

Telephone company, Missouri Telephone Company, New Florence Telephone Company, New London Telephone Company, Orchard Farm Telephone Company, Oregon Farmers Mutual Telephone Company, Rock Port Telephone Company, Seneca Telephone Company, Steelville Telephone Exchange, Inc., Stoutland Telephone Company, and Wheeling Telephone Company.

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Thomas R. Schwartz, Jr., Senior Counsel, and Cherlyn D. McGowan, Assistant General Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the staff of the Missouri Public Service Commission.

HEARING

EXAMINER: Cecil I. Wright.

REPORT AND ORDER

On May 6, 1994, Southwestern Bell Telephone Company (SWB) submitted proposed tariff sheets designed to establish rate bands for services which had been classified as transitionally competitive in Case No. TO-93-116. The services for which the rate bands were filed are: Message Toll Service, Operator Assistance, 800 Service, Common Line 800, WATS, MegaLink II, High Capacity Private Line, and MegaLink Data. On May 26, 1994, SWB submitted a tariff sheet designed to establish a rate band for MegaLink III service. The Commission by order issued June 10, 1994, consolidated the proposed MegaLink III tariff sheet with those previously submitted proposed tariff sheets and suspended all of the tariff sheets until October 29, 1994. A procedural schedule was established by Commission order issued August 3, 1994, and the tariff sheets were further suspended to January 1, 1995. Subsequently, the tariff sheets were suspended to April 29, 1995, and supplementary prefiled testimony was filed. The supplementary prefiled testimony adjusted the rate band proposals for Message

Toll Service to reflect a reduction in revenues generated by the rates approved for SWB on October 1, 1995.

The original hearing in this case was scheduled for October 24-25, 1994. A continuance of this hearing was granted because of the October 1 rate changes. The hearing was ultimately held on January 12-13, 1995.

Intervention was granted to: MCI Telecommunications Corporation (MCI); AT&T Communications of the Southwest, Inc. (AT&T); Alma Telephone Company, Choctaw Telephone Company, Chariton Valley Telephone Corporation, Mid-Missouri Telephone Company, MoKan Dial, Inc., Northeast Missouri Rural Telephone Company, and Peace Valley Telephone Company (Mid-Missouri Group); Midwest Independent Coin Payphone Association (MICPA); GTE Midwest Incorporated (GTE); United Telephone Company of Missouri (United); ALLTEL Missouri, Inc., Bourbeuse Telephone Company, Citizens Telephone Company of Higginsville, Missouri, Inc., Craw-Kan Telephone Cooperative, Inc., Eastern Missouri telephone Company, Ellington Telephone Company, Farber Telephone Company, Fidelity Telephone Company, Goodman Telephone Company, Inc., Granby Telephone Company, Green Hills Telephone Corporation, Holway Telephone Company, Iamo Telephone Company, KLM Telephone Company, Kingdom Telephone Company, Le-Ru Telephone Company, Mark Twain Rural Telephone Company, McDonald County Telephone Company, Miller Telephone company, Missouri Telephone Company, New Florence Telephone Company, New London Telephone Company, Orchard Farm Telephone Company, Oregon Farmers Mutual Telephone Company, Rock Port Telephone Company, Seneca Telephone Company, Steelville Telephone Exchange, Inc., Stoutland Telephone Company, and Wheeling Telephone Company (ALLTEL, et al.); and Kansas City Fiber Network, L.P. The City of St. Joseph, Missouri, was granted participation without intervention pursuant to 4 CSR 240-2.110(15).

Briefs were filed by the parties and this case has been submitted to 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.

This case is a continuation of the process of implementing the statutory changes enacted in 1987 which allow for pricing flexibility and reduced regulation for companies and services which are found to be subject to competition. This process has been prolonged and arduous and SWB is the only local exchange company (LEC) to avail itself of the benefits offered by the 1987 changes to Chapter 392.

Even SWB has not fully embraced the changes nor sought swift compliance with the competitive features of the 1987 provisions. Initially, SWB sought classification of a wide range of services as transitionally competitive (TC) in Case No. TO-89-56. SWB then withdrew its application. The Commission, though, did not dismiss the case but ordered the parties to address the costing issues which are prescribed in subsections 392.400.1, 2, 3 and 4, R.S.Mo. 1994. (All statutory references are to R.S.Mo. 1994 unless otherwise noted.)

The Commission issued a Report And Order in TO-89-56 on August 28, 1991, establishing requirements to comply with Section 392.400. SWB did not seek TC classification of any services then until September 24, 1992, in Case No. TO-93-116. That case resulted in the classification of Message Toll Service (MTS), Operator Services, 800 Service, Common Line 800 (also known as MaxiMizer 800), Jointly Provided WATS, MegaLink II and III, MegaLink Data Services, and High Capacity Services as TC.

SWB has now filed rate bands, pursuant to Section 392.510, to establish the maximum and minimum rates that it can charge for each service classified as TC. The focus of this case and the issues addressed by the parties involve the method utilized by SWB to set the maximum and minimum rates in the

proposed bands. Issues have also been raised concerning the procedures that SWB should utilize in changing rates within an approved band and customer notice of rate changes within the bands.

Rate Bands

The initial inquiry concerning the proposed rate bands is the method utilized to establish the minimum rate. This minimum rate must pass the statutory requirements of Section 392.400 as well as the Commission interpretation of those requirements as set out in its Report And Order in TO-89-56. The Commission addressed the first four subsections of 392.400 in its Report And Order in TO-89-56 and in this case must address how those provisions affect the minimum rate in a rate band and also must consider the provisions of subsection 5.

The Commission in TO-89-56 summarized the requirements of subsections 1 through 5. That summary is as follows.

Subsection 1 states that the Commission shall not allow or establish any rate or charge for an NC (noncompetitive) service which in any way recovers the expenses, investment, incremental risk or increased cost of capital associated with the provision of C-TC (competitive-transitionally competitive) services. This prohibition very clearly requires close scrutiny of how rates for NC and C-TC services are established. The prohibition in this subsection has been described as requiring that NC services not provide a subsidy or cross-subsidy of C-TC services.

Subsection 2 requires the Commission to establish procedures, including accounting procedures, to implement the prohibition in subsection 1.

Subsection 3 requires the Commission to develop procedures or methods for calculating costs to determine whether rates for any telecommunications service offered by an LEC are equal to or above those costs.

Subsection 4 allows the Commission to include revenue from C-TC services in setting rates for NC services, but only if in the aggregate those revenues exceed expenses plus a reasonable return on investment. The Commission is authorized, when making the classification decision, to remove the subject service from the aggregate calculation and treat its revenues and expenses below the line.

Subsection 5 prohibits an LEC from pricing a C-TC service below the cost of the service as determined by the Commission if the rate is not consistent with full and fair competition.

In its Report And Order in TO-89-56 the Commission found that subsections 1, 2, 3 and 4 would be satisfied by requiring SWB to utilize a Cost Accounting Procedure (CAP) cost study in calculating the costs of an existing TC service. The Commission then indicated that the service would be required to provide a fair contribution to shared costs. The contribution, the Commission found, could be negotiated or could become a contested issue to be resolved by the Commission. The Commission established different cost studies for new services, but since all of the services addressed in this case are existing services, those cost studies need not be addressed.

The Commission did not address subsection 5 in the body of its decision in TO-89-56 since subsection 5 involves pricing and TO-89-56 addressed costing procedures and methods. The primary focus of the Commission decision was to determine what costing procedures are necessary to prevent a subsidy from NC services to C-TC services and the costing information necessary if the decision is made to take the C-TC service below the line.

The case now before the Commission presents the next aspect of the movement by LECs into the competitive market as reflected in subsection 5. That aspect is the pricing of TC services. This issue arises in the context of a proposed rate band since a major benefit of TC classification is flexible pricing

within a rate band. The Commission must, therefore, now decide at what level minimum and maximum rates should be set. The primary focus in this inquiry is on minimum rates since that rate level is the one that must meet the requirements of Section 392.400 in order to prevent a subsidy from occurring. If the minimum rate meets the requirements of Section 392.400, all other rates within the band will meet them.

SWB has proposed rate bands for nine services classified by the Commission in TO-93-116 as transitionally competitive. According to SWB witness Bailey, a CAP cost study was performed for each service but SWB did not set its minimum rates based upon the results of the CAP cost studies. In fact, SWB's position, as stated by Bailey, is that the CAP cost study should be used to determine, in the aggregate, if all C-TC service revenues recover all C-TC costs plus a contribution, not whether an individual service covers that service's CAP cost.

SWB, in support of the rate bands, did not file its CAP cost studies but instead offered the testimony of its product managers to support the minimum rates set for each band. The method for setting the minimum rates for each band can be generally described as a mixture of price comparison with services in competition with SWB's services and a comparison to ensure that the prices recovered incremental unit costs (IUCs), as determined by SWB, plus some contribution. Utilizing this method of setting minimum rates, there are four services for which the minimum rates are below CAP-determined costs. The four are Operator Services, 800 Service, Common Line 800, and WATS. In the aggregate, all nine TC services provide a 4.18 percent contribution over CAP-determined costs and a 65 percent contribution over incremental unit determined costs. When SWB's competitive services are included in the aggregate calculation, the total C-TC service revenues exceed CAP costs by 5.5 percent.

Of the other parties, only Commission Staff supports SWB's proposed rate bands, although Staff arrives at its support through a different method. Staff indicates that even though it believes the Commission intended that CAP costs be used to set the minimum rate in each service's rate band, the Commission did not intend to limit itself to this method entirely. Staff believes the Commission should utilize additional criteria and aggregation of complementary services in determining the appropriate minimum rate for a rate band. Staff views the CAP study results as a starting point for determining the costs that must be recovered in a minimum rate. Staff states that where the minimum rate recovers CAP costs, then the inquiry is complete, but where it does not, other criteria should be reviewed to determine at what level the minimum rate should be set.

Staff proposes as other criteria a positive net present value from a discounted cash flow (DCF) analysis, rates which recover costs identified by an updated incremental cost study, as well as additional marketing evidence that might suggest greater profitability through repricing of the service. Staff evidence addresses only two of SWB's TC services revenues which did not recover CAP study costs. Those are Common Line 800 and Operator Services. Staff witness Van Eschen testified that he reviewed other relevant criteria concerning these services, as discussed above, and based upon that review believes that SWB's minimum rates for these services are not anticompetitive. Van Eschen testified his review indicated that Common Line 800 service showed a positive net present value based upon a DCF analysis and Operator Services should be aggregated with MTS since they are complementary services. When aggregating Operator Services with MTS, together they recover CAP costs.

In addition to its proposal regarding the method to be utilized in determining how to establish a minimum rate, the Staff recommends that any minimum rate be set to recover at least five percent contribution above the

service's long run incremental cost. Staff's position is that long run incremental costs are the appropriate cost standard for establishing minimum rates and that a five percent minimum contribution will ensure that a portion of SWB's shared costs will be recovered through TC rates.

The other parties which filed briefs in this case oppose the rate bands proposed by SWB. It is AT&T's position that although it believes total long run incremental costs calculated on a basic network function basis is the proper method for measuring SWB's costs for TC services, it believes the issues in this case are limited to whether SWB's cost studies comply with the Commission decision in TO-89-56. AT&T contends that CAP costs plus a contribution should be used in determining compliance with subsection 392.400.5.

It is MCI's position that two of SWB's rate bands should be rejected: Common Line 800 and Operator Services. MCI contends that the minimum rates in the proposed bands are below CAP costs and the minimum rate for Common Line 800 has not passed an appropriate imputation test. MCI contends the minimum rates in these two services are anticompetitive and therefore not in compliance with the intent of Chapter 392 nor with the Commission decision in TO-89-56.

It is the position of the Office of Public Counsel (OPC) that the proposed rate bands are not in compliance with Section 392.400 nor the Commission decision in TO-89-56. OPC argues that since SWB did not present a CAP study or propose a reasonable contribution to shared costs, there is no evidence in the record to support the reasonableness of the rate bands. If bands are established, OPC proposes that the proper way to establish rates is to set the minimum rate at CAP costs plus a 20 percent contribution to shared costs. OPC witness Trippensee provided a schedule which showed revenues for each TC service at the minimum and maximum compared to CAP and SWB-determined IUC costs. This is the only evidence in the record of the total dollar results of SWB's cost studies.

It is MICPA's position, as reflected by its objections at the hearing and in its brief, that SWB has failed to adduce competent and substantial evidence to support the rate bands it proposes for its TC services. In addition, MICPA argues that the shift in regulatory focus from protection of monopoly rate-payers to a competitive environment will necessarily mean a shift by the Commission in the approach it takes to LECs such as SWB. The Commission is encouraged to use its authority to prohibit SWB from utilizing its monopoly power to thwart emerging competition. MICPA asserts that utilization of CAP costs plus a contribution best protects emerging competitive companies and that if SWB cannot meet competition, it should not be protected by allowing it to price services below cost.

The first issue to be addressed by the Commission, before getting to the issue of at what level minimum rates should be set, is whether there is sufficient evidence in the record to support any rate band. SWB has provided little help in addressing this issue since its evidence in support of the rate bands is from product managers who set the maximum and minimum rates based upon their comparison of prices charged by competitors. This method of setting rates may be realistic in a totally competitive environment, but lacks probative value for a rate band which must be found reasonable by the Commission for TC services of an LEC. SWB witnesses also reviewed IUC studies to ensure the minimum rates were above these costs. As pointed out by OPC and MICPA, neither the IUC studies nor the CAP studies were made a part of the record and the Commission has not approved the IUC studies utilized by SWB.

The evidence presented by SWB witnesses to support the minimum rate in the rate bands is as follows:

Countryman (Exhibit 11, page 3): "The minimum rates (for OUTWATS, 800 Service, and Common Line 800 service) have been established at incremental unit cost plus some contribution...."

Willman (Exhibit 13, page 3): "Our proposed price floors (for MTS) are based on market factors and are consistent with the tariffed prices of other alternative intraLATA long distance providers. They exceed the incremental unit cost of providing the service. Lastly, they exceed imputed access expenses plus the access expenses charged by non-Bell Local Exchange Carriers under the Primary Toll Carrier Plan."

Meador (Exhibit 9, page 3): "The upper rate band (for MegaLink II and III) was set at current levels because we anticipate a need in the future to lower prices. The lower rate band has been moved closer to the federal rate level because we are experiencing growth at those price levels in the interstate jurisdiction."

Tieperman (Exhibit 13, page 2): "In general, we were trying to price to the market (for Operator Services). Competitor rates were used as a basis for both the minimum and maximum limits."

Mayfield (Exhibit 10, page 2): "I used the Company's federal tariff rate levels and those of competing Alternate Access Providers (to set maximum and minimum rates for Digital Data and High Capacity Special Access)."

The other evidence concerning the CAP and IUC costs is addressed through Staff and OPC witnesses. Staff and OPC experts reviewed the results of the cost studies for use in support of their positions.

After careful consideration, the Commission finds that there is sufficient competent and substantial evidence in the record upon which to determine whether the rate bands are reasonable. No party has challenged the results of the studies, only the fact they were not put into the record. The Commission finds that the fact the cost studies were not put into the record is not fatal to SWB's case. Each party had access to the cost studies under the Commission protective order and expert witnesses testified to the results of the studies. Any irregularities with the studies could have been addressed during the hearing.

The next issue to be addressed by the Commission is what method should be used to establish rate bands, especially the minimum rate. The

Commission, as indicated above, addressed in TO-89-56 the proper costing procedures which it found reasonable to implement the prohibition of subsection 392.400.1 and the requirements of subsections 392.400.2, 3 and 4.

The Commission found that for determining the costs of existing services, a CAP study plus some level of contribution would ensure NC services were not subsidizing the C-TC services. The CAP study was also found to comply with subsections 2 and 3. Subsection 3 also authorizes the Commission to require a cost study when a rate band is proposed and the results must be provided to the Commission. SWB proposed CAP studies of its services and the results were provided to the Commission, Staff and other parties. SWB thus complied with this portion of the Commission's order in TO-89-56 and subsections 392.400.1, 2 and 3.

SWB, though, did not take the next step and set its minimum rates at the CAP costs plus a contribution. Instead, it proposed minimum rates using market analysis and comparison with IUC studies. SWB then interpreted the Commission's TO-89-56 decision to only require CAP costs be covered in the aggregate by both C and TC services.

The Commission finds that SWB's position on the utilization of the CAP study in the aggregate is not consistent with the Report And Order in TO-89-56 nor with the requirements of Section 392.400. The Commission did not propose an aggregation of C-TC revenues to set prices to cover CAP costs in its decision. The Commission, in fact, did not propose any aggregation of services, even those of complementary services as proposed by Staff.

The Commission found in TO-89-56 that the costs of existing C-TC services were to be established using CAP costs with a contribution level to be determined at some later time. The Commission's decision was aimed at meeting the requirements of subsections 392.400.1, 2 and 3. The focus and intent of the Commission's decision was to ensure that when rates for NC services were set, the costs of C-TC services would be appropriately determined to ensure that

no subsidy occurred and to provide an appropriate determination of C-TC costs if the Commission found that a particular C-TC service should be treated below the line for ratemaking purposes pursuant to subsection 4. The Commission intentionally indicated in that decision that a determination concerning the pricing of C-TC services would be addressed in a later proceeding.

This proceeding provides the Commission with an opportunity to address pricing under Section 392.400 and specifically as prescribed in subsection 5. The Commission finds that subsection 5 allows the Commission some flexibility in establishing prices for C-TC services and reflects the Commission's belief that pricing and costing are not necessarily synonymous. The language in subsection 5 provides the Commission authority to disapprove rates set below the costs found to be reasonable under procedures established pursuant to subsections 1, 2 and 3 unless the pricing is consistent with full and fair competition.

In reviewing the costs as reflected by Exhibit 24HC, Schedule 2, only four services have minimum rates priced by SWB in this proceeding below CAP costs. The other services recover CAP costs and provide some level of contribution to shared costs. The proper level of contribution has been made an issue by OPC and will be addressed later.

The Commission finds that its decision concerning the appropriate costing method is still appropriate and consistent with the statutory requirements. A company, such as SWB, must provide a CAP cost study at the time it seeks classification of services as C or TC so that the Commission can make an initial determination of below the line treatment and a determination of what costs are associated with a C-TC service to ensure that NC services do not subsidize those C-TC services.

The evidence shows that SWB's minimum rates for the rate bands for MTS, High Capacity Service, MegaLink Data, MegaLink II and MegaLink III are set

above CAP costs and so meet the requirements of Section 392.400 and the Commission's decision in TO-89-56. The contribution from these services varies greatly. Both OPC and Staff would have the Commission establish a minimum level of contribution for each service. The Commission, though, finds that in establishing minimum rates no set level of contribution is necessary. Contribution levels may vary from TC service to TC service as long as rates are set to recover CAP costs plus some contribution. The Commission finds that there is no real basis for OPC's twenty percent contribution level nor for Staff's five percent. Contribution to shared costs is necessary to ensure C-TC services do not subsidize NC services, but this does not require contribution at a certain level for each service to establish prices for TC services. Whether these contributions will be found sufficient in a proceeding in which NC rates are established is an issue which the Commission need not resolve in this proceeding. The Commission finds that in any case involving NC service rates it will be obligated to determine at what level C-TC services must provide contribution. That determination need not be made in this proceeding.

For the four services SWB has proposed minimum rates below CAP costs, the Commission is faced with a difficult decision. On the one hand, rates must be set to ensure there is no subsidy to NC services while, on the other hand, it is precisely these services which evidence in TO-93-116 showed were subject to the most competition. This decision is further complicated because SWB has chosen to provide only limited evidence to support a finding that the rates are consistent with full and fair competition.

The Commission has found that the four services, Common Line 800, 800 Service, WATS (jointly-provided WATS) and Operator Services, are subject to sufficient competition to be classified as TC. This finding, though, does not address the price at which SWB may market the services. Some other evidence is necessary to show that a price below CAP cost plus a contribution is consistent

with full and fair competition for the Commission to approve a minimum rate below CAP as proposed by SWB.

OPC and MICPA oppose the setting of a minimum rate below CAP plus a contribution for all of the four services. MCI, a competitor for these services, has taken the position that Jointly-provided OUTWATS and 800 Service are technologically obsolete services and even though their minimum rates do not recover CAP costs plus a contribution, MCI is not opposing the minimum rates. The evidence indicates these minimum rates cover IUC, as calculated by SWB, as well as provide some contribution.

The Commission finds that where competitors have not opposed the minimum rates for a TC service and those rates cover IUC plus provide a reasonable contribution above IUC, then these minimum rates are consistent with full and fair competition. By basing the decision concerning those two services on SWB's IUC studies, the Commission is not finding that the IUC studies utilized by SWB are approved for services which are opposed. SWB should seek Commission approval of its IUC studies in its next case involving rate bands for C-TC services. Since fair competition is the focus of the inquiry under the provisions of Chapter 392 enacted in 1987, where no competitor objects, the Commission should not establish a barrier to the LEC from pricing its services to meet competition.

As stated above for the services which recover CAP costs, by approving this pricing below CAP plus a contribution the Commission is not rendering a finding as to the ratemaking treatment to be afforded SWB's revenues when a case involving the rates for NC services is before the Commission. To prevent a subsidy from flowing when NC services are priced, the Commission will again review the contribution level from C-TC services, even those allowed to be priced below CAP costs.

For the two remaining services with minimum rates below CAP plus contribution, the Commission finds that SWB has produced little evidence to support the reasonableness of below-CAP pricing for these services. SWB's evidence that the minimum rates are above its IUC study results provides little support establishing what the proper minimum rate should be. SWB's IUC studies were specifically rejected in TO-89-56 and those parties supporting IUC pricing for minimum rates in this case, MCI, Staff and AT&T, do not support SWB's studies. These parties support some form of total service long run incremental costs or long run incremental costs.

The evidence to support below-CAP pricing for Common Line 800 suggests that pricing at CAP costs would force SWB to raise its current rate. Common Line 800 is a relatively new service which does not recover CAP costs. There is evidence that the proposed minimum rate for Common Line 800 resulted in a positive net value from a DCF analysis. This evidence, though, is not sufficient to support a finding that the minimum rate proposed by SWB is consistent with full and fair competition. Staff's evidence of DCF analyses and positive net value provides some support for the lower-than-CAP costs but the statute speaks in terms of competition, not costing analyses, and there must be some evidence adduced which addresses market share, number of competitors, or other related evidence.

The Commission finds, further, that there is insufficient evidence to show that the minimum rate passes the imputation test required by past Commission decisions. There is no evidence of the results of the imputation analysis, nor was it clear how the analysis was performed. There was evidence the imputation method had been changed but this process did not appear to be complete and no analysis using the new method was presented. Without sufficient evidence showing that the minimum rates for Common Line 800 are consistent with full and fair competition and that they meet some imputation test, the Commission

cannot find that SWB's proposed minimum rate for Common Line 800 service complies with subsection 392.400.5.

Although the rejection of the minimum will delay SWB's ability to take advantage of pricing flexibility, it does not, as SWB witness Bailey suggests, limit SWB's ability to offer new services. For new services SWB need only price above a DCF analysis and IUC study if it seeks TC classification for the new service at the time it is implemented. The Commission believes that evidence could have been adduced to support below-CAP cost minimum rates for Common Line 800 but that SWB chose not to adduce that evidence. SWB relied instead on its aggregation theory, which the Commission cannot accept as a basis for establishing prices. The Commission finds that the statute permits SWB to price below CAP costs only if it can show that the minimum price is consistent with full and fair competition.

For Operator Services, SWB has provided information concerning its current rates and its explanation of how its various rates for operator service were priced. The following chart is helpful in analyzing the proposed rate band:

	<u>Current Price</u>	<u>Minimum Price</u>	<u>Maximum Price</u>
Station-to-Station			
Fully-Automated	\$.70	\$.50	\$1.10
Semi-Automated	.90	.65	1.50
Operator-Handled	1.10	.85	1.95
Person-to-Person			
Semi-Automated	\$2.00	\$1.05	\$2.65
Operator-Handled	2.40	1.40	3.50
Calling Card			
Fully-Automated	\$.35	\$.25	\$.85
Semi-Automated	.65	.45	1.05

For operator-assisted Station-to-Station and Person-to-Person services, SWB set the minimum price at 20 percent below its lowest competitor. SWB then used a 25 percent discount from this rate for each level of automation. For the Calling Card rate, SWB again used a 20 percent discount from the lowest

competitor's rate for the minimum rate. The semi-automated Calling Card rate was set at a percentage below that of the Calling Card rate.

The only evidence, other than the rates of its competitors, adduced by SWB to support the minimum rate was MCI's practice of setting its rate \$.01 below SWB's. SWB contends it needs this 20 percent discount to meet this type of competition.

The Commission finds that there is no support for the 20 percent discount below the lowest competitor for SWB's Operator Services. There is no evidence to show this minimum rate is consistent with full and fair competition. The evidence indicates that Operator Services revenues do not quite recover CAP costs under existing rates, so any minimum rate set below existing rates would need further justification.

The Commission does find, though, that there is evidence of significant competition in the operator services market. The list on Exhibit 12, Schedule 2, shows approximately fifty-three competitors. Based upon the number of competitors, the Commission finds some pricing flexibility below CAP costs would be consistent with full and fair competition. A minimum rate set at or near the lowest rate of its competitors appears to the Commission to be reasonable. On the record before it, though, the Commission cannot approve a minimum band for SWB Operator Services rates set 20 percent below the lowest competitor's. Therefore, SWB's rate band for this service must be rejected.

There seems to be no real controversy over the maximum rates in the rate bands proposed by SWB except for Operator Services. For all of the services except Operator Services the maximum rate is set at existing rates. Since these rates have already been found to be just and reasonable by the Commission, the Commission believes they are reasonable for the maximum rate band rates.

For Operator Services, SWB set the maximum rate at rates comparable to the highest competitor's rates. The maximum rate, if charged, would provide

a significant contribution above CAP costs where existing rates do not recover CAP costs. The Commission finds that absent the rate moratorium under which SWB is currently operating, maximum rates for Operator Services should be set at CAP costs or above. The Commission finds, though, that granting SWB the authority to increase rates above current rates in this proceeding would be inconsistent with the moratorium. Therefore, the Commission finds that maximum rates for Operator Services should be set at current rates while the moratorium is in effect. Since SWB has proposed a higher maximum, the proposed rate band will be rejected.

Tariffing Issues

There are three issues in this case other than those involving the rate bands proposed for TC services. These issues were raised by Staff and involve (1) customer notice for rate increases within a band, (2) tariffing of promotional offerings for TC services, and (3) tariffing of prices being charged within a band.

It is Staff's position that SWB should be required to provide notice to customers when it increases rates within a rate band for TC services approved by the Commission. Staff asserts that it has consistently required customer notification for rate changes and recommends the notice be made ten days before the increase is effective. OPC supports Staff's proposal.

It is SWB's position that Section 392.510 only requires written notice to the Commission of any increase or decrease within the band within ten days of the effective date of the rate change. AT&T takes the position that pricing flexibility for TC service should not be greater than for C services.

Subsection 392.510.1 states that an LEC, within an approved rate band for a TC service, can charge rates within that band without prior notice or prior Commission approval. Subsection 392.510.3 prescribes the only statutory notice

requirement necessary for changes within an approved band: notice within ten days of the date the rate change is effective.

The Commission finds that to be consistent with the provisions of Section 392.510, no advance notice to customers is required. Rates within a band have been found to be reasonable and if competition is to enter these markets, customers will have to become more sophisticated in their purchasing of telecommunications service. The statute was designed to allow greater flexibility for TC services and the Commission finds any prior notice requirements would diminish that flexibility.

The Commission, though, does realize that the rates being charged to customers must be on file with the Commission so that customers can obtain the correct information about the rates being charged by SWB for these services when deciding whether to take an SWB service. Even though subsection 392.510.3 only requires notice of change ten days after a rate has become effective, the Commission finds that this does not promote competition nor protect customers by allowing those customers to compare prices for competitive services. The Commission finds that customers should be able to call the Commission and find out what SWB's current rates are for its TC services. The customer could not do this with any certainty if SWB did not have to inform the Commission of the rates at the time the rates went into effect. The Commission therefore finds that SWB shall give notice to the Commission before the effective date of a rate change within an approved rate band. This notice can be, as proposed by SWB, in a price sheet which will be submitted to the Commission and placed in SWB's tariff book. The price sheet shall indicate the date the new rate becomes effective. By requiring this type of notice the Commission is allowing maximum flexibility as intended by Section 392.510 while protecting the competitive market and consumers as required by Section 392.530.

Concerning Staff's second issue, SWB's tariff sheets which propose to implement rate bands for TC services contain a provision that SWB can file a letter with the Commission indicating a promotion for a TC service. Staff opposes the use of a letter for promotions and supports current procedures which require thirty-day tariff filings for promotions for all regulated companies, including gas, electric, water, sewer, and competitive interexchange carriers (IXCs). AT&T supports SWB's position, while OPC supports Staff's position.

The Commission has considered SWB's proposal and, quite frankly, wonders why this issue is being addressed in a case which was established to address rate bands for TC services. From a review of the tariff sheets, the proposed revisions regarding promotions only involve rates for which rate bands have not been proposed.

Nevertheless, the Commission will address the issue. The Commission finds that promotions filed by LECs which reduce or waive charges for a limited period not within a band should be filed on tariff sheets as currently required. Pricing flexibility and reduced regulatory oversight applies to rates within rate bands and if SWB wishes to have flexibility for other rates and charges associated with TC services, then it should propose rate bands for those rates. The requirement of a tariff sheet for a promotional rate, of course, only applies to reductions or waivers of rates not within a band. Any change within a band need only comply with the requirements established by the Commission above.

An issue raised as a tangential matter which does not specifically affect SWB's proposed tariffs is the requirement for competitive IXCs to tariff their promotions. The Commission believes, in the current competitive environment, that changes in rates for services provided by competitive companies should be submitted to the Commission on supplemental schedules and treated as any other rate change made by a competitive company pursuant to Section 392.500. This includes textual changes as well as rate changes. If the promotion involves a

rate reduction, which presumably it will, then the IXC should give seven days notice of the change to the Commission. If the IXC then wishes to end the promotion and increase a rate, notice to affected customers and the Commission must be made ten days in advance of the increase.

The issue of the filing of the specific rates being charged by SWB within the band has been addressed by requiring the filing of a supplemental schedule or price sheet containing the rates being charged and the effective date of the rate indicated on the schedule.

Conclusions of Law

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

The Commission has jurisdiction over the issues presented in this proceeding pursuant to the provisions of Chapter 392 and, with regard to rate bands specifically, Section 392.510. Pursuant to Section 392.510, SWB may file proposed rate bands for services classified as TC. The Commission has previously classified nine of SWB's services as TC and in this proceeding SWB is proposing rate bands for these services.

Section 392.400 establishes the statutory requirements for pricing rates for TC services. Specifically, subsection 392.400.5 requires pricing at costs established by the Commission unless the Commission finds the below-cost pricing is consistent with full and fair competition.

By its Report And Order in Case No. TO-89-56 the Commission established the methods required for establishing costs for TC services. In this proceeding the Commission has found that five services have rate bands whose minimum rates exceed their costs as calculated according to TO-89-56, and so those rate bands are just and reasonable for those services. Four of the services have minimum rates below properly-calculated costs. The rate bands for

two of these services have been found by the Commission to be reasonable based upon competitors' failure to challenge those rates. Rate bands for two of the services, though, have been found to be unreasonable because of lack of support for the below-cost pricing proposed for the bands' minimum rate. Those bands are for Common Line 800 and Operator Services. Based upon its findings the Commission concludes that the rate bands for MTS, 800 Service, WATS, High Capacity Private Line, MegaLink Data, MegaLink II and MegaLink III will be approved. The Commission concludes that based upon its findings, the rate bands for Common Line 800 and Operator Services will be rejected.

Additionally, the Commission has reviewed the statutory requirements for customer notice and tariffing of rates within bands as well as for promotions which reduce rates not within bands. The Commission concludes that based upon its findings, no advance customer notice is required for rate movement within a band. The Commission, though, has found that a condition should be placed on rate changes within a band which requires additional notice other than that provided for in Section 392.510. The Commission has authority pursuant to Section 392.400 to impose any condition that it deems reasonable and necessary on services provided by a regulated company. The Commission concludes that a condition will be placed upon SWB to submit rate changes within a rate band prior to the date the rate will become effective. The Commission concludes that this condition is reasonable.

IT IS THEREFORE ORDERED:

1. That the rate band tariff sheets for Message Toll Service, 800 Service, WATS, MegaLink Data, MegaLink II, MegaLink III and High Capacity

Private Line are hereby approved for service on and after April 11, 1995. Southwestern Bell Telephone Company shall file substitute tariff sheets for these services which reflect the Commission's decision in this case.

2. That the rate band tariff sheets for Common Line 800 and Operator Services are hereby rejected.

3. That Southwestern Bell Telephone Company shall submit to the Commission rates to be charged within the rate bands approved in Ordered Paragraph 1 before the date the rate will become effective. The submission shall contain the date the new rate is effective.

5. That this Report And Order shall become effective on the 11th day of April, 1995.

BY THE COMMISSION



David L. Rauch
Executive Secretary

(S E A L)

Mueller, Chm., McClure, Perkins
and Kincheloe, CC., concur;
Crumpton, C., dissents, with
separate opinion to follow;
certify compliance with the
provisions of Section 536.080,
R.S.Mo. 1994.

Dated at Jefferson City, Missouri,
on this 29th day of March, 1995.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Southwestern Bell)
Telephone Company tariffs to establish)
rate bands for services which have been)
found to be transitionally competitive.)

CASE NO. TR-94-364

DISSENTING OPINION BY COMMISSIONER HAROLD CRUMPTON

I respectfully dissent from the majority in this case and support the recommendation of the Staff of the Missouri Public Service Commission (Staff) in support of rate bands for Operator Services and Common Line 800 services. Staff supported the proposed rate bands because they found the rate bands to not be anti-competitive. Staff testified that Common Line 800 Service showed a positive net present value. Further, Staff testified that Operator Services and MTS are complementary services and when treated as such, they recover CAP costs.

The majority finds that the minimums established must meet those statutory requirements of Section 392.400, Subsections 1 through 5. However, the majority erred in deciding that its decision in TO-95-56 should be the prevailing standard. Competitive markets have changed. MCI and Sprint United had a much smaller presence in 1989 in the markets for Operator Services and Common Line 800 substitutes. The goal of Section 392.400 is to promote a diverse supply of efficiently delivered, universally available telecommunications services at widely affordable, reasonable prices in a market where full and fair competition acts as the market regulator consistent with the protection of ratepayers and consistent with the public interest. The Commission has a new role under Section 392.400, i.e., as a market place umpire, line judge, field judge, or referee.

Transitionally competitive and competitive offerings must have a range of prices available to the noncompetitive company. In the real

world, the range may vary from one that recovers only the variable costs, to one that recovers variable costs plus an optimistic contribution to joint and common costs. Competitive companies have this latitude. In fact, on occasion, competitive telecommunications companies have exercised the option to lose money in order to attract business and retain market share. MCI and AT&T are formidable market powers when it comes to Operator Services and Common Line 800 substitutes. If it is wrong for the non-competitive company to offer services in a transitionally competitive market at prices that are subsidized by its other customers; then it is wrong for the competitive company to offer prices in the same market that are subsidized by its other customers? I am not suggesting that a noncompetitive company should be permitted to offer transitionally competitive services at prices subsidized by noncompetitive services. However, in competitive and transitionally competitive markets, noncompetitive companies must be allowed to act like competitive companies subject to regulatory review in order to prevent cross subsidization.

By what right does the regulator say that the competitive company can operate in a transitionally competitive market with a different set of rules? Who loses when the non-competitive company is denied access to the transitionally competitive market place by misguided and outdated regulations? The consumers lose! Witness the tariffs for operator services offered by two competitive providers:

(1) Provider A = \$4.50 per call person-to-person

(2) Provider B = \$1.00 per call person-to-person

What is the range offered by the tariff under question?

Proposed tariff = \$1.40 to \$3.50 per call person-to-person

Finally, I applaud the majority in finding that minimum rates for jointly-provided OUTWATS and 800 Services are consistent with full and fair competition. They are not making a finding as to the ratemaking

treatment to be accorded the company's revenues when a case involving the rates for noncompetitive services is before the Commission. Obviously, the majority should have used the same approach in its finding concerning Operator Services and Common Line 800 service.

Respectfully submitted,


Harold Crumpton, Commissioner

Dated at Jefferson City, Missouri
on this 31st day of March, 1995.