

Exhibit :
Issue : Intercompany Compensation
Witness : Taylor
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Sponsoring Party : Southwestern Bell Telephone Co.
Company : Southwestern Bell Telephone Co.
Case No. : TW-97-333

SOUTHWESTERN BELL TELEPHONE COMPANY

CASE NO. TW-97-333

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REBUTTAL TESTIMONY

OF

RICHARD L. TAYLOR

Exhibit No. 27
Date 6/23/97 Case No. TW-97-333
Reporter KRM

St. Louis, Missouri

May 1997

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

IN THE MATTER OF AN INVESTIGATION INTO)
THE PROVISION OF COMMUNITY OPTIONAL)
CALLING SERVICE IN MISSOURI)

Case No. TW-97-333

AFFIDAVIT OF RICHARD L. TAYLOR

STATE OF MISSOURI)
) SS
CITY OF ST. LOUIS)

I, Richard L. Taylor, of lawful age, being duly sworn, depose and state:

1. My name is Richard L. Taylor. I am presently Director-Regulatory and Industry Relations for Southwestern Bell Telephone Company.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 14.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.



Richard L. Taylor

Subscribed and sworn to before me this 22nd day of May 1997.



Notary Public

My Commission Expires: Jan. 5, 2000

MARYANN PURCELL Notary Public - Notary Seal STATE OF MISSOURI ST. LOUIS COUNTY COMMISSION EXP JAN 5, 2000

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2

REBUTTAL TESTIMONY OF RICHARD L. TAYLOR

3

4 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

5 **A.** My name is Richard L. Taylor and my business address is 100 North Tucker Blvd.,
6 St. Louis, Missouri 63101.

7

8 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

9 **A.** I am employed by Southwestern Bell Telephone Company (SWBT) as Director-
10 Regulatory and Industry Relations.

11

12 **Q. HAVE YOU PREVIOUSLY FILED DIRECT TESTIMONY IN THIS CASE?**

13 **A.** Yes.

14

15 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

16 **A.** The purpose of my testimony is to provide SWBT's position in response to the Direct
17 Testimony filed by other parties in this docket related to the following issues:

- 18 1. Intercompany compensation for Community Optional Service (COS).
19 2. The business relationship between SWBT and other Local Exchange Carriers
20 (LECs) in the provision of COS.

21

**Q. WHAT ARE YOUR PRIMARY CONCERNS REGARDING INTERCOMPANY
COMPENSATION FOR COS?**

A. Both Mr. Schoonmaker on behalf of the Small Telephone Company Group (STCG) and Mr. Jones on behalf of the Mid-Missouri Group recommended in their testimony that the current COS compensation arrangements should be retained. SWBT has several reasons for objecting to that proposal.

1. As demonstrated in my Direct Testimony, the current compensation provisions cause SWBT as PTC for Secondary Carriers (SCs) to provide COS service to SC exchanges, receive COS revenue and pay access charge compensation to the SCs in amounts which dramatically exceed the COS revenue.
2. This arrangement sets up a scenario in which benefits flow to customers of the SCs, even greater benefits flow to the SCs, and both combine to create a negative impact on SWBT as the PTC.
3. While SWBT views this arrangement as unacceptable under any circumstances, we view it as categorically unfair and unsustainable in a competitive intraLATA presubscription environment because SWBT's historic toll revenue stream will not be there to support such losses.
4. As described more fully in Ms. Bourneuf's Rebuttal Testimony and later in this testimony, we have recently identified situations where the current compensation-serving arrangement has created what SWBT believes to be misuse of COS service, including tariff violations by some SCs and/or their affiliates. Whether

1 intentional due to the conflicting business interests of SCs versus those of SWBT
2 or inadvertent, these situations are occasioned by the current structure of COS.
3 SWBT is convinced that these situations would not have occurred if the SCs were
4 the responsible COS providers on their petitioned-for COS routes. But, even if
5 they had occurred, the negative impact would not have accrued to SWBT but
6 instead to the parties which created the situation.

7 Therefore, SWBT believes very strongly that the present compensation-serving
8 arrangement must be changed whatever the Commission decides about the future form of
9 COS as an end-user service.

10
11 **Q. WHAT IS SWBT'S REACTION TO MR. SCHOONMAKER'S SUGGESTION**
12 **THAT IF THE COMMISSION DECIDED TO MAKE NO CHANGES IN THE**
13 **PROVISION OF COS, "THE PTC COULD USE THE PROVISION OF COS AS A**
14 **MARKETING TOOL TO ENCOURAGE CUSTOMERS TO CONTINUE TO USE**
15 **THEIR INTRALATA TOLL SERVICE"?**

16 **A.** With respect to services provided in Secondary Carrier exchanges, SWBT loses money
17 providing COS due to the intercompany compensation arrangement. For the same reason,
18 SWBT loses money as the PTC for intraLATA toll service in those exchanges. SWBT
19 has no interest in using one unprofitable service to attract customers to another
20 unprofitable service.

1 **Q. ARE THERE OTHER SUGGESTIONS IN MR. SCHOONMAKER'S DIRECT**
2 **TESTIMONY WITH WHICH YOU TAKE ISSUE?**

3 **A.** Yes. Under the subject of proposals for educating the public (Issue No. 5) at page 23,
4 lines 3-7, Mr. Schoonmaker suggests, "The Commission should also give consideration as
5 to whether IXC's should be required to notify customers of the impact that choosing the
6 IXC will have on the availability of COS as part of the marketing approach they use.
7 Such requirements would tend to offset the burdens that the PTCs bear by continuing to be
8 required to offer COS."

9
10 My first observation is that, at least on the surface, there is recognition that requiring
11 PTCs to offer COS is a "burden". However, I find it ironic that the SCs, who have
12 substantial positive access revenue due to COS, recognize that the service, as currently
13 constructed, is a burden to PTCs and propose that placing some additional burden on IXC's
14 somehow balances things. That "logic" infers that the PTCs' burden is caused by the
15 IXC's and that simply isn't the case. The "burden" is largely the intercompany
16 compensation paid to SCs, coupled with having the PTCs be the service provider rather
17 than the SCs. The SCs' attitude appears to be: If we burden the PTCs because they
18 provide COS, it is only fair to burden the IXC's because they don't provide COS.

19

20 **Q. IS THERE A MORE EQUITABLE WAY TO DEAL WITH THE COS**
21 **"BURDEN"?**

1 A. Yes. SWBT believes the best method is that described in SWBT's Direct Testimony—
2 changing COS to one-way local service provided by the petitioning exchange LEC with
3 intercompany compensation at terminating switched access rates less carrier common line.
4 The illustrations on page 9 of my Direct Testimony reflect various scenarios for one-way
5 and one-way reciprocally available COS which are each far more equitable than the SCs'
6 recommendations.

7

8 **Q. PLEASE DESCRIBE THE SITUATION YOU REFERRED TO AS MISUSE OF**
9 **COS BY SCs AND/OR THEIR AFFILIATES?**

10 A. Some SCs of petitioning COS exchanges either directly or indirectly through an affiliate
11 company are reselling and/or sharing the use of COS in the provision of non-regulated
12 Internet access service. Our investigation, while not complete at this time because the SCs
13 have not all complied with our data requests, has identified at least two major problems
14 with this situation. One is that COS is being used in inappropriate ways, and the second is
15 that SWBT's COS tariff rates are not being applied on a per line basis as specified in the
16 tariff.

17

18 **Q. PLEASE DESCRIBE HOW COS IS BEING USED IN THE PROVISION OF**
19 **INTERNET ACCESS SERVICE?**

20 A. The following simplified factual example illustrates the arrangement.

- 1 1. There is a COS route where Mark Twain Rural Telephone Company's (Mark
2 Twain) Hurdland exchange is the petitioning exchange and SWBT's Kirksville
3 exchange is the target exchange. SWBT, as PTC for Mark Twain, is the COS
4 provider under the terms of SWBT's tariff.
- 5 2. Mark Twain, through an affiliate, Rural Area Information Network (RAIN), is in
6 the non-regulated Internet access business.
- 7 3. Mark Twain subscribes (as an end-user customer) to COS on the Hurdland to
8 Kirksville route.
- 9 4. RAIN sells Internet access service to customers in the Kirksville exchange
10 (SWBT's exchange and the target COS exchange).
- 11 5. To access the Internet, the Kirksville customer dials the Hurdland COS telephone
12 number assigned to Mark Twain. The call is sent through the toll network from
13 Kirksville to Hurdland and is exempted from toll charges through the COS billing
14 system.
- 15 6. When the call gets to Hurdland, Mark Twain routes it to a modem bank in Mark
16 Twain's office and the call is passed through RAIN to the Internet.

17
18 **Q. WHAT ARE SWBT'S OBJECTIONS TO THE ARRANGEMENT YOU JUST**
19 **DESCRIBED?**

20 **A.** There are several, including the following:

- 1 1. SWBT's COS tariff restrictions prohibiting the resale and sharing of COS are
2 being violated.
- 3 2. SWBT is placed in the position of incurring the cost of providing service from
4 Kirksville to Hurdland with no revenue.
- 5 3. The criteria for a Kirksville customer to be able to call Hurdland toll free in this
6 scenario is that they subscribe to Mark Twain/RAIN Internet access service.
- 7 4. SWBT has been unknowingly forced to treat a call from Kirksville to Hurdland as
8 a target exchange to petitioning exchange COS call, often referred to as "COS
9 return calling". In fact, the call is not that at all, as the following demonstrates:
10 A. Mark Twain is the Hurdland COS subscriber, but Mark Twain does not place
11 calls to Kirksville on the COS subscribed lines.
12 B. The calling is from Kirksville to Hurdland (actually through Hurdland to
13 anyplace in the world via the Internet).
14 C. The Kirksville customer does not make return calls to Mark Twain.
15 D. The call is not a point-to-point call from Kirksville to Hurdland as was
16 contemplated in the construction of COS for calls from a COS target
17 exchange to a petitioning exchange COS subscriber.
18 E. There is no communication between the Kirksville customer and anyone at
19 Mark Twain, the COS subscriber in Hurdland.
20 F. The call has nothing to do with any community of interest between Hurdland
21 and Kirksville.

1 G. This Kirksville to Hurdland calling is not qualified COS traffic.

2
3 **Q. DOES SWBT PAY MARK TWAIN TERMINATING ACCESS FOR**
4 **TERMINATING THE KIRKSVILLE TO HURDLAND TRAFFIC IN THIS**
5 **EXAMPLE?**

6 **A.** I'm not sure yet; however, it may be that we do not. Since Mark Twain bills SWBT for
7 terminating access based on a Terminating/Originating factor (T/O factor) rather than
8 based on actual terminating traffic, the additional terminating traffic would not affect
9 billable terminating minutes until the T/O factor is next adjusted. Obviously in other
10 situations where LECs bill actual terminating traffic, SWBT would be paying access
11 charges on this type of traffic.

12
13 **Q. IF SWBT IS NOT PAYING TERMINATING ACCESS ON THIS TYPE TRAFFIC,**
14 **DOES THAT MEAN THERE IS NOT A COMPENSATION PROBLEM?**

15 **A.** No. Even where SWBT is not paying access, we still incur our other network and billing
16 system costs to provide the service and we are not being properly compensated with either
17 COS or toll revenue.

18
19 **Q. DOESN'T SWBT RECEIVE COS REVENUE FOR MARK TWAIN'S**
20 **SUBSCRIPTION TO COS?**

1 A. Not as called for in paragraph 1.11.C11c of SWBT's COS tariff, which is the second
2 major problem I referred to earlier. I found in discussing this matter with Mark Twain that
3 the Internet access traffic volumes are so substantial that large multiline hunt groups are
4 required to be equipped with COS. In several cases only the first line in the multiline
5 hunt group is being charged for COS even though COS is actually being provided on as
6 many as 34 lines in the group. Mark Twain has reviewed 1996 data and has
7 acknowledged underbilling of COS on as many as 84 lines in a month. Mark Twain was
8 the end-user customer for all of those lines. This means Mark Twain has not been paying
9 for service it has received.

10

11 **Q. HAS MARK TWAIN AGREED TO CORRECT THE UNDERBILLING AND**
12 **REMIT THE COS REVENUE TO SWBT?**

13 A. Yes, initially. Subsequently, that commitment was modified to reserve to Mark Twain the
14 right to discuss the applicability of the rate and the right to a refund if it was determined
15 that the rate per line should not apply.

16

17 **Q. WHAT IS SWBT'S POSITION REGARDING THE UNBILLED COS CHARGES?**

18 A. At a minimum, SWBT is due COS revenue on a per-line basis. Given that the calling at
19 issue here is not really COS qualified traffic, however, it might be more appropriate for
20 Mark Twain to compensate SWBT in some other manner.

21

1 **Q. HAVE YOU IDENTIFIED A MORE APPROPRIATE FORM OF**
2 **COMPENSATION?**

3 **A.** One method is to rate the traffic out at Maximizer 800 rates and require Mark Twain to
4 pay on that basis.

5

6 **Q. WHY IS THAT AN APPROPRIATE ALTERNATIVE?**

7 **A.** Mark Twain did not really use the service like COS. They used it for one-way incoming
8 traffic from Kirksville to Hurdland with no billing applied to the calling party. That is
9 exactly the serving arrangement for 800 service, only without using an 800 number. In
10 effect, SWBT provided the equivalent of Maximizer 800 service to Mark Twain.

11

12 **Q. IS MARK TWAIN THE ONLY SC INVOLVED IN THE SITUATION YOU HAVE**
13 **BEEN DISCUSSING?**

14 **A.** I don't believe so. Through data requests and other discussions we've been attempting to
15 identify the magnitude of this issue, but have not completed the process as not all SCs
16 have provided the information required. I'm confident there are several other SCs in
17 similar situations but certainly not all SCs.

18

19 **Q. WHAT CONCLUSIONS HAVE YOU REACHED IN THIS MATTER?**

- 1 **A. SWBT should not be left in the untenable position of being the COS provider in SC**
2 exchanges. We cannot effectively administer and enforce our COS tariff, and when others
3 should, they sometimes don't have the incentive to do so. Some things need to change.
- 4 1. The provider of COS needs to change from the PTC to the petitioning exchange
5 LEC.
- 6 2. COS needs to change from a toll service to a local service so that the provider-
7 customer relationship is clear and not at counter purposes.
- 8 3. Intercompany compensation needs to change from the divisive burden it has
9 become to the rather simple and equitable proposal contained in my Direct
10 Testimony.

11
12 **Q. DO YOU HAVE ANY OTHER RESPONSES TO MR. JONES' TESTIMONY?**

- 13 **A. Yes.** Beginning at page 5, line 20 and concluding at page 6, line 2 Mr. Jones comments,
14 "Most COS subscribers of the Mid-Missouri Group companies which have COS routes
15 reside in the petitioning exchange." Since COS can only be subscribed to by customers in
16 a petitioning exchange, I would expect that statement to say all rather than most. I'd like
17 for Mr. Jones to identify every COS subscriber who is not in a petitioning exchange and
18 explain the basis for allowing such subscription.

- 19
20 Also, at page 10 of his testimony Mr. Jones discusses his view that the current
21 intercompany compensation mechanism "was implemented on a revenue neutral basis,

1 with SC access rates discounted to reflect stimulation." He adds, "These reduced rates
2 benefited PTCs and IXC's." The following facts should be considered in any consideration
3 of Mr. Jones recommendation:

- 4 1. The access rate adjustment made by some SCs was a one-time event which
5 preceded implementation of many COS routes. Those subsequent routes and the
6 increased traffic have never been factored into any SC access rate reduction.
7 Hence, if COS was ever revenue neutral (and I'll explain why I don't think it was),
8 it was so only for a moment in time. Thereafter, COS became revenue positive for
9 SCs at SWBT's expense.
- 10 2. Since only PTCs, not IXC's, pay access on COS and as Mr. Jones says, the reduced
11 rates benefited PTCs and IXC's, COS was never revenue neutral to SWBT as the
12 PTC. Some of the value of the reduced access rates was transferred to IXC's.
- 13 3. In some cases the SC knew of routes which qualified for COS service but withheld
14 actions to implement those routes until shortly after their one-time access rate
15 adjustment was finalized. Thus, those new routes generated immediate increased
16 revenue to the SCs and increased access expense to SWBT, neither of which have
17 ever been accounted for in a revenue neutrality determination.

18
19 As an example, Mark Twain Rural Telephone Company's one-time access rate
20 adjustment for COS was effective July 10, 1995. That adjustment was based on
21 traffic volumes from one COS route, Green Top to Kirksville. On September 11,

1 1995, Mark Twain implemented seven additional COS routes. Based on Mark
2 Twain's response to SWBT's Data Request Number 15, we know that Mark
3 Twain was aware prior to July 10, 1995, that all seven of the routes met the COS
4 qualifying criteria.

5
6 It may or may not be coincidental that some of those COS routes implemented
7 September 11, 1995, are substantial factors in the inappropriate Internet access use
8 of COS which I described earlier or that the Internet access service was initiated in
9 the fall of 1995.

10
11 **Q. PLEASE COMMENT ON THE SUGGESTION IN MR. HARPER'S TESTIMONY**
12 **THAT COS COULD BE CONVERTED TO MANDATORY EAS?**

13 **A.** Ms. Bourneuf's Rebuttal Testimony addresses most aspects of this alternative. I will
14 address only the intercompany compensation issue. SWBT would recommend that two-
15 way mandatory EAS be compensated at Terminating Switched Access rates, less the
16 Carrier Common Line Element. This is the same compensation mechanism I
17 recommended in my Direct Testimony for one-way or one-way reciprocally available
18 COS. The same mechanism could be used in the event service is offered as one-way
19 mandatory EAS. Under any of the alternatives the LEC of the petitioning exchange
20 should be the provider of service to its customers.

1 **Q. DO YOU HAVE COMMENTS CONCERNING THE TESTIMONY OF GTE**

2 **WITNESS MS. KAHNERT?**

3 **A.** Yes. Ms. Kahnert at page 4, lines 18-25 of her testimony expresses GTE's conditional
4 support for retaining access-based compensation for COS. I understand how access
5 compensation could be acceptable to GTE given their relatively small impact from SCs
6 and the condition of adequate rates to cover costs. However, such a compensation
7 mechanism will not work for SWBT. Given the substantial impact that SCs have on
8 SWBT for COS, as described in my Direct Testimony, and given the SC access rate
9 levels, COS rates might have to be higher than toll rates to cover COS costs.

10

11 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

12 **A.** Yes.