC pays terminating access less the
11 CCL element to the Target exchange LEC for one-way only COS. The proposal is
12 reversible for a reciprocally available Target exchange to Petitioning exchange COS.

13 Under the conditions described in Ms. Bourneuf's testimony SWBT is
14 willing to consider offering a LATAwide COS arrangement to its customers. I have
15 proposed paying Terminating Switched Access to other LECs who terminate such
16 traffic. Similarly, I have proposed that Switched Access charges are the appropriate
17 compensation in the event that a statewide COS is created.

Direct Testimony
Richard L. Taylor
Case No. TW-97-333

1 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

2 **A. Yes, it does.**

SUMMARY OF EDUCATION, WORK EXPERIENCE AND QUALIFICATION

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I graduated from Drury College in Springfield, Missouri, in 1973 with a Bachelor of Science degree in Business Administration.

Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.

A. I have been employed by Southwestern Bell Telephone Company in Missouri since 1964. During that time, I have held various business office management positions in Kansas City, Hannibal, Springfield and Joplin over a period of approximately ten years. In those positions, I was responsible for local customer contacts including inquiries and requests for expanded local calling.

I held the position of District Manager-Installation and Maintenance for four years in western Missouri involving both metropolitan and rural service areas. In 1983, I was appointed District Manager-Rate Administration. In that position my responsibilities included administration of Missouri tariffs for toll and access services, as well as Extended Area Service.

In December 1985, I was appointed to the position of District Manager-Industry Relations. In January 1995 my title was changed to Director-Regulatory and Industry Relations to reflect the assumption of additional areas of responsibility. Since December 1985 I have been personally involved in all matters relating to intercompany compensation and the joint provisioning of services to customers by Southwestern Bell and the independent local exchange telephone companies in Missouri.

**Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE
COMMISSION?**

A. Yes. I testified concerning intercompany compensation issues in Case No. TO-87-131, Case No. TO-90-232 and Case No. TO-92-306.

COS ROUTES ANALYZED

PETITIONING LEC PETITIONING EXCHANGE TARGET EXCHANGE

KLM	1	METZ	NEVADA
	2	RICHARDS	NEVADA
GOODMAN	3	GOODMAN	NEOSHO
GREEN HILLS	4	AVALON	CHILLICOTHE
	5	COWGILL	KANSAS CITY
	6	DAWN	CHILLICOTHE
	7	KNOXVILLE	KANSAS CITY
	8	LUDLOW	CHILLICOTHE
	9	MOORESVILLE	CHILLICOTHE
	10	POLO	KANSAS CITY
	11	WHEELING	CHILLICOTHE
MARK TWAIN	12	BARING	EDINA
	13	BRASHEAR	KIRKSVILLE
	14	GREENTOP	KIRKSVILLE
	15	HURDLAND	EDINA
	16	HURDLAND	KIRKSVILLE
	17	KNOX CITY	EDINA
	18	NOVELTY	EDINA