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December 13, 2002

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Missouri Public
Service Commission

Secretary
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102-0360

Re: Case No. TR-2001-65

Dear Sir:

Enclosed please find for filing an original and five (5) copies of the Initial Brief of the Missouri Independent Telephone Group.

Thank you for seeing this filed.

Sincerely,

Lisa Chase

Lisa Cole Chase

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cc: MITG Managers
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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of an Investigation of the Actual Costs Incurred in Providing Access Service and the Access Rates to be charges by Competitive Local Exchange Telecommunications Companies in the State of Missouri	))))))	Case No. TR-2001-65

INITIAL BRIEF OF THE MISSOURI INDEPENDENT TELEPHONE COMPANY GROUP

COMES NOW the Missouri Independent Telephone Company Group (MITG) and files its initial brief with respect to this Commission's investigation into the actual costs of providing access service and the access rates to be charged by CLECs. It is the understanding of the MITG that the Commission's original intention in establishing this docket was to have a cost study of the current access costs of all LECs. With such a study, the Commission could then compare costs of all LECs, with such a cost comparison it could see how rural LECs' costs compared to urban LECs' costs, the Commission could then set it side by side with the existing LEC access rates and see if the relative cost levels bear a reasonable resemblance to the relative rate levels and judge whether the IXCs past claim that the rural LEC access rates are "too high" has any basis in cost. With that information the Commission could determine what range of access rates were best for IXCs, IXC customer rates, small LECs, and small LEC customer local rates. The Commission could use that information to decide what access rates needed to be changed, and if any access rates were lowered, what possible offsetting revenue sources could be turned to, such as local rates or the Missouri Universal Service Fund ("MoUSF").

When making such an apples-to-apples comparison, the Commission could have kept in mind public policy considerations such as: (1) parity of rates and services between urban and

rural areas, (2) universal service, (3) incentive of IXCs to exit or enter rural markets, (4) continued averaging of toll rates, (5) incentive of IXCs to deaverage toll rates, (6) competitive services are priced to properly contribute their share of joint and common costs, and (7) that monopoly services are priced not to subsidize the pricing of competitive services. Then the Commission would have been in a position to decide some of the additional issues that have been brought into this docket such as: (1) forward looking or incremental pricing, (2) inclusion of all or part of the local loop in access rates, (3) your ability to change price cap LEC access rates, (4) your ability to change competitive CLEC access rates, and (5) whether the suggestion of the large price cap ILECs that local loop costs be excluded from small LEC access rates is appropriate when their access rate caps do include loop costs.

In order to start this process, the first step needed to be an "apples-to-apples" existing access cost comparison for all LECs. That does not exist here. Instead, there is a confusing mix of different types of cost studies done by different companies and consultants, using different assumptions, different measures of costs, and different methods of preparation of the cost study. This mix does not give the Commission what it needed as a starting point for an orderly process to determine what access rate levels are consistent with the public interest. As a result, there is little, if anything the Commission can do with the evidence presented in this matter.

Selection of Model

Early in this proceeding, the Commission's Staff ("Staff") decided to proceed using a forward looking cost model to develop the costs of access for the purposes of this docket. This was a matter left to the discretion of Staff. It was on this basis that Staff's consultant, Ben Johnson Associates ("BJA"), submitted its proposal. Unfortunately, no consideration was given to utilization of the type of embedded cost studies used by the small LECs when they come

before the Commission in a rate case. As noted by Dr. Johnson, "the original directive by the Commission was open-ended enough that one could comply by either submitting economic cost studies or embedded cost studies. Embedded cost studies are appropriate for several reasons: (1) they measure a company's *actual* costs, not future, potential or estimated costs[1]; (2) they are a type of cost study currently in use that are not idiosyncratic to individual company databases, and all LECs have an understanding of the inputs and method of application involved; (3) because they are the cost study used by rate of return LECs in the context of a rate case, the data would subsequently be of direct use to the Commission which has authority over the setting of rate of return LEC access rates, and (4) the embedded cost study is a readily available tool that is not proprietary and does not require each company to acquire at an exorbitant cost.[2] The part 36/part 69 embedded cost study also provides the Commission with more information on joint and common costs.[3] Given these qualities, an embedded cost study would have been a better tool to study LEC costs and ensure an apples-to-apples comparison.

Instead, Dr. Johnson, noted that it was clear from the outset that Staff was going to be using a forward looking cost model to develop cost of access for the purposes of this docket. The Staff, in drafting the RFP consciously made a decision that they would prefer contractors to provide forward looking costs rather than embedded costs.[4] From the outset, Dr. Johnson did not intend to do a detailed cost study of the actual costs of the small LECs. In his April 23, 2001 response to the RFP at page 6, Dr. Johnson states that they will do detailed carrier specific cost

[1] Kent Larsen Direct Testimony, p. 8, l. 3-8.
[2] Kent Larsen Rebuttal Testimony, p. 17, l.18 – p. 18, l.4 ("FLEC and variations of LRIC cost analysis are not appropriate for exchange access service. Mr. Farrar incorrectly relied upon the FCC's *Local Competition* Order where the FCC requires Total Service LRIC (TSLRIC) for *local interconnection* and Total Element LRIC (TELRIC) for pricing *unbundled network elements*. Neither the FCC Orders he cites nor FCC rules in Part 51 deal in any way with interstate or intrastate exchange access service. FCC rules related to exchange access service are found in Parts 36 and 69, the methods used by the MITG, STCG, the ILECs represented by Mr. Warinner and Alltel.")
[3] Kent Larsen Direct Testimony, p. 16 l. 4-11, p. 29 l. 4-12, ; TR. 848-49, 938-39.
[4] TR. 171.

studies for the four largest LECs, but more limited generic cost studies for the smaller ILECs and CLECs.[5] BJA was given the flexibility in the RFP and in their proposal to use simplifying assumptions and to use other techniques to make it manageable in dealing with numerous small carriers.[6]

Dr. Johnson states that his study "is not meant as a roadmap to be followed on a frequent or routine basis."[7] He considers the data "the best currently available *estimate* of the cost of providing access service" of the small LECs.[8] Dr. Johnson's studies do not set forth the *actual* costs of the small LECs. Dr. Johnson used the FCC model for the loop.[9] A regression analysis using Sprint and Verizon's data was used to determine the permanent costs of the small ILECs.[10] The only small company specific information used in the regression analysis was the identity of their switches and the number of lines at those switches to the extent that it was available.[11]

As testified by Kent Larsen, Dr. Johnson's statistical approach to determining the MITG's actual costs was based on an unreliable regression technique using an unreliable statistical surrogate calculation – a statistical sample based on the costs of Verizon and Sprint.[12] The reliability of the regression technique used by BJA was addressed by Kent Larsen in his Direct Testimony. Mr. Larsen stated that

> "[w]hen performing a linear regression analysis, the reliability of the predicted results can be demonstrated by the 'R Squared' value and the value of the 'Standard Error'. R Squared is a value between 0 and 1.00. The higher the R Squared value, the better the predictive ability of the regression analysis thus an R Squared value of .95 (or 95%) is considered very reliable.[13]

[5] TR. 171-72.
[6] TR. 171-72.
[7] TR. 174.
[8] TR. 175.
[9] TR. 200.
[10] TR. 206-08.
[11] TR. 208.
[12] Kent Larsen, Surrebuttal Testimony, p. 6, l. 2-11.
[13] Kent Larsen, Direct Testimony, p. 24, l. 9-13.

Mr. Larsen provided a table summarizing his analysis which demonstrated a high level of confidence, based on an R Square value of 94%, in the BJA model's ability to predict Line Termination costs. However, the BJA model was not as successful in predicting 'Getting Started' and 'Traffic Sensitive' costs, showing an R Square value of 53% and 66% respectively.[14] At hearing, Mr. Larsen testified that statistically, the data produced by the BJA model for the MITG and STCG ILECs is wholly unreliable.[15] Dr. Johnson has not refuted or discussed the statistical reliability of his regression methods at all.[16] As articulated by Mr. Larsen in his surrebuttal testimony, the 8th Circuit Court of Appeals has found that

> "the FCC may establish TSLRIC or TELRIC as the cost standard for local interconnection instead of embedded or historical cost but the calculation of those TLSRIC or TELRIC costs must be based upon the LECs TSLRIC or TELRIC cost, not an imaginary carrier's cost."[17]

Mr. Larsen goes on to state that his "concern is that Dr. Johnson's use of a statistical regression analysis developing the MITG LEC's costs represents the imaginary carrier the 8th Circuit cautioned against."[18]

Dr. Johnson's assertions that it was necessary to use estimating techniques and approximations to estimate the small companies access costs due to a lack of data from the small companies were raised for the first time in his surrebuttal testimony.[19] Contrary to his assertions, the MITG did respond to approximately 85% of the data requests from BJA.[20] Included in the remaining 15% were questions dealing with maps of exchanges and the relationship of switches and transport network that were not provided, but the cost data underlying those switches and

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[14] Kent Larsen, Direct Testimony, p. 24 l. 13 – p. 25 l. 11 (Another measure addressing the BJA Model's ability to predict Local Switching 'Getting Started' costs is summarized at p. 25 l. 13 – p. 26 l. 26).
[15] Tr. p. 817, l. 22-23.
[16] Kent Larsen, Surrebuttal Testimony, p. 6, l. 17-19.
[17] Kent Larsen, Surrebuttal Testimony p. 8, l. 8-11, citing *Iowa Utilities Board v. FCC*, 120 F.3d 753 (1997)
[18] Kent Larsen, Surrebuttal Testimony p. 8, l. 11-13.
[19] TR. 266, 819.
[20] TR. 788-89

transport networks was provided.[21] On January 25, 2002 Staff filed a Motion to Compel Discovery of data requests directed at Southwestern Bell Telephone Company, and a supplement to that Motion was filed on January 28, 2002. While Staff could have easily done so, they did not indicate any concern with the MITG data responses.

It was clear from the April 23, 2001 response to the RFP at page 6, that BJA intended to conduct "more limited generic cost studies for the smaller ILECs and CLECs." In fact, AT&T provided information to Dr. Johnson as part of his analysis in their capacity as a CLEC. Dr. Johnson did not use that information in developing costs for AT&T, the CLEC, exclusively.[22] Similarly, as stated by Kent Larsen, "...Alltel testified that they also cooperated extensively with Dr. Johnson and he still chose to use the same faulty regression analysis on their data."[23] Dr. Johnson testified that

> it is fair to say that less time was spent and less information gathered from small rural ILECs in regard to how their operations work in the state. Because there are so many of them and each one is so unique, there was a limitation on what was practical. The information provided is the most comprehensive information a state Commission would normally ever see, particularly to this full array, the entire group of companies. It is sufficient for you to draw some general conclusions.[24]

In fact, Dr. Johnson said, "...frankly, the final product that we've delivered to the Commission is probably more detailed than I envisioned at the time I wrote that response to that proposal."[25] Setting forth "the best currently available *estimate* of the cost of providing access service" of the small LECs is all that Dr. Johnson had envisioned and proposed to accomplish with respect to the small LECs.

[21] TR. 818-19, 933-34
[22] TR. 1064
[23] TR. 831; Kent Larsen Surrebuttal Testimony p. 7 l. 9-12.
[24] TR. 252-53
[25] TR. 173

No Apples-to-Apples Cost Study

Dr. Johnson agrees that the Commission cannot draw meaningful conclusions by comparing the studies set forth by the parties to one another.[26] He states that "In a generic docket like this, you either need to use a uniform modeling process, the same models, or at least you have to go to substantial effort to reconcile the models and ensure that there's an adequate level of consistency.[27] A uniform modeling process was not used in this docket.[28] Even Dr. Johnson's cost studies include different cost models of Sprint, Verizon and SWBT as inputs that BJA altered through its own modeling process to calculate down to a cost per minute.[29] Dr. Johnson asserts that BJA reconciled the models to ensure that there was an adequate level of consistency.[30] All participating LECs have pointed out that the process used by BJA to calculate their costs per minute fail to reflect each LEC's actual costs.[31] For the small companies, the FCC synthesis model used by BJA does not produce reasonable results of the forward-looking loop costs of small LECs, and the regression analysis techniques used by Dr. Johnson does not provide an appropriate measure of the small LECs local switching and transport costs.[32] As a result, none of the cost studies submitted for the Commission's review are sufficient for the Commission to achieve its original intention of having a cost study of the actual access costs of all LECs.

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[26] TR. 114
[27] TR. 341
[28] The initial brief of STCG and Holway et al. provides a detailed analysis of the cost methodologies set forth, this analysis is consistent with the testimony of MITG witness, Kent Larsen, and the MITG concur in this analysis.
[29] TR. 182-97
[30] TR. 341
[31] Kent Larsen Surrebuttal Testimony, p. 9, l. 7-12 ("Dr. Johnson included elements of the larger LEC's costs *provided by the larger LECs* in his allocation methods. While the larger LECs embrace Dr. Johnson's use of LRIC, a careful reading of SWBT and Sprint witnesses' testimony reflects their concern that he did not accurately reflect *their* LRIC costs. I believe the larger LECs concerns are consistent with the 8th Circuit Court's prohibition against the use of imaginary networks Dr. Johnson cited in his rebuttal.")
[32] Kent Larsen Direct Testimony, p. 21 l. 18-21 ("Compared to current costs and rates, the FCC Model generally appears to be predicting higher loop costs than the actual loop costs of the small ILECs. Conversely, predicated

Urban/Rural costs compared

The Office of Public Counsel's (OPC's) witness, Mr. Dunkel, reviewed Dr. Johnson's cost studies and reached the conclusion that the current switched access rates are in the subsidy-free zone.[33] There is no flow of implicit support from customers in urban areas to customers in rural areas through access rates.[34] Mr. Dunkel states "...the rates are higher in rural areas doesn't mean there is mispricing, because the costs are also *probably* higher in the rural areas...."[35] Dr. Johnson also qualifies his comparison of rural to urban costs by stating the actual cost of operating *may be* higher in rural exchanges.[36] The MITG believes that having a comparison of the actual costs of all LECs was the original intent of this Commission so that this question could be definitively answered, but the cost studies submitted do not provide a definitive answer. In fact, the Sprint witness, Mr. Farrar, questioned the soundness of Dr. Johnson's TSLRIC cost study. He found the TSLRIC calculation for Sprint at 25% higher than the average TSLRIC for the small companies counter-intuitive.[37] He stated that a cost study that has Sprint, a larger company, having higher costs than the rural telephone companies is indicative of some sort of serious methodology flaw in the cost study.[38]

Some parties have argued against Dr. Johnson's premise that costs in the telecommunications industry are coming down. Dr. Johnson provides a general observation that 1) volumes have increased, 2) there has been an increase in the number of second lines people are using for faxes and the internet, 3) firms are cutting cost and 4) firms have been the

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traffic sensitive costs appear to be lower than the costs submitted by the MITG and SCTG ILECs."), p 24 l. 8 – p. 25 l. 11.; Kent Larsen Surrebuttal Testimony, p. 6 l. 2-11, p. 8 l. 1-23.

[33] TR. 385

[34] TR 388

[35] TR. 389

[36] TR. 266

[37] TR. 703

[38] TR. 701

beneficiaries of improving technologies.[39] However, this observation was refuted by several of the other witnesses. Ms. Meisenheimer pointed out that there are cost tradeoffs, and that labor costs are not falling.[40] Mr. Birch agrees that some costs have declined, but the costs of labor, new technologies, software and uncollectable expenses have all increased.[41] Mr. Staihr testified that Sprint's lines are falling as well as their minutes. By default their cost per unit are going up.[42] He states that wireless substitution and cable modems are killing second lines.[43] Mr. Larsen testified that the software costs for the industries' highly sophisticated electronic switching do not go down. If the amount of traffic is declining, the cost per unit must go up, which is a particular concern in small company territories where they never really have enjoyed economies of scale or scope.[44] Mr. Warriner testified that companies have invested significant amounts of money into infrastructure over the past ten years, and those additional investments have somewhat curtailed.[45] The fact that the companies are depreciating that investment means net investment may be declining.[46] Furthermore, Mr. Schoonmaker testified that switching equipment costs might not be going down for small companies due to regulatory requirements, including 4-digit CIC codes, interchangeable NPA/NXX codes, intraLATA presubscription, and CALEA requirements which require frequent updates to software. Companies replace switches every 10 to 18 years, not the following year when prices drop. The expense is a continuing one as the companies depreciate it and incur capitol expenses.[47]

[39] TR. 317-18
[40] TR. 495
[41] TR. 666
[42] TR. 763
[43] TR. 764
[44] TR. 822
[45] TR. 884
[46] TR. 884
[47] TR. 899-900

Some companies have argued that it is necessary to look at the cost of providing combined services in order to determine whether there is a subsidy in the access rates. Dr. Johnson admits that he did not look at stand alone costs of all services that switched access can be a part of to determine whether a subsidy is occurring with access costs. Instead, he placed the burden on the companies asserting that rates are too high to identify the kind of additional types of studies that are necessary. The MITG does not believe it was this Commission's original intent to require such a cumbersome process to compare the access costs of all LECs and reach general conclusions pertaining to whether access rates are too high in light of costs. Dr. Johnson's process of utilizing the differing large LEC model inputs, and reconciling the models to ensure that there was an adequate level of consistency has not provided a basis for comparing the actual costs of LECs. This docket needed but did not produce a uniform model applied to all companies to achieve the Commission's original goals.

Public Policy Issues

1. Lack of Competition in Rural Markets

At the hearing, it became clear that the small company access rates are not the sole factor for the lack of competition in rural markets. Dr. Johnson testified that there are several factors that would discourage competitive entry in rural markets: 1) they are difficult markets to penetrate from a marketing standpoint, 2) the actual cost of operating may be higher, 3) there may not be an option to rent UNEs from the rural carrier, and 4) underlying costs tend to be high, including customer service costs.[48]

Mr. Dunkel testified that high access charges are as financially attractive as high basic rates would be; it is the total stream of revenue that counts.[49] He said the problem with

[48] TR. 266
[49] TR. 407-08

competing in rural areas is that the ILEC has federal high cost support, which the competitor might be able to get, that maintenance is higher with customers spread over a larger geographic area and there is the marketing problem.[50] Mr. Dunkel would not count on competitors coming into rural low density areas for a long, long time.[51]

Ms. Meisenheimer testified that toll competition is fairly robust in Sprint and Verizon exchanges even though their access rates are comparable to the average of the small companies.[52] She states that the level of access charges do not necessarily explain the difference in robust toll competition in Sprint and Verizon exchanges compared to small ILEC exchanges.[53] Mr. Dunkel testified that there is no evidence that access rates are too high or too low for the small ILECs.[54] Both witnesses for the OPC testified that the appropriate way to deal with access rates is as the Commission has been doing, on a case-by-case basis looking at all relevant factors.[55]

2. Incentive of IXC to enter/exit rural markets

AT&T's witness, Matt Kohly, indicated that AT&T cannot say whether it would flow through to all customers in all parts of the state any access rate reduction.[56] He stated that AT&T is regulated as a competitive company which provides this Commission with limited jurisdiction over their rates.[57] AT&T did not flow through its share of Sprint and Verizon's $9 Million dollar access rate reduction following their first year of rate rebalancing.[58] It wasn't until after the

[50] TR. 408
[51] TR. 410
[52] TR. 479
[53] TR. 479-80
[54] TR. 490
[55] TR. 483, 490
[56] TR. 1078
[57] TR. 1079
[58] TR. 1092

second year of rate rebalancing which totaled $18 Million dollars before AT&T flowed through its share of access rate reduction.

Dr. Johnson testified that over half of his time was spent with regard to the major ILECs in Missouri.[59]He stated that "...it was appropriate to put a lot of emphasis on the ILEC costs because the ILECs are the primary providers of access".[60]The major ILECs in Missouri serve the vast majority of the access lines in this state, and are subject to price-capped regulation under §392.245.2 RSMo. As discussed below, the Commission does not have the jurisdiction to direct a price-cap ILEC to reduce or restructure its access rates. As discussed further below, the Commission does have jurisdiction over the small carriers' access rates, however, the practical effect of access rate reduction will be fairly minimal given the MITG LECs access rates are a very small portion of an IXC's total costs to provide toll service in Missouri.[61]

As reflected above, it is unlikely that any rate rebalancing of the small carriers' access rates will rise to a level sufficient for AT&T to flow through such reductions to their customers. In fact, Mr. Dunkel testified that he conducted a national study that showed the access rates in the five highest states were only seven cents higher than the access rates in the five lowest states, but that AT&T only had a one-cent difference in its charges to its customers.[62]

Regulatory Issues briefed at the request of the Commission

1. Whether the Commission has the jurisdiction to direct an ILEC regulated under price-cap regulation pursuant to § 392.245 RSMo 2000 to reduce its switched access rates?

[59] TR. 252
[60] TR. 102
[61] Kent Larsen Direct Testimony, p. 18 l. 7-11;
[62] TR. 405

No. There is no general power on the part of the Commission to affect the rates set by an ILEC for any of its services when it is subject to regulation under this section. The key requirement for an ILEC to fall within regulation of this section is the existence and positive determination of competition from an "alternative local exchange telecommunications company" which has been certified to provide and is providing basic local telecommunications within that exchange area. § 392.245.2 RSMo. If there is competition, § 392.245 RSMo permits a price cap ILEC to set its rates under the price cap in a more competitive manner than ILECs regulated under the traditional rate of return regulations. § 392.245.4(5) RSMo permits an *ILEC* to change its rates for its services "consistent with the provisions of section 392.200, but not to exceed the maximum allowable prices, but filing tariffs which shall be approved by the commission within thirty days, provided that any such rate is not in excess of the maximum allowable price established for such service under this section."

2. Whether the Commission has the jurisdiction to direct an ILEC regulated under price-cap regulation pursuant to § 392.245 RSMo restructure its switched access rates?

The answer to this question is similar to the above question with the understanding that 'restructuring' would involve changing the rate elements to a rate that would ultimately result in a monetary change to the rate as a whole.

3. Whether an ILEC regulated under price-cap regulations may voluntarily reduce its switched access rates?

The statute has two sections which address this issue. Section 392.245.4(5) RSMo states:

An incumbent local exchange telecommunications company may change the rates for its services, consistent with the provisions of 392.200, but not to exceed the

> maximum allowable prices, by filing tariffs which shall be approved by the commission within 30 days, provided that any such rate is not in excess of the maximum allowable price established for such service under this section.

This is a general provision that provides for a price-cap ILEC to change its rates, as long as they are within the maximum allowable prices ("MAP") that are currently set. However, section 392.245.8 RSMo pertains specifically to a price-cap carrier's intrastate access rates:

> An incumbent local exchange telecommunications company regulated under this section *may* reduce intrastate access rates, including carrier common line charges, subject to the provision of subsection 9 of this section, to a level not to exceed one hundred fifty percent of the company's interstate rates for similar access services in effect as of December thirty-first of the year preceding the year in which the company is first subject to regulation under this section.

This provision permits a voluntary reduction in a price cap carrier's intrastate access rates, and gives a four year window for when the necessary adjustment have to be made. This subsection does not preclude a price-cap carrier from voluntarily establishing its intrastate access rates at a level lower than one hundred fifty percent of the company's interstate rates for similar access services in effect as of December 31 of the year preceding the year in which the company is first subject to regulation under this section.

4. Whether an ILEC regulated under price-cap regulations may voluntarily restructure its switched access rates?

Section 392.245.4 RSMo sets forth the only methods by which exchange access rates may be changed. As long as the appropriate methods are followed, this section is silent as to a carrier's ability to voluntarily restructure its switched access rates. The Commission has authority to ensure that a price cap carrier's rates are just reasonable and lawful by employing price cap regulation which is the establishment of maximum allowable prices. It appears a carrier may voluntarily restructure its switched access rate within the parameters of section 392.245

RSMo, as long as it remains below the maximum allowable prices. However, section 392.245.9 RSMo establishes limits for offsetting intrastate access rate reductions through rate increases for basic local telecommunications services, thus any voluntary restructuring of switched access rates would have to be done in compliance with this provision.

5. Whether the Commission has the jurisdiction to direct an ILEC that is regulated under rate of return regulation to reduce its switched access rates without conducting a full rate case?

No. Under section 392.240 RSMo the Commission is given the power to take action that changes, or forces the telecommunications company to change, various aspects of its rates, practices, or physical connections if the Commission finds that aspect to be unjust, unreasonable, discriminatory, or other like reasons. Such a finding may only be made after a full rate case hearing in which the Commission considers all relevant factors. Action by the Commission to reduce the switched access rates of an individual company without such consideration would be prohibited single-issue ratemaking. *State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc. 1979).

6. Whether the Commission has the jurisdiction to direct an ILEC that is regulated under rate of return regulations to restructure its switched access rates without conducting a full rate case?

No. As stated above, under section 392.240 RSMo the Commission's powers may only be exercised after a hearing to ensure the ILEC's rights to due process. Furthermore, restructuring switched access rates would be a form of prohibited single issue ratemaking.

7. Whether an ILEC that is regulated under rate of return regulations may voluntarily reduce its switched access rates without filing a full rate case?

Rate of return regulated ILECs, the small telephone companies in Missouri, are permitted to file tariffs with the Commission to change their rates without a full rate case. The Commission must make a determination as to whether the rates are just and reasonable. Sections 392.220 and 392.230 RSMo.

8. Whether an ILEC that is regulated under rate of return regulations may voluntarily restructure its switched access rates without filing a full rate case?

Assuming that restructuring involves the individual elements to a rate, it would appear that a rate of return regulated company could file tariffs to change their rates on a revenue neutral basis, subject to Commission approval as discussed under issue #7.

9. Whether the Commission has jurisdiction to direct a CLEC to reduce its switched access rates?

For CLECs seeking to operate in Missouri, the Commission has authority to modify or waive sections 392.200 through 392.340 (but not 392.200 subsections 2-5) pursuant to section 392.361. The Commission would have to determine on an individual company basis whether these sections, and the Commission's jurisdiction pursuant to these sections, were modified or waived. Generally they are, and once modified or waived, the procedures for changing CLEC rates are set forth in section 392.500. Under that provision, CLECs have broad authority to change their rates up or down on relatively short notice. The Commission does not have jurisdiction under this section to direct a CLEC to reduce its access rates.

10. Whether the Commission has jurisdiction to direct a CLEC to restructure its switched access rates?

The reasoning set forth for question #9 above is equally applicable here.

AT&T's challenge to the Standard Protective Order

The MITG believes the Missouri Commission's standard Protective Order appropriately contains provisions for 'Highly Confidential' and 'Proprietary' data that has served to protect company sensitive information well in proceedings before this Commission and should not be revised. With that said, the MITG is not opposed to modifying the standard Protective Order on a case-by-case basis to enable the company's, in this case AT&T's, internal cost expert to review the proposed cost studies set forth in this proceeding, provided said expert signs the standard non-disclosure agreement and abides by its terms. Given the strategic position of an internal expert, the MITG believe it is also appropriate in this case to adopt SWBT's proposal that the internal expert certify that they are not involved in retail marketing, pricing, procurement or strategic analysis or planning.

Commission authority to establish local calling scopes

The statutes establishing the Commission's jurisdiction to determine local calling scopes, to classify expanded calling services as being toll or local, and to determine the accompanying changes in intercompany compensation, have not changed since the 1992. The Commission has the same legal authority today to create a rural expanded calling plan as it did in 1992 to create both urban and rural expanded calling plans.

§386.020(31) defines local exchange telecommunications service as service between two points within an exchange." §386.020(4) RSMo defines basic local telecommunications service as "two way switched voice service between a local calling scope as determined by the

commission...". This last phrase suggests that the Commission has the discretion to extend the calling scope for basic local service beyond exchange boundaries.

In its Order creating MCA, the Commission last dealt with the interplay of statutes enabling it to classify expanded calling services as local. Verbatim excerpts of the Commission's conclusions and reasoning utilized in creating MCA service, taken from pages 26-29 of the December 23, 1992, Report and Order in TO-92-306, while somewhat lengthy, demonstrates the path the Commission can now use:

"Tariffing/Intercompany compensation

These issues are closely related and so will be addressed together since the parties have taken position on one issue based upon that party's position on the other issue. **The tariffing issue requires two decisions: (1) what is the appropriate classification of MCA service; and (2) what LECs should be responsible for filing the tariffs to implement the service. The intercompany compensation issue then requires a decision of how companies will compensate one another for handling MCA calling.**

The Signatory Parties in their Joint Recommendation propose that MCA service be classified as local, tariffed by the individual LECs, and that intercompany compensation be based upon the agreement among the Signatory Parties with support payments to LECs not signatories to the Joint Recommendation. The other parties propose that MCA service be classified as toll or long distance, tariffed by the Primary Toll Carriers (PTCs), and that intercompany compensation be through access charges.

The parties supporting the classification of MCA as local discuss the MCA service in terms of basic local telecommunications service or characterize the service requested by customers as expanded local calling. The parties supporting the classification of MCA as toll discuss the MCA service as replacing interexchange toll service and characterize the MCA service as flat rate interexchange telecommunications service.

These discussions and characterizations are not definitive or very probative. The consistent customer comment concerning the existing services provided by the LECs is that they involve toll charges between areas customers consider within their communities of interest. Customers want a flat rate calling service which will allow them to call their doctors, schools, relatives or other persons in neighboring exchanges without the uncertainty of the size of their telephone bill which occurs through use of usage-sensitive toll rates. Under a flat rate service customers would know what they were paying to call regardless of the number of minutes of telephone use during a month. Customers do not care nor are they concerned whether the MCA service will be classified as toll or local; they want the flat rate.

With the adoption of the MCA plan, the Commission will be requiring the implementation of a **flat rate interexchange calling service**. This service will allow a subscriber to purchase unlimited interexchange calling at a flat rate and thus eliminate this major point of contention for customers who are unable to call exchanges with which they have a community of interest.

A review of the briefs indicates that **there is no legal requirement that the Commission classify MCA service as either local or toll**. The statutory definitions of basic local telecommunications serve and interexchange service, the Commission's rules, the Primary Till Carrier Plan, and the Uniform System of Accounts are neither prescriptive nor prohibitive on this issue.

The statutes define basic local service and interexchange service. The distinction between the two types of services revolves around whether calls are within a local calling scope or between points in different calling scopes. The Commission is of the opinion that the **MCA service is neither a basic telecommunications service nor basic interexchange service. The Commission believes that MCA is a substitute for these two services which provides an option to those two basic services**. For the MCA service to be basic local telecommunications service, it would have to be mandatory throughout the MCAs.

Since the Commission has determined that there is no requirements, either legal or factual, to classify MCA service as local or toll, the Commission will look to the evidence concerning the proposals to determine which is more reasonable.

Based upon its review, the Commission finds that the proposal presented by the Signatory Parties is more reasonable.

Several factors support the Commission's decision. First, the Commission has found earlier that the calling pattern of the MCA plan should be a continuation of the WASP currently being provided. WASP service is now tariffed as local, and even though the Commission will be substantially expanding the number of exchange in the MCA beyond the current WASP exchanges, it is more consistent to continue the same classification as is currently in place.

Staff contended that the MCA is different from WASP since MCA will require intercompany compensation while WASP does not. Although this is true, the Commission does not find this difference sufficient to require that MCA be classified as toll.

The Commission also finds that a classification of MCAs as local is consistent with the intercompany compensation plan the Commission finds the most reasonable. The Signatory Parties represent a substantial majority of the exchanges within the MCAs. Those companies have reached agreement on a plan for intercompany compensation that will not require adjustment to access rates and which compensates each company for lost revenues. The adoption by the Commission of the additive rate design, which will cause additional revenue losses to United, does not alter the reasonableness of this decision. Under this plan there are not substantial revenue shifts between the Signatory Parties and these parties have agreed to support payments to the smaller LECs which will be included in the MCAs.

The proposals supported by the Signatory Parties is based upon each LEC billing its own customers/subscribers for the MCA service and then keeping the revenue. Any small LEC which incurs a loss under this system will receive support payments from the Signatory Parties. The Signatory Parties propose to continue these support payments through the next rate proceeding of each affected small LEC. This will be true even under the additive rate design.

The Commission, while adopting the bill-and-keep intercompany compensation proposal and support payments, finds that the time limitation on support payments to the small LECs is not reasonable. Any limitation on the duration of the support payments

will just exacerbate any problems that small LECs have in implementing the MCA service and will reduce the Commission's flexibility in approving just and reasonable rate in any future small LEC rate case.

The Commission finds that the support payments will continue for the small LECs until the Commission issues an order in which it finds that they should cease. This will allow for a review of the issue in a rate case but will give the Commission the flexibility to allow the support payments to continue. The Joint Recommendation proposal for tariffing, classification and intercompany compensation will be adopted with this modification."(bolding added)

The Commission's authority for creating a rural expanded calling plan is no different than that that existed in 1992 when it created MCA service. However, the MITG would note that since the implementation of MCA in 1992, section 392.200.9 RSMo provides that the Commission may only alter local exchange boundaries if the companies providing service in the exchange approve of the alteration.

Difficulties Presented with respect to expanding rural local calling scopes in a competitive environment

The introduction of local and intraLATA toll competition by the 1996 Act has made the practical aspects of creation or expansion of local calling plans more difficult. Former PTCs and former SCs no longer jointly provision interexchange services. Today IXCs order access services from LECs. There is no longer a mutuality of interest in serving the same customers.

Today the largest ILECs are price cap regulated, and the majority of small ILECs are rate of return regulated. Fashioning a revenue neutral platform overlaid upon intercompany compensation upon which an expanded calling plan can be constructed is more difficult now.

The Commission should not forget that the Missouri Universal Service Fund may provide a tool in this regard.[63]

It will be essential to any such effort for the Commission to create a straw proposal for the industry to consider, evaluate, and respond to. Any such proposal should include a description of the service, its classification as local, its calling scope, its pricing and the amount of traffic included in the price, who the provisioning company will be, what facilities the traffic will traverse, the type of intercompany compensation to be used, and what source or sources of revenue will be available to allow implementation without adverse financial impacts to provisioning carriers.[64]

The MITG companies stand ready to cooperate in any such effort.

Current Capping of CLEC access rates

If the Commission continues to cap CLEC access rates, the CLEC access rates should be capped at the maximum rate a price cap LEC is permitted to charge.[65] CLEC access rates should not be capped at the rate the price cap LEC is actually charging since the price cap LECs' current capped rates are each presumed to be just, reasonable and lawful. Should a CLEC require

[63] The MITG has previously suggested that, assuming essential local service includes expanded calling needs, the MoUSF may provide the better vehicle, by use of the high cost fund component of the fund, and by use of the assessment mechanism of the fund, to equalize or provide comparable expanded calling plan scopes without directly impacting intercompany compensation.

[64] In the MoUSF docket, the MITG made a similar suggestion with a "RCA" straw proposal.

[65] The MITG does note that under Section 392.361, a company is granted competitive status upon a finding by the Commission that all telecommunications services offered by such company are competitive and a determination that a telecommunication service is subject to sufficient competition to justify a lesser degree of regulation and that such lesser regulation is consistent with the protection of ratepayers and promotes the public interest. With that in mind, the MITG supports Mr. Stock's comments that "If the Commission is truly interested in fostering competition, I think it has to be cautious in imposing regulatory solutions to market problems. And the whole nature of a CLEC is that its market oriented, and, therefore, if its going to act in a prudent way to try to be a viable competitor to the current LECs, it has to have enough flexibility to do its job in an appropriate manner and have the ability to influence its costs or control its costs and its rates so that it succeeds. Otherwise, you're not going to have competition." TR. p. 1240, l. 9-19.

exchange access rates that exceed the prescribed capped rate, the CLEC should be permitted to seek rate relief with a supporting cost study.

Course of Action with Respect to Switched Access Rates

As stated earlier, this Commission has not been presented with a uniform and consistent cost methodology to all LECs. Without a uniform cost comparison, the Commission will be unable to compare relative costs of access with relative rates for access. Without such a comparison, the Commission cannot determine what comparative rate difference levels are consistent with the public interest. Without such a comparison, the Commission cannot determine what levels of contribution are contained in current access rates, and what contribution amounts can be transferred to another funding mechanism consistent with the public interest. There has been no effort to apply a consistent cost methodology in this docket. As this docket will not provide the starting point necessary for subsequent steps, this docket will have little if any practical benefit to the Commission.

The Commission's efforts in this docket are not solely impeded by lack of a uniform cost comparison, it is also impeded by regulatory restrictions. As Kent Larsen testified, "even if an examination of ILEC access costs leads to an order impacting access rates, Commission authority is limited to the rates charged by rate of return ILECs and then only in the context of a rate case where all relevant factors can be considered."[66] As discussed above, the Commission lacks jurisdiction to reduce the access rates of price cap ILECs, which hold the vast majority of access lines in Missouri. Furthermore, since the small companies represent a small portion of the LEC market, even if IXCs passed through the savings from access rate rebalancing of the rate of return ILECs, it is unlikely the customers of the those companies would enjoy toll rate reductions

sufficient to overcome the local rate increases required to provide rate of return LECs the opportunity to recover their total costs.[67]

Assuming the Commission moves forward based upon the cost studies submitted in this docket, the MITG supports the use of actual, embedded cost studies for the small companies, but takes no position regarding the studies that should be used for the large companies. As stated by Kent Larsen, the MITG "would urge the Commission keep three key points in mind: 1) capped prices for exchange access service were set based on fully distributed actual costs; 2) price cap carriers neither price nor advocate pricing exchange access service at LRIC; and 3) the majority of price cap carriers continue to collect access service revenues based upon fully distributed costs including loop costs that they now do not include in the LRIC analysis."[68]

The MITG does not believe it is necessary that individual company costing methodologies be identical so long as each LEC's exchange access service rates are maintained at just and reasonable levels. For each class of similarly situated LEC, the Commission should apply consistent methods. The costs of MITG LECs and other rate of return LECs should be developed on a consistent basis; price cap LEC costs may be developed using a different method and CLECs costs calculated with a third method. The MITG believes that any costing method developed in this case can only be considered as a guideline and that changing rates of companies will need to be an individual company effort rather than fixed to a specific procedure.

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[66] Kent Larsen Direct Testimony p. 15 l. 9-11.
[67] Kent Larsen Surrebuttal Testimony p. 10 l. 8-13.

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CERTIFICATE OF SERVICE

The undersigned does hereby certify that a true and accurate copy of the foregoing was mailed, U.S. Mail, postage pre-paid, this 13th day of December, 2002, to all attorneys of record.

Lisa Chase
Lisa Cole Chase

[68] Kent Larsen Rebuttal Testimony p. 5 l. 21 – p. 6 l. 5.