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August 7, 1997

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MISSOURI
PUBLIC SERVICE COMMISSION

Mr. Cecil I. Wright
Executive Secretary
Missouri Public Service Commission
301 West High Street, Floor 5A
Jefferson City, Missouri 65101

Re: Case No. TW-97-333

Dear Mr. Wright:

Enclosed for filing with the Commission in the above-referenced case is an original and 14 copies of Southwestern Bell Telephone Company's Initial Brief.

Please stamp "Filed" on the extra copy and return the copy to me in the enclosed self-addressed, stamped envelope.

Thank you for bringing this matter to the attention of the Commission.

Very truly yours,

Leo J. Bub

Enclosure

cc: Attorneys of Record

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

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| In the Matter of an Investigation into the Provision of Community Optional Calling Service in Missouri. | ) ) | Case No. TW-97-333 |

**SOUTHWESTERN BELL TELEPHONE COMPANY'S**
**<u>INITIAL BRIEF</u>**

FILED
AUG 8 1997
MISSOURI
PUBLIC SERVICE COMMISSION


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August 8, 1997

16.

## TABLE OF CONTENTS

Page

**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 |

**SOUTHWESTERN BELL TELEPHONE COMPANY'S**
**INITIAL BRIEF**

Southwestern Bell Telephone Company respectfully submits this initial brief to the Missouri Public Service Commission.

## EXECUTIVE SUMMARY

The Commission established this docket to determine whether Community Optional Service (COS) should continue to be offered in Missouri, and if so, how. All parties agree it must change due to the changing competitive environment. And many advocate its complete elimination. While Southwestern Bell does not believe complete elimination is necessary, it concurs with Staff and many other parties that COS' present structure is inconsistent with competition and its current subsidy flows are inappropriate.

While not its first recommendation, Southwestern Bell would support a Commission decision to eliminate COS. Southwestern Bell agrees with parties proposing this option that companies should not be required to offer specific expanded calling services due to the high degree of competition in the market today. Rather, COS should be optional for providing companies. If permitted to function, competition will drive individual companies to offer services that customers desire at competitive prices. For example, Southwestern Bell would like to continue providing COS to its own customers as a one-way only cost-based local service. It would also consider offering a LATAwide COS alternative to its own customers. Southwestern Bell believes customers would find a one-way, LATAwide, flat-rated service very appealing.

But if the Commission is reluctant to immediately eliminate COS, Southwestern Bell recommends: (1) converting COS to a one-way only local service provided by the local exchange company (LEC) serving the petitioning exchange, and (2) changing the intercompany compensation on COS traffic away from full access and instead basing it on switched access charges less the carrier common line (CCL) element. This proposal presents no significant technical barriers and is the simplest approach to providing expanded local calling. Making COS local and reducing access charges for this traffic will eliminate the unnecessary and inappropriate subsidy flows supporting COS, remove the unintended incentives which have pitted the financial interests of the Primary Toll Carriers (PTCs) and Secondary Toll Carriers (SCs) against each other, and refocus COS on the community of interest needs it was established to meet.

Making COS a one-way local service would also avoid the negative impacts of 1+ intraLATA presubscription: i.e., as a local service, COS' availability to customers will not be affected by their choice of an intraLATA toll provider. It would also avoid negative impacts in the PTC Plan docket, TO-97-217/TO-97-220. In that docket, the PTCs and the SCs have stated that they do not want to be responsible for providing toll in SC exchanges. Several large interexchange carriers (IXCs), however, have indicated that they are willing to do so. A Commission determination to keep COS toll and require it to be provided in all qualifying exchanges could potentially alter these carriers' willingness to be intraLATA toll providers in SC exchanges. It will also most likely require COS issues to be revisited in the PTC Plan case.

Southwestern Bell believes its proposal is a reasonable compromise that solves the various technical and policy problems associated with COS, retains an expanded local calling option for the narrow customer group with certain community of interest calling needs, and balances these needs against the benefits intraLATA presubscription and competition will bring all telephone customers in Missouri.

## BACKGROUND

The Commission originally established COS as a non-toll, extra-exchange calling plan in 1989.[1] It was a jointly provided service between LECs that, on qualifying routes,[2] provided discounted calling[3] between an exchange that requested the service (the petitioning exchange) and another exchange (the target exchange). Southwestern Bell tariffed it as a local service. Other LECs tariffed it as neither toll nor local, but as "other." Rather than basing compensation between providing companies (intercompany compensation) on access charges, the Revenue Sharing Plan the parties devised (and later the Revised Revenue Sharing Plan) required the providing companies to share the COS revenue equally on a flat-rated basis. Under the Revenue

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[1]In the matter of the investigation of experimental extended measured service (EMS), Case No. TO. 87-131, Report and Order, pp. 3-4, issued December 25, 1989.

[2]The PSC-established COS qualifying criteria is that there must be (1) an average of six or more calls per line per month from the petitioning exchange to the target exchange, and (2) that at least two-thirds of the petitioning exchange access lines must make two or more calls in the study month to the target exchange to qualify for COS. Both criteria must be met in order for a requested route to qualify for COS. Id., pp. 19-20.

[3]There were three discounted plans: Option 1 provided a 50% discount from toll rates for a $4.00 per month charge. Option 2 provided a one-way flat-rated unlimited calling plan with rural rates of $5.75 residential/$12.10 business per month; and metropolitan rates of $11.05 residential/$23.55 business per month. Option 3 provided a two-way flat-rated unlimited calling plan with rural rates of $10.10 residential/$21.25 business per month; and metropolitan rates of $19.35 residential/$41.35 business per month. Id., pp. 6, 9.

Sharing Plans, detailed procedures ensured that if a LEC experienced a net cash gain from providing COS, that LEC would share its gain with the LEC experiencing a net cash loss. (STCG, Schoonmaker Direct, pp. 5-6, Tr., pp. 319-321).

The Commission reevaluated COS and established the current version of COS in 1992 as a two-way toll service provided by PTCs.[4] At the same time, it created the Metropolitan Calling Area (MCA) and Outstate Calling Area (OCA) plans. Many customers who previously subscribed to COS were converted to one of these two new plans. The current COS plan allows a petitioning exchange subscriber to pay a flat monthly rate[5] and place unlimited toll-free calls to any telephone number in a target exchange. It also allows any customer in the target exchange, without signing up for the plan or paying toll charges, to make unlimited calls to COS subscribers in the petitioning exchange. Calls to non-COS subscribers continued to be toll calls. (Staff, Smith Direct, pp. 2-3).

The Commission has correctly recognized that developments in the industry and in the use and growth of COS require it to revisit COS again. All parties to this case, to one degree or another, agree COS must change. The developments requiring changes result from the advent of competition and presubscription. They result from unexpected growth in both COS usage and COS routes which caused large and unintended subsidy flows from PTC customers to SC

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[4]In the matter of the establishment of a plan for expanded calling scopes in metropolitan and outstate exchanges, Case No. TO-92-306, Report and Order, pp. 34-39, issued December 23, 1992.

[5]Currently, COS is being provided at rural rates of $16.00 residential/$33.50 business per month; metropolitan St. Louis and Kansas City rates of $37.80 residential/$80.20 business per month; metropolitan Springfield rates of $24.50 residential/$50.50 business per month; and noncontiguous exchange additive charges of $5.15 for residential and $10.85 for business subscribers. (Id., pp. 37-39, Attachment 7).

customers and from PTCs to SCs. It has been estimated that SC customers receive approximately $7.4 million worth of toll calling from COS (subscribers in petitioning exchanges generate approximately $3.5 million worth of toll calling, or about $616 per access line; return calling from target exchanges generates approximately $3.9 million worth or about $687 per access line) but pay only $1.3 million (about $218 per customer). And while the PTCs providing COS collectively receive approximately $1.3 million in COS revenue, they pay approximately $4.2 million in access charges associated with those COS calls. (STCG, Schoonmaker Rebuttal, p. 4, Sch. RCS-3, p. 1 of 3). Southwestern Bell's situation is a bit worse. Based on a study of 18 of the 67 COS routes where it is the PTC and one of its SCs serves the petitioning exchange, for every $1.00 of COS revenue Southwestern Bell receives, it pays out $4.05 in access payments to SCs. (SWBT, Taylor Direct, pp. 2-4). Given the choices COS customers currently have (plus the additional choices competition will bring) and the burden being placed on other customers, these subsidies are not appropriate. And in a competitive environment they are simply not sustainable .

The developments necessitating the Commission's review and restructuring of COS are detailed below:

## I. COMPETITION AND INTRALATA PRESUBSCRIPTION REQUIRE COS TO CHANGE.

The implementation of 1+ intraLATA presubscription will fundamentally change the basic arrangement under which COS is currently being provided. These changes will make it impossible to continue COS as it is presently being offered.

Currently, the four PTCs in the state (Southwestern Bell, GTE, Sprint/United and Fidelity Telephone) provide COS -- as well as all 1+ intraLATA long distance calling -- to all customers of the SCs (basically the members of the Small Telephone Company and Mid-Missouri Groups). This is done under contracts that require the SCs to send all their customers' 1+ intraLATA toll calls to the PTCs. Under these agreements, the PTCs receive their respective toll rates and pay the SCs their respective originating and terminating access rates. This Plan has been in place since 1988 and has been the basis of the arrangement being used to provide COS since 1993. (Staff, Smith Direct, p. 3; SWBT, Taylor Direct, p. 2).

But once a LEC implements intraLATA toll presubscription, customers in that exchange can choose any certified IXC to be their 1+ intraLATA toll provider (just like they can have any certified IXC for their 1+ interLATA toll provider today). This new ability to choose a 1+ intraLATA toll provider, however, will affect the availability of COS: If customers in petitioning exchanges choose anyone other than the PTC for their 1+ intraLATA toll traffic, COS will not be available to them. Also, if customers in a target exchange choose anyone other than the PTC, those customers will not be able to use COS' return calling feature. And most parties agree that the existing billing system method that is used to implement COS (by passing records between PTCs and SCs enabling them to identify and zero rate COS calls so they will not be billed as toll calls) cannot be feasibly expanded to accommodate all IXCs that potentially could serve COS exchanges. (See, e.g., SWBT, Bourneuf Direct, p. 3; STCG, Opening Statement Tr., p. 46, Schoonmaker Direct, pp. 12-14; GTE, Opening Statement Tr., p. 76, Kahnert Direct, p. 2).

In addition, the Commission in Docket No. TO-97-217/TO-97-220 is examining the possible elimination or modification of the PTC Plan. Thus, unless something is done, COS could just completely cease to exist or be reduced to a service that only works between customers that continue to use the PTC as their 1+ intraLATA toll provider - - which would, at the very least, significantly degrade COS.

## II. PUBLIC POLICY REQUIRES COS TO CHANGE.

A. Current subsidy flows to COS customers are inappropriate. As currently configured, all parties involved in the provision of COS acknowledge that it is a highly subsidized service. The Small Telephone Company witness calculated that SC customers subscribing to COS receive approximately $3.5 million worth of intraLATA toll calling from COS. In addition, SC customers in target exchanges receive approximately $3.9 million worth of intraLATA toll in return COS calling. Yet, SC customers subscribing to COS pay only $1.3 million for the service. (STCG, Schoonmaker Rebuttal, pp. 4, Sch. RCS-3, p. 1 of 3). Overall, Southwestern Bell's annual COS revenue is approximately $1.6 million. Its annual cost of providing the service is over $6.9 million (which includes access payments made to other LECs and the estimated incremental cost of the COS usage of Southwestern Bell's own customers). (SWBT, Bourneuf Rebuttal, p. 4).

Essentially, the present arrangement has resulted in people elsewhere in the state paying higher rates for some services so that SC customers can have COS calling at below cost rates. All parties concur on this point. (Staff, Smith Tr., pp. 776, 794; OPC, Meisenheimer Tr., pp. 535, 544; CompTel, Opening Statement Tr., p. 67; Mid-Missouri, Jones Tr., pp. 117,146-147 and Godfrey Tr., p. 286; STCG, Opening Statement Tr., p. 44, STCG, Schoonmaker Tr., p. 352; SWBT, Bourneuf Tr., p. 572; GTE, Opening Statement, pp. 76-78; United, Harper Tr., p. 745).

When the Commission established COS, it sought to meet a discrete customer group's expressed community of interest calling needs by providing discounted extra-exchange calling. But in doing so, its intended that COS' prices would cover costs:

> . . . the Commission believes it is necessary to establish rates for these calling plans which ease the burden of high toll bills from customers living in exchanges demonstrating a community of interest. At the same time, these rates should not reduce the revenue of the LECs offering these services so as to necessitate raising the rates of other customers to those LECs to an unreasonable level. The Commission is of the opinion that the rates should be low enough to stimulate usage in order to recover some of the LECs' lost toll revenues but high enough to recover the LECs cost of providing the service.[6]

At the time, the Commission recognized that it was lowering the price for this group of extra-exchange calling on qualifying routes which would lead to revenue losses for the telephone companies involved. To avoid these losses, the Commission found that it may be necessary to raise the price of other telephone company services. The Commission saw its responsibility as balancing "the interests of the customers desiring rate relief from high toll bills against the interests of the other ratepayers who might have to pay higher rates to offset the reduced revenues even though they will not benefit from such rate relief" and this responsibility guided its decision.[7]

But over time, COS has grown and so have the subsidies. Thirty to 50 routes have been added since the present two-way version was established. (Staff, Smith Tr., p. 802). And the traffic has grown considerably. This growth was not expected. The Commission believed COS

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[6]In the matter of the investigation of experimental extended measured service (EMS), Case No. TO-87-131, Report and Order, p. 8, issued December 25, 1989.

[7]In the matter of the investigation of experimental extended measured service (EMS), Case No. TO-87-131, Report and Order, pp. 3-4, issued December 25, 1989.

was a diminishing service when it created the current COS plan.[8] And Staff testified that from its perspective, COS traffic has grown in unexpected ways and the present subsidization of COS by PTC customers was not intended. (Staff, Smith Tr., pp. 802-803).

These subsidies to COS customers are not appropriate or needed. As several parties have pointed out, subsidizing COS routes distorts the market and is inconsistent with competition. (United, Tr., p. 746; SWBT, Taylor Tr., p. 710). CompTel, a group of companies that would like to compete for this traffic, stated that it is unrealistic to expect a competitive provider to attempt to respond to such a heavily subsidized service. (CompTel, Opening Statement Tr., pp. 66-68). And in Staff's view, while some customers benefit from COS, others are being negatively impacted by its continuance due to its subsidization and detrimental impacts on competition. (Staff, Opening Statement Tr., p. 97). Even OPC is concerned that there are a large number of PTC customers subsidizing SC customers' service. (OPC, Meisenheimer Tr., p. 535).

Customers also have more viable options now than they did when the Commission created COS. MCA and OCA are now widely available to meet customer needs for extra-exchange calling. The Small Telephone Company Group's witness acknowledged that these services have, for large parts of customers in the State, met the needs COS was designed to address. He also acknowledged that Southwestern Bell's toll rate reductions possibly could reduce some of the pressure on the Commission from customers seeking relief from toll rates. (STCG, Schoonmaker Tr., pp. 357, 358, 398-399). Customers now also have access to 800/888 number service and prepaid calling cards. In addition, cellular telephones with large calling scopes are now available at reasonable prices (while rates for cellular service may be higher, the calling scope is much

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[8]TO-92-306 December 23, 1992 Report and Order, p. 39.

broader). And as the market becomes more competitive, customers will have more options available. (Staff, Smith Tr., pp. 774-775, 790). For example, competitive carriers like AT&T and CompTel could also provide this extra-exchange calling. But it is not suspected that they will under COS' present economics. (STCG, Schoonmaker Tr., pp. 362-363; Mid-Mo., Jones Tr., pp. 212-213).

There simply does not appear to be sufficient justification to continue COS as a below cost service for SC customers at PTC customers' expense. Many parties, including Staff, agree that such discounts are not appropriate. (Staff, Smith Tr., p. 792). Much of the demand for such expanded local calling came from customers choosing to move to the country or outlying bedroom communities. (Mid-Missouri, Opening Statement Tr., p. 29). Individuals choosing to live in rural versus metro areas receive numerous benefits from living in a rural environment such as less congested roads and highways and a unique quality of life. (Mid-Missouri, Jones Tr., pp. 152-153). These varied benefits, however, carry trade-offs such as higher commuting costs and higher telecommunications costs. But as metro residents should not be required to subsidize commuting costs of those living in rural areas (Staff, Smith Tr., p. 792; OPC, Meisenheimer Tr., p. 546), metro telephone customers should not be required to pay higher rates to subsidize COS for SC customers. (Staff, Smith Tr., p 792; SWBT, Taylor Tr., p. 690).

COS was not established as a service for low-income customers. There is no means test or needs-based criteria for COS. (Staff, Smith Tr., p. 791). In fact, the witness for the Mid-Missouri Group acknowledged that many customers could pay higher rates, even double the existing rate. (Mid-Missouri, Jones Tr., p. 118).

B. Current subsidy flows to SCs from the PTCs' provision of COS are inappropriate. Throughout all the COS cases, the Commission sought to ensure that in meeting customer community of interest calling needs, some companies would not profit at the expense of others. (STCG, Schoonmaker Tr., p. 324). But that is not what happened. As the Small Telephone Company Group explained, "its no secret that the PTCs are losing money today and that money loss has grown as a result of the stimulation or the growth in usage of COS as well as the growth in COS routes that exist today that did not exist in 1993." (STCG, Opening Statement Tr., pp. 44-45). On a statewide basis, the Small Telephone Company Group's witness calculated that the PTCs received $1,255,174 in revenue from providing COS in SC exchanges. The PTCs, however, paid the SCs $4,149,863 in associated access charges in providing these services. (STCG, Schoonmaker Rebuttal, Schedule RCS-3, p. 1). This revenue transfer between companies that occurred was never an intended purpose in creating COS. (Staff, Smith Tr., p. 795; STCG, Schoonmaker Tr., p. 388).

When it first created COS, the Commission recognized that establishing a low-cost, flat-rated plan providing unlimited calling between exchanges with a community of interest would stimulate or increase calling between these exchanges. And it also recognized that such stimulation could subject a providing company to significant financial losses if intercompany compensation for COS was usage-based. This is one of the main reasons the Commission rejected the access-based proposals in favor of the Revenue Sharing Plan (RSP) when it initially established COS in 1990:

> The Commission determines that the RSP should be adopted as the COS intercompany compensation plan. There are several reasons to choose the RSP over the other two plans. The RSP prevents any LEC

> from profiting at the expense of another LEC not only at implementation, as do the other plans, but over time. Unlike the SWB and MO plans, the RSP has no usage sensitive element in the intercompany compensation which could eventually result in one LEC profiting at the expense of another. Since the bulk of the COS program is priced at a flat rate so that stimulation of traffic would not increase profits, a usage sensitive charge between the companies which would increase with stimulation of traffic could create a loss for the company paying the usage sensitive charge and a windfall for the company charging it.[9]

At that time, COS was expected to be a large and growing service. But with the later creation of Metropolitan Calling Area (MCA) service and Outstate Calling Area (OCA) service, the Commission expected most COS customers' needs would be addressed by these new services. In fact, it was expected that they would subsume most COS routes. Viewing COS as a diminishing service, the Commission did not believe shifting to an access-based intercompany compensation plan in 1993 would expose the providing companies to financial losses:

> The Commission . . . believes that subscription to COS will diminish dramatically once the OCA plan is fully implemented. Most COS routes are between exchanges within 23 miles and OCA should adequately address the calling patterns of customers . . . Also, many COS routes will be eliminated by their inclusion in one of the MCAs . . . The Commission finds that continuation of the Revised Revenue Sharing Plan (RRSP) for COS, in light of these circumstances, is not warranted. The RRSP was adopted when COS was the only service available and expected losses for PTCs were substantial . . . A reduction in the number of COS routes and the potential diminishing nature of the service make it more reasonable to shift the method of intercompany compensation.[10]

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[9]In the Matter of the administration of community optional service (COS) program and the consideration of the intercompany compensation plan, expedited treatment of COS-related rate increases and attendant issues, Case No. TO-90-232, Report and Order, p. 10, issued April 18, 1990.

[10]TO-92-306 December 23, 1992 Report and Order, pp. 39-40.

Yet, even under these circumstances, the Commission believed it appropriate to put some safeguards in place. The SCs, who proposed this access-based plan, acknowledged at the time that there would be an overall revenue gain to SCs and that those gains sometimes would be substantial. They also acknowledged in that case -- and in the present case -- that it was not appropriate that the companies obtain such a gain as a result of implementing COS. (STCG, Schoonmaker Tr., pp. 323-324). To prevent a windfall gain to the SCs, the Commission required them to make a one-time access charge reduction. The intent was to keep all companies, PTCs and SCs, revenue neutral. (Id., p. 325).

If the PTCs were ever revenue neutral because of this adjustment, it did not last long. Although it was not expected, many subsequent routes were established after the SCs made their one-time access adjustments. As additional COS routes were added and usage stimulated, the SCs received gains in access revenue payments from the PTCs. And on those routes, the PTCs lost revenue from toll which was replaced by lower COS revenue. They also gained expenses, i.e., additional access payments to the SCs which were not covered by COS revenues they received. (STCG, Schoonmaker Tr., pp. 326-327).

But because there was only one true-up after the present two-way version of COS was implemented, these gains to the SCs and losses to the PTCs from subsequently implemented routes were never trued up. While at least Southwestern Bell argued for subsequent true-ups (SWBT, Taylor Tr., pp. 702-705), the Commission's Order was interpreted as only permitting one true-up. At that time, it was expected that there would be few additional routes and subsequent true-ups would not be needed. (Staff, Smith Tr., pp. 801-802). As the evidence in this case shows, this forecast significantly underestimated the adverse financial impact of COS on the PTCs.

From Southwestern Bell's perspective, this impact has been particularly unsatisfactory. And for the most part, it has been caused by the current intercompany compensation mechanism which forces Southwestern Bell to pay out substantially larger amounts in access payments to SCs than it receives in COS revenue. Based on a study of the revenue and expense relationships on 18 COS routes that Southwestern Bell participates in (which represents 27% of the 67 routes where Southwestern Bell is the PTC and one of its SCs serves the petitioning exchange), for every $1.00 of COS revenue Southwestern Bell receives, it pays out $4.05 in access payments to SCs. (SWBT, Taylor Direct, pp. 2-4). Given that Southwestern Bell is impacted substantially more by SCs than are other PTCs, this analysis is reasonably consistent with that performed by the Small Telephone Company Group showing that PTCs pay out $3.31 in access charges for each $1.00 in COS revenue they receive. (STCG, Schoonmaker Direct, Sch. RCS-3 and Tr., pp. 328-329; SWBT, Taylor Surrebuttal, pp. 5-6).

While this result has been unsatisfactory, it is also unsustainable. PTCs will lose a significant share of their profitable toll traffic to competition when 1+ intraLATA presubscription is implemented. PTCs currently use profits from these routes as a source of subsidy for COS. In a presubscription environment, all of this traffic will not be available to help support COS. (SWBT, Taylor Tr., pp. 690-691).

The adverse financial impacts the PTCs currently experience would be unsatisfactory for any carrier. In the prior COS case, when faced with potential additional losses from their continued provision of COS, the Small Telephone Company Group in Case No. TO-92-306 alternately proposed eliminating COS, grandfathering it to existing customers, raising COS rates or changing intercompany compensation to an access-based arrangement. (STCG, Schoonmaker Tr., pp. 321 - 323). In this case, the Mid-Missouri witness testified that if it were required to be the COS provider, it certainly would want the opportunity to be made whole if new COS routes were added. He agreed that the PTCs should want that reasonable opportunity as well. (Mid-Mo, Jones Tr., p. 112). The Small Telephone Company Group's witness also testified that his clients would probably want true-ups too if they were required to provide COS and there were significant adverse financial impacts on them from adding COS routes. (STCG, Schoonmaker Tr., p. 399). Only in this case, the SCs did not lose money; the PTCs did. (Id., pp. 397-398).

While most of the negative impact on PTCs most likely arose from unexpected, but natural, growth in the service, it appears that some carriers gamed the process the Commission set up by holding back on the establishment of new routes until after they made their one-time access charge adjustment. Mark Twain Telephone Company appears to be a clear example. Its one-time access rate adjustment for COS was effective July 10, 1995. That adjustment was based on traffic volumes from one COS route (Greentop to Kirksville). Two months later, on September 11, 1995, Mark Twain implemented seven additional COS routes. According to its response to Southwestern Bell Data Request 15, Mark Twain was aware prior to July 10, 1995 that all seven of the routes met the COS qualifying criteria. (SWBT Data Request 15 attached to Bourneuf Rebuttal as Schedule 13-1; Taylor Rebuttal, pp. 12-13). The result can be seen in the disproportionate growth of Southwestern Bell's access expense relative to revenue growth. From April 1995 to April 1997, Southwestern Bell's total access payments to Mark Twain increased

115% while Southwestern Bell's total revenue from providing toll services in Mark Twain's exchanges increased only 7.5%. (SWBT, Taylor Surrebuttal, p. 8).

But purposeful or not, this situation shows that the arrangement under which COS is provided pits the interests of the SCs against those of the PTCs. Because PTCs are required to pay full access charges on COS traffic, the addition of each COS route and each increase in COS calling means increased access payments and increased losses for the PTCs. On the other hand, such increases mean increased profits for the SCs collecting those access charges. The diametrically opposed financial incentives are obvious. And this conflict is not good. It is not good policy for the Commission. It is not good for the industry. And ultimately, it is not good for customers. (SWBT, Taylor Rebuttal, p. 11, and Tr., pp. 715-720).

C. Improper use of COS by SCs. The current arrangement, under which SCs market COS to their own customers and administer the PTCs' COS tariffs, is not working. The problem arises from the PTCs having little control over how their COS service is sold by SCs and used by them and their customers. Because the PTCs have no direct relationship with the COS subscriber, they are not in a position to know how their service is being used or to ensure tariff compliance. (SWBT, Bourneuf Direct, p. 33). The SC is the only one with that relationship. Customers in SC exchanges order COS from the SCs which has to determine whether that customer's use is or is not consistent with the tariff. The SCs have acknowledged that the PTCs rely on them to enforce the tariff and make sure correct rates are charged to the end user. (STCG, Schoonmaker Tr., p. 332). The SCs act as agents for the PTCs. (Mid-Missouri, Jones Tr., pp. 129, 204).

During the course of this docket, Southwestern Bell learned for the first time that some SCs have been using Southwestern Bell's COS service as a component of their or their affiliate's

Internet access service offering. (SWBT, Bourneuf Rebuttal, pp. 7-9). They have been subscribing to COS in a petitioning exchange, establishing a modem pool there, and, for a monthly and/or hourly charge, allowing people in the target exchange to use the COS return calling feature to call back on a toll-free basis to that modem pool to access the Internet. (STCG, Opening Statement, p. 52). This use of COS violates several COS tariff provisions.

Paragraph 1.11.C.7 of Southwestern Bell's COS tariff indicates that when a customer's telecommunications service is arranged for its administrative use, versus use by its patrons, COS may be purchased for administrative trunks only. For example, COS may be purchased by a customer to receive calls from its own customers placing orders, to answer their customers' questions about products or services, or to market products and services to their potential customers. (SWBT, Bourneuf Rebuttal, p. 34).

But when an SC or its affiliate subscribes to COS for the use and communications of patrons of its Internet access service businesses, it is not using COS for its outgoing or inward administrative calling needs. None of these calls actually terminate to the SC or its affiliate. Target exchange customers are not calling these COS numbers to actually communicate with anyone employed by or acting on behalf of the SC; customers are not calling to talk about service problems; order products or services; obtain information about telecommunications services; or meet any of the ordinary and expected communications needs of a business customer. (SWBT, Bourneuf Rebuttal, pp. 34-35). These COS calls are simply being forwarded through SCs' and their Internet networks to other end users, who could be located anywhere in the world. (Mid-Missouri, Godfrey Tr., p. 233). The actual COS subscriber (the SC or its affiliate) is not communicating in any way with the target exchange caller. In short, these SCs or their affiliates appear to be using COS as a below-cost, subsidized special access line to provide interexchange calling to the entire Internet, not to themselves for administrative purposes. (SWBT, Bourneuf Rebuttal, p. 35).

Paragraph 1.11.C.8 indicates that COS is not to be shared, with the exception of Shared Tenant Services. When an SC (or its affiliate) subscribes to COS, but then allows end users to communicate with other end users over that service arrangement through the Internet, the SC is not participating in the communication at all. COS is not being used for the SC's own communications. Rather, the SC is allowing its COS subscription to be used for the communications of other end users. Such sharing is not permitted under the tariff. (SWBT, Bourneuf Rebuttal, pp. 35-36).

Paragraph 1.11.C.5 of Southwestern Bell's COS tariff states, in part, that COS is offered on a per line basis. Paragraph 1.11.C.11.a also indicates, in part, that the monthly COS rates apply on a per line basis (and clarifies how the per line rate applies to Plexar or Centrex-type services). These sections do not indicate that COS rates apply on anything other than a per line basis (such as per telephone number or hunt group). Whether a customer uses its two-way COS only for outgoing calling, or only for incoming calls, or for both, the rate applies on a per line basis to all lines that have the benefit of toll-free outgoing and/or incoming COS calling capabilities. (SWBT, Bourneuf Rebuttal, p. 37).

Paragraph 1.11.C.11.c indicates that COS must be purchased on all access lines for an account which is combined billed. COS is a two-way service. If all outgoing or incoming usage is combined billed for multiple access lines, the customer must subscribe to COS either for all lines, or for none of them. (SWBT, Bourneuf Rebuttal, p. 37).

Southwestern Bell understands some SCs are now interpreting paragraph 1.11.C.11.c, the "combined billing" provision, to excuse them from the tariff requirements to pay the COS monthly rate on each access line using COS if all such lines are not "combined billed." (SWBT, Bourneuf Rebuttal, pp. 40-41).

Some SCs, after Southwestern Bell inquired, admitted their aggregation of usage from multiple lines in a hunt group but paying COS rates only on the primary line was not appropriate and repaid Southwestern Bell on a retroactive basis. Northeast Missouri Rural Telephone Company candidly acknowledged that it was "not in a position to defend not paying all the rates." (Mid-Missouri, Godfrey Tr., pp. 254-255). Others, like Mark Twain Telephone Company, explained that their non-payment was just a mistake on their or their vendor's part. (SWBT, Bourneuf Rebuttal, pp. 39-40). But others, like Green Hills Telephone Company (using COS on 57 lines under five COS subscriptions) and Kingdom Telephone Company (using COS on 41 lines on two COS subscriptions), are somehow trying to twist Southwestern Bell's tariff claiming that they only have to pay one COS subscription for all lines in a multi line hunt group if those lines are not combined billed, even if all lines in that group receive incoming COS traffic. (See, Green Hills' Answer to SWBT DR No. 13 and Kingdom's Answer and Supplemental Answer appended to SWBT, Bourneuf Rebuttal as Schs. 1, 3 and 4).

This interpretation (which Southwestern Bell just heard for the first time during this proceeding) does not make sense given the clear language in the tariff that COS is offered and charged on a per line basis, the purpose behind that language, and its history. If a group of lines is combined in a hunt group (whether or not they are "combined billed"), the COS rate applies to each line in the group technically using COS (for outgoing calling, incoming calling, or both).

The argument that access lines receiving toll-free COS calls are not "subscribed" to COS and are not billed the COS rate because they are not "combined billed" has no merit. COS is a two-way service. If an access line is receiving toll-free COS calls from the target COS exchange, then it is provisioned with COS (whether or not the SC wants to consider it "subscribed" to COS for outgoing calling purposes), and the monthly COS rate should apply. Any access lines that are not charged the COS monthly rate should not be provisioned to receive toll-free inward COS calls. (SWBT, Bourneuf Rebuttal, pp. 37-38).

This per line rate application is exactly as it was when COS was provided by the petitioning exchange LECs on a local or non-toll basis from May 1990 to May 1993. At that time, the SCs agreed that COS should be charged on a per line basis because it was a flat-rated service. (SWBT, Bourneuf Rebuttal, p. 38). In fact, the minutes from the industry implementation committee (which the Small Telephone Company Group's witness actively participated in) show agreement that all lines in a hunt group must have the same COS service and that they are to be billed on a per line basis. (STCG, Schoonmaker Tr., pp. 330-331). Mid-Missouri witness David Jones agrees that this is the right way to do it and stated that from the beginning his company (Mid-Missouri Telephone Company) has always paid for COS on every line in its trunk hunting arrangements capable of using COS. It also applies COS rates in this manner to its customers with multi-line hunt groups using COS. (Mid-Missouri, Jones Tr., pp. 128-130).

The language now being questioned has been in the PTCs' COS tariffs since May 1993. If any of the SCs had questions about this tariff provision or how to apply it, they had an obligation to seek clarification from their PTC. None did. (SWBT, Bourneuf Rebuttal, p. 36; see also, Mid-Missouri, Godfrey, Tr., p. 250).

Southwestern Bell is not trying to discourage use of the Internet. The Commission is aware of Southwestern Bell's efforts to help make the Internet available to customers in Missouri, both through services like Designated Number Optional Calling Plan and community service programs like the TeleCommunity Centers. But the SCs' use of COS is improper. If the SCs believe COS should be offered and used in this manner, they should do it with their own service.

Southwestern Bell raises these side issues not because it thinks remedying these tariff violations will solve the serious problems with COS. It won't. Rather, these examples are to help show how the relationship between the PTCs and SCs, and the incentives between them, are out of whack. Southwestern Bell believes the best alternative is to make COS a one-way local service provided by each LEC and to change intercompany compensation to switched access charges less CCL. This was Southwestern Bell's position even before it discovered the tariff violations, and would be its position if the violations never occurred.

From Southwestern Bell's standpoint, the current arrangement is not working. And it is only going to get worse when 1+ intraLATA presubscription is implemented. In its testimony and this brief, Southwestern Bell has set out what it thinks needs to be done. And it stands ready to work with the Commission in its efforts to conform COS to the new competitive environment.

## CONTESTED ISSUES

### I. STRAW PROPOSALS, COMPENSATION MECHANISM AND PROPOSED ALTERNATIVES.

A-1. Should two-way COS be modified to use 800/888 number based service for the return calling portions of the service?

Southwestern Bell does not support maintaining two-way COS, but if the Commission determines that two-way COS must be continued, the 800/888 number approach is the most viable two-way alternative proposed to date. (SWBT, Bourneuf Direct, p. 3).

The 800/888 approach, however, has several significant problems. Using 800/888 numbers to provide two-way COS contributes to the depletion of those numbers which are already approaching exhaust. (Id., pp. 5-10; Bourneuf Rebuttal, pp. 15-17; Staff, Smith Direct, pp. 9-10). While the allotment process for 800/888 numbers is not as restrictive as it was (instead of restricting a carrier's weekly allotment, the new procedure restricts the number of 800/888 numbers a carrier can have on reserve), there is still an allotment process for 800/888 numbers. (SWBT, Bourneuf Tr., pp. 480-483).

Customers may also feel it is an inconvenience to have to use a second number for their toll free return calls, as they did when COS was provided using two telephone numbers and Remote Call Forwarding technology. Under that method, customers complained about the need for two numbers and the difficulties associated with advertising and printing stationary and other business supplies when their customers had to call the COS number from certain locations and the local number from other locations. Customers were also concerned with the difficulty callers may have in locating their correct COS number. There may also be customer dissatisfaction from confusion surrounding the use of 800/888 numbers. (SWBT, Bourneuf Direct, pp. 7-8).

Southwestern Bell, however, does not believe that it is necessary to make the 800/888 number return calling capability a mandatory component of COS for all customers. Instead, those customers with a need for toll free inward calling can use a wide variety of existing competitive 800 services and can customize the inward calling scopes of such services to suit their individual needs. (Southwestern, Bourneuf Direct, p. 4).

A-2. Should one-way reciprocal COS service replace two-way COS service?

Southwestern Bell recommends that the Commission modify COS to a one-way only service. In the alternative, it could be modified to a one-way reciprocally available service. With the reciprocal COS alternative, customers in COS target exchanges with a community of interest to petitioning exchanges would have the opportunity to subscribe to COS for calling back to those petitioning exchanges. While these target exchange subscribers would be required to pay for the service, they would also have a much larger calling scope than they presently have because they would be able to call all customers in a petitioning exchange toll free, not just COS customers. (SWBT, Bourneuf Direct, pp. 10-11).

There are no technical constraints to either the one-way only or the one-way reciprocal alternative. In either case, it should be offered as a local, 7-digit (or 10-digit) dialed service by the originating exchange LEC. In this manner, COS would be available to more customers in the petitioning exchanges, because their choice of 1+ intraLATA toll provider would not affect whether the one-way service was available to them. (SWBT, Bourneuf, Direct, pp. 10-11).

If the Commission adopts the one-way reciprocally available alternative, it will need to determine how the service will be provided in exchanges that are target exchanges on multiple routes. The question is should customers in such exchanges be able to subscribe to COS on just one of the multiple return COS routes, all of them, or some combination of routes. Given central office switch programming limitations and administrative burdens, it is not feasible to permit such customers to pick a certain COS route or a combination of routes. For these reasons, Southwestern Bell recommends making COS one-way only. But if the Commission selects one-way reciprocal, customers in target exchanges on multiple routes should only have the option of purchasing COS to all petitioning exchanges at a higher COS rate than for a single route. (SWBT, Bourneuf Direct, pp. 12-16).

If the Commission selects the one-way reciprocally available alternative, it will also have to determine whether the reciprocally available COS would also be offered to the target Extended Area Service (EAS) points; and whether those EAS points should continue to be included in the COS calling scope for petitioning exchanges. (Currently, COS extends to the EAS points of target exchanges and COS subscribers pay the applicable EAS additives in these cases.) Southwestern Bell believes reciprocally available COS should not be offered to customers in EAS points of target exchanges. These EAS exchanges have not petitioned and qualified for COS, nor has the petitioning exchange demonstrated any community of interest with these EAS points. For this reason, Southwestern Bell also believes the Commission should consider eliminating target exchange EAS points from the COS calling scope (with a concurrent reduction in the COS rate for these customers to reflect elimination of the EAS additive). While there may be some customer dissatisfaction with the smaller COS calling scopes, these problems could be minimized if a LATAwide COS were also offered. (SWBT, Bourneuf Direct, pp. 16-18).

A-3. Should One-Way COS Service Replace Two-Way COS Service?

Southwestern Bell recommends that the Commission modify COS to a one-way only service to be offered by the petitioning exchange LEC. In a competitive environment, Southwestern Bell believes the one-way option is the best and most sustainable alternative.

The only community of interest showing on all current COS routes has been from the petitioning exchange to the target exchange. This showing has been made by studying the calling patterns of customers in the petitioning exchanges. No similar showing has ever been made for the target to petitioning exchange routes. If the Commission determines that COS should be continued for qualifying routes and makes COS a one-way only service, customers in target exchanges with a community of interest to petitioning exchanges can petition the Commission to establish a return COS route. Such customers will then have the opportunity to demonstrate that the route meets the Commission-established criteria and qualifies for COS.

Southwestern Bell disagrees with the Mid-Missouri Group's contention that COS' return calling feature is just as important, if not more so, than the ability to make outgoing calls to the target exchange. (See, Mid-Missouri, Jones Direct, p. 6). When both one and two-way COS service was available, the number of Southwestern Bell's one-way COS subscribers was 80% of the number of two-way subscribers. (SWBT, Bourneuf Rebuttal, p. 6). The Small Telephone Company Group attempts to demonstrate the importance of return calling through its calculations showing that the average return COS calling is about 5.75 hours a month (compared to 7.75 for outgoing COS calling). (See, STCG, Schoonmaker Direct, p. 11). This return calling figure, however, has been artificially and perhaps severely inflated by some SCs' or their affiliates' improper use of COS as a network element to provide interexchange Internet access services to end users.

Most of the COS return calling traffic appears to be generated by such improper use of COS by SCs' Internet businesses. Southwestern Bell was able to identify 13 COS telephone numbers, where the COS subscriber is an SC or its affiliate and is using COS to provide Internet access services. These 13 telephone numbers represent only 0.1% of all COS telephone numbers that can be called toll-free under COS from all Southwestern Bell target exchanges. Using one month's data, Southwestern Bell analyzed the amount of return COS calling that terminated to these 13 COS telephone numbers versus calling that terminated to all other COS telephone numbers. For all COS routes on which Southwestern Bell serves as the target exchange, 42 percent of all COS minutes of use from target to petitioning exchanges terminated at these 13 COS numbers, which are all SCs or their affiliates. When Southwestern Bell looked only at the COS routes on which these 13 telephone numbers were subscribed, those SCs' or their affiliates' 13 telephone numbers received 91 percent of the total COS minutes of use from the target to the petitioning exchanges on those specific routes. (SWBT, Bourneuf Rebuttal, pp. 11-12).

Data filed by the SCs as late-filed exhibits in response to Commissioner Crumpton's requests confirm these results. For those SCs providing information on return call volumes, the SCs' affiliated Internet provider Rural Area Information Network (RAIN) is the most heavily-called COS subscriber (RAIN uses telephone numbers that spell "R-A-I-N on the dial, i.e., NPA-NXX-7246). (See, late-filed exhibit filed by STCG on August 1, 1997 showing return call volumes for ALLTEL's Bellflower's exchange, ALLTEL's Milan exchange, New Florence's New Florence exchange and Northeast Missouri's Pollock exchange. See also, Mid-Missouri late-filed exhibit 48HC showing return call volumes on the COS route from Modern Telephone's Omaha exchange to GTE's Unionville exchange).

This use of COS has nothing to do with the original community of interest intent of the service. The intent of COS when it was established by the Commission was to provide a low-priced service to end users to address those situations where end users worked, went to school, attended church, received medical care, etc. in a neighboring exchange. A two-way option was made available for individuals to call their own homes from that neighboring exchange, or so friends, family or associates in that exchange could call them toll-free. The use of two-way COS to provide Internet access is not consistent with the intent of COS. Callers to the Internet number are not making such calls because they have a community of interest with the COS subscriber or the exchange where the Internet access provider happens to be located; they are not actually communicating with the Internet access provider at all. They just want to use the Internet itself, which actually allows them to communicate with any location in the world, not just the COS subscriber in the petitioning exchange. (SWBT, Bourneuf Rebuttal, pp. 10-11).

A-4. <u>Should COS be eliminated completely</u>?

Southwestern Bell supports the elimination of the mandatory requirement to offer COS. No carrier should be required to offer a specific expanded calling service due to the high level of competition that exists. LECs that are willing to continue to offer it, however, should be permitted to do so. Southwestern Bell does not want COS eliminated in its exchanges, just the price to be adjusted so the rates cover the costs. In fact, Southwestern Bell has committed to offer a one-way, cost-based optional local service to its customers. (SWBT, Bourneuf Tr., pp. 566-568).

B-1. <u>If some form of COS is preserved, should the current compensation mechanism for COS also be maintained</u>?

As currently configured, COS is a highly subsidized service. The COS revenue falls dramatically short of covering even the direct cost of access paid out by the PTCs providing COS, much less their network and administrative costs associated with providing COS. (SWBT, Taylor Direct, p. 4). Regardless of how the Commission reconfigures the COS retail product, the current compensation mechanism should be terminated.

Southwestern Bell recommends that COS be provided as a local service by the LEC serving each individual exchange. The LEC of the petitioning COS exchange should be the provider of the one-way COS to customers in the petitioning exchange. Should the Commission mandate one-way reciprocally available COS, the LEC of the target exchange should be the COS provider for the reciprocal (target exchange to petitioning exchange) service. (SWBT, Taylor Direct, p. 7).

In both cases, the LEC providing COS should pay terminating compensation to any other LEC whose network is used to terminate COS traffic. The terminating compensation should be at terminating switched access rates less the Carrier Common Line (CCL) element of the terminating LEC. In each case, the COS provider would receive and retain the COS revenue. (SWBT, Taylor Direct, pp. 7-8). This proposal is consistent with the reciprocal compensation rate Southwestern Bell has established with local service providers (LSPs) for exchanging similar traffic. (SWBT, Taylor Tr., p. 694).

If the Commission adopts a two-way, 800/888 number-based serving arrangement, the LEC of the petitioning exchange should be the COS provider. That LEC should receive the COS revenue and pay terminating switched access less CCL (as previously described) to the target exchange LEC. In addition, the COS provider should pay the target exchange LEC originating switched access, less CCL for the origination of the target exchange to petitioning exchange traffic. (SWBT, Taylor Direct, p. 8).

Both of these proposals set out a compensation mechanism that is better coordinated with the current retail price. Under both, the CCL element has been removed. If COS (or any like service) is intended by the Commission to be subsidized or "socially priced," compensation based on rates which themselves incorporate implicit subsidies is not practical. (Id., p. 7).

B-2. If Some Form of COS is Preserved, Should it be Classified as a Local or Toll Service?

Southwestern Bell believes that COS should be classified as local, and offered by the LEC in the petitioning exchange. A local designation is consistent with the type of expanded calling service that customers generally desire. Customers like flat-rate services, and they like seven-digit or ten-digit dialed services (no 1+), and both of these characteristics are more consistent with local service than toll services. In addition, if COS was local, all of the LEC's customers in COS exchanges would have the ability to subscribe to, and have access to, outgoing COS regardless of their choice of intraLATA toll carrier in an intraLATA presubscription environment. There should not be any technical constraints preventing this classification, because COS has already been provided in Missouri by the petitioning exchange LEC on a local or other non-toll basis from May 1990 until May 1993. (SWBT, Bourneuf Direct, pp. 18-19). If COS is classified in this docket as a local service, then changes to the PTC Plan which arise out of Case No. TO-97-

217/TO-97-220 will not cause the Commission to have to revisit all of these issues pertaining to the continued provisioning of COS. (Id., p. 19; Staff, Smith Tr., p. 786).

Given the high degree of competition in the toll market, discounted toll services should not be mandated. But if the Commission finds that there is an imperative social need that is not being met by competitive forces in the toll market, it should conclude that the mandated services should be classified as local to recognize the fact they meet a social goal. (SWBT, Bourneuf Direct, pp. 18-19).

While some SCs have claimed that they do not have the physical facilities necessary to provide COS themselves, actual ownership of such facilities is unnecessary. One carrier generally does not own the complete interexchange toll facilities which connect its exchanges with another company's exchanges. Rather, these facilities are currently being provided jointly by the PTCs and SCs on a meet point basis. Today, when a new COS route is implemented, the PTC does not construct its own interexchange facility between the petitioning and target exchanges. Instead it pays the SC access charges to use the SC's facilities from the meet point back to the rest of the SC's facilities. (SWBT, Taylor Tr., pp. 708-710; Mid-Missouri, Jones Tr., p. 203).

And even though SCs do not own the complete interexchange facility, the portions they do not own are fully available to them. When asked by Vice Chair Drainer, the Mid-Missouri Group's witness admitted that SCs could use the PTCs' portions of these facilities through a contract arrangement. He acknowledged that an SC could pay Southwestern Bell or the other PTCs from the meet point back to their facilities and that the SC could do it day one without any change in the network. The SC would simply pay Southwestern Bell (or another PTC) its access rates from the meet point back to Southwestern Bell's facilities. Alternatively, the SC could use the facilities of another carrier. (Mid-Missouri, Jones Tr., pp. 147-149, 202-204). Staff concurred that such arrangements are available. (Staff, Smith Tr., p. 816).

If Southwestern Bell is permitted to stop providing toll for SC exchanges, it is not going to remove its portion of the existing interexchange facilities. Southwestern Bell still must have a means of delivering its own customers' toll traffic to SC exchanges. Southwestern Bell is more than willing to permit SCs to use those facilities to provide COS and outbound toll calling to their own customers. (SWBT, Taylor Tr., pp. 651-652). Southwestern Bell's intrastate access tariff already provides the arrangements for such facility use. (See, Southwestern Bell Access Services Tariff, P.S.C.Mo.-No. 36, Section 6).

B-3. If any form of COS is preserved, should aggregation and/or resale of COS service be allowed?

If the Commission preserves some form of COS, Southwestern Bell acknowledges that consistent with the Telecommunications Act, it is available for resale by other LSPs. If resale is permitted, no resale discount should apply if the price set by the Commission does not cover all costs of providing the service.

Aggregation of multiple end users, however, should not be permitted. Carriers design and price retail services based on an individual end user's anticipated usage, not on the usage of multiple end users sharing a single service. If aggregation were permitted, prices based on individual end user usage levels could not be sustained. Rather, prices would have to cover anticipated aggregated usage of multiple end users. As a result, carriers would not be able to offer the service at prices that would benefit individual end users. (SWBT, Bourneuf Surrebuttal, p. 29).

In addition, permitting such aggregation would preclude incumbent LECs from competing in the retail market and would relegate them to the role of wholesale service providers because the incumbents' tariffed prices could in no way compete with the price an aggregator could charge once the underlying rate was spread among multiple end users. This would have the immediate effect of dramatically reducing the overall level of competition in the telecommunications market, to the detriment of all telecommunications customers. (SWBT, Bourneuf Surrebuttal, p. 29).

Southwestern Bell witness Debbie Bourneuf provided a mathematical example showing why aggregation should not be permitted for a flat-rate service. While this example was geared to a proposed LATAwide COS service, it is just as applicable to the currently configured COS service. If a LEC were to offer a service at $60 per month, and if the resale discount were 20 percent, then the cost of this service to the reseller would be $48 (or 20 percent off of $60). Even without aggregating multiple end users, the reseller is placed at a potential competitive advantage because the lowest price it can charge end users and continue to cover its cost is $48, $12 less than the LEC's tariffed rate. If, on top of that, resellers could aggregate multiple end users, their advantage grows unfairly and substantially. If only two end users were aggregated, the price for each of the reseller's end users can drop to $24, or half of the $48 total. With three end users, the reseller's price may be as low as $16. Actually it is not likely the end users would actually obtain prices this low from the reseller. It is far more likely that the reseller would simply price low enough to undercut the LEC's $60 rate, say at $50. With three end users aggregated on one service, the reseller could charge $150 total, but its costs would remain at $48, and the reseller could keep $102 in profit. (Id., p. 30).

Allowing such aggregation does not provide an "alternative" form of COS, as CompTel claims (CompTel, Ensrud Rebuttal, p. 19). It is just a math exercise. With aggregation of multiple end users on LATAwide COS, a CompTel member does not add any value to the service, and does not change its properties, its scope, or its availability. The reseller does not improve the quality of service. It is simply reselling the service of the underlying LEC. While CompTel claims it wants to be able to compete on a "head-to-head" basis, (Id., p. 20) allowing aggregation would ensure that such head-to-head competition could never occur. The benefits that accrue to resellers under aggregation are not due to their own efficiency, productivity, marketing prowess, creativity, ingenuity, or even plain old hard work. It is the underlying LEC that expends the marketing, network, administrative and creative efforts and resources to develop and implement such customer-oriented services. (SWBT, Bourneuf Surrebuttal, pp. 30-31).

The Commission has previously found aggregation restrictions to be reasonable for other optional calling plans. In its Order in the interconnection arbitration between Southwestern Bell and AT&T and MCI, the Commission, following extensive testimony and briefing on the issue, found it appropriate to maintain the restrictions on aggregation of toll service for resale.[11] Therefore, all of Southwestern Bell's toll services (including optional toll calling plans) currently fall under this restriction. The Commission reaffirmed this position when it approved

[11] In the Matter of AT&T Communications of the Southwest, Inc.'s Petition for Arbitration pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company, Case No. TO-97-40 and Petition of MCI Telecommunications Corporation and its Affiliates, Including MCImetro Access Transmission Services, Inc. for Arbitration and Mediation Under the Federal Telecommunications Act of 1996 of Unresolved Interconnection Issues with Southwestern Bell Telephone Company, Case No. TO-97-67, Arbitration Order, issued December 11, 1996, p. 46.

Southwestern Bell's amended tariff for its Designated Number Optional Calling Plan which made the service available for resale, provided that the tariff aggregation restriction applies to resellers as it did to Southwestern Bell.[12] Such a restriction is appropriate for any form of COS (including LATAwide COS) for exactly the same reasons it is appropriate for toll services.

B-4. What is (are) the potential impact(s) of expected changes in the Primary Toll Carrier Plan on COS?

Southwestern Bell currently provides COS for many SC exchanges as the PTC for those exchanges. As explained in more detail in Section I of the Background portion of this brief (above), there are fundamental technical problems that make the PTC Plan incompatible with intraLATA presubscription. Those issues are to be addressed in Case Nos. TO-97-217/TO-97-220. There, Southwestern Bell seeks to be relieved of PTC responsibilities for SC exchanges. Instead, intraLATA toll provider responsibility for those exchanges should pass either to IXCs who have indicated a willingness to provide 1+ intraLATA toll or to the SCs who would assume toll carrier responsibility. If the Commission makes COS a local service provided by the petitioning exchange LEC, the COS issues being addressed in this case will not have to be revisited in the PTC case. If the Commission here determines that COS should remain a toll service, Southwestern Bell believes the issue will be revisited in Case No. TO-97-217/TO-97-220 and will potentially alter some parties' willingness to be intraLATA toll providers in SC exchanges. (SWBT, Taylor Tr., p. 688).

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[12] In the Matter of Southwestern Bell Telephone Company's tariffs to revise PSC Mo. No. 26, Long Distance Message Telecommunications Services Tariff to introduce Designated Number Optional Calling Plan, Case No. TT-96-268, Order Approving Tariff, issued February 5, 1997, p. 2.

## II. ISSUES SET BY THE COMMISSION

1. Is the appropriate pricing mechanism for one-way COS with reciprocal service the same as set out by the Staff in Case No. TT-96-398? If not, so indicate and substantiate an alternate proposal. No. Southwestern Bell believes that the one-way COS prices should be company-specific prices and should be based on each participating companies' individual circumstances. Other than on the Commission-mandated expanded calling services, the rates for every other service of a LEC, including basic local service, are set on a company-specific basis and there is no requirement to match the rates of another LEC. When even basic local exchange service is priced at company-specific levels, there does not appear to be a unique reason why expanded calling services should be treated differently from other services in this regard. (SWBT, Bourneuf Direct, p. 20).

In addition, Southwestern Bell believes that the company-specific COS prices should be set so that the service's revenue exceeds the costs to provide it, including applicable intercompany compensation expenses. If COS is modified to a one-way service, each participating company can provide the rationale for its proposed rate when it makes its tariff filing modifying or offering COS. (SWBT, Bourneuf Direct, pp. 20-21).

Southwestern Bell's specific pricing proposal depends in part on whether the service is provided as local or toll, because Southwestern Bell's costs are dramatically affected by the level of intercompany access payments. Therefore, Southwestern Bell makes the following alternative pricing recommendations, depending on the outcome of the local or toll classification for the service:

| | | Local | Toll |
|---|---|---|---|
| I. | Proposed Business One-Way COS Prices: | | |
| | A. Metro COS to St. Louis or Kansas City | | |
| | 1. Petitioning Exchange, per route, or Single-Route Target Exchange | $40.10 | $ 70.55 |
| | 2. Multi-Route Target Exchange | $80.20 | $141.10 |
| | B. Metro COS to Springfield | | |
| | 1. Petitioning Exchange, per route, or Single-Route Target Exchange | $25.25 | $ 70.55 |
| | 2. Multi-Route Target Exchange | $50.50 | $141.10 |
| | C. Rural COS | | |
| | 1. Petitioning Exchange, per route, or Single Route Target Exchange | $16.75 | $ 57.10 |
| | 2. Multi-Route Target Exchange | $33.50 | $114.20 |

| | | Local | Toll |
|---|---|---|---|
| II. | Proposed Residence One-Way COS Prices: | | |
| | A. Metro COS to St. Louis or Kansas City | | |
| | 1. Petitioning Exchange, per route, or Single Route Target Exchange | $18.90 | $ 35.30 |
| | 2. Multi-Route Target Exchange | $37.80 | $ 70.60 |
| | B. Metro COS to Springfield | | |
| | 1. Petitioning Exchange, per route, or Single Route Target Exchange | $12.25 | $ 35.30 |
| | 2. Multi-Route Target Exchange | $24.50 | $ 70.60 |
| | C. Rural COS | | |
| | 1. Petitioning Exchange, per route, or Single Route Target Exchange | $ 8.00 | $ 28.55 |
| | 2. Multi-Route Target Exchange | $16.00 | $ 57.10 |

If COS is classified as local and offered by the originating exchange LEC, Southwestern Bell has no objection to Staff's proposed 50 percent COS price reduction if it becomes a one-way service. These proposed prices will cover Southwestern Bell's costs of providing the service for the 12 COS routes it serves as petitioning exchange LEC. For this reason, Southwestern Bell's recommended prices for COS petitioning exchanges or single-route target exchanges under a local classification are the same as those recommended by Staff. (SWBT, Bourneuf Direct, pp. 54-56).

To determine its recommended prices for one-way COS under a toll classification, Southwestern Bell calculated its costs of providing COS for those routes on which Southwestern Bell currently serves as the petitioning exchange PTC. Those costs include the originating switched access paid to SCs in COS exchanges served by Southwestern Bell as a PTC, plus the terminating switched access paid to other LECs for terminating COS calls. In addition, the costs include Southwestern Bell's incremental costs of carrying and completing COS calls originated by Southwestern Bell customers. Using Mr. Evans of GTE's proposed convention, total usage-sensitive costs were increased by 20 percent as an estimate of non-usage (i.e., retailing) costs. The total costs were divided by the number of COS subscribers served by Southwestern Bell, and then rounded up to the next nickel, to determine the proposed COS prices. The costs on rural routes appeared to be sufficiently different than costs on metro routes to justify different rate levels for rural versus metro COS routes. (SWBT, Bourneuf Direct, p. 56).

In all cases, the price that Southwestern Bell proposes for target exchanges on multiple COS routes (under the one-way reciprocal COS proposal) is double that of the single-route price. Southwestern Bell did not have information on which to base a value for this service. For example, Southwestern Bell cannot determine whether individual customers in target exchanges tend to make most of their calls on one COS route, or on multiple COS routes, and if multiple routes, on how many of the routes individuals tend to call. This is further complicated by the fact that target exchange customers would be able to call all petitioning exchange customers, not just COS subscribers. Therefore, it is difficult to support a specific price for multi-route target exchanges based on calling data. However, it is clear that customers who could call on multiple routes would have a broader calling scope than customers who could call on only one route. Therefore, Southwestern Bell proposes a multiple-route target exchange COS price that is double that of the single-route COS price based on the expectation that customers would value the multi-route calling scope twice as much, or more, as the single-route calling scope. (SWBT, Bourneuf Rebuttal, pp. 56-57).

2. Shall all competitive LECs be required to offer this service? No. Due to the high degree of competition in the telecommunications market today, Southwestern Bell does not believe that any company should be required to offer specific expanded calling services. Customers in the market should determine the calling services that will be offered by competitors and such competition should eliminate the need for mandated services. (SWBT, Bourneuf Direct, pp. 24-25; Tr., 576).

If the Commission determines that it is necessary to mandate the continued provision of COS, then it should classify COS as a local service to reflect the fact that its offering has been mandated in order to meet a social goal. Only if the Commission requires LECs to offer an expanded calling service below cost, it should require all competitive LECs to offer the service so that no single competitor is disadvantaged relative to others (and no resale discount should apply). (SWBT, Bourneuf Direct, pp. 24-25; Tr., 576).

3. What, if any, change must be made in the Primary Toll Carrier (PTC) Plan to accommodate or accomplish the proposed COS changes herein? If the Commission changes COS to a local one-way only or one-way reciprocally available service with the intercompany compensation mechanism Southwestern Bell proposes, little if any changes will have to be made to the PTC Plan to accommodate changes to COS. (There are, however, other reasons outside this docket to change the PTC Plan.) If a LEC, for technical or other reasons, determined to provide COS on a 1+ basis rather than on a local dialed basis, the PTC/SC Agreements might have to be amended to reflect that 1+ COS traffic is not the responsibility or property of the PTC. The only other change is more of a process change than a PTC Plan change. COS usage and compensation will have to be segregated from other intercompany compensation due to the difference in who pays who and the compensation rate differential. Given that COS traffic already has to be segregated and handled differently for customer billing purposes, that should not be a significant administrative issue. (SWBT, Taylor Direct, pp. 10-11).

4. Shall the Commission stay all pending and future COS applications? Yes. Southwestern Bell believes that COS should be grandfathered to existing locations as a local service and that all pending and future COS applications should be stayed. (SWBT, Bourneuf Direct, p. 26).

While there are still exchanges that request COS and a small number that continue to pass the calling criteria, Southwestern Bell believes that the vast majority of exchanges that have an interest in COS and can pass the COS calling criteria have already done so. Of the 78 COS routes currently filed in Southwestern Bell's toll tariff, 50 of the routes were implemented in 1993, 12 were implemented in 1994, ten were implemented in 1995, four were implemented 1996, and two have been implemented thus far in 1997. The number of routes that pass the calling criteria has declined every year, and is reaching a very small number. (SWBT, Bourneuf Direct, pp. 26-27).

In addition, it will be difficult to perform an accurate calling study in a competitive environment. As intraLATA presubscription is implemented in Missouri, and as new LSPs begin to operate in various exchanges, the incumbent LEC will no longer have the ability to measure and report all toll calls from the petitioning to the target exchanges. In order to perform a complete calling study in the future, presumably the Staff would have to acquire the sensitive calling information from the various competitors to compile the total calling volumes between the two exchanges. Given the potentially large number of companies from which Staff would have to obtain data in order to conduct a usage study, Southwestern Bell questions whether it is realistic to believe that Staff will be able to obtain all of the necessary data. Even under the best case assumption that Staff will be able to obtain data from all competitors, Southwestern Bell does not believe that calling usage studies will be able to be completed in the same time frames that they are done today. (SWBT, Bourneuf Direct, pp.27-28).

Only OPC opposes the Commission staying all pending and future COS applications. It maintains consumers should not be denied COS awaiting resolution of issues pertaining to the service. (OPC, Meisenheimer Direct, p. 5)

Southwestern Bell disagrees. Customer dissatisfaction is likely to be greater if we proceed with implementing new routes at this time, then change their service shortly thereafter. This belief is based in part on the time it takes to conduct a calling usage study, submit the results to the Commission, obtain an Order of Implementation, notify customers of a new route, receive orders for the new service, process the orders, enter the telephone numbers into the billing systems, and potentially make required network changes. For petitions processed now, customers will likely be notified of the availability of the service around the same time the Commission may be issuing an order changing the service. Customers are not likely to understand a notice explaining that the service they just received may soon be unavailable. They are also unlikely to understand why giving them a new service and taking it away a short time later is in their best interest. By staying current and pending COS routes, nothing is being taken away from the customers' existing choices of services. (SWBT, Bourneuf Rebuttal, p. 58)

5. What is the participants' proposal for educating the public? Southwestern Bell believes that COS subscribers in the petitioning exchanges and all customers in target exchanges should be notified on existing routes prior to changes taking place in their exchange. Existing COS subscribers should be notified via a direct mail letter, separate from the bill, sent by the end office LEC. If the Commission adopts the one-way reciprocal COS proposal, target exchange customers should be similarly notified by a direct mail letter. If the Commission adopts the one-way only alternative or the 800/888 number return calling alternative, the target exchange customer should be notified via a bill message by the end office LEC. In all cases, the letters or bill message should explain the service change and any impact on customer rates. The specific contents of the letters and bill messages Southwestern Bell proposes are outlined in the Direct Testimony of Debbie Bourneuf. (SWBT, Bourneuf Direct, pp. 28-32).

Southwestern Bell concurs that the educational process should include an explanation to help customers understand that the changes to COS are necessary due to changes in the environment and technology. (SWBT, Bourneuf Tr., p. 573).

6. Could a LATAwide or statewide flat-rate COS plan be a viable substitute for the current COS arrangement? Yes. But Southwestern Bell does not believe that a two-way LATAwide or statewide flat-rate COS offering is a viable alternative. The same type of problems that currently exist with return calling on two-way COS would also apply to a LATAwide or statewide two-way service but on a greater scale. (SWBT, Bourneuf Direct, p. 33).

Southwestern Bell, however, believes that customers would find a one-way LATAwide flat-rate COS very appealing. In contrast with a route-specific plan, a LATAwide calling service is more likely to include an individual customer's communities of interest, even in those situations where the individual's calling pattern may be quite different from that of the average caller in his or her exchange. Such a service would be automatically available on an optional basis to all customers. Therefore, customers would no longer have to submit specific petitions and pass calling criteria in order to obtain a desired expanded calling scope. (SWBT, Bourneuf Direct, pp. 33-34).

If carriers like Southwestern Bell are permitted to offer a LATAwide COS, competition will generally be increased and encouraged in Missouri. Since other competitive carriers will be more interested in offering similarly attractive options, customers will benefit from such increased competition and additional choices. (SWBT, Bourneuf Direct, p. 36).

For such an offering to be viable, the offering company must be permitted to offer the service with tariff use limitations prohibiting subscribers or resellers from aggregating the calling of multiple end users. It should be permitted to be offered as an optional local service, available in the local exchange tariff, provided with a local dialing pattern (no 1+), and subject to local dialing parity requirements. But carriers who are PTCs should not be required to make the service available on an originating basis to customers of SCs. It should not be a mandated offering for all LECs. As the service would be available for resale, it should not be subject to imputation of access charges. (SWBT, Bourneuf Direct, pp. 34-39).

## CONCLUSION

Southwestern Bell recommends modifying COS to a one-way only, locally dialed and tariffed service provided by the LEC serving the originating (petitioning) exchange. Alternatively, COS should be modified to a one-way reciprocally available service offered on a similar basis. In either case, intercompany compensation on COS traffic should be based on switched access charges less the CCL element (rather than full access charges).

This proposal presents no significant technical barriers and is the simplest approach to providing expanded local calling. Making COS local and reducing access charges for this traffic will eliminate the unnecessary and inappropriate subsidy flows, remove the unintended incentives which have pitted the financial interests of the PTCs and SCs against each other, and refocus COS on the community of interest needs it was established to meet.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

Copies of this document were served on the parties listed below by facsimile, overnight delivery and first-class U.S. Mail postage prepaid, on August 8, 1997.

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