Rebecca B. DeCook
Senior Attorney

Room 1575
1875 Lawrence Street
Denver, CO 80202
303 298-6357

December 13, 2002

Dale Hardy Roberts
Secretary of the Commission
Missouri Public Service Commission
PO Box 360
Jefferson City, MO 65101

FILED[3]
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Missouri Public Service Commission

Re: Case No. TR-2001-65

Dear Mr. Secretary:

Attached for filing with the Commission, please find the original and eight (8) copies of AT&T Communications of the Southwest's Initial Post Hearing Brief.

I thank you in advance for your cooperation in bringing this to the attention of the Commission.

Very truly yours,

Rebecca B. DeCook TN

Rebecca B. DeCook

Attachment
cc: All Parties of Record

BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION

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

INITIAL POST HEARING BRIEF OF AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.

Comes now AT&T Communications of the Southwest, Inc. ("AT&T") and submits its Initial Brief in the above-captioned matters.

INTRODUCTION

Following the passage of the Telecommunications Act of 1996, the FCC issued its First Report and Order on August 8, 1996, wherein it articulated its strategy for achieving the general purpose of the Act which is "to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid development of new telecommunications technologies." The FCC refers to this strategy as the "Competition Trilogy." Taken together, there are three sets of fundamental reforms that the FCC concluded would provide the vehicle by which the transition from the current regulatory oversight of the monopoly provision of local service to a fully competitive telecommunications marketplace is to occur.

The reforms identified by the FCC included Interconnection and Unbundling, Universal Service Reform, and Access Reform. Interconnection and Unbundling were

designed to allow efficient and speedy entry into the local market thereby hastening the development of competition as envisioned by Sections 251 and 252 of the Act. Universal Service Reform was designed to preserve and advance Universal Service such that local service remains affordable and of high quality, while the subsidy that supports it is to be designed and distributed in accordance with the principles of competitive neutrality as envisioned by Section 254 of the Act. Access Reform was designed to reform the current system of implicit subsidies reflected in the access charges assessed by incumbent local exchange carriers because such subsidies are economically inefficient, discriminatory, and may thwart the development of competition.

The FCC concluded that "[o]nly when all parts of the trilogy are complete will the task of adjusting the regulatory framework to fully competitive markets be finished. Only when our counterparts at the state level complete implementing and supplementing these rules will the complete blueprint for competition be in place."[1]

In initiating the universal service reform docket, the FCC concluded:

> This proceeding is part of a trilogy of actions that are focused on achieving Congress's goal of establishing a "pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening up all telecommunications markets to competition."[2] The other components of the trilogy are the local competition[3] and access reform rulemakings.[4]

In carrying out its duties under the Act, the FCC determined that the Act:

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[1] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *First Report and Order*, FCC 96-325 (August, 8, 1996), ¶ 9. (*Local Competition Order).*
[2] Joint Explanatory Statement at 1.
[3] Local Competition Order.
[4] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing and End User Common Line Charges*, CC Docket Nos. 96-262, 94-1, 91-213, and 95-72, *Notice of Proposed Rulemaking, Third Report and Order and Notice of Inquiry*, 62 Fed. Reg. 4,670 (released January 31, 1997).

placed on the Commission the duty to implement these principles in a manner consistent with the pro-competition purposes of the Act. It also emphasized that the preservation and advancement of universal service was to be the result of federal and state action stating "[t]here should be specific, predictable and sufficient Federal *and State* mechanisms to preserve and advance universal service."[5] Congress also entrusted the states with a role in universal service, including expressly granting states the authority "to adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service" and requiring every telecommunications carrier that provides intrastate telecommunications services to "contribute, on an equitable and nondiscriminatory basis, in a manner determined by the state, to the preservation and advancement of universal service in that state" when such state establishes universal service support mechanisms.[6]

The three sets of reforms are inextricably interrelated and contain an underlying logic that, if implemented in their entirety, will result in the achievement of the key policy objectives of the Telecommunications Act of 1996. One inevitably leads to the other and indeed none of the three can be successfully implemented without consideration of the other two.

At the state level, this Commission has taken numerous steps to implement the interconnection and unbundling obligations set forth in the Act and the FCC's implementing orders. The Commission has initiated the process to implement the universal service mandates of the Act and the FCC's implementing orders. However, significant access reform has not occurred in Missouri. The implicit subsidies that have historically been included in the rates for access service to keep the cost of local service low still remain in Missouri access service rates. These implicit subsidies must be removed from the rates for access services, and, to the extent deemed necessary, must be

[5] 47 U.S.C. § 254(b)(5) (emphasis added).
[6] 47 U.S.C. § 254(f).

recovered through explicit support mechanisms. As the FCC indicated, such reform is critical to the development of competition.

BACKGROUND

On June 15,1999, the Commission issued its Order Establishing Case and Directing Notice in Case No. TO-99-596 in order to investigate certain language appearing in stipulations and Agreements used with competitive local exchange telecommunications carriers (CLECs). The Commission held an evidentiary hearing in that docket on December 15 and 16,1999. On June 1, 2000, the Commission issued a Report and Order, in which it found "that the public interest would be best served by reductions in exchange access rates rather than by increases."[7] The Commission further stated:

> the present record does not include detailed evidence concerning the actual costs incurred in providing exchange access service. Therefore, the present order is an interim solution addressing only the so-called "standard stipulation" as a barrier to market entry and as a competitive disadvantage to CLECs. The Commission will establish a separate case in which to examine all of the issues affecting exchange service and to establish a long-term solution which will result in just and reasonable rates for exchange access service.[8]

On August 8, 2000, the Commission established this case "to investigate all of the issues affecting exchange access service, including particularly the actual costs incurred in providing such service."[9] The Commission explained that this case "will take the form of a Commission investigation in order to ensure that the necessary detailed cost

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[7] *In the Matter of the Access Rates to be Charged bv Competitive Local Exchange Telecommunications Companies in the State of Missouri,* Case No. TO 99-596, Report & Order, dated June 1, 2000), p. 29.1

[8] *Id.*

[9] Order Establishing Case, August 8, 2000, p. 13.

information is included in the record."[10] The Commission directed Staff to gather, compile and analyze such information as is necessary and useful, including particularly data concerning the actual costs incurred, to examine all of the issues affecting exchange access service in order to establish a long-term solution which will result in just and reasonable rates for this service.[11]

ARGUMENT

I. SCOPE OF THE PROCEEDING

The issues surrounding the purpose and scope of this case have been debated throughout the entirety of this docket. Some parties contend that this case was created only to address CLEC access rates. For example, SWBT's witness Mr. Unruh contends that the "purpose of this case was to determine a long-term solution for determining maximum rates for switched access service by a CLEC."[12] Mr. Unruh makes this statement even though he previously testified that this case was an "access reform case" and was an appropriate vehicle for examining ILEC switched access rates.[13]

Not surprisingly, AT&T agrees with Mr. Unruh's earlier testimony that this is a broader access reform case, rather than one focused only on CLECs. This conclusion is supported by various orders issued in this proceeding.

On August 8, 2000, the Commission established this case "to investigate all of the issues affecting exchange access service, including particularly the actual costs incurred in providing such service."[14] The Commission has clarified that this docket includes

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[10] *Id.*, p. 61.
[11] *Id.*
[12] Ex. 16, Unruh Rebuttal, p. 2.
[13] Case No. TO-98-329, Testimony of Craig Unruh, Tr. 3672.
[14] Order Establishing Case, August 8, 2000, p. 13.

ILECs, and that ILEC access costs are within the scope of this proceeding. In its December 12, 2000 Order Granting Clarification, the Commission stated:

> Next, Staff asks whether the Commission intends to include ILECs as well as CLECs in this case. This question should not require clarification. In its Order Establishing Case, issued on August 8. 2000, Staff was directed to compile "a list of all carriers, with their addresses, presently certificated to provide basic local telecommunications services in the state of Missouri." As stated previously, the carriers appearing on that list were all made parties hereto by the order of September 21, 2000. That list necessarily included large and small ILECs, as well as CLECs, because all are carriers certificated to provide basic local telecommunications services. SWBT opposes inclusion of the ILECs in this case. The access rates of the large ILECs have been adopted as caps on CLEC access rates in each exchange; therefore, it is appropriate to review the ILECs' cost information.[15]

The Commission again addressed this issue in its March 14, 2002 order. In its Order Clarifying the Scope of this Proceeding, the Commission stated:

> The purpose of this proceeding is "to investigate all of the issues affecting exchange access service, including particularly the actual costs incurred in providing such service, in order to establish a long term solution which will result in just and reasonable rates for this service." The Commission believes that this statement is clear. To the extent rates are an issue, this case includes that issue.[16]

This conclusion is also supported by the Request For Proposal issued by the Staff in this proceeding, and the work actually performed by the consultant hired by Staff.

On February 22, 2001, the Division of Purchasing and Materials Management (Division) issued a Request for Proposals (RFP) for a Telecommunications consultant to assist Staff and the Commission with this proceeding. In the RFP, the Division explained that the contractor shall gather and compile detailed cost information regarding the provisioning of intrastate exchange access service in Missouri which shall include, but

[15] Order on Clarification, December 12,2000, p. 2.1
[16] Order Clarifying the Scope of this Proceeding, March 14, 2002, p. 5.1

should not necessarily be limited to, the following existing exchange access services rate elements: carrier common line charges, local switching charges, line termination charges, and local transport charges.[17]

The Division further explained that when preparing its cost information, the Contractor "should use a forward-looking costing method consistent with federal costing guidelines."[18] According to the RFP, the contractor would be required to identify access costs for incumbent local telephone companies (ILECs) and facility-based competitive basic local exchange companies (CLECs) in Missouri.[19]

The only logical conclusions that can be drawn is that this case was established to address access charges of both ILEC and CLECs, with the goal of establishing a long-term solution that will result in just and reasonable rates for exchange access service. The Commission has already found that the public interest is best served by lower rather than higher switched access rates.[20] If the public interest is served by lower access rates it makes no sense to focus on CLECs and ignore the remaining 90+% of the switched access market. If the Commission is going to affect any significant change, it needs to address ILEC access rates as well. As a result, the scope of this proceeding extends beyond CLEC access charges. The Commission must develop an overall strategy to establish a long-term solution that will result in just and reasonable rates for exchange access service.

II. JURISDICTIONAL ISSUES

[17] Johnson Direct, pp. 3-5.
[18] *Id.*
[19] *Id.*
[20] Case No TO-99-596, Report and Order, p. 28.

On January 9, 2002, AT&T filed a Response to the Staff's Proposed Procedural Schedule in this matter and in the same pleading offered comment concerning the scope of the proceeding. On page six (6) of its Response, AT&T asked the Commission to establish a short briefing schedule so that the parties could address ten (10) critical jurisdictional issues. While the Commission did not adopt AT&T's request at the time, the parties have now been asked to address the issues raised by AT&T in its Response in their post-hearing briefs in this matter. Accordingly, those issues will now be taken up in this brief.

STATUTES CONSTRUED

The resolution of the issues enumerated by AT&T necessarily involves quoting portions of many statutes. Section 392.185 [21] sets out the purposes of Chapter 392.

> **392.185. Purpose of chapter. - -** The provisions of this chapter shall be construed to:
>
> (1) Promote universally available and widely affordable telecommunications services;
>
> (2) Maintain and advance the efficiency and availability of telecommunications services;
>
> (3) Promote diversity and a supply of telecommunications services and products throughout the State of Missouri;
>
> (4) Ensure that customers pay only reasonable charges for telecommunications services;
>
> (5) Permit flexible regulation of competitive telecommunications companies and competitive telecommunications services;

[21] Citations to statutes in this Brief shall be to RSMo 2000 unless otherwise indicated.

(6) Allow full and fair competition to function as a substitute for regulation when consistent with the protection of rate payers and otherwise consistent with the public interest;

(7) Promote parity of urban and rural telecommunications services;

(8) Promote economic, educational, healthcare and cultural enhancements; and

(9) Protect consumer privacy.

Section 392.200.1 provides:

Every telecommunications company shall furnish and provide with respect to its business such instrumentalities and facilities that shall be adequate and, in all respect, just and reasonable. All charges made and demanded by any telecommunications company for any service rendered, or to be rendered, in connection therewith, shall be just and reasonable and not more than allowed by law or by order or decision of the Commission. Every unjust or unreasonable charge made or demanded for any service, or in connection therewith, or in excess of that allowed by law or by order or decision of the Commission is prohibited and declared to be unlawful.@

Section 392.245 provides in part:

1. The commission shall have the authority to ensure that rates, charges, tolls and rentals for telecommunications services are just, reasonable and lawful by employing price cap regulation. As used in this chapter, **"price cap regulation"** shall mean establishment of maximum allowable prices for telecommunications services offered by an incumbent local exchange telecommunications company, which maximum allowable prices shall not be subject to increase except as otherwise provided in this section.

* * *

3. Except as otherwise provided in this section, the maximum allowable prices established for a company under subsection 1 of this section shall be those in effect on December thirty-first of the year preceding the year in which the company is first subject to regulation under this section. Tariffs authorized under subsection 9 of this section shall be phased in as provided under such tariffs as approved by the commission.

4.(1) Except as otherwise provided in subsections 8 and 9 of this section and section 392.248, the maximum allowable prices for exchange access and basic local telecommunications services of a small, incumbent local exchange

telecommunications company regulated under this section shall not be changed for a period of twelve months after the date the company is subject to regulation under this section. Except as otherwise provided in subsections 8 and 9 of this section and section 392.248, the maximum allowable prices for exchange access and basic local telecommunications services of a large, incumbent local exchange telecommunications company regulated under this section shall not be changed prior to January 1, 2000. Thereafter, the maximum allowable prices for exchange access and basic local telecommunications services of an incumbent local exchange telecommunications company shall be annually changed by one of the following methods:

(a) By the change in the telephone service component of the Consumer Price Index (CPI-TS), as published by the United States Department of Commerce or its successor agency for the preceding twelve months; or

(b) Upon request by the company and approval by the commission, by the change in the Gross Domestic Product Price Index (GDP-PI), as published by the United States Department of Commerce or its successor agency for the preceding twelve months, minus the productivity offset established for telecommunications service by the Federal Communication Commission and adjusted for exogenous factors;

(2) The commission shall approve a change to a maximum allowable price filed pursuant to paragraph (a) of subdivision (1) of this subsection within forty-five days of filing of notice by the local exchange telecommunications company. An incumbent local exchange telecommunications company shall file a tariff to reduce the rates charged for any service in any case in which the current rate exceeds the maximum allowable price established under this subsection.

(3) As a part of its request under paragraph (b) of subdivision (1) of this subsection, a company may seek commission approval to use a different productivity offset in lieu of the productivity offset established by the Federal Communication Commission. An adjustment under paragraph (b) of subdivision (1) of this subsection shall not be implemented if the commission determines, after notice and hearing to be conducted within forty-five days of the filing of the notice of a change to a maximum allowable price, that it is not in the public interest. In making such a determination, the commission shall consider the relationship of the proposed price of service to its cost and the impact of competition on the incumbent local exchange telecommunications company's intrastate revenues from regulated telecommunications services. Any adjustments for exogenous factors shall be allocated to the maximum allowable prices for exchange access and basic local telecommunications service in the same percentage as the revenues for such company bears to such company's total revenues from basic local, nonbasic and exchange access services for the preceding twelve months.

(4) For the purposes of this section, the term "exogenous factor" shall mean a cumulative impact on a local exchange telecommunications company's intrastate regulated revenue requirement of more than three percent, which is attributable to federal, state or local government laws, regulations or policies which change the revenue, expense or investment of the company, and the term "exogenous factor" shall not include the effect of competition on the revenue, expense or investment of the company nor shall the term include any assessment made under section 392.248.

(5) An incumbent local exchange telecommunications company may change the rates for its services, consistent with the provisions of section 392.200, but not to exceed the maximum allowable prices, by 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.

* * *

7. A company regulated under this section shall not be subject to regulation under subsection 1 of section 392.240.

8. An incumbent local exchange telecommunications company regulated under this section may reduce intrastate access rates, including carrier common line charges, subject to the provisions 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. Absent commission action under subsection 10 of this section, an incumbent local exchange telecommunications company regulated under this section shall have four years from the date the company becomes subject to regulation under this section to make the adjustments authorized under this subsection and subsection 9 of this section. Nothing in this subsection shall preclude an incumbent local exchange telecommunications company from 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 thirty-first of the year preceding the year in which the company is first subject to regulation under this section.

9. Other provisions of this section to the contrary notwithstanding and no earlier than January 1, 1997, the commission shall allow an incumbent local exchange telecommunications company regulated under this section which reduces its intrastate access service rates pursuant to subsection 8 of this section to offset the revenue loss resulting from the first year's access service rate reduction by increasing its monthly maximum allowable prices applicable to basic local exchange telecommunications services by an amount not to exceed one dollar fifty cents. A large incumbent local exchange telecommunications company shall not increase its monthly rates applicable to basic local telecommunications service under this subsection unless it also reduces its rates for intraLATA

interexchange telecommunications services by at least ten percent. No later than one year after the date the incumbent local exchange telecommunications company becomes subject to regulation under this section, the commission shall complete an investigation of the cost justification for the reduction of intrastate access rates and the increase of maximum allowable prices for basic local telecommunications service. If the commission determines that the company's monthly maximum allowable average statewide prices for basic local telecommunications service after adjustment pursuant to this subsection will be equal to or less than the long run incremental cost, as defined in section 386.020, RSMo, of providing basic local telecommunications service and that the company's intrastate access rates after adjustment pursuant to this subsection will exceed the long run incremental cost, as defined in section 386.020, RSMo, of providing intrastate access services, the commission shall allow the company to offset the revenue loss resulting from the remaining three- quarters of the total needed to bring that company's intrastate access rates to one hundred fifty percent of the interstate level by increasing the company's monthly maximum allowable prices applicable to basic local telecommunications service by an amount not to exceed one dollar fifty cents on each of the next three anniversary dates thereafter; otherwise, the commission shall order the reduction of intrastate access rates and the increase of monthly maximum allowable prices for basic local telecommunications services to be terminated at the levels the commission determines to be cost-justified. The total revenue increase due to the increase to the monthly maximum allowable prices for basic local telecommunications service shall not exceed the total revenue loss resulting from the reduction to intrastate access service rates.

10. Any telecommunications company whose intrastate access costs are reduced pursuant to subsections 8 and 9 of this section shall decrease its rates for intrastate toll telecommunications service to flow through such reduced costs to its customers. The commission may permit a telecommunications company to defer a rate reduction required by this subdivision until such reductions, on a cumulative basis, reach a level that is practical to flow through to its customers.

Pursuant to Section 392.248 the Commission may establish a universal service board.

This statute provides in part:

1. In order to ensure just, reasonable and affordable rates for reasonably comparable essential local telecommunications services throughout the State, there is hereby established the "Universal Service Board" which shall consist of the members of the Public Service Commission and the Public Counsel, and which shall be incorporated as a not-for-profit, public benefit corporation in the manner provided pursuant to Chapter 355 RSMo., except as otherwise

provided in this Section. Consistent with the rules adopted by the commission, the universal service board shall create a universal service fund.

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The commission shall adopt rules governing the operations of the state universal service fund within three months of the adoption of the rules adopted by the Federal Communication Commission for the federal Universal Service Fund. Nothing in the ruels adopted by the commission shall be inconsistent with the support mechanisms established for the federal Universal Service Fund, but the commission may adopt any additional definitions and standards it believes are necessary to preserve and advance universal service in the state of Missouri.[22]

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The Commission shall adopt rules governing the operations of the universal service fund and the operation of the universal service board.

Section 392.248.2 RSMo 2000 expressly requires that:

[fJunds from the universal service fund shall only be used:

(1) To ensure the provision of reasonably comparable essential local telecommunications service, as that definition may be updated by the commission by rule, throughout the state including high-cost areas, at just, reasonable and affordable rates. . .

The term "Exchange Access Service" is specifically defined by Section 386.020(17):

"Exchange Access Service" A service provided by a local exchange telecommunications company, which enables the telecommunications company or other customer to enter and exit the local exchange telecommunications network in order to originate or terminate inter-exchange telecommunications service;

JURISDICTIONAL ISSUES

1. Whether the Commission has the jurisdiction to direct an ILEC regulated under "price cap regulation" pursuant to Section 392. 245 RSMo 2000 to reduce its switched access rates?

[22] These particular statutory obligations appear to be lifted from Section 254(f) of the Federal Act. 47 U.S.C. §254(f).

2. Whether the Commission has the jurisdiction to direct an ILEC regulated under "price cap regulation" pursuant to Section 392.245 RSMo 2000 to restructure its switched access rates?

Determining the answers to these and the other 8 questions posed by AT&T is a matter of statutory interpretation. In interpreting Section 392.245, the Commission is guided by rules of statutory construction. The primary rule of statutory construction is to ascertain the legislature's intent from the language used and give effect to that intent if possible. Murray v. Missouri Highway and Transp. Comm'n, 37 S.W.3d 228, 233 (Mo. banc 2001).

> Statutes are construed in such a way as to avoid unreasonable, oppressive, or absurd results. Words contained in a statute should be given their plain and ordinary meaning. Provisions of the entire legislative act must be construed together and, if reasonably possible, all provisions must be harmonized. Related clauses are considered when construing a particular portion of a statute. Courts, in interpreting a particular statute, properly consider other statutes involving similar or related subject matter. All consistent statutes relating to the same subject are in *pari materia* and are construed together as though constituting one act, whether adopted at different dates or separated by long or short intervals. [citations omitted]

State v. One Hundred Fifty-Two Thousand Seven Hundred Sixty, and 00/100 Dollars ($152,760.00), in United States Currency, 2002 WL 31235863, pages 2-3 (Mo.App. S.D.)[23] AT&T submits that the short answer to "Question 1" is "yes." By enacting Section 392.245, the legislature did not intend for the Commission to lose its power to enforce Section 392.200. Even though the legislature may have established a method for the Commission to ensure the reasonableness of rates by setting "maximum allowable rates" it did not divest the Commission of its other proven ways of insuring reasonable and just rates. For instance, if the Commission were to determine after hearing that a price cap regulated company=s exchange access charges failed to "[p]romote universally available and widely affordable telecommunications services"[24] or failed to "advance the efficiency and availability of telecommunications services"[25] or failed to "[p]romote parity of urban and rural telecommunications services"[26] could Section 392.245 be interpreted to handcuff the Commission from remedying the problems? AT&T submits that it cannot. The Public Service Commission Law in its piece parts cannot be interpreted to forbid the Commission from meeting its overall purpose of ensuring that customers are charged only reasonable rates. It would be unreasonable to interpret Chapter 392 such that one of its sections (Section 392.245) bars the Commission from setting aside a "maximum allowable rate" which, as a consequence of the passage of time or a change in economic conditions or otherwise, has become unreasonable and unjust. If the Commission were to adopt such an interpretation of Section 392.245, it would mean that the legislature enacted a provision, which directly impedes the remedial

[23]Westlaw citation is the only one available.
[24]See Section 392.185(1)
[25]See Section 392.185(2)
[26]See Section 392.185(7)

purposes for which the Commission was created. This is repugnant to the rules of statutory construction and cannot be seriously entertained.

Under Section 392.245, the Commission has the authority to regulate companies by means of "maximum allowable prices." The maximum allowable prices carry the presumption of reasonableness but nothing more. Nothing in Section 392.245 restricts the authority of the Commission to correct a maximum allowable price, which has proven to be unreasonable and antagonistic to the purposes of the Public Service Commission Law. In pursuit of its purposes under Section 392.185, the Commission has the lawful discretion to examine a rate once justified as a maximum allowable rate, and ensuring that it is just and reasonable under other lawful standards. If that rate fails under examination, the Commission may set it aside and enter other appropriate relief.

Regarding "Question 2" AT&T submits that the answer is also "yes." For the purposes of "restructuring" the major question is how revenue lost from a reduction in a company's switched access rates could be recovered. Section 392.245 does not prohibit, expressly or by inference, the authority of the Commission to order a restructuring of a company's rates in connection with the correction (in this case a reduction) of an unjust or unreasonable rate. Indeed, Section 392.245.8 and 9 supply a blueprint for rate restructuring when a price cap company voluntarily reduces its access rates. When a price cap company elects to reduce its intrastate access rates under those sections, the Commission is to allow an offset in revenue loss to be recovered by the company, in amounts and manner prescribed, by increases in basic local exchange rates. If a restructuring of this nature was envisioned by the legislature in Section 392.245, then a restructuring of similar genre ordered by the Commission under its general authority and

jurisdiction cannot be labeled as *ultra vires*. This result is also supported by the legislature's enactment of Section 392. 248 regarding the establishment of a Missouri Universal Service Fund ("USF"). Under 4 C.S.R. 240-31.040(6) the Commission has promulgated a rule regarding the affect of disbursements from the fund as follows:

> The affect of distribution from the MoUSF shall be revenue-neutral, with offsetting reductions in rates for other services to be determined by the Commission.

The Commission recognizes by its own rules that in appropriate contexts, rates can be adjusted to effect the purposes of its other orders.

Furthermore, a restructuring in which revenue losses are offset against an increase in basic local rates, or by creation of rate device-- like a surcharge --to recover lost revenue, is consistent with the purposes of the chapter. One purpose of Chapter 392 to "ensure that customers pay only reasonable charges for telecommunications services." Section 392.185(4). Testimony before this Commission in recent cases has established with little debate that

> exchange access rates have historically been set above cost and the excess earnings thereby realized have been used to effectively subsidize the cost of local telephone service. This situation was permitted in the days of traditional rate of return regulation because it was considered in the public interest to promote the goal of universal service, that is, basic local telephone service affordable by all.[27]

Support for such restructuring also comes from the statute when the obligations of the Federal Act are overlaid on the interpretation of the Missouri statute. Section 392.248 requires that the Missouri USF must be consistent with the rules and obligations established by the FCC in implementing the requirements of the Federal Act. The

[27] *In the Matter of the Access Rates to be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Case No. TO-99-596, Report and Order, (June 1, 2000), p. 15.

Federal Act states that support mechanisms must be specific and predictable[28] and equitable and nondiscriminatory.[29] This obligation was confirmed by the Supreme Court in *AT&T v. Iowa Utilities Board* where the Court stated that "§254 [of the Act] requires that universal subsidies be phased out," and any existing implicit subsidies are "temporary."[30] The FCC has recognized that the historic support for local service that is currently still reflected in access rates in Missouri is a subsidy that must be eliminated or made explicit under the Federal Act. In fact, in the Calls Order, the FCC stated that the purposed of the Order was to "remove "implicit subsidies in access charges and recovering costs from those services that cause them."[31]

The implicit subsidy provided by access charge revenue to basic local service is unreasonable and contrary to the Act. This subsidy must be eliminated or made explicit, either by increasing basic local service rates to require basic local subscribers to pay a rate more reflective of the cost of basic local service or through some other mechanism, such as offsets from the USF or through surcharges. To correct the inequity between access rates and basic local rates, the Commission has broad authority and a broad range of solutions including implementation of a "surcharge" to recover on a non-traffic, sensitive basis, the costs of the local loop which have been historically recovered by traffic-sensitive access charges. AT&T submits that a reduction in an unjust access rate and corresponding use of the Missouri USF to offset such reductions or the development of a surcharge, or increase, in an existing rate, for purposes of revenue-neutrality is well within the Commission's discretion.

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[28] 47 U.S.C. §254(b)(5).
[29] 47 U.S.C. §254(b)(4).
[30] *AT&T v. Iowa Utilities Board*, 525 U.S. 366, 393-94 (1999).
[31] Ex. 25, Staihr Surrebuttal, p. 4.

The question may arise whether a reduction in switched access rates by a price cap regulated company would be prohibited by the rule against single issue rate making. The Commission describes single issue rate making in *MCI Telecommunications Corporation, Inc., et al. v. Southwestern Bell Telephone Company*, Case No. TC-97-303:

> Setting aside the various technical pleading of procedural irregularities of the Complaint, the Commission turns its attention to the concern over single issue rate making. The term "single issue rate making" is essentially a short-hand method of referring the requirement that all relevant factors must be considered. Rate making is a balancing process, which focuses on a number of factors such as the rate of return the utility has an opportunity to learn, the rate based upon which a return my be earned, the depreciation costs of plant and equipment and allowable operating expenses. *Union Electric Company v. Public Service Commission* 765 S.W. 2d 618, 622 (Mo.App. 1988).
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> Section 392.240 requires the Commission to consider all relevant factors when determining a rate.

Single issue rate making is not a factor in this case. Section 392.245 provides that price cap regulated companies are no longer subject to regulation under 392.240.1, the source of rate of return regulation authority in this Commission. If a company is no longer to be regulated as if it were rate of return regulated, then the "all relevant factors" consideration under that section is inapplicable. The Commission should have the authority to examine the reasonableness of a particular maximum allowable rate on a rate-by-rate basis.

3. Whether an ILEC regulated under "price cap regulation" pursuant to Section 392.245, RSMo 2000 may voluntarily reduce its switched access rates.

4. Whether an ILEC regulated under "price cap regulation" pursuant to Section 392.245, RSMo 2000 may voluntarily restructure its switched access rates.

Section 392.245.4(5) provides:

> An incumbent local exchange telecommunications company may change the rates for its services, consistent with the provisions of section 392.200, but not to exceed the maximum allowable prices, by 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.

Under the authority of this section, a price cap regulated company may at any time propose a reduction in its switched access rates. The Commission has already determined that the public interest would be best served by reductions in exchange access rates rather than by increases; *In re: CLEC Access Rates,* at page 29; and AT&T would expect the Commission to welcome voluntary reductions of those rates.

The process of restructuring authorized by Section 392.245.8 and 9 has already been described above. That process is permissive. It is initiated by the price cap regulated company. There is a window within which a price cap regulated company must utilize the benefits of these subsections. According to Section 392.245.8:

> Absent commission action under subsection 10 of this section, an incumbent local exchange telecommunications company regulated under this section shall have four years from the date the company becomes subject to regulation under this section to make the adjustments authorized under this subsection and subsection 9 of this section.

If more than four years has passed since a company was subjected to regulation as a price cap regulated company, then ostensibly, the company cannot qualify for the restructuring available under subsections 8 and 9.

Section 392.245.8. and 9 cannot be construed however as the only way in which a price cap regulated company can voluntarily restructure switched access rates. Again, the purposes of Chapter 392 would be defied if Section 392.245.8 and 9 were interpreted to

mean that a company's failure to file for restructuring under their particular arrangement would foreclose a company from ever proposing something different. To the contrary, a price cap regulated company may at any time voluntarily propose a restructuring of its switched access rates pursuant to Section 392.220. The proposal would be subject to the Commission's review and approval just as any change in telecommunications rates regulated by the Commission would be.

The answer to Questions 3 and 4 is "yes."

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?

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

In its Report and Order in *In the Matter of an Investigation Concerning the Primary Toll Carrier Plan and IntraLATA Dialing Parity,* Case No. TO-99-254, et al., the Commission decided the means by which the conflict between intraLATA dialing parity and the Primary Toll Carrier plan would be eliminated. In that case, local exchange telephone companies, which included rate of return regulated ILECs, estimated costs that each would incur in implementing intraLATA dialing parity, and each proposed a method of recovering those costs in the interest of revenue neutrality. The Commission approved the separate plans proposed by the parties for recovery of those estimated costs. However, it imposed a "true up" procedure on companies that were to begin collecting those costs before they were actually known.

In separate cases, the Commission approved the dialing parity plans of each company and also approved the cost recovery mechanism proposed by each. For instance, regarding Choctaw Telephone Company, the Commission approved a surcharge on the Carrier Common Line element for all originating access minutes.[32] This surcharge was approved without a full rate case. Since Choctaw decided to start recovering this cost immediately, it was subject to a later audit and the requirement of filing a general rate case where all relevant factors would then be considered. However, no general rate case was filed for purposes of implementing the surcharge requested by Choctaw.

Obviously, there have been cases in which the Commission has approved,-- outside the context of a general rate case, but in the interest of maintaining revenue neutrality,-- the creation of new rates, such as a surcharge, for purposes of recovering discrete costs identified by rate of return regulated LECs. Having exercised its jurisdiction to approve these mechanisms, the Commission must therefore have the jurisdiction to direct rate of return regulated ILECs to reduce or restructure their switched access rates in a like manner. AT&T submits that access charge reform is the ideal candidate for this type of treatment in that reductions in access rates can be offset nearly dollar for dollar to a flat rated surcharge such as a subscriber line charge.

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

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

[32] *In the Matter of the IntraLATA Toll dialing Parity Implementation Plan of Choctaw Telephone Company*, Case No. TO-99-256.

Regarding Question 7, there is nothing in the Public Service Commission Law that prohibits a rate of return regulated company from charging rates that will yield less than its authorized rate of return. Section 392.240.1 allows the Commission after hearing to set the **maximum** rates, charges and rentals to be observed by the company. The company has the liberty to charge rates that are less than the maximum and which earn less than what is authorized. Companies certainly are encouraged to reduce approved rates where earnings exceed the authorized rate of return. The company is presumed to know it business and how its earnings compare to what has been authorized. Nothing in Chapter 392 forbids such a company from voluntarily proposing a decrease in one of its approved rates including switched access rates. The Commission is free to hold a hearing on the proposed reduction to determine whether a negative financial impact may result or otherwise whether the public interest is affected, but that does not bar the company from making the proposal. Again, the Commission has already determined that the public interest is best served by reductions in exchange access rates than by increases.

Similarly, a rate of return regulated company is free to voluntarily propose a restructuring of its switched access rates. If the proposed restructuring involves an offsetting increase in an approved rate, the increase must be approved by the Commission; Section 392.240.1, however, the statute does not mandate that the Commission enter a comprehensive review of all the company's rates. Where the restructuring involves two discrete services, such as switched access and basic local service for example, the Commission would not abuse its discretion in conducting truncated review limited to the revenue effects generated by changing those two rates. The answer to Question 8 is "yes."

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

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

The Commission has already exercised jurisdiction over the access rates charged by CLECs. The Commission determined in *In the Matter of the Access Rates to be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Case No. TO-99-596, Report and Order (June 1, 2000) that the public interest required the capping of access rates charged by CLECs at the level charged by the ILEC against which the CLEC directly competes. Per the Commission's order, if the ILEC reduces its access rates, then the CLEC competing with it must also reduce its access rates. In this way, the Commission has retained jurisdiction to order reductions in a CLEC's access rates.

II. PROTECTIVE ORDER ISSUE.

AT&T has already fully addressed the issues concerning the propriety of modifying the Standard Protective Order. AT&T incorporates herein the following filings it has made regarding the modification of the Standard Protective Order: AT&T's and TCG's Motion Requesting the Adoption of Modified Protective Order, dated May 3, 2002; AT&T's and TCG's Reply to Southwestern Bell's Response in Opposition to AT&T's Motion Requesting the Adoption of a Modified Protective Order, dated May 23, 2002; and Motion for Reconsideration, dated July 18, 2002.

In addition, based upon testimony adduced at the hearings on this matter, it is clear that there is no legitimate justification for maintaining the multi-level confidentiality scheme currently employed in the Standard Protective Order. Testimony

confirmed that Missouri is unique in having this scheme, particularly in the territory in which SWBT operates, and that in house experts are permitted to review the cost studies of the incumbent LECs in other states, when they have signed an Exhibit A.

Specifically, SWBT witness Barch conceded that AT&T in house experts have been permitted to review SWBT's cost studies in other states, subject to the protective order.[33] Sprint's in-house witness testified that in every other instance in any way similar to this proceeding, including proceedings in Texas and Oklahoma, he always had access to other companies' cost data as long as he signed the nondisclosure agreement.[34] In addition, Sprint indicated that it has no objection to the elimination of the two-tier confidentiality scheme in Missouri so that other cost analysts can review confidential information, so long as there is some protection of the confidential information from disclosure.[35] One of the small companies' witnesses indicated that cost study information in an Oklahoma case he was involved was made available to in-house experts.[36]

Given that in house experts are routinely given access to this cost study information in other states under the provisions of a protective order, it is hard to conceive how any party could argue that they would be harmed by providing in house experts the similar access to cost information in Missouri. As AT&T indicated in its prior filings, Missouri is the only state in which it has encountered this two-tier confidentiality scheme in the standard protective order. It is not aware of any state other than Missouri, where in house experts are foreclosed from accessing other parties' cost studies under the standard protective order. Nor is AT&T aware that any incumbent LEC

[33] Tr. 689.
[34] Tr. 717.
[35] Tr. 717-718.
[36] Tr. 842-45.

or CLEC has ever accused an in-house expert of abusing or misusing cost information they have reviewed as a result of disclosure in a Commission proceeding. For all these reasons and the reasons set forth in AT&T's prior filings, the Standard Protective Order should be modified to eliminate the two-tier confidentiality scheme and to allow in-house experts to review confidential cost information in future proceedings.

III. SUBSTANTIVE ISSUES

ISSUE 1 – What is the appropriate cost methodology (i.e., TSLRIC, LRIC, embedded, stand alone, etc.) to be used in determining the cost of switched access?

1. Appropriate Cost Methodology.

TSLRIC is the only cost standard that is consistent with the FCC's forward looking economic cost standard developed to comply with the requirements of the Act. TSLRIC complies with the cost standard required by Missouri law. And TSLRIC is the cost standard that is almost universally employed by other state commissions in determining network costing issues

With the FCC's adoption of Local Competition Order (FCC 96-325), followed by the Universal Service Order (FCC 97-157), the FCC has articulated that forward-looking economic cost is the proper methodology for the pricing of UNEs and the economically efficient level of Universal Service support. The FCC has addressed some level of access reform through the adoption of the stipulation in the CALLS Order.

The federal Act requires that network elements prices be based on cost.[37] The FCC rules define the minimum network elements that ILECs must offer. Among other elements, ILECs is required to offer dedicated interoffice facilities, tandem switching, shared transmission facilities, and local switching.

[37] 47 U.S.C. § 252(d)(1).

Because these network elements are used in the provision of access service and are functionally equivalent to and substitutes for UNEs, the rates for these elements of access service must be established at cost-based levels.[38] Because the network elements used in the provision of access services are identical to the unbundled network elements used to provide local service, the logic for use of forward-looking economic cost and consistent cost-based pricing of both is essential. It would be counterintuitive and counter to the development of competition in telecommunications markets to cost out and price the same network elements differently for these three purposes. Moreover, it would lead to economically inefficient entry and encourage artificial and uneconomic arbitrage.

In addition, Missouri telecommunications law has directed the Commission to use a cost methodology that, at a minimum, considers long run incremental cost or "LRIC." The Missouri telecommunications law directs the Commission to apply LRIC principles when it evaluates the cost of intrastate access for Price Cap companies in connection with rate re-balancing.[39] In addition, the Commission has historically used LRIC as a means to assessthe cost of telecommunications service in Missouri.[40] Further, as mentioned above, the Commission relied on Sprint's cost study that conformed to the FCC's Forward-Looking Economic Cost standard in approving Sprint's rate rebalancing.[41] The Commission also relied on GTE's TSLRIC cost studies in approving GTE's rate rebalancing.[42] Finally, the Missouri telecommunications law specifically requires that the Commission ensure that all new services are priced above LRIC.[43]

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[38] Ex. 23, Farrar Surrebuttal, pp. 4-6.
[39] *See* Section 392.245.9 RSMo.
[40] *In the Matter of the Cost of Service Study of Southwestern Bell Telephone Company*, Case No. 18, 309, Report and Order, dated May 27, 1977.
[41] Exhibit 21, Farrar Direct, pp. 7-8.
[42] *Id.*
[43] *See* Section 392 200(4)(2)(c).

Cost calculations should be forward looking because this is the perspective from which competitive sellers and competitive buyers make decisions. Any cost calculation formed from any other vantage - for example, historical costs - would distort the signals offered to consumers, sellers and potential entrants. This would in turn reduce economic welfare and undermine the pursuit of economic efficiency. Sellers of telecommunications services, current or prospective, make output decisions based on how these actions are likely to affect current and future cost and revenues. The existence or absence of sunk costs and the magnitude of historical costs have no effect on the firm's optimal behavior. Similarly, consumers make consumption decisions based on forward looking assessments. They assess current and anticipated income streams as well as current and expected future prices. Past costs, however, are unimportant to consumer choice.

For all these reasons, the Commission should calculate switched access costs based upon the forward-looking cost of providing the service, TSLRIC.

SWBT and Sprint agreed that Total Service Long Run Incremental Cost ("TSLRIC") or LRIC is the appropriate standard to be used to determine the cost of access services.[44] Sprint agreed that support for such a standard stems from the FCC's adoption of a forward looking cost methodology for use in pricing network elements. As Mr. Farrar stated in his surrebuttal testimony,

> The Commission should adopt an incremental cost standard for all companies based upon widely-accepted economic costing principles. The FCC's Forward- Looking Economic Cost standard, as defined in the Local Competition Order, best meets the needs of this proceeding. Contrary to the claims of some witnesses, the Forward-Looking Economic Cost

[44] Tr. 721, 730, 760.

standard is ideal for switched access because it is well defined, well documented, easily applied, widely used, and widely accepted.[45]

SWBT also supports the use of a forward looking cost approach is appropriate. SWBT witness Barch stated that LRIC/TSLRIC "is the appropriate basis on which pricing decisions can be made." [46]

Accordingly, the Commission should adopt the Total Service Long Run Incremental Cost ("TSLRIC") standard consistent with the FCC's pricing rules.

2. Meaning of "Actual Cost."

The term "actual cost" as used by the Missouri Commission in its procedural orders does not mean historic embedded costs, as some parties advocate. In rebuttal testimony, Dr. Johnson cited a decision from the United States Supreme Court that addressed this very issue and concluded that the term "cost" can mean forward-looking.[47] The addition of the adjective "actual" does not change this. In a competitive market where businesses make decisions based upon cost, the only relevant actual costs are forward-looking costs as this represents the "actual" costs the firm will pay if it makes the purchase or sell decision.[48]

Accordingly, AT&T contends that the actual cost that this Commission should consider in this proceeding as the TSLRIC of access. The other cost methodologies presented by Dr. Johnson and some other parties do not measure the actual cost of providing access services. Nor are they useful in establishing the long term solution that will result in just and reasonable rates for access. In particular, AT&T contends that the stand-alone cost study is not useful, either for assessing costs or the existence of

[45] Ex. 23, Farrar Surrebutal, p. 7.
[46] Ex. 19, Barch, Rebuttal, p. 18.
[47] Ex. 2, Johnson Rebuttal, p. 6.
[48] Ex. 48, Kohly Surrebuttal, p. 5.

subsidies. Because switched access is not provided on a stand-alone basis in Missouri, the stand-alone cost of providing switched access has nothing to do with the "actual cost" of providing access service.[49] Moreover, because the companies being analyzed are multi-product firms, the stand-alone costs for groups of services must be analyzed in order to determine the existence of subsidies.[50]

The other cost studies all include arbitrary allocations of common cost that have no economic support.[51] Allocated costs have little, if any, connection with actual firm and societal costs involved in providing a particular service. Pricing and costing decisions based on any cost measure other than actual service costs thus are not supported by principles of cost causation.

Second, because of the arbitrariness of allocations of common costs, service specific costs become a loose, subjective concept, easily altered by those desiring to advance their own private interests, rather than those of the general public and economic efficiency.

3. Use of TSLRIC for Pricing Access Services.

Section 252(d)(1)(a)(i) mandates that the rates for network elements shall be based on cost. As discussed above, the FCC has directed that costs, as that term is used in the Act, shall mean forward looking costs. It follows, therefore, that since access service is comprised of UNEs, the rates for access service should be based on TSLRIC (the service equivalent of TELRIC). Indeed, the FCC has required that reciprocal compensation rates be set at the TELRIC rates of the UNEs for the termination of local traffic. Access service uses these same network elements. It would be antithetical to

[49] Ex. 24, Staihr Rebuttal, p. 4.)
[50] Ex. 24, Staihr Rebuttal, pp. 5-10; Ex. 25, Staihr Surrebuttal, pp. 6-8.
[51] Tr. 657.

price reciprocal compensation at TELRIC-based rates, but allow incumbents to continue to price access at rates many multiples of the UNE rates used to provision the service. But that is the situation in Missouri.

In fact, the FCC concluded:

> We recognize that transport and termination of traffic, whether it originates locally or from a distant exchange, involves the same network functions. Ultimately, we believe that the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge[52].

It is interesting to note that while SWBT objects to pricing switched access based upon the UNE rates used to provision the service (Tr. 693), SWBT uses UNE rates to support its conclusion that local service rates are below cost (Tr. 562). SWBT can't have it bothe ways. In fact, SWBT witness Barch stated that LRIC/TSLRIC "is the appropriate basis on which pricing decisions can be made." [53] Sprint witness Staihr also confirmed that TSLRIC, including some common cost, is the appropriate basis for setting rates.[54]

TSLRIC recognizes the principal of cost-causation and serves as the appropriate and efficient basis for making pricing decisions. The use of TSLRIC best simulates the conditions in a competitive marketplace and will encourage efficient levels of entry and investment.

Pricing access at TSLRIC is necessary to prevent companies that provide both switched access services and interexchange services from leveraging their monopolies in switched access service and the above cost-based access rates to engage in discriminatory

[52] CC Docket No. 96-98, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 First Report and Order, ¶ 1033.
[53] Ex. 19, Barch Rebuttal, p. 18.
[54] Tr. 760.

pricing against unaffiliated inter-exchange carriers in what is commonly referred to as a 'price squeeze'. To the extent that access charges exceed forward looking economic costs, the combined switched access/toll provider faces a lower cost of providing long distance services than competitors who must pay the entirety of the access rates priced above economic costs. The FCC recognized this competitive advantage when it adopted the CALLS Order, which reduced interstate access charges into the range of estimated economic cost. In that Order, the FCC concluded the following:

> The reduction in switched access usage charges will promote competition in the long distance market between BOC affiliates entering the market and IXCs. To the extent switched access usage charges paid by IXCs are significantly above cost, BOC affiliates would have a competitive advantage because they would obtain switching services from the BOCs at cost.... the CALLS proposal will minimize the competitive advantage BOC affiliates would have over IXCs in offering long-distance services while the switched access rates were significantly above cost."[55]

The CALLS Order, of course, did not address the problem of intrastate access charges so the concerns still remain with respect to intrastate access rates.

Some parties may argue that monopoly providers have no incentive to discriminate because they would lose the profit they are making on access as a result. This argument basically assumes that the combined entity will seek to maximize the profit of the switched access business and their interexchange business independently, rather than maximize the profit of the combined entity. This assumption is overly simplistic and is belied by the realities of the market. If the monopolist believes it will lose both the customer's local service, especially from high-revenue local customers, and the toll business, the monopolist is better off retaining the local customer even if it prices

[55] CALLS Order, ¶ 158.

toll below the imputed cost of access. By retaining the customer, it still receives the local revenues as well as earns an economic profit by providing toll services at rates that exceed the underlying economic cost. Meanwhile, an unaffiliated IXC will have to incur a financial loss to match the other company's rate. In similar fashion, the above cost access rates create the ability and incentive to engage in discriminatory pricing in one market to protect a monopoly in another market. In this instance, the integrated provider would use the above cost-based switched access rates to engage in discriminatory pricing in the interexchange market in order to protect its monopoly in the local exchange market. This is similar to the strategy employed by Microsoft in which it attempted to monopolize the Internet browser market to protect its monopoly in the operating system market.

In addition, consider what is actually occurring in the market. In order for residential customers located in SWBT territory to be eligible for the SBC LD's Domestic Saver Gold, which offers an intrastate rate of 7 cents per minute, the customer must also purchase Simple Solutions from SWBT, which ranges in price from $39.95 to $89.95 depending upon the options selected. The minimum option requires the customer to subscribe to a bundle of eight high margin vertical features, as well as unregulated services such as voice mail (CallNotes® Plus), inside wiring (InLine®), and even hand set protection (Phone-Protect℠). If the customer does not wish to purchase these extraneous services from SWBT, the customer must pay SBC LD $1.95 more per month to get the same rate. On the business side, a customer may enroll in the Business Long Distance Total Solutions Plus plan that provides interstate calling for 7 cents a minute and intrastate calling for 10 cents a minute with no monthly fee levied by SBC LD.

However, to be eligible, SBC LD's customer must also purchase Access Advantage Plus or On-Line Office, Plexar I, Plexar II, or Complete Link Basic from SWBT. If the customer does not want to purchase all of these extraneous services from SWBT, the customer will pay 12 cents a minute.[56]

As is readily apparent, any supposed lost opportunity cost from pricing below the imputed cost of access is readily recovered through the sale of high margin local and unregulated services which also requires the customer to continue to be a basic local customer of the integrated access/toll provider.[57] The difference between the access rate and the TSLRIC of access provides the integrated switched access/interexchange carrier with a revenue cushion to engage in discriminatory pricing without ever incurring a financial loss. An IXC competitor would incur a financial loss if it tried to match the lower interexchange toll rates.[58] Pricing access rates at TSLRIC would eliminate this advantage.

In a prior proceeding in Missouri, David E. Stahly appearing on behalf of Sprint Communications, L.P. confirmed this conclusion, stating that when SWBT is both a switched access provider and an interexchange carrier through its long distance affiliate, the intra-company switched access payment between the long distance affiliate and the local access provider is merely a paper transaction and does not represent the real economic cost upon which pricing decisions are made.[59] According to his testimony, the difference between TSLRIC and the access rates is what provides the incentive and

[56] Ex. 48, Kohly Surrebuttal, p. 8.
[57] *Id.*
[58] *Id.*
[59] *Id.*, p. 9 (citing Case No. TO-99-227, Application of Southwestern Bell Telephone Company to Provide Notice of Intent to File an Application for Authorization to Provide In-Region InterLATA Services Originating in Missouri Pursuant to Section 271 of the Telecommunication Act of 1996, Direct Testimony of David E. Stahly, pgs 28 – 47, January 5, 1999.

ability to engage in discriminatory pricing. This is precisely the competitive advantage that the FCC was referring to in its CALLS Order. This competitive advantage must be eliminated in Missouri.

4. TSLRIC Estimates.

AT&T's witnesses were unable to review the incremental cost studies submitted by Staff's consultant or by individual carriers. Therefore, AT&T is unable to provide any direct support or critique of the specific cost studies offered by any party to this proceeding. However, to assist the Commission in assessing the cost of switched access in Missouri, AT&T presented testimony of publicly available TSLRIC surrogates that could be used as a cost proxy for assessing the legitimacy of the cost study results offered by the other parties to this proceeding. As discussed above, the incremental cost of terminating local and interexchange traffic involves the same network functions and, therefore, has the same costs as switched access service. As the FCC stated:

> We recognize that transport and termination of traffic, whether it originates locally or from a distant exchange, involves the same network functions. Ultimately, we believe that the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge.[60]

Because of this cost relationship, the Commission should consider the local (reciprocal) compensation rates presented by AT&T witness Matt Kohly in Exhibit 48, Table MK-1 as useful estimates of the TSLRIC cost associated with the network facilities used in the provision of switched access service. These rates are as follows:

[60] CC Docket No. 96-98, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 First Report and Order, ¶ 1033.

Table MK-1 Comparison of Reciprocal Compensation Rates to Corresponding Switch Access Rates.				
Company	**Rate Source**	**Local Compensation Rate per end**	**Intrastate and Interstate Access Rate**	**Comments**
Verizon	Recip. Comp.	0.52¢	8.19¢ / 0.40¢	Recip. Comp. Rate set in Case No. TO-97-63, AT&T – GTE arbitration
SWBT	Recip. Comp.	0.56¢	2.97¢ / 0.31¢	Rate for SWBT's Rate Group A – exchanges 0 – 4,999 access lines, set in Case No. TO-97-40, AT&T/MCI – SWBT arbitration
Sprint	Recip. Comp.	1.32¢	9.47¢ / 0/082¢	Negotiated Rate contained in Sprint Master Interconnection and Resale Agreement, 3/31/2000
Spectra	Recip Comp.	1.79¢	9.70¢ / 3.1¢	Negotiated Rate – Footnote indicates rate based upon Spectra Cost Studies
Orchard Farm*	Wireless Termination	1.9655¢	9.48¢ / 3.8¢	Negotiated Rate
New London*	Wireless Termination	1.954¢	9.80¢ / 3.45¢	Negotiated Rate
Stoutland*	Wireless	1.476¢	14.12¢ /	Negotiate Rate

	Termination		2.92¢	
* - Wireless termination rates reflect the rates by CMRS providers paid for terminating a call. Therefore, the wireless termination rates are compared to the equivalent interLATA access rates for terminating a call. ** - the access rates listed in this table are based upon those presented by Staff's Witness Dr. Ben Johnson in his direct testimony.				

If one assumes that these rates that have been agreed to by these carriers are above cost, these rates support the conclusion reached by Staff consultant Dr. Johnson that Missouri's rates for access service are significantly higher that their costs and provides support for the TSLRIC estimates presented by Dr. Johnson.[61]

ISSUE 2 – Should the cost methodology (i.e TSLRIC, LRIC, embedded, stand alone etc.) for determining switched access costs be uniform and consistent for all Missouri LECs?

While there may be some value in evaluating access service costs using the same cost standard/methodology for all local exchange carriers, in devising an approach to reducing access prices, the Commission may choose a different approach with different timing for addressing the access issues between the various companies. For example, The Commission may take a different approach for the price cap companies than it does for the rate of return regulated companies. The Missouri statutes have differing requirements for small ILECs than for large ILECs, as well as differing requirements for ILECs regulated under price cap regulation versus ILECs regulated under rate of return regulation. The Federal Act and the FCC's rules also have different requirements for different companies. As long as there is a rational and justifiable reason for differing treatment, the Commission does not need to adopt a one-size fits all approach.

[61] See Ex. 1HC, Johnson Rebuttal Testimony, Schedule 2, pp. 8-9.

ISSUE 3 – Should loop costs be included in the determination the cost of switched access, and if so, at what level?

1. Allocation of Loop Costs.

Loop costs are not properly included as an incremental cost of switched access. Under basic cost causation principles, the cost of the local loop is caused by basic local service and, therefore, the cost of the loop should be included in basic local service cost studies, not in the cost of switched access service.[62]

The local loop is the functionality that allows an end-user to have access to the first point of switching. It provides the end-user with the ability to place and receive calls.[63] A customer cannot purchase basic local service without the full use of local loop. Without basic local service, a customer cannot receive the benefit of E-911, purchase vertical or other ancillary services or have the ability to place or receive toll calls. There is a cost that the LEC incurs when it provides the end-user with access to basic local service. Once that cost has been incurred by the LEC, nothing the end-user does affects the cost of his or her loop.[64] That is the manner in which a customer uses his or her loop has no impact on, or anything to do with, the cost of that loop, or the proper method for recovering that cost.[65] Therefore, loop costs are incurred as a direct result of the decision to purchase basic local service and do not represent a common cost.

Some parties contend that the loop should be treated as a common cost because multiple services can make use of it.[66] Dr. Johnson and witnesses appearing on behalf of

[62] Tr. 643. 724.
[63] Ex. 24, Staihr Rebuttal, p. 17.
[64] *Id.*
[65] *Id.*, pp. 17-18.
[66] Ex.13, Meisenheimer Rebuttal, pp. 11-13.

the rate of return ILECs generally support this conclusion as well. However, the cost of the loop does not vary based upon usage.[67]

> According to the Local Competition Order, Paragraph 676, common costs
>
> are... incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers).

When considering the local loop, the key phrase in this definition is the " ... relative proportion ...." This condition does not exist for the local loop. Many products traverse the loop, including basic service, local usage, toll usage, and access usage. However, loop costs change as the relative proportion of these products varies. As the number of basic subscribers increases, independent of any change in usage, loop costs obviously increase.[68] Therefore, the local loop cannot be a common cost.

> According to the Local Competition Order, Paragraph 676, joint costs are
>
> ... incurred when two or more outputs are produced in fixed proportion by the same production process (Le. when one product is produced, a second product is generated by the same production process at no additional cost)

When considering the local loop, the key phrase in this definition is "... produced in fixed proportion ... ." Again, this condition does not exist for the local loop. Many products traverse the loop, including basic service, local usage, toll usage, and access usage. However, these products are clearly not "produced in fixed proportion" by the production of loops. The production of loops produces loops, not MOU traffic.[69]

[67] Tr. 668, 719-20, 750.
[68] Ex. 22, Farrar Rebuttal, p. 18.
[69] Id., pp. 17-18.

Therefore, the local loop cannot be a joint cost. The joint use of an input or a product does not mean that input is a joint cost.[70]

Sprint's Witness Dr. Staihr's comparison to televisions and personal computers highlights the flaw in this logic.[71] As another example, consider the market for compact disc players and compact discs (CD). If a customer wants to listen to a particular CD, she has to buy "access" to a CD player. Since the CD player is necessary for the usage of the CD, should the price of the CD include an allocation of the costs involved in manufacturing the CD player? Of course it should not, and in reality it does not. Such cost allocation, and therefore the resulting price, is inefficient and not found in competitive market settings. In line with efficiency requirements, CD prices are independent of the costs associated with the manufacturing of CD players.[72]

In summary, the costs of the local loop are directly caused by the provision of subscriber access, not the many services carried over the network.

Several parties fail to distinguish between the economic exercise of "calculating" cost versus the political policy or decision as to how the cost should be "recovered" once the cost has been calculated. As discussed above, a proper incremental cost study for access services does not include any cost associated with the local loop. However, some portion of the local loop costs associated with basic local service has historically been allocated, for public policy reasons, to access services and recovered through access rates, including the Carrier Common Line charge.

The allocation of loop costs across multiple services that is being advocated by several parties has significant competitive impacts. First, as the FCC confirmed, the

[70] Ex. 24, Staihr Rebuttal, p. 18.
[71] Ex. 24, Staihr Rebuttal, pp. 18, 20.
[72] Ex. 48, Kohly Surrebuttal, pp. 13-14.

historical allocation process has created implicit subsidies that the Act requires be made explicit because of the adverse impact such subsidies have on competition. In addition, Section 392.455 RSMo. 2000 of the Missouri statutes require CLECs to provide basic local service as a separate and distinct service. In complying with this statutory requirement, CLECs incur the full loop costs and yet are forced to offer basic local service at rates that do not reflect their costs, because the prevailing market price of basic local service reflects the fact that residual recovery of cost attributable to local service has been allocated to other services which the CLEC may or may not provide or the customer may or may not subscribe to.

In any event, even if one were to agree that allocating the cost of the local loop across all services is appropriate (which AT&T does not), there is simply no practical and non-discriminatory method to allocate the cost of the loop facility to all of the individual services that use the loop in a non-discriminatory manner. Ms. Meisenheimer acknowledges that any such allocation is "primarily a matter of judgment and discretion."[73] Similarly, Dr. Johnson acknowledges that allocation procedures necessarily involve a degree of arbitrariness. This task is made increasingly complex by "the ever increasing variety of services" that use of the loop. Add into this mix, the differing service providers such as CLECs that most likely have a unique customer base and unique service offerings and it is simply not possible. In recognition of this impossibility, Staff Witness Mr. William L. Voight testified in another proceeding that the inability to accurately spread the loop across all services was one of the "fatal flaws of the fully allocated costing method."[74]

[73] Ex. 13, Meisenheimer Rebuttal, p. 9.
[74] Ex. 48, Kohly Surrebuttal, p. 15.

The loop allocation methods proposed in this case arbitrarily select two services to bear the cost of the local loop; basic local service (measured in terms of local minutes) and switched access service, (also measured in terms of minutes) and then allocate the costs between the two services based upon differing accounting rules. While this may have been done in the past, the telecommunications market has changed and this arbitrary selection method is discriminatory, is inappropriate and can no longer be sustained.

Supporters of loop allocation recognize that many services beyond local minutes and landline interexchange minutes rely upon the loop and non-traffic sensitive switching elements. In Missouri, basic local service includes E-911, which whether used or not provides a benefit to the end-user. Basic local service also includes the ability to place and to receive calls which has a value whether used or not. Vertical features such as CallerID, Call Waiting, Auto Call Return among others generate significant revenues for local exchange companies and just like E-911, these services are only made possible by the use of the loop. Many local exchange carriers also provide voice-mail service either directly or through an unregulated affiliate.[75] Each of these services jointly uses the loop. If the Commission is going to engage in allocating the cost of the loop, it must do so across all services that use the loop in a non-discriminatory manner, not just on a few select services. AT&T submits that such an allocation process would be so complicated and inexact that there is no way it could be done in a non-discriminatory manner. And even if it somehow possible to arrive at a non-discriminatory allocation mechanism at a point in time, that mechanism would require constant tinkering as usage changed and new services were introduced.

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[75] *Id.*, pp. 15-16.

The bottom line that the many parties that advocate allocation of loop cost fail to acknowledge is that, regardless of how the loop costs are allocated, in the long run customers in total will pay rates that will recover those costs. Any allocation methodology is really just an exercise in determining which retail customers will pay more or less for the dedicated access line into their home or business. Because loop allocation proliferates the historic scheme of implicit subsidies, in violation of the Federal Act, and, at the end of the day, the customer ends up paying for loop costs through higher rates for other services, the loop allocation proposals cannot be supported and should be rejected.

2. Non-Traffic Sensitive Recovery of Loop Costs.

Loop costs are non-traffic sensitive or non-service specific.[76] However, the portion of these non-traffic sensitive costs that has been historically subsidized by access service are recovered, via the traffic sensitive rate element, known as the Carrier of Common Line (CCL). This rate element is an implicit subsidy that the Federal Act requires be made explicit and funded through the mechanisms such as a universal service fund. However, to the extent this rate element is retained in any form, the costs that it seeks to recover should be recovered on a non traffic sensitive basis. The current mechanism of using a traffic sensitive CCL element is discriminatory and inefficient. By recovering the cost of this facility in usage rates, such as the Carrier Common Line, some high volume customers pay far more than the cost to serve them -- in effect, providing an added "subsidy" through higher rates. Meanwhile low volume users pay less than the cost to serve them.

[76] Ex. 48, Kohly Surrebuttal, p. 17; Ex. 23, Farrar Surrebuttal, pp. 14-15.

An allocation mechanism based upon minutes will create a subsidy regardless of the customer's ability to pay and represents an economically inefficient subsidy mechanism. This is not an efficient subsidy mechanism as it is not means-tested and is in direct conflict with the purpose of the Life-Line program which is designed to create an explicit subsidy targeted to those that need it, which is a much more economically efficient subsidy mechanism.

The FCC addressed the CCL in its recent "MAG Plan Order,"[77] and found that the interstate CCL is "an inefficient cost recovery mechanism and implicit subsidy" and should be phased out of the common line rate structure. (MAG Plan Order at paragraphs 40-41, 61-68.)

From a competitive standpoint, the Commission must also realize that interexchange carriers increasingly compete against wireless carriers. Interexchange carriers incur higher intrastate call termination rates, while FCC rules mandate that wireless carriers pay traffic termination charges that are based upon TELRIC costs and cannot include any rate element designed to recover non-traffic sensitive costs for IntraLATA calls. IXCs such as AT&T compete on the same toll routes as wireless carriers and even though the calls may utilize the exact same facilities to terminate traffic, IXCs incur higher termination rates. As a result, the current access mechanism is discriminatory and favors one type of service provider for no justifiable reason. This is contrary to the mandates of the Act.

The Kansas Corporation Commission ("KCC") recently adopted a stipulation and agreement that significantly restructured SWBT and Sprint's switched access rates and

[77] Ex. 48, Kohly Surrebuttal, pp.17-18 (citing Second Report And Order And Further Notice Or Proposed Rulemaking" *In the Matter of the Multi-Association Group (MAG) Plan, etc.*, CC Docket Nos. 00-256, 96-46, 98-77, and 98-166, issued November 8, 2001.

moved the non-traffic sensitive costs into the local rates. In doing so, the KCC found that "the issue is not so much about how costs are allocated among services, but how the costs are recovered – whether on a fixed or variable basis". In support of that conclusion the KCC stated:

> The cost of the local loop is essentially fixed, that is, it does not vary based on the volume of usage or whether the usage is local or long distance. Each customer has the same basic capabilities and opportunities for use of the loop once the customer is connected. The rate structure for telephone services (as it has happened historically) generally includes a flat rate for unlimited local calling, and access rate based on minutes of usage, which is paid the customer's IXC to the LEC, and passed through to the consumer in the IXC's rates for toll and long distance services. Under this structure, to the extent that access rates includes the cost of the loop and is charged based on minutes of use, a consumer that is a heavy user of toll and long distance services pays more to support the loop costs than a customer who uses his phone only to make local calls[78].

The KCC further found:

> These basic facts show the inefficiency, as well as the unfairness, of a usage sensitive recovery mechanism when "the loop would be necessary even if no long distance calls were made or if the customer only received calls." [citation omitted] Thus it is reasonable and appropriate that those costs be recovered through a flat rate charge to the end-user.[79]

In recognition of the need to structure cost recovery in an efficient manner consistent with the manner in which costs are incurred, the KCC found that:

> The recovery mechanism becomes all the more important as the Commission attempts to implement the legislative mandate to transition to a more competitive environment. Consumer may bypass the wireline network and make their toll calls using wireless or voice over internet services. Providers of these services do not pay access charges so they can offer services at lower costs. Since the providers do not pay access charges, implicit subsidies are not sustainable because LECs will recover ever-decreasing amounts[80].

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[78] Ex. 48, Kohly Surrebuttal, pp. 18-19, citing *In the Matter of a General Investigation into the Reformation of Intrastate Access Charges*, Kansas Corporation Commission, Docket No. 01-GIMT-082-GIT, September 25, 2001, p. 12.
[79] Id.
[80] Id.

The Kansas Commission has clearly employed a properly reasoned approach for addressing access reform. Using this same logic, the Commission should move immediately to restructure access rates to eliminate the CCL element. Where it is necessary to provide revenue neutrality, the CCL elements should be restructured into a flat-monthly end user surcharge to reflect the manner in which costs are incurred.

ISSUE 4 – What are the appropriate assumption and/or appropriate values for the following inputs:

a. **Cost of capital**
b. **Switch discounts**
c. **Depreciation**
d. **Maintenance factors**
e. **Common and shared costs**
f. **Fill factors**
g. **Other major assumptions and/or inputs**

Because of the difficulties with the Standard Protective Order addressed above, AT&T's internal experts have been unable to review Staff's or the other parties' estimates of switched access costs. Therefore, AT&T is unable to assess any specific assumption or inputs used in the cost studies of or advocated by any other party to this proceeding

ISSUE 5 – Is the current capping mechanism for intrastate CLEC access rates appropriate and in the public interest?

AT&T supports the continuation of the current cap on the access rates charged by CLECs. No party to this proceeding has objected to the continuation of the CLEC cap. The cap should continue to be equal to the maximum access rate that can be charged by the ILEC in whose territory the CLEC is competing. In a competitive market,

competitors should be permitted the same revenue opportunity as the ILECs and should be permitted to charge a rate equal to the prevailing market price, which is the incumbent's switched access rates.

ISSUE 6 – Are there circumstances where a CLEC should not be bound by the cap on switched access rates?

There are three situations where a CLEC should not be bound be the cap on switched access rates. The first exception is where a CLEC files an appropriate TSLRIC cost study that demonstrates its costs of providing switched access are higher than the rates allowed under the cap.[81] This is consistent with Sprint witness Mr. Harper's proposal, although AT&T advocates that the cost standard necessary to justify higher rates be TSLRIC, while Mr. Harper does not propose a definite cost standard. If the CLEC can cost justify the higher rates, it should be permitted to charge a cost-based access rate even if it is higher than the rate charged by the ILEC in whose territory the CLEC is competing. No party has contested this exception.

The second exception is where the ILEC reduces access rates, based upon the receipt of offsets from the Missouri Universal Service Fund or offsetting revenues from some other mechanism that is not available to the CLECs.[82] The CLEC would most likely not be able to receive Universal Service Fund receipts to offset its access reductions because of the statutory requirement that it must be a Carrier of Last Resort in order to receive MO USF High Cost funds. It would be unreasonable in this situation to require the CLEC to match the ILECs access rate where the ILEC receives offsetting support but the CLEC does not. Requiring the CLEC to do so would be create the same

[81] Ex. 48, Kohly Surrebuttal, p. 20; *See also*, Exhibit 27, Harper Rebuttal, pp. 6-7).
[82] Ex. 48, Kohly Surrebuttal, pp. 20-21

direct and undeniable competitive advantage as permitting the ILEC to charge higher access rates than its competitors. However, this exemption should not apply in a situation where the ILECs is not permitted to offset its access rate reductions via a revenue neutral offset, such as in a typical rate case, or when a CLEC is a Carrier of Last Resort and is able to receive USF receipts. Again, no party has taken issue with this exception.

The third exception is to permit the CLEC, at its discretion, to charge reciprocal terminating access in the same manner as the compensation scheme that applies to the exchange of local traffic.[83] Under this mechanism, a CLEC may elect to assess reciprocal terminating access rates for terminating interexchange traffic to its customers as the incumbent ILEC charges for terminating interexchange traffic in its territory. In other words, at its option, AT&T may elect to assess the access rate that Sprint charges AT&T for AT&T calls terminating in Sprint's territory on traffic that Sprint or its affiliate terminates to AT&T's Missouri customers.

This reciprocal mechanism is identical to the reciprocal compensation mechanism mandated by the FCC for the exchange of local traffic. In the Local Competition Order, the FCC concluded that the costs an ILEC would incur in the termination and transport of local services would be similar to those of a new entrant.[84] As the costs were presumed to be similar, the FCC established a presumption of symmetry in setting reciprocal compensation rates for the transport and termination of local traffic.[85] Specifically, the FCC directed state commissions to depart from the presumption of symmetry only if the CLEC rebuts the presumption of symmetrical costs by showing it incurs higher costs

[83] Ex. 48, Kohly Surrebuttal, pp. 21-23
[84] *See Local Competition Order*, ¶ 1085; *See also*, Ex. 23, Farrar Surrebuttal, pp. 4-6.
[85] *Local Competition Order*, ¶¶ 1085-90.

using a forward looking cost study.[86] Because the transport and termination of local traffic involve the same network functions as access traffic and cause the provider to incur the same costs that are incurred in the provision of access services, the presumption of symmetry between the costs incurred by new entrants and incumbents in the provision of transport and termination of local traffic is equally applicable to access services.

Allowing CLECs to employ this exception would provide many competitive benefits. First, it promotes revenue symmetry by permitting a CLEC to receive the same compensation that another carrier charges it for providing the very same service. For example, under the current access rate cap, AT&T operating as a CLEC in SWBT's exchanges is permitted to charge Sprint Missouri, Inc. a end-office terminating access rate of 3.37¢ per minute for terminating calls, i.e., SWBT's access rate. Meanwhile, when AT&T terminates toll traffic in Sprint Missouri, Inc.'s territory, Sprint is able to charge AT&T a terminating access rate of 10.86¢ per minute. Permitting Sprint or any company operating in their franchise territory to charge a rate that is over 3 times higher than the rate AT&T or any other CLEC is permitted to charge for the exact same service is unreasonable, especially when the rate is not cost-based.

Second, as Commissioner Murray recognized, permitting CLECs to begin charging reciprocal access rates would provide a powerful incentive for the incumbents to reduce their terminating access rates – an incentive that does not exist today. In agreeing that terminating switched access was a locational monopoly, Dr. Debra Aron testifying on behalf of SWBT in TO-2001-467 acknowledged that creating competitive incentives to reduce terminating access "would involve more institutional changes about how we

[86] *Id.*

bill calls to originating and terminating customers."[87] Permitting CLECs to begin charging reciprocal terminating access is the type of institutional change that has the potential to create the incentive to reduce terminating access rates. As local competition develops, reciprocal access rates will certainly create the incentive to reduce terminating access rates. Permitting reciprocal switched access rates would provide necessary revenues to assist in offsetting the CLECs terminating access expense.

ISSUE 7 - What, if any, course of action can or should the Commission take with respect to switched access as a result of this case?

This Commission should move to implement a comprehensive cost-based pricing system that does not discriminate between types of calls or carriers. The long-run goal of this process should be to price the traffic sensitive switched access rate elements at TSLRIC for all companies. While this is a far-reaching goal, if it addressed in steps in concert with other pending cases, such as the Missouri Universal Service Fund proceeding, it can be accomplished.

At a minimum, in this proceeding, the Commission should make the current interim CLEC rate cap permanent and adopt the three exceptions AT&T has proposed.

Second, the Commission should reduce and ultimately eliminate the per minute Carrier of Common Line rate element from the current exchange access rate structure, replacing it with a flat monthly per-line charge. The CCL is not cost-based. It is a rate element that was developed as the repository to support the costs of providing basic local service.[88] Rather than raising local service rates to cover their costs, state commissions created the CCL and whatever costs the Commission determined could not be charged to

[87] Ex. 48, Kohly Surrebuttal, pp. 22-23.
[88] Tr. 536.

local service customers, in the interest of universal services, were included, inter alia, in the CCL rate element. As explained earlier, elimination of the CCL will allow costs to be recovered in the manner in which they are incurred. In addition, taking this action will eliminate a current implicit subsidy mechanism that forces high volume toll users to pay disproportionately more than low volume toll users for facilities which bear the same cost regardless of use and regardless of customers' ability to pay. This step can be initiated quickly and does not require the Commission to make any decision on the TSLRIC cost of switched access.

As discussed above, for ILECs regulated under price regulation, AT&T contends that this Commission has the discretion to alter or restructure access rates and other rates that it concludes are no longer just and reasonable. Moreover, the Commission can require the restructuring of price capped rates via revenue neutral offsetting rates changes, end user surcharges or explicit support from the Missouri USF.

For example, revenues associated with the CCL could be shifted and recovered via a flat monthly rate element assessed directly to retail customers in the same manner as a subscriber line charge. The monthly rate would reflect the underlying cost of the loop facilities that are currently subsidized via the CCL rate element and would provide for the proper recovery of those costs in a non-traffic sensitive manner. There is precedent for the implementation of such a surcharge based upon the Commission's ruling in a similar situation, where Southwestern Bell was permitted to recover the cost of implementing IntraLATA Dialing Parity over a three-year period as a new access rate element assessed on total intrastate originating minutes while under price cap regulation.[89] The imposition

[89] Case No. TO-99-535, *In the Matter of Southwestern Bell Telephone Company IntraLATA Long Distance Dialing Parity Plan*, Issued 6/10/99, download from http://168.166.4.147/orders3.asp

of a subscriber line charge would not result in an increase in basic local rates. Basic local rates are set forth in the current tariffs would not be altered in any way.

Alternatively, the revenue associated with the CCL could be offset using support from the Missouri USF for the reason set forth in the Jurisdictional Issues section, above. SWBT witness Mr. Unruh contends that the Missouri USF cannot be used to reduce exchange access rates. Ironically, Sprint disagrees with SWBT and contends, as AT&T does, that an end user charge or the USF could be used to offset access reduction.[90] SWBT's position is simply not consistent with the Federal Act, Missouri law and the policy that underlies the enactment of these statutory provisions. The overriding purpose of the High Cost Fund is to remove implicit subsidies from the existing rates and replace those with explicit, predictable, and competitively neutral subsidies necessary to ensure the availability of local service at just, reasonable and affordable rates in a competitive market. To accomplish this, both the Federal Act and the Missouri statute contemplates that the implicit subsidies or support historically included in switched access rates must be eliminated and the universal service fund is to be used as the means to make such subsidies/support explicit. Eliminating the CCL and moving the other switched access rates towards TSLRIC is consistent with that approach.

As discussed in the Jurisdictional Issues section, above, for rate of return regulated companies, the Commission could perform the same restructuring either in the context of a rate case where all rates are reviewed or, on a revenue neutral basis, outside of a general rate case.

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[90] Tr. 767.

For illustrative purposes, Schedule MJP-4 to AT&T's witness Mr. Pauls testimony provides an estimate of the total monthly per line surcharge that would be required to offset an elimination of the CCL.[91] As shown on the schedule, the total ILEC industry access impact would be a revenue reduction of approximately $158.9 million. Schedule MJP-4 also provides ILEC-specific end-user monthly increases that would fully offset the access revenue reductions—they range from $1.06 per month (SWBT) to $26.42 per month (Steelville). The statewide average end-user impact would be $3.49 per month. Finally, Schedule MJP-4 illustrates that if the $158.9 million industry access reduction was to be fully offset by the Missouri USF, the resulting end-user surcharge would be approximately 8.9%.

Third, the Commission should adopt a specific cost standard and methodology to be used in establishing the cost of access service so that it can assess the justness and reasonableness of current access rates.

The next and final step the Commission should take is to move the traffic sensitive access rate elements towards their TSLRIC costs.[92] Based upon the evidence presented in this proceeding, it cannot seriously be disputed that Missouri's access rates are among the highest in the nation.[93] Based upon AT&T's own data, Missouri ranks fifth in the nation for the highest average switched access rates.[94] The only states exceeding Missouri in this category are North Dakota, South Dakota, New Mexico and Alaska.[95] These states have lower population densities than Missouri. The access rates charged by SWBT in Missouri are higher than those charged in the other four

[91] Ex. 53, Pauls Surrebuttal.
[92] Ex. 48, Kohly Surrebuttal, p. 27.
[93] Id. p. 24; Ex. NP, Johnson Direct, p. 130.
[94] Ex. 48, Kohly Surrebuttal, p. 27.
[95] Id.

SWBT states or by its affiliate PacBell or Ameritech.[96] The same is true for Sprint and Verizon.[97] Yet, Missouri is not one of the highest cost states in the nation. Comparing the current access rates with the TSLRIC surrogates presented in Mr. Kohly's testimony shows that for SWBT, Sprint and Verizon, Missouri access rates are well above TSLRIC levels. Dr. Johnson's analysis supports this conclusion as well.

Missouri's access rates not only distort the interexchange market, but also create disincentives to serve certain areas, provide the incentive as well as the ability for ILECs to engage in discriminatory pricing and cause other adverse competitive consequences. For example, recently in the recent on-the-record presentation in the ongoing MCA case, the small LECs counsel, Mr. England, complained that high terminating access rates impacted his client's ability to offer expanded calling into neighboring exchanges, especially into exchanges served by Sprint and Verizon[98]. High terminating access rates were the reason cited by SWBT for eliminating its Local Plus Service. In Case No. TM-2002-465, SWBT's witness Jason Olson testified that high terminating access rates deters entry in exchanges that are next to ones with high access rate-related business expense.[99] [Cite to testimony in this case] In addition, high terminating access rates in general deter local entry as they increase business expenses for new entrants.[100]

Past efforts that have focused on band-aid approaches, such as expanded local calling, are insufficient. The use of expanded local calling areas results in the elimination

[96] *Id.*
[97] *Id.*
[98] Case No. TO-2001-391, In the Matter of a Further Investigation of the Metropolitan Calling Area Service After the Passage and Implementation of the Telecommunication Act of 1996On-the Record Presentation, Response of Mr. England to Questions from Commissioner Lumpe, pg. 148-149.
[99] Case No. TM-2002-465, In the Matter of the Joint Application of Northeast Missouri Rural Telephone Company and Modern Telecommunications Company for Approval to Merge Modern Telecommunications Company and Northeast Missouri Rural Telephone Company, Direct Testimony of Jason Olson, pg. 4.
[100] Ex. 48, Kohly Surrebuttal, p. 25.

of toll service and the access revenues associated with such toll services, thereby eliminating an important revenue source in exchange for lower local service revenues. Inter-company compensation must be fixed. Radical changes must occur in order to fix Missouri's access woes. Inter-company compensation needs to be priced correctly so that a carrier's cost to terminate a call is not dependent upon technology, the exchange boundaries, or the retail classification. If both access (for "toll") and call termination (for "local") charges are the same, then carriers will be free to design products with differing boundaries, with the goal to attract subscribers by offering a "better" local calling area.[101] To facilitate such an environment, however, termination rates must not differentiate between types of calls or different types of carriers. Otherwise, all carriers will have their cost-structure defined by Missouri's existing exchange boundaries – with a lower cost to terminate a "local" call, a higher cost to complete a "toll" call.

With such non-discriminatory charges, carriers, including incumbent local exchange carriers, would be free to decide the scope of their own local calling areas, sizing these areas to match their own perception of the market and to reflect their own pricing and marketing strategies. In this way, the market -- which is to say, *consumers* -- will decide the size and shape of the local calling area as carriers compete along this important dimension of service.

This is the type of competition envisioned by the Act. This is also the endpoint described by the United States Telephone Association, of which SBC is a member:

> Ultimately, the 1996 Act contemplates a competitive endpoint where the pricing of local interconnection is not dependent upon the identity of the interconnecting entity, e.g. an IXC, a CAP, a CLEC, a CMRS provider or an information service provider.[102]

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[101] *Id.*

[102] USTA Comments, FCC Docket CC 96-98, page 3.

Differing regulatory schemes may require separate approaches for ILECs regulated under price cap regulation as compared to ILECs regulated under rate-of-return. Either in this proceeding or a subsequent proceeding, the Commission needs to determine the appropriate TSLRIC for each rate element. Once that is done, those costs can be compared to the existing rates. To the extent there are differences between the TSLRIC and the current access rates, the first choice would be to rebalance within the differing rate elements to match the rates with the TSLRIC results. For price cap LECs, any excess revenue that needs to be offset should be recovered through the Missouri Universal Fund. While this may not seem ideal, it is the only way those revenues may be recovered on a competitively neutral basis. For rate of return LECs, any differences can be dealt with in a subsequent earnings case, through a similar use of the MO USF, or both.

CONCLUSION

For all the reasons set forth herein, the Commission should begin the process of devising a long-term solution that will result in just and reasonable rates for exchange access service. In addition, the Commission should 1) adopt a Total Service Long Run Incremental Cost (TSLRIC) standard, consistent with the FCC's pricing rules; 2) reject the proposals for arbitrarily allocating loop costs to switched access service based upon accounting rules that are contrary to incremental cost principles; 3) continue the existing CLEC access rate cap, permitting the three exceptions recommended by AT&T; 4) eliminate the non-cost-based CCL element and replace it with an end user surcharge, Missouri USF support or both; and 5) begin the process of moving the traffic sensitive access rate elements to TSLRIC levels.

Respectfully submitted this 13th day of December, 2002.

AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.

By: Rebecca B. DeCook

Rebecca B. DeCook
1875 Lawrence Street, Suite 1575
Denver, CO 80202
(303) 298-6357
(303) 298-6301 (FAX)

J. Steve Weber MO Bar #20037
101 W. McCarty, Ste. 216
Jefferson City, MO 65101
Tel: 573-635-5198
Fax: 573-635-9442
jsweber@att.com

ATTORNEYS FOR AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing in Case No. TR-2001-65 was served upon the parties on the following service list on this 13th Day of December, 2002 by either hand delivery or placing same in postage page envelope and depositing in the U.S. Mail or Airborne Express.

Rebecca B. DeCook

General Counsel
PO Box 360
Jefferson City, MO 65102

Office of Public Counsel
PO Box 7800
Jefferson City, MO 65102

Cass County Telephone Co.
PO Box 398
Peculiar, MO 64078

GTE Inc. d/b/a Verizon Midwest
601 Monroe St., Ste. 304
Jefferson City, MO 65101

MO-KAN Dial, Inc.
PO Box 429
Louisburg, KS 66053

Southwestern Bell Telephone Co.
One Bell Plaza, Room 3520
St. Louis, MO 63101

Sprint Missouri, Inc.
319 Madison St.
Jefferson City, MO 65102

Craig S. Johnson
Andereck/Evans/Milne/Peace/ Baumhoer
PO Box 1438
Jefferson City, MO 65102

ALLTEL Missouri, Inc.
PO Box 180
Bolivar, MO 65613

Choctaw Telephone Co.
PO Box 82
Halltown, MO 65664

Lathrop Telephone Co.
PO Box 167
Princeton, MO 64673

Orchard Farm Telephone Company
5065 North Highway 94
St. Charles, MO 63301

Spectra Communications Group
9200 Ward Parkway, #600
Kansas City, MO 64114-3358

Adelphia Business Solutions
121 Champion Way
Canonsburg, PA 15317

Mpower Communications Corp.
175 Sully's Trail, Ste. 202
Pittsford, NY 14534

1-800-Reconex, Inc.
PO Box 40
2500 Industrial Ave.
Hubbard, OR 97032

Thomas R. Parker
Verizon
601 Monroe Street, Ste. 304
Jefferson City, MO 65101

ALLTEL Communications, Inc.
PO Box 2177
Little Rock, AR 72203

Brooks Fiber Communications
701 Brazos, Ste. 600
Austin, TX 78701

Navigator Telecommunications
PO Box 13860
North Little Rock, AR 72113-3860

AccuTel of Texas, Inc.
7900 John W. Carpenter Freeway
Dallas, TX 75247

Allegiance Telecom of Missouri
1950 Stemmons Freeway, Ste. 3026
Dallas, TX 75207-3118

American Communications Svcs.
131 Natl Business Pkwy, Ste. 100
Annapolis Junction, MD 20701

BarTel Communications, Inc.
333 Leffingwell Avenue, Suite 101
Saint Louis, MO 63122-6400

BroadSpan Communications d/b/a Primary Network Communications
11756 Borman Drive, Ste. 101
St. Louis, MO 63146

Business Telecom, Inc. d/b/a BTI
4300 Six Forks Road, Ste. 400
Raleigh, NC 27609

Buy-Tel Communications, Inc.
PO Box 1170
Colleyville, TX 76034

Central Missouri Telecomm.
PO Box 596
Osage Beach, MO 65065

Mary C. Albert
Vice President Regulatory and Interconnection
1919 M Street N.W., Suite 420
Washington, D.C. 20036

Computer Business Sciences, Inc.
80-02 Kew Gardens Rd., Ste. 5000
Kew Gardens, Ny 11415

DMJ Communications, Inc.
2525 North Grandview, Ste. 900
Odessa, TX 79761

EZ Talk Communications, LLC
4727 South Main
Stafford, TX 74777

Fidelity Communications
60 North Clark
Sullivan, MO 63080

Camarato Distributing, Inc.
900 Camarato Drive
Herrin, IL 62948

Choctaw Communications d/b/a Smoke Signal Communications
1600 Viceroy
Dallas, TX 75235

Comm. South Companies d/b/a Missouri Comm. South, Inc.
6830 Walling Lane
Dallas, TX 75382-1269

Delta Phones, Inc.
PO Box 784
Delhi, LA 71232

ExOp of Missouri, Inc.
303 North Jefferson
Kearney, MO 64060

Green Hills Telecom. Svcs.
PO Box 227
Breckenridge, MO 64625

Carol Keith, Gabriel Communications of Missouri, Inc.
16090 Swingley Ridge Rd., Ste. 500
Chesterfield, MO 63017

Global Crossing Local Svcs., Inc.
1221 Nicollet Mall, Ste. 300
Minneapolis, MN 55403

Logix Communications Corp.
3555 NW 58th, Ste. 900
Oklahoma City, OK 73112

Ionex Communications, Inc.
5710 LBJ Frwy, Ste. 215
Dallas, TX 75240

LDD, Inc.
24 South Minnesota
Cape Girardeau, MO 63702

Global Crossing Telemanagement
1221 Nicollet Mall, Ste. 300
Minneapolis, MN 55403

Maxcom, Inc.
1350 Timberlake Manor Parkway, Suite 501
Chesterfield, MO 63017-6042

MCImetro Access Svcs., LLC
701 Brazos, Ste. 600
Austin, TX 78701

Level 3 Communications LLC
1025 Eldorado Blvd.
Broomfield, CO 80021

Mark Twain Communications Co.
PO Box 128
Hurdland, MO 63547

KMC Telecom III, Inc.
1543 Route 206, Ste. 300
Bedminster, NJ 07921

McLeodUSA Telecom.
PO Box 3177
Cedar Rapids, IA 52406-3177

MCG Communications, Inc.
175 Sully's Trail, Ste. 202
Pittsford, NY 14534

Max-Tel Communications, Inc.
PO Box 280
Alvord, TX 76225-0280

NOW Communications, Inc.
713 Country Place Drive
Jackson, MS 39208

The Pager Company
3030 East Truman Road
Kansas City, MO 64127

QCC, Inc.
8829 Bond Street
Overland Park, KS 66214

Quintelco, Inc.
1 Blue Hill Plaza
Pearl River, NY 10965

Ren-Tel Communications, Inc.
7337 S. Mitchell Ct.
Villa Rica, GA 30180

Missouri Telecom, Inc.
PO Box 419
Monett, MO 65708

Nextlink Missouri, Inc.
810 Jorie Blvd., Ste. 200
Oakbrook, Il 60523

Omniplex Communications Group
17 MO Research Park Drive
St. Charles, MO 63304

Preferred Carrier Svcs., Inc. d/b/a Phones for All
14681 Midway Rd., Ste. 105
Dallas, TX 75001-3147

Quick-Tel Communications
PO Box 1220
Bridgeport, TX 76426

Reitz Rentals, Inc.
P.O. Box 200606
Austin, TX 78720-0606

Simply Local Svcs., Inc.
2225 Apollo Dr.
Fenton, MO 63026

Snappy Phone of Texas, Inc.
PO Box 29620
6901 W. 70th Street
Shreveport, LA 71129-2309

Teligent Services, Inc.
8065 Leesburg Pike, Ste. 400
Vienna, VA 22182

Tin Can Communications Co.
7941 Katy Fwy, #304
Houston, TX 77024-1924

US Telecommunications, Inc.
5251 110th Ave. No., Ste. 118
Clearwater, FL 33760-4837

USLD Communications d/b/a Qwest Communications
4250 N. Fairfax Dr., Ste. 12W002
Arlington, VA 22203-1607

Sprint Communications Co., LP
8140 Ward Parkway – 5E
Kansas City, MO 64114

Suretel, Inc.
5 North McCormick
Oklahoma City, OK 73127

Advanced Telcom Group, Inc.
110 Stony Point Road, 2nd Floor
Santa Rosa, CA 95401

Winstar Wireless, Inc.
1615 L Street NW, Ste. 1260
Washington DC 20036

Worldcom, Inc. d/b/a MCI Worldcom Communications, Inc.
Six Concourse Pkwy, Ste. 3200
Atlanta, GA 30328

BroadBand Office Inc.
P.O. Box 37
Springfield, VA 22150-0037

Atlas Communications, Ltd.
482 Norristown Rd., Ste. 200
Blue Bell, PA 19422

BellSouthBSE, Inc.
32 Perimeter Center East
Atlanta, GA 30346

2nd Century Communications, Inc.
7702 Woodland Center
Tampa, FL 33614

CapRock Telecommunications
15601 N. Dallas Pkwy, Ste. 700
Addison, TX 75001

Basicphone, Inc.
2245 N. 11th Street
Beaumont, TX 77703

Bluestar Networks, Inc.
P.O. Box 190624
Nashville, TN 37219-0624

American Fiber Network Inc.
9401 Indian Creek Pkwy, Ste. 140
Overland Park, KS 66210

Convergent Communications, Inc.
P.O. Box 746237
Arvada, CO 80006-6237

Cypress Communications, Inc.
15 Piedmont Center, Ste. 100
Atlanta, GA 30305

Eagle Communications MO., Inc.
60 East 56th Street
New York, NY 10022

Fidelity Cablevision, Inc.
60 North Clark
Sullivan, MO 63080

HJN Telecom, Inc.
3235 Satellite Blvd. Building 400, Suite 300
Duluth, GA 30096

Group Long Distance, Inc.
400 E. Atlantic Blvd.
Pompano Beach, FL 33060-6200

Maxcess, Inc.
100 West Lucerne Plaza, Ste. 500
Orlando, FL 32801

Z-Tel Communications, Inc.
601 South Harbour Island Blvd., Ste. 220
Tampa, FL 33602

Tel-Save Incorporated of Pennsylvania, d/b/a The Phone Company
6805 Route 202
New Hope, PA 18938

Supra Telecommunications and Information Systems, Inc.
2620 SW 27th Ave.
Miami, FL 33133

U.S. TelePacific Corp. d/b/a TelePacific Communications
515 S. Flower Street, 49th Floor
Los Angeles, CA 90071

BroadStream Corporation
4513 Pin Oak Court
Sioux Falls, SD 57103

Compass Telecommunications, Inc.
7001 Scottsdale Road, Ste. 2000
Scottsdale, AZ 85250

Digital Broadcast Network Corp.
424 S. Woods Mill Road, Ste. 350
Chesterfield, MO 63017

CCCMO, Inc. d/b/a Connect!
124 W. Capitol, Ste. 250
Little Rock, AR 72201-3713

Dial & Save of Missouri, Inc.
8750 N. Central Expressway,
Ste. 1500
Dallas, TX 75231

Fidelity Communications Services III, Inc.
60 North Clark
Sullivan, MO 63080

Kansas City Fiber Network, LP
1111 Main Street, Ste. 300
Kansas City, MO 64105

Fidelity Communications Services II, Inc.
60 North Clark
Sullivan, MO 63080

JATO Operating Corporation
303 East 17th Avenue, Suite 930
Denver, CO 80203-1262

Payroll Advance, Inc.
808 South Baker
Mountain Home, AR 72643

dPi-Teleconnect, LLC
2997 LBJ Freeway, Ste. 225
Dallas, TX 75234

Digital Teleport, Inc.
8112 Maryland Ave., 4th Flr
St. Louis, MO 63105

Excel Telecom. Systems, Inc.
8750 N. Central Expressway,
Suite 2000
Dallas, TX 75231

GE Capital Communication Services d/b/a GE Exchange
6540 Powers Ferry Road
Atlanta, GA 30339

Local Line America, Inc.
PO Box 4551
Akron, OH 44310

Focal Communications Corporation of Missouri
200 North LaSalle Street, Ste. 800
Chicago, IL 60601

RSL COM USA
49 West 37th Street, Fl. 13
New York, NY 10018

MVX.com Communications, Inc.
100 Rowland Way, Ste. 145
Novato, CA 94945

Rocky Mountain Internet
7100 East Belleview Avenue, #201
Greenwood Village, CO 80111-1635

Metro Connection d/b/a Transamerican Telephone
209 East University
Danton, TX 76201

Paul H. Gardner
Goller, Gardner & Feather
131 E. High Street
Jefferson City, MO 65101

Lisa C. Hendricks, Esq.
Sprint
6450 Sprint Parkway
Overland Park, KS 66251

Dale Hardy Roberts, Secretary/ Chief
Regulatory Law Judge
Missouri Public Service Comm.
P.O. Box 360
Jefferson City, MO 65102

Carl J. Lumley/Leland B. Curtis
Curtis, Oetting, Heinz, Garrett & Soule, PC
130 S. Bemiston, Ste. 200
St. Louis, MO 63105

B. T. McCartney/W.R. England, III
Brydon, Swearengen & England
PO Box 456
Jefferson City, MO 65102-0456

Transnational Telecom
17120 Classen Road
San Antonio, TX 78247-2001

Pathnet, Inc.
11720 Sunrise Valley Drive
Reston, VA 20191

Verizon Select Services
6665 N. MacArthur Blvd., 2nd Flr.
Irving, TX 75039

Sheldon K. Stock
Greensfedler, Hemker & Gale, PC
10 South Broadway, Ste. 2000
St. Louis, MO 63102

Universal Access, Inc.
233 S. Wacker Drive, Ste. 600
Chicago, IL 60606

Mary Ann Young
PO Box 104595
Jefferson City, MO 65110-4595

Stephen F. Morris
MCI Telecommunications Corp.
701 Brazos, Ste. 600
Austin, TX 78701

Mark W. Comley
Newman, Comley & Ruth, PC
601 Monroe St., Ste. 301
Jefferson City, Mo 65101