BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Southwestern Bell Telephone Company's Tariffs to Revise P.S.C. Mo.-No. 36, Optional Payment Plan (Volume and Term Discounts) for Switched Access Service.	)))))	**Case No. TT-96-21**

REPORT AND ORDER

Issue Date: May 24, 1996

Effective Date: June 4, 1996

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APPEARANCES

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and

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ADMINISTRATIVE LAW JUDGE: **Cecil I. Wright, Chief.**

REPORT AND ORDER

On July 3, 1995, Southwestern Bell Telephone Company (SWB) submitted proposed tariff sheets to the Missouri Public Service Commission (Commission) designed to implement an optional payment plan for switched access service. Switched access service enables interexchange carriers to originate and terminate long distance calls to and from the local exchange carrier network. The optional payment plan would provide price discounts to interexchange carriers if the carrier commits to purchasing switched access from SWB for a certain length of time at a certain volume.

On August 4, 1995, the proposed tariff sheets were suspended by the Commission. On August 15, 1995, the Commission granted intervention in this proceeding to AT&T Communications of the Southwest, Inc. (AT&T), MCI Telecommunications Corporation (MCI) and Digital Teleport, Inc. (Digital), and set a prehearing conference. On September 19, 1995, the Commission granted intervention to Competitive Telecommunications Association of Missouri (CompTel), Kansas City Fiber Network, L.P. (KCFN), and GTE Midwest Incorporated (GTE). On September 27, 1995, the Commission adopted a procedural schedule for this case and allowed the tariff sheets to become effective on the effective date of November 3, 1995.

An evidentiary hearing was held on January 22 and 23, 1996. Parties subsequently filed briefs and the case is now before the Commission for decision.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact.

SWB is a regulated local exchange company which provides service in certificated areas throughout the state of Missouri. One of the services which SWB provides is switched access service. Switched access service provides the interconnection between calls originating or terminating in a local exchange and the interexchange carrier (IXC) which has been chosen to handle the long distance, interexchange, call. The IXCs therefore are customers of SWB for this service, and the IXCs are charged tariffed rates for using SWB's facilities in transmitting the IXCs' traffic.

Switched access consists of carrier common line, local switching and local transport. Carrier common line is that portion of the SWB network between the individual subscriber to local service and the local switching serving wire center. The local switch then routes the call toward its destination. Local transport is the interexchange element which transports the call between the IXC's point of presence and the end office. Under the current rate structure, these elements are bundled so that an IXC pays one rate for the bundled services which comprise switched access service.

In this case SWB offers a discount to any IXC which agrees to provide a certain volume of the IXC's traffic to SWB for a certain amount of time. The commitment levels range from 80 percent to 100 percent of an IXC's base period traffic. The base period is the IXC's most recent twelve months of billed usage. The discount is available for terms of one, two, three, four or five years. Discounts increase for a higher percentage of commitment and for a longer term of commitment. The maximum discount is 10 percent, which is given if an IXC agrees to provide 100 percent of its base period traffic to SWB for a five-year period.

Under SWB's optional payment plan (OPP), if the IXC's traffic exceeds its commitment levels, it will receive a discount on all traffic. If the IXC does not meet its commitment level, it will be liable for the difference between its agreed-to discounted rate and the discount level met; but if its traffic falls below 80 percent of its base period, the IXC will be liable for the difference between the agreed-to discounted rate and the regular tariffed rate. If the IXC terminates the agreement prior to the end of the agreed-to term, it is liable for the difference between the discounted rate and the tariffed rate.

SWB, MCI and CompTel support the retention of the tariffs which provide for the OPP. SWB's witnesses testified that the OPP is procompetitive since it is an optional service, it contains no termination penalty, and it treats small and large IXCs the same. SWB also noted that an IXC may take advantage of the OPP without committing 100 percent of its Missouri traffic. It may subscribe to the OPP by local access and transport area (LATA); by access customer name abbreviation (ACNA), or by shifting growth minutes. This provides a market for other providers of switched access. SWB argues that the OPP does not impede competition nor forestall customers from enjoying the efficiency and benefits of competition.

MCI and CompTel, IXCs, support the OPP because it reduces access rates, which MCI considers a significant benefit to the interexchange market. MCI argues that the OPP will not have anticompetitive effects in practice since it applies only to Missouri intrastate switched access minutes, not interstate minutes, and thus constitutes only a small portion of total traffic. Affecting only a small percentage of total traffic, the OPP will have little potential of preventing an alternate provider from entering the switched access market.

Opposition to the plan comes from Commission's Staff (Staff), the Office of the Public Counsel (OPC) and two other IXCs, AT&T and KCFN. These parties in opposition raise basically the same points. They argue that the OPP is not a true volume discount but is a loyalty discount. These parties point out that the discounts are based upon a percentage of a customer's minutes of use, rather than the volume of minutes of use. Likewise, they assert that the OPP is not a true term discount plan because the "penalty," or amount owed if the customer terminates the plan, increases over the term of the plan rather than decreases. Since the OPP is neither a true term nor volume discount, these parties argue that the OPP violates Section 392.200[1] as a special preference to certain customers. These parties also assert that the OPP is anticompetitive since it ties the customer to SWB for a specific term, and any competitor trying to enter the switched access market would have to buy the customer's contract to carry the customer's business, that is, pay any amounts the customer would owe SWB for terminating the OPP early. These parties argue that SWB is using its monopoly position to "lock in" customers with the OPP. They conclude that the OPP creates a barrier which prevents a competitor from entering the switched access market and, therefore, is not consistent with the goal of the Telecommunications Act of 1996. 47 U.S.C. §§ 229 (1996).

The Commission finds that these arguments do not warrant a discontinuance of the OPP. Although the discounts provided by the OPP are not true term and volume discounts, they are reasonable. Granting discounts to customers based upon a percentage of each customer's total traffic, rather than being anticompetitive, enhances competition between the small and larger carriers in a nondiscriminatory fashion. A straight minute-of-use discount or a reduction in access charges would leave the level of competition in the current market unchanged. The OPP discounts will make a small IXC more competitive since it can receive the same discount as a large IXC. Even though the discounts are not cost-based, the difference in the discounted rates and the current tariffed rates is reasonable. The Commission finds it is reasonable and not unduly discriminatory to charge customers different rates, based upon the customer's agreement to commit a certain level of its switched access traffic to SWB for a certain amount of time. Cost-based differences are not the only differences

[1]All statutory references are to R.S.Mo. 1994 unless otherwise noted.

which can make a classification reasonable. While SWB will receive a benefit from the certainty of OPP traffic, customers fulfilling their commitments under the OPP will be charged lower rates than the customers unwilling to make such commitments.

The Commission finds that the evidence is clear the OPP does not exclude competition from the switched access market. Any competitors for switched access can enter the market for any growth in minutes from an access customer, and the evidence indicates a customer can choose to take the OPP by LATA or ACNA, thus leaving some of that IXC's traffic available for a switched access competitor. The Commission finds, further, that the OPP is not a loyalty discount since all of a customer's minutes are not required to be provided through SWB. A true loyalty discount would take all of an access customer's minutes and penalize the customer for terminating the agreement. Here, there is no penalty since paying the tariffed rate approved by the Commission is not a penalty.

The Commission finds that the voluntary nature of the OPP allows each access customer the ability to evaluate its requirements and opt into the plan if it believes it will provide an economic benefit. Section 392.530 requires the Commission to foster fair competition, and the Commission believes the OPP will benefit competition and, ultimately, the end-user customer. A carrier which receives a discount under the plan would not be able to retain any cost savings since other carriers will also take the OPP and compete for that carrier's customers. If cost savings are not passed on, the market will punish the carrier that does not reduce rates accordingly.

The Commission believes that the split in opinion among the IXCs in this case further illustrates the competitiveness of the OPP. MCI and CompTel support the plan because it offers a customer the opportunity to reduce its access costs. These costs can be reduced for one year to five years and if a better deal comes along, a carrier can terminate the agreement by paying the tariffed rate. Since the tariffed rates have been found to be reasonable by the Commission, there is no penalty for termination of the OPP.

The Commission finds, further, that the discounts create rates which are just and reasonable since they recover incremental costs plus a contribution to joint and common costs. SWB provided cost studies for local transport access and local switching access. No cost study was performed for the carrier common line since it is residually priced. The evidence, though, is that even without cost studies for all of the switched access elements, the discounted rates will exceed costs and the discounts move the rates closer to costs. The discounts, therefore, are reasonable. The Commission finding concerning costs for the OPP should not be taken as a general endorsement of SWB's long run incremental costing methodology as being in compliance with either the federal Telecommunications Act of 1996 or Missouri's Telecommunications Reform Act (S.B. 507), which will become effective August 27, 1996. The issue of what methodology should be used to determine whether prices set under the Act are cost-based will be addressed in another docket.

An issue was also raised in this case of how SWB would utilize the discounts in imputing costs to itself. The Commission finds that this issue should be addressed in another docket since resolution of imputation issues is not necessary for a decision in this case.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

The Commission has jurisdiction over Southwestern Bell Telephone Company and the subject matter of this case pursuant to the provisions of Chapters 386 and 392. SWB is a regulated public telecommunications utility as defined by Section 386.020(42). Pursuant to the provisions of Sections 392.200 and 392.220, SWB shall only charge rates for service that are just and reasonable, and SWB must file tariff sheets containing those rates for Commission approval.

The Commission in this case has allowed the tariff sheets which implement the OPP to become effective. Under the provisions of Section 392.230, the Commission can allow a tariff to go into effect and then take evidence on the tariff's reasonableness after the effective date. This action by the Commission does not change the burden of proof, since the Commission has indicated that the tariff sheets are being approved subject to later review. SWB still carries its burden of proof to show that the proposed rates are just and reasonable.

In this case SWB has proposed rates for a discount for its switched access service. The Commission has found that these discounts are reasonable and are consistent with the purpose of Section 392.530. Several parties, though, have raised the issue of whether the discounts violate the provisions of Section 392.200. Those provisions are:

> No telecommunications company shall directly or indirectly or by any special rate, rebate, drawback or other device or method charge, demand, collect or receive from any person or corporation a greater or less compensation for any service rendered or to be rendered with respect to telecommunications or in connection therewith, except as authorized in this chapter, than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with respect to telecommunications under the same or substantially the same circumstances and conditions . . . (§§ 392.200.2)

and

> [n]o telecommunications company shall make or give any undue or unreasonable preference or advantage to any person, [or] corporation. . . . (§§ 392.200.3).

The courts have held that a company may make reasonable classifications of its customers and charge different rates for each classification. ***DePaul Hospital School of Nursing v. Public Serv. Com'n,*** 464 S.W.2d 737

(Mo. App. 1970). In this case, SWB has proposed to charge different rates to customers who agree to provide a certain number of their total minutes for a certain amount of time. Even though the differences in rates for those customers taking discounts and those not taking discounts is not based upon a reduction in cost, the Commission has found that the classification is reasonable. There is a benefit to SWB from a customer that agrees to a certain level of usage for a certain period which is different from the benefit from a customer that does not agree. The Commission concludes that the difference between the discounted rates and the current tariffed rates is based upon differences in conditions of service and is therefore justified. ***DePaul,*** 464 S.W.2d at 740.

The Commission requested that the parties present their positions on the effect the federal Telecommunications Act of 1996 might have on the OPP proposal. No party saw any specific conflict between the OPP and the Act, but those who oppose the OPP stated their belief that the OPP is a barrier to competition in the switched access market and therefore is prohibited by the Act.

The Commission has found that the OPP is not a barrier to competition and is not prohibited by the Act. The Commission is of the opinion that the OPP may be a basis for negotiations concerning pricing of switched access service under the Act, and that the Act may have made the OPP less significant. Either way, the Commission concludes that the OPP is not prohibited by the new federal law.

IT IS THEREFORE ORDERED:

1. That Southwestern Bell Telephone Company's tariff sheets establishing an optional payment plan for switched access service are just and reasonable.

2. That this Report And Order shall become effective on the 4th day of June, 1996.

BY THE COMMISSION

David L Rauch

David L. Rauch
Executive Secretary

(S E A L)

Zobrist, Chm., Crumpton and
Drainer, CC., concur;
McClure and Kincheloe, CC.,
dissent in separate opinion;
and certify compliance with the
provisions of Section 536.080,
R.S.Mo. 1994.

Dated at Jefferson City, Missouri,
on this 24th day of May, 1996.

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DISSENTING OPINION OF COMMISSIONERS KENNETH MCCLURE AND DUNCAN KINCHELOE

This case presents an overriding, generic question applicable to all regulated industries that are moving toward a future of competition: To what extent will incumbent companies be permitted to trade on their current monopoly status (by offering conditional discounts and other comparable mechanisms) to gain advantage in the anticipated competitive market? We respectfully dissent from the majority opinion which allows the tariff sheets implementing the optional payment plan (OPP) discount mechanism to remain in effect. This case involves a monopoly service for which the provider has proposed to charge discounted prices to certain customers that commit to maintain specific percentages of their purchases for various terms of years. Although such assurance of continued patronage might seem an unusual interest on the part of a monopoly provider, the legal protections of the monopoly status have, not unexpectedly, crumbled since its discount tariffs were filed -- so its business acumen should not be subject to criticism. The primary valid criticisms which prevent us from joining the majority are grounded instead in law and the public interest.

These problems fall into three general areas. First is the tariffs' failure to meet the fundamental statutory requirement that they be shown to be not only "in the public interest" but also "consistent with the provisions and purposes" of Chapter 392. Second, as a distinct concern as well as an aspect of broader non-compliance with Chapter 392, is the OPP's prohibited discrimination among customers in like circumstances. Finally, we are most concerned about the anticompetitive effects of these tariffs, features of which amount to market entry barriers inconsistent with the federal Telecommunications Act of 1996 and contrary to the goals of the state telecommunications legislation signed by the Governor one week ago today.

In its discussion on page five of the Report and Order, the majority opinion notes that the "discounts provided by the OPP are not true volume and term discounts . . ." This is understandably correct. There is no absolute volume of usage which entitles different customers to any particular specified rate or discount level. It further notes that the differences in price under the OPP are not cost based. Again this is true. The discounts are not grounded in any per unit cost avoidance experienced by Southwestern Bell (SWB) when it provides service in excess of certain volumes.

According to Section 392.200.5 RSMo 1994, no telecommunications company may charge a different price per minute for the same interexchange service over an equivalent distance without filing a tariff proceeding in which the company establishes that the difference in charges is in the public interest and consistent with the provisions of Chapter 392. An exception is made for volume discounts, as long as they are non-discriminatory. As this exception does not apply to this case since the "discounts provided by the OPP are not true volume and term discounts . . ." we must look to see whether the discounts offered under OPP are in the public interest and consistent with the provisions of Chapter 392. In considering Chapter 392, we note the majority acknowledges that Section 392.530 RSMo 1994 "requires the Commission to foster fair competition . . ." and we further note that the section also requires the Commission to "promote diversity in the supply of telecommunications services and products throughout the state of Missouri." The fact that "SWB will receive a benefit from the certainty of OPP traffic" appears to be inconsistent with the goals of diversifying suppliers and fostering competition. In short, the Report and Order overlooks clear and direct anticompetitive effects on the switched access market, where competition remains to be fostered by the Commission. It focuses instead on illusory claims of secondary enhancement of the interexchange market, which is already classified as fully competitive as a matter of law and recognized as hotly competitive as a matter of fact. We cannot agree that this approach is consistent with the provisions of Chapter 392 mandating Commission action to promote fair competition and diversity of supply.

Further, in weighing the public interest, a finding that "SWB will receive a benefit from the certainty of OPP traffic" does not equate to a determination that the OPP serves the public interest. The Commission has made no finding that the OPP is in the public interest. The best it could do is find it "reasonable" and a "benefit" to SWB.

With respect to discriminatory charges, the Report and Order quotes, on page 8, the provisions of Section 392.200.2, which precludes charging customers differently with respect to the same service. The majority notes that the "courts have held that a company may make reasonable classifications of its customers and charge different rates for each classification." ***DePaul Hospital School of Nursing v. Public Serv. Com'n***, 464 S.W. 2d 737 (Mo. App. 1970). It has long been this Commission's custom to allow companies to tariff as different services those services that may be essentially the same, but are used differently by separate classes of customers (as in the difference between the rates charged for business and residential users of basic service, due to the inherently different uses of the service). The case cited makes clear that there must be a reasonable basis for the classifications, and that the Commission's Order must contain competent and substantial evidence to support the difference in classification.

In the present case, the majority opinion fails to rely on competent and substantial evidence to support a difference in classification, and fails to reconcile its reasoning with SWB's lack of intention to actually classify interexchange carriers (IXCs) that participate in the OPP into a different customer category than those that do not participate. These failures simply reflect the absence of any distinction, neither based on the customer's use of service nor the provider's cost of service, between transactions that qualify for the discount and those that do not. This is not a result permitted by Chapter 392.

We are not convinced, as is the majority, that the OPP does not constitute a barrier to entry. Again, we are presently concerned not with the health of competition among IXCs, as that market appears to be thriving, but with competition in the market for the provision of switched access services, which is nonexistent. At the time these tariffs were filed, there was some anticipation on the part of SWB that competition was imminent. SWB's own witness testified that competition in the provision of switched access was inevitable, and that the OPP was a means to retain some of those minutes of switched access traffic that might otherwise be lost to competition (Tr. 116). As KC Fibernet notes in its initial brief:

> The Optional Payment Plan would have a significant deleterious effect on competition in the intrastate telecommunications market in Missouri. If the Commission allows the tariff to remain in effect, potential competitors such as KC Fiber will be unable to establish themselves in the crucial early years, so they will never mature into companies providing significant competition for Southwestern Bell.

The majority apparently agrees, and notes in the Report and Order, that OPP indeed benefits SWB.

Since the time of the filing of this tariff, the federal Telecommunications Act of 1996 was passed and Senate Bill 507 has been signed by the Governor and will go into effect on August 28, 1996. Both laws provide for competition in the provision of switched access services in SWB's service territory, and both laws include language protective of the development of competition in that and other telecommunications markets.

Section 253 of the Telecommunications Act of 1996 provides that no state legal requirement may have the effect of prohibiting the ability of any entity to provide any telecommunications service. In Section 257 of the Telecommunications Act of 1996, Congress specifically seeks to eliminate market entry barriers for small businesses in the provision of telecommunications services to providers of telecommunications services.

Senate Bill 507 will change significant portions of Chapter 392 RSMo and will permit competition in the provision of local and access services, thereby ending the monopoly enjoyed by SWB when this tariff was filed. Section 392.200.4(2) of the bill provides:

> It is the intent of this act to bring the benefits of competition to all customers and to ensure that incumbent and alternative local exchange telecommunications companies have the opportunity to price and market telecommunications services to all prospective customers in any geographic area in which they compete.

Section 386.020(14) of the bill provides:

> "Effective competition" shall be determined by the commission based on:
> (a) The extent to which services are available from alternative providers in the relevant market;. . .
> (d) Existing economic or regulatory barriers to entry; . . . [and]

Although these sections are not yet effective, they are the law in the state of Missouri. OPP is inconsistent with both of these sections, in that it was designed to limit the effect of competition and reduce the number of "alternate providers in the relevant market."

Although the majority declares that the payment of the tariffed rate is not a penalty, it will certainly operate as a market deterrent (or barrier to entry) to those competitive access providers which will be forced to pay it if they are to entice carriers to abandon the SWB discount and take their service instead. The single largest expense IXCs have is access. A medium-sized IXC can easily incur access charges of millions of dollars in a year in Missouri. If the company were to realize an access reduction of 8 percent over four years on only one million of those dollars, a competitive access provider, as a new entrant into the competitive local market, could find itself in the position of paying $240,000, just to add that mid-sized IXC to its customer base. Competitive access providers cannot be assumed to have the necessary capital to be able to buy out those contracts. They will be forced to wait until the end of the contract term.

The majority asserts on page 6 of its opinion that the potential competitors are not disadvantaged because they can compete for any growth in minutes. Relegating potential competitors to only the growth in minutes (over the annually ratched-up contract minutes) on its face limits the potential for competition to only those excess minutes and is a *per se* and insurmountable barrier to effective competition. Approval of the OPP effectively excludes competitive access providers from providing switched access services to a segment of the telecommunications industry, and it is just such a barrier to competition that Congress meant to prohibit under Sections 253 and 257.

Finally, we are disappointed that the majority failed to address the length of the OPP contracts and the massive changes in the telecommunications industry that are likely to occur during that time. The OPP was designed to operate in a monopoly environment that should soon no longer exist. During the mid-1980's, the Federal Energy Regulatory Commission (FERC) in instituting its open access transportation program recognized the need to significantly change its interpretation and enforcement of natural gas sales transmission contracts that were entered into in a monopoly environment. The FERC required gas pipelines to offer firm sales customers the opportunity to convert their contractual rights from sales to firm transportation and thereby obtain access to competitively priced gas supplies. The FERC's regulations were designed to enable pipelines and their customers to make the transition to the new competitive open access environment without waiting for the existing sales contracts to expire. (See, FERC Order No. 436, issued October 9, 1985, Federal Energy Guidelines, Statutes & Regulations ¶30,665 and FERC Order 500, issued August 7, 1987, Federal Energy Guidelines, Statutes & Regulations ¶30,761 at 30,794.) The OPP, having been devised and approved in a monopoly environment, appears to be inconsistent with a competitive environment. At the very least, this Commission should establish some periodic review mechanism to determine whether the OPP contracts are having an anticompetitive effect on the provision of competitive access. The FERC experience would seem to point to the legitimacy and even necessity of establishing some level of conversion rights that would reform the OPP contracts to prevent an anticompetitive effect.

Especially in the absence of such action, it should be recognized that SWB's regular tariff rates for switched access may no longer be just and reasonable, particularly when applied to calculate a premium to be charged for the exercise of new competitive options. In fact, it may be difficult to perceive any continuing basis for the reasonableness of a tariff which a local exchange carrier avows its readiness to discount at volumes as small as 80 percent of the traffic of the smallest IXC. Moreover, it is the continuing application of the base tariff rates that is most likely to give rise to claims of grievance based on the discriminatory effects discussed above. We expect that the Commission should be prepared to receive and consider complaints against the pre-existing base tariffs promptly upon the effective approval of the OPP.

Respectfully submitted,

Kenneth McClure
Commissioner

Duncan E. Kincheloe
Commissioner

Dated at Jefferson City, Missouri,
on this 24th day of May, 1996.