

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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| In the Matter of the Petition |) | |
| of |) | |
| |) | |
| AT&T COMMUNICATIONS OF THE |) | CAUSE NO. U-86-113 |
| PACIFIC NORTHWEST, INC., |) | |
| |) | FOURTH SUPPLEMENTAL ORDER |
| for Classification as a |) | |
| Competitive Telecommunications |) | COMMISSION ORDER GRANTING |
| Company. |) | PETITION WITH CONDITIONS |
| |) | AND GRANTING WAIVERS |
| |) | IN PART |
| |) | |

NATURE OF PROCEEDINGS: On August 29, 1986, AT&T Communications of the Pacific Northwest, Inc., hereinafter referred to as AT&T, petitioner or company, filed with the Commission under Cause No. U-86-113, a petition pursuant to RCW 80.36.310 and 80.36.320 and WAC 480-120-022 and 480-120-023 for classification as a competitive telecommunications company and, pursuant to WAC 480-120-024, for waivers of various statutes and rules governing regulated telecommunications companies. Petitioner provides interexchange telecommunications service in Washington State and alleges in its petition that its services are subject to vigorous competition from numerous other interexchange carriers, local exchange companies and customer provided networks.

HEARINGS: A prehearing conference in the above-entitled matter was held on December 1, 1986, which was followed by a clarification proceeding on January 6 and 7, 1987. Hearings were held on March 11, 1987 and on April 6, 7, and 8, 1987, before Chairman Sharon L. Nelson, Commissioner Robert W. Bratton and Commissioner Richard D. Casad. Elmer E. Canfield was the presiding Administrative Law Judge. All proceedings took place in Olympia, Washington.

APPEARANCES: The following parties participated in the hearings.

PETITIONER: AT&T COMMUNICATIONS OF THE
PACIFIC NORTHWEST, INC.
By Daniel M. Waggoner
Attorney at Law
2600 Century Square Building
1501 Fourth Avenue
Seattle, Washington 98101-1688

COMMISSION: WASHINGTON UTILITIES AND
 TRANSPORTATION COMMISSION
 By Donald T. Trotter
 Assistant Attorney General
 1300 Evergreen Park Drive South
 Olympia, Washington 98504

PUBLIC COUNSEL: PEOPLE OF THE STATE OF WASHINGTON
 By Charles F. Adams
 Assistant Attorney General
 1300 Dexter Horton Building
 Seattle, Washington 98104

INTERVENOR: MCI TELECOMMUNICATIONS CORPORATION (MCI)
 By Clyde H. MacIver
 Attorney at Law
 701 Fifth Avenue, Suite 6500
 Seattle, Washington 98104
 and
 Robert W. Nichols
 Attorney at Law
 707 17th Street, Suite 4200
 Denver, Colorado 80202

INTERVENOR: US SPRINT COMMUNICATIONS
 COMPANY (US SPRINT)
 By Federic A. Morris and
 John Daniel Ballbach
 Attorneys at Law
 1900 Washington Building
 Seattle, Washington 98101
 and
 Craig D. Dingwall
 Attorney at Law
 One Bay Plaza
 1350 Old Bayshore Highway, Suite 580
 Burlingame, California 94010

INTERVENOR: WASHINGTON INDEPENDENT
 TELEPHONE ASSOCIATION (WITA)
 By Theodore D. Schultz
 Attorney at Law
 Professional Arts Building, Suite 1
 Olympia, Washington 98501

INTERVENORS: TELEPHONE UTILITIES OF
WASHINGTON, INC. and
INTER-ISLAND TELEPHONE COMPANY
By Leonard A. Girard
Attorney at Law
900 S.W. Fifth Avenue, Suite 2300
Portland, Oregon 97204

INTERVENOR: PACIFIC NORTHWEST BELL
TELEPHONE COMPANY (PNB)
By Richard Hemstad
Attorney at Law
2400 Evergreen Park Drive S.W.
Olympia, Washington 98502
and
Corey K. Ford
Attorney at Law
1600 Bell Plaza, Room 3206
Seattle, Washington 98191

INTERVENOR: UNITED TELEPHONE COMPANY OF
THE PACIFIC NORTHWEST (UNITED)
By David W. Matson and
Terry A. Vann
Attorneys at Law
601 State Street
Hood River, Oregon 97031

INTERVENOR: CONTINENTAL TELEPHONE COMPANY OF
THE NORTHWEST, INC. (CONTEL)
By John L. Nichols
Attorney at Law
P. O. Box 1315
Tacoma, Washington 98401

INTERVENOR: TELECOMMUNICATIONS RATEPAYERS
ASSOCIATION FOR COST EFFECTIVE AND
EQUITABLE RATES (TRACER)
By Arthur A. Butler
Attorney at Law
1111 Third Avenue, Suite 1500
Seattle, Washington 98101

INTERVENOR: AMERICAN NETWORK, INC. (AMNET)
By William McInerney
Attorney at Law
1900 Fourth & Blanchard Building
Seattle, Washington 98121
and
Deborah Johnson Harwood
Attorney at Law
P. O. Box 3535
Vancouver, Washington 98668-3535

SUMMARY OF COMMISSION ORDER: The Commission concludes that AT&T's services are subject to effective competition and that its petition for classification as a competitive telecommunications company should be granted subject to four conditions to remain in effect until at least March 1, 1990. These conditions are: (1) AT&T shall continue charging geographically uniform rates; (2) AT&T shall continue providing service in all areas of the state; (3) AT&T shall be restricted in its ability to change prices charged to customers using one hour of long distance service per month relative to the prices charged to customers using ten hours of long distance service per month; and (4) AT&T shall be restricted from placing prohibitions or surcharges for resale or shared use of any interexchange service or facility.

The Commission grants waivers of statutes and rules relating to budgets, excessive earnings to reserve fund, investigation of accidents, reports of accidents, lease of utility facilities, securities, tariffs, tariff schedules, service offered, contract for service and form of bills; the remaining waiver requests are denied.

As a competitive telecommunications company, AT&T is allowed to file price lists with the Commission instead of tariffs.

Pursuant to statute, the Commission may at any time reclassify AT&T and/or revoke any of the granted waivers if it deems such action necessary to protect the public interest.

MEMORANDUM

I. BACKGROUND

With the breakup of American Telephone & Telegraph Company and emerging competition in the telecommunications industry, the Washington State Legislature passed the Regulatory Flexibility Act to govern the transition from a monopolistic to a more competitive telecommunications environment. The Act went into effect on July 28, 1985. In Section 1 of the Act (RCW 80.36.300), the

policy of the Legislature is declared to be, among other things, to preserve affordable universal telecommunications service, to maintain and advance the efficiency and availability of telecommunications service, to promote diversity in the supply of telecommunications and products in telecommunications markets throughout the state and to permit flexible regulation of competitive telecommunications companies and services. Section 3 (RCW 80.36.310) authorizes telecommunications companies to petition to be classified as competitive telecommunications companies under Section 4 (RCW 80.36.320) or to have services classified as competitive telecommunications services under Section 5 (RCW 80.36.330).

Section 4 of the Act (RCW 80.36.320) states, in part:

The commission shall classify a telecommunications company providing service in a relevant market as a competitive telecommunications company if it finds, after notice and hearing, that the telecommunications company has demonstrated that the services it offers are subject to effective competition. Effective competition means that the company's customers have reasonably available alternatives and that the company does not have a significant captive customer base. In determining whether a company is competitive, factors the commission shall consider include but are not limited to:

- (a) The number and sizes of alternative providers of service;
- (b) The extent to which services are available from alternative providers in the relevant market;
- (c) The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions; and
- (d) Other indicators of market power which may include market share, growth in market share, ease of entry, and the affiliation of providers of services.

Subsection (2) provides, in part:

Competitive telecommunications companies shall be subject to minimal regulation. Minimal regulation means that competitive telecommunications companies may file, instead of tariffs, price lists which shall be effective after ten days' notice to the commission and customers. The commission shall prescribe the form of notice. The commission may also waive other regulatory requirements under this title for competitive telecommunications companies when it determines that competition will serve the same purposes as public interest regulation. The commission may waive different regulatory requirements for different companies if such different treatment is in the public interest.

Subsection (4) authorizes the Commission to revoke any waivers it grants and to reclassify any competitive telecommunications company if required to protect the public interest.

II. POSITIONS OF THE PARTIES

A. AT&T

In support of its petition for classification as a competitive telecommunications company, and for waivers of various statutes and rules, the company presented evidence and testimony from Dr. David L. Kaserman, an economist; John F. Sumpter, AT&T District Manager; Douglas M. Dunn, Vice President of External Affairs; and George M. Reed, a market researcher. In general, the company's witnesses testified that AT&T faces extensive competition in the Washington interexchange telecommunications market and that its services are subject to effective competition. AT&T's witnesses testified that the company should be classified as competitive and that it should be granted the requested waivers as set forth in Appendix A.

1. Classification

The relevant market to be examined in this competitive classification proceeding was defined by Dr. Kaserman to include all interLATA interexchange telecommunications services encompassing at least the State of Washington. It is necessary to define the relevant market in order to assess whether a firm has market power, which was defined by Dr. Kaserman as the "ability of a firm to raise and successfully maintain the market price of a

good or service above the competitive level for a significant period of time." (Exhibit T-1, page 5). The evidence showed that more than thirty vendors of telecommunications services were operating in the State of Washington and that at least ten of these companies are based in Washington. Six of the interexchange carriers operating in Washington were estimated to have gross earnings of over \$5 million per year in the Washington market. Some of the largest companies in the world are operating in the Washington telecommunications market, such as IBM, GE, United and GTE. Extracts from 1985 annual reports of MCI (IBM), GTE (US Sprint) and ALC (Allnet, Lexitel) listed annual revenues of over \$2.5 billion, \$15.7 billion and \$300 million, respectively. (Exhibit T-5, page 5). As evidence of the ability of competitors to enter the telecommunications market in Washington, Mr. Sumpter pointed out that the number of vendors has grown at a rate of about six per year since 1982. Dr. Kaserman also concluded that there were no significant barriers in the interexchange market.

Mr. Sumpter testified that the competing vendors of telecommunications services ". . . provide alternatives to all the services provided by AT&T, for every service category and in every geographical area of Washington." (Exhibit T-5, pages 3 and 4). The services provided by the competing interexchange carriers were described as being substitutable, although not identical. Listed as representative samples of Washington intrastate competitive service offerings were: long distance, including discounts for time-of-day and volume; WATS; 800; directory assistance; credit card/travel service; long distance operator; and private line, analog and digital. (Exhibit 8). The quality of service available to customers was shown to be comparable. According to Dr. Kaserman, the responsiveness of the supply of other firms indicated that alternative providers were able to make functionally equivalent services readily available at competitive rates, terms and conditions.

Mr. Sumpter testified that nearly all areas of Washington had competing suppliers of telecommunications service available and that by the end of 1987, about 81 percent of the Washington population will have access to competing interexchange carriers on an "equal access" basis.¹ Pointing to the decline in AT&T's

1. The Modification of Final Judgment (MFJ) mandated that "by September 1, 1986 the Operating Companies must provide access services to interexchange carriers and information service providers which are 'equal in type, quality, and price' to the access services provided to AT&T and its affiliates." See U.S. v. AT&T, 552 F. Supp. 131 (1982) and supplemental orders. Section 4(3) of the Regulatory Flexibility Act [RCW 80.36.320(3)] provides

estimated market share measured in revenue from over 90 percent in 1984 to 70 percent of the MTS market in 1986, Mr. Sumpter concluded that AT&T's customers have alternatives available and are taking advantage of them. He further argued that AT&T has lost up to 50 percent of the market share in the most lucrative markets. Citing the scope of service offerings of its competitors, the availability of services across the state, the ability of customers to choose alternatives, and the degree to which they have done so, the company concluded that it does not have a significant captive customer base.

A market research study was conducted by Market Trends, Inc., which is a market research company headquartered in Bellevue, Washington. George Reed, a principal and co-founder of Market Trends, provided testimony on the status and trends of competition in the Washington telecommunications market. As a significant finding, he testified that AT&T's market penetration for intrastate interLATA message toll service (MTS) had declined from 79 percent of all business customers and 93 percent of all residential customers in 1985 to 63 percent of business and 87 percent of residential markets in 1986. The MTS revenue market share had declined from 78 percent of the combined business and residential markets in 1985 to about 69 percent in 1986, according to his survey. Mr. Reed found AT&T's market penetration and revenue market share to be even lower in areas where equal access conversion had been completed prior to the survey. A significant percentage of customers (48 percent of business and 50 percent of residential) indicated they were likely to switch to a different provider of long distance service if faced with a 10 percent rate increase from their present carrier, assuming all other carriers' rates remained the same. So, it was concluded that customers are quite sensitive to rate increases. It was also found in the study that a large percentage of customers subscribing to other common carriers (OCCs) had subscribed within the past six months. Mr. Reed further concluded that AT&T's market penetration and revenue market share would continue to erode in the near term. According to Mr. Dunn, AT&T has not made a profit in its Washington intrastate operations since divestiture.

Dr. Kaserman cautioned against giving too much weight to overall market share figures, as such, when a firm has been subjected to rate-of-return regulation and pointed out that the regulation rather than market power might be indicated. For instance, because AT&T is charging geographically uniform rates across the

that when the equal access requirements have been met, there is a rebuttable presumption of effective competition in the interLATA interexchange telecommunications market.

state, including the areas with different costs of providing service, Dr. Kaserman argued that losses necessarily result in the relatively high cost rural areas. Such areas are not attractive targets for OCC entry and the result is a large market share for AT&T in unprofitable areas.

Other common carriers are rapidly expanding and new competitors are entering the market; Dr. Kaserman concluded that no significant entry barriers exist. He further testified that AT&T's customers are being offered reasonably available alternatives and that they do not represent a significant captive customer base. Dr. Kaserman concluded that AT&T does not have market power and that it faces effective competition.

The concerns of predatory pricing, universal service, rural service pricing and premature lessening of regulation were discussed and Dr. Kaserman argued that they did not constitute a legitimate basis to delay relaxed regulation. He deemed the feared consequences as extremely unlikely and, as an interim transition policy of reduced regulation, AT&T offered a commitment to charge geographically uniform rates and to continue providing service in all areas of the state through March 1, 1990. AT&T further offered that it would not thereafter discontinue such practices unless the Commission approved. Mr. Dunn testified that proper notice to other interested parties would be given when, and if, the matter was brought before the Commission.

2. Waivers

In view of the extensive competition faced by AT&T, Mr. Dunn argued that AT&T should be granted competitive company status and further requested that specific Commission rules be waived. The waivers requested are listed in Appendix A. Among others, the requested waivers relate to annual reports, budgets, contracts, valuation of public service property, depreciation and retirement accounts, securities, transfers of property, affiliated interests, tariffs, discontinuance of service and form of bills. The company argued that in the current competitive telecommunications environment, the rules were no longer necessary to protect the consumer and that the requested waivers would relieve AT&T of the burdensome reporting and oversight obligations. The company stated that the waivers were consistent with regulatory flexibility granted in other states. At the conclusion of the hearing, the company did acknowledge that the discontinuance of service issue might better be addressed at a later time.

B. Commission Staff

The Commission staff presented testimony and exhibits from Mr. Richard Cabe, WUTC Telecommunications Regulatory Flexibility Manager.

1. Classification

Mr. Cabe concluded that AT&T's services are subject to effective competition and recommended that its petition for competitive classification should be granted with two restrictions he recommends due to certain "vestiges of market power". Staff's recommended restrictions are: (1) AT&T should be required to continue its current practice of charging rates which do not vary between routes, and (2) AT&T should be restricted in its ability to change prices faced by customers using one hour of long distance service per month relative to the prices faced by customers using ten hours of long distance service per month. The ratio of the two prices is to stay the same, the effect of which is to give the benefits of competition to the one-hour-per-month users. It was recommended that this provision remain in force until January 1, 1989.

In analyzing AT&T's competitive classification petition, Mr. Cabe analyzed each of AT&T's services described as long distance service, which he also referred to as MTS (measured toll service), WATS, 800 service, and channel service, which he also referred to as private line service. He explained that the relevant product market for MTS must include WATS, 800 service and private line service due to the ease of substitution of these services. Likewise, the relevant market for WATS must also include MTS, 800 service and private line. He concluded the relevant market for AT&T's 800 service must include MTS, WATS and private line. The private line relevant market he used included the facilities-based portions of WATS, 800 and MTS.

After identifying the relevant product markets for AT&T's services, he determined the relevant geographic markets. He defined the geographic dimension of the private line relevant market as all routes between each pair of LATAs (local access transport areas) in the state. He then examined other markets in a statewide context. Mr. Cabe explained that a prohibition of geographic deaveraging rendered the question of geographic market definition moot.

Mr. Cabe testified that there were thirty registered telecommunications carriers in Washington, and he acknowledged the existence of additional alternative carriers who have not registered. AT&T, serving approximately 70 to 80 percent of the

market, was clearly the largest, with the next largest firm described as serving less than 10 percent of the market. After identifying several measures of AT&T's market share, Mr. Cabe estimated AT&T's share at approximately 75 percent. He pointed out that a high market share alone is insufficient to establish market power; further analysis is required, particularly in the areas of growth of market share and ease of entry. Mr. Cabe stated that, "Market power is the ability to raise price without suffering significant losses in market share. If a firm is losing market share it probably does not have significant amounts of market power" (Exhibit T-40, page 27). Analyzing the present structure of the industry together with the evidence of declining market share suggests to Mr. Cabe that market power no longer exists, or is at least dissipating.

While acknowledging that some barriers to entry exist, Mr. Cabe concluded that they are not preventing entry into the interexchange industry and thus were not "significant" barriers to entry. He characterized the entry and expansion in the telecommunications industry as occurring at a rapid rate. According to Mr. Cabe, functionally equivalent or substitute services at competitive prices from numerous alternative providers were widely available in the relevant market. Upon applying the statutory tests to the above-mentioned circumstances, staff's witness concluded that AT&T meets the statutory definition of a firm subject to effective competition.

The staff also addressed concerns raised by other parties. Although staff did not believe a prohibition on route abandonment was needed, it did not oppose this condition. Staff believed that a prohibition against AT&T's placing restrictions or surcharges on services purchased for resale was not necessary in view of the increased number of alternative providers available. Commission staff opposed placing a cap on AT&T's rate of return and opposed keeping all rate relationships intact; staff considered this tantamount to full ratemaking which would not give the intended flexibility to a company found to be competitive under the Act. Mr. Cabe also pointed out that the Commission was free to reconsider AT&T's classification at any time. Staff saw no merit in WITA's request to impose a restriction on short-haul interLATA toll rates. Staff characterized the problem cited by WITA as a very limited condition which could be handled by the independent companies putting in trunk groups to serve the customers involved.

2. Waivers

Staff pointed out that AT&T is seeking waivers of statutes and rules similar to waivers granted to other competitive

telecommunications companies, with minor variations. These include statutes and rules relating to securities (chapter 80.08 RCW, WAC 480-120-036); transfers of property (chapter 80.12 RCW, WAC 480-120-036); affiliated interests (chapter 80.16 RCW, WAC 480-120-036); tariffs (RCW 80.36.100, chapter 480-80 WAC, WAC 480-120-026 and 046); contracts (RCW 80.36.150, WAC 480-120-066); and accident reporting (WAC 480-120-131). Commission staff agrees that such waivers should also be granted to AT&T. Of AT&T's waiver requests that have not been requested by other competitive telecommunications companies, staff recommends waiving budget requirements (RCW 80.04.300-330); excessive earnings to reserve fund (RCW 80.04.360); investigation of accidents (RCW 80.04.460); and leasing of utility facilities (RCW 80.04.520).

In recommending that certain waiver requests of AT&T be denied, the Commission staff pointed out that requests of other competitive companies for waiver of the disconnect rule (WAC 480-120-081) have consistently been denied by the Commission and staff recommended against granting it to AT&T. Commission staff also recommended against granting waiver requests of annual report filing (RCW 80.04.080); the valuation statute (RCW 80.04.250); and depreciation schedules (RCW 80.04.350); it was argued that these are needed in order that sufficient records be kept especially should re-regulation be necessary. Staff also recommended that AT&T be required to cooperate in providing data for the Commission's annual report to the Legislature.

C. Public Counsel

Public counsel presented testimony and exhibits from Dr. Mark N. Cooper, president of Citizens Research, a consulting firm.

1. Classification

Public counsel's witness testified that effective competition does not exist and recommended that AT&T should not be classified as a competitive company. However, in the event that AT&T is classified as competitive, public counsel recommended: (1) imposing a rate of return cap as a safeguard against excessive profits; (2) requiring that current rate relationships between services and across mileage bands be preserved; and (3) monitoring AT&T's costs, prices, demand and capacity.

In assessing the competitiveness of the telecommunications market, Dr. Cooper's testimony stressed the importance of market share and points out that market concentration is a focal point of analysis. He cited Oligopoly Theory by James W. Friedman on market concentration. He likewise made use of two measures of concentration frequently used in antitrust analysis,

the Hirschman/Herfindahl Index and the measure of the largest four firms' percentage of sales. He also used Department of Justice merger guidelines in his assessment of the Washington telecommunications market.

As a result of his analysis, Dr. Cooper concluded that AT&T remains an overwhelmingly dominant firm in a highly concentrated market. He believed the exercise of market power and price discrimination by AT&T were distinct possibilities. He testified that AT&T still has adequate market power to set prices above cost. He therefore recommended against granting the petition, but offered the above safeguards in the event that competitive classification is granted. Public counsel saw no reason for a restriction on short-haul toll rates or a restriction on "prepayment plans".

2. Waivers

Public Counsel concurred with the Commission staff's recommendations on the waiver requests.

D. US SPRINT

US Sprint presented testimony from Dr. Nina W. Cornell, an economist.

1. Classification

Dr. Cornell recommended that AT&T be classified as a competitive company subject to price boundaries and market rules in addition to the minimal requirements set forth in the Regulatory Flexibility Act. She noted that the telecommunications market had changed greatly in the last few years, but that it was still in transition from a monopolistic to a fully competitive market.

Dr. Cornell described AT&T as still being the dominant firm in the interLATA market. She concluded that AT&T retained significant market power in view of a continuing need for competitors to lease facilities or services from AT&T and a continuing existence of unequal access for some users and service offerings. Even though she felt that market power was significant, she noted its uneven "pocket" nature and deemed that it was no longer universal market power.

Dr. Cornell pointed out that the Market Trends survey was "flawed" in several respects. For example, she noted that Mr. Reed estimated AT&T's revenue market share for long distance service based only on MTS revenues. There was no attempt by Mr. Reed to estimate AT&T's revenue market share for the intrastate

WATS market. Dr. Cornell also pointed out that the 69 percent estimate of AT&T's revenue market share excluded private line and 800 service revenues. In arriving at his estimate on the likelihood of customers changing carriers, Mr. Reed included the responses of those customers who were only somewhat likely to change carriers. Confusion on the part of business respondents as to what constituted a private line service billing caused Mr. Reed to be unable to accurately determine the overall subscription to private line service. Even though many survey questions asked for very detailed information, the survey made no attempt to verify the information supplied by respondents who were relying on their memories. In view of these deficiencies, US Sprint argued that the Market Trends Survey results were unreliable. Dr. Cornell stated that the information and estimates contained in the Commission's 1987 Annual Report on the Status of the Washington Telecommunications Industry were more reliable. Market Trends estimated AT&T's revenue market share in Washington to be 69 percent, whereas the 1987 Annual Report estimated AT&T's Washington intrastate, interLATA MTS/WATS market based on minutes of use to be 82 percent. In short, US Sprint argued that AT&T still has considerable market power over certain types of customers.

As mentioned above, US Sprint recommended price boundaries and market rules be imposed on AT&T if it is granted competitive status. For each rate element, US Sprint recommended a price floor based on costs, including AT&T's own costs of providing service, current access charges and any billing charges paid to local exchange companies. Dr. Cornell argued that this would help limit price discrimination. A price ceiling could also be set to provide additional protection. She recommended the following market rules:

1. Price lists must be filed for all services.
2. Tariffs and price lists may contain no prohibitions or surcharges for resale or shared use of any interexchange service or facility.
3. Rates for the basic dial-up calling service (MTS) may not differ based on the location of the origination or termination of calls.
4. Any discounts or reduced rates offered for a service must be applied for all use or to all customers who qualify based on volume of service, type of service, time of day of use, or length of haul of call, without requiring advanced payment or a monthly fixed fee in order to be eligible for participation in a special rate plan and without setting any charges not based directly on cost for terminating or changing a service or pricing plan

they use. Any current plans that violate this rule must be eliminated within a year.

US Sprint concurred with the Commission staff's recommendation that AT&T's pricing flexibility be limited so that customers with low volumes of usage receive the same benefit of competition as high volume customers. It also agreed with public counsel's recommendations on pricing and market rules.

2. Waivers

US Sprint expressed some concerns with several of AT&T's waiver requests, specifically: discontinuance of service (WAC 480-120-081); annual report filing (RCW 80.04.080); valuation statute (RCW 80.04.250); depreciation statute (RCW 80.04.350); budget requirements (RCW 80.04.300, .310, .320, .330 and chapter 480-140 WAC) and form of bills (WAC 480-120-106). US Sprint pointed out that its waiver request on discontinuance of service was denied by the Commission. US Sprint recommended denial of the above-mentioned waiver requests and proposed that if the waivers are granted, they should be granted also to US Sprint and other competitive telecommunications companies.

E. PNB

Pacific Northwest Bell cross-examined witnesses and participated in the hearings, but did not present any witnesses of its own. At the conclusion of the proceeding, PNB did not take a position on either the classification issue or on the issue of waivers.

F. WITA

The Washington Independent Telephone Association presented testimony and evidence from James P. Cerveny, Jr., president and general manager of Lewis River Telephone Company, Inc.

1. Classification

Mr. Cerveny testified that WITA is an association of 23 independent telecommunications companies which provide local exchange services in Washington and also participate in providing long distance service. The centers of most WITA exchanges are small towns located in rural areas. Mr. Cerveny testified that alternative providers of interexchange service having the ability to provide interLATA long distance service at competitive rates, terms and conditions do not exist in the territories served by most WITA member companies, whose customers depend on AT&T for such long distance service. WITA testified that AT&T retains, in essence, a captive customer base in these areas.

WITA argued that if the Commission finds that AT&T is subject to effective competition, three conditions should be imposed on the company: (1) that AT&T not geographically deaverage rates at least until March 1, 1990, and thereafter until the Commission decides otherwise after proper notice to interested parties and a hearing; (2) that AT&T continue providing service in all areas of the state at least until March 1, 1990, and thereafter until the Commission decides otherwise after proper notice and hearing; and (3) that AT&T not change its rates for short-haul (22 miles or less) interLATA toll calls.

2. Waivers

WITA expressed a concern over the requested waiver dealing with transfers of property, fearing that AT&T could transfer property in such a manner as to circumvent the recommended conditions.

G. Telephone Utilities of Washington and Inter-Island Telephone Company

Telephone Utilities of Washington and Inter-Island Telephone Company presented testimony from Robert A. Smith, manager of access charges and toll settlements for Pacific Telecom, Inc., which is the parent company of Telephone Utilities of Washington and Inter-Island.

1. Classification

The customers of Telephone Utilities of Washington and Inter-Island are located in rural service areas. The switches providing local exchange service have not yet been converted to equal access. Mr. Smith was fearful that AT&T will abandon service to rural areas or geographically deaverage its rates. Telephone Utilities of Washington and Inter-Island did not oppose AT&T's application if it is subject to the two basic conditions that AT&T not deaverage its rates or abandon service at least through March 1, 1990 and then only after approval of the Commission after notice and hearing. Mr. Smith argued that in such a proceeding, the independent companies should not be required to carry the burden of proof.

2. Waivers

Telephone Utilities of Washington and Inter-Island Telephone did not take positions on waiver issues, except to second WITA's position on transfers of property.

H. TRACER

TRACER cross-examined witnesses and participated in the hearings, but did not present any witnesses. At the conclusion of the hearing, TRACER did not take a position on either the classification issue or on the issue of waivers.

I. AmNet

American Network, Inc., cross-examined witnesses and participated in the hearings, but did not present a witness. AmNet did not take a position on the issues of classification or waivers.

J. United

United Telephone Company did not sponsor evidence of its own, but did cross-examine witnesses and participate in the hearings.

1. Classification

United did not oppose the petition in view of AT&T's assurances regarding abandonment of service and the geographic deaveraging of rates.

2. Waivers

United took no position on waivers.

K. CONTEL

Continental Telephone Company did not sponsor any witnesses in this proceeding but did participate in cross-examination of others' witnesses.

1. Classification

Contel also requested that AT&T be prohibited from abandoning service or deaveraging rates.

2. Waivers

Contel expressed no position on the issue of waivers.

L. MCI

MCI Telecommunications Corporation cross-examined witnesses and participated in the hearings, but did not sponsor a witness.

1. Classification

MCI argued that AT&T has a large market share, but that AT&T's market share has substantially declined. MCI argued that granting AT&T's petition with a ban on geographic deaveraging and abandonment would serve to decrease the vestiges of market power. MCI emphasized that AT&T does not provide local franchise monopoly service and does not provide bottleneck service (access). Like US Sprint, MCI believed AT&T's market survey was fundamentally flawed.

2. Waivers

MCI did not take a position on the requested waivers.

III. COMMISSION DISCUSSION AND CONCLUSIONS

The Commission believes AT&T has demonstrated that the services it offers are subject to effective competition, and grants AT&T's petition for competitive classification subject to the conditions enumerated below. The relevant market is the Washington interLATA interexchange telecommunications market. However, the record indicates that "vestiges" or "pockets" of market power remain in certain locations. Therefore, the Commission believes some of the conditions recommended by the parties should be imposed on the company for a period of time, during which we will continue to monitor developments in this market.

The evidence submitted is sufficient to comply with the statutory requirements of RCW 80.36.320. The Washington telecommunications market has changed since divestiture. Thirty registered telecommunications carriers providing substitutable service were identified and the existence of others is known by the Commission staff.

Many telecommunications companies have entered the market, demonstrating the ease of entry. Entry barriers discussed by the various witnesses were not shown to be "significant" barriers to entry. The evidence showed that functionally equivalent or substitutable competitive services from numerous alternative carriers were widely available in the Washington telecommunications market.

AT&T's market share evidence was severely criticized. The Commission believes many of these criticisms are points well taken and accordingly ascribes less weight to the Market Trends results. However, the Commission's 1987 Annual Report and the Commission staff's analysis persuades us that the staff's estimate of AT&T's market share is reasonable. By all measures, AT&T retains great market share, but we agree with the staff that market share is but one factor we must analyze. That analysis should not be a static analysis. AT&T's market share has declined dramatically in recent years, which is significant evidence of a decline in AT&T's market power.

The Commission believes that the absence of a significant captive customer base is a major factor in its analysis of this case. AT&T does not provide "bottleneck" service, i.e. access. Competing carriers do not have to go to AT&T to buy essential local exchange connections. AT&T is not affiliated with a local exchange monopoly company.

The record indicates that as of the beginning of 1987, approximately 70 percent of all access lines had been converted to equal access or "1+" dialing. Although not yet complete, the equal access requirements of the Modification of Final Judgment (MFJ) are being met. Although we do not rely on the rebuttable presumption contained in RCW 80.36.320(3), the Legislature believed that once the technological barriers to competition were removed, regulatory flexibility might follow. PNB has surpassed the MFJ's requirement and expects to be offering equal access in all of its exchanges by 1988.

We find that AT&T's customers have reasonably available alternatives and, thus, within the meaning of the statute, AT&T does not have "a significant captive customer base". (Emphasis added). However, "vestiges" of market power remain, especially in rural areas. The Commission is mindful that in many of the industries which have recently been "deregulated", competition most often served the interest of consumers in metropolitan areas. In order to protect the broader public interest, the Commission therefore imposes the following conditions on AT&T:

- (1) AT&T shall continue charging geographically uniform rates;
- (2) AT&T shall continue providing service in all areas of the state;

(3) AT&T shall be restricted in its ability to change prices charged to customers using one hour of long distance service per month relative to the prices charged to customers using ten hours of long distance service per month, (In applying this restriction, reference should be made to Mr. Cabe's testimony, Exhibit T-40, pages 38-40); and

(4) AT&T shall be restricted from placing prohibitions or surcharges for resale or shared use of any interexchange service or facility.

These conditions shall remain in effect until at least March 1, 1990, and thereafter until AT&T comes before the Commission in a proceeding with notice to interested parties and carries the burden of proving to the Commission that the conditions are no longer necessary to protect the public interest. AT&T shall also be required to cooperate in providing data for the Commission's annual report to the Legislature. The Commission's authority is based upon the Regulatory Flexibility Act. RCW 80.36.320(2) specifically authorizes the Commission to adjust the level of regulation for different companies having determined that "such different treatment is in the public interest".

The Commission rejects all other recommended conditions and rules, such as imposing a rate of return cap, requiring all current rate relationships to remain intact, imposing price boundaries, imposing restrictions on discount plans and imposing a restriction on short-haul toll rates. In our view, the evidence simply did not support these recommendations. Some are contrary to the intent of the Regulatory Flexibility Act because they would impose more, not fewer, regulatory burdens on the company. Some of the conditions are just not workable in a competitive marketplace. Finally, the concerns raised by some of the proponents of these recommended conditions are adequately addressed in the conditions that have been imposed by the Commission.

As provided by Section 4(2) of the Regulatory Flexibility Act [RCW 80.36.320(2)], competitive telecommunications companies are subject to minimal regulation, which includes the filing of price lists instead of tariffs. See WAC 480-120-027 and WAC 480-80-041. The price lists shall be filed for all services, including any intraLATA offerings of AT&T. Price lists are to be designed to effectively communicate to customers and should contain sufficient detail to insure that the Commission and AT&T's customers understand the nature of the service offered and the charges for the service. The price lists shall be effective after ten days' notice to the Commission and customers, with the advance

notice of price changes being made in the billing cycle or by separate mailing.

RCW 80.36.320(2) provides that the Commission may waive other regulatory requirements as a part of the minimal regulation required of competitive telecommunications companies. See also WAC 480-120-024. The Commission determines that competition will serve the same purposes as the following public interest regulations, which the Commission hereby waives:

| | |
|------------------------------------|--|
| budgets | RCW 80.04.300, .310, .320, and .330 and WAC chapter 480-140 |
| excessive earnings to reserve fund | RCW 80.04.360 |
| investigation of accidents | RCW 80.04.460 |
| reports of accidents | WAC 480-120-131 |
| lease of utility facilities | RCW 80.04.520 |
| securities | RCW chapter 80.08, WAC 480-120-036 (securities portion only) and WAC chapter 480-146 (securities portion only) |
| tariffs | WAC chapter 480-80, and WAC 480-120-026 |
| tariff schedules | RCW 80.36.100 |
| service offered | WAC 480-120-046 |
| contract for service | WAC 480-120-066 |
| form of bills | WAC 480-120-106 |

The following waiver requests are denied:

| | |
|---------------------------|-----------------|
| discontinuance of service | WAC 480-120-081 |
| annual reports | RCW 80.04.080 |

| | |
|--------------------------------------|---|
| valuation of public service property | RCW 80.04.250 |
| depreciation and retirement accounts | RCW 80.04.350 |
| transfers of property | RCW chapter 80.12, WAC chapter 480-143, and WAC 480-120-036 (transfers of property portion) |
| affiliated interests | RCW chapter 80.16, WAC 480-120-036 (affiliated interests portion), and WAC chapter 480-146 (affiliated interests portion) |
| contracts filed with Commission | RCW 80.36.150 |

The discontinuance of service regulation serves as guidelines to the company and its customers and the Commission has consistently denied waiver requests of this rule. In this case, the evidence established that AT&T was not able to terminate a customer's AT&T service without also terminating local exchange service and AT&T has not yet developed disconnect rules. AT&T agreed that this issue could better be addressed at some later time. The annual report required is consistent with the type of report already required by the FCC and does not impose an extra burden on AT&T. These rules and regulations provide necessary monitoring information for the Commission and would be especially useful should reregulation become necessary.

The competitive influences of the marketplace, along with the retained regulatory controls and conditions imposed on AT&T by the Commission, should provide adequate safeguards for the public. The opinions expressed by the public in letters received into evidence were appreciated and considered by the Commission in reaching this decision. In our view, additional monitoring of AT&T is not necessary. The Commission retains statutory authority to, at any time, reclassify AT&T and/or revoke any of the granted waivers, if necessary, to protect the public interest. Also, if abuses are discovered, the Commission's complaint procedures (RCW 80.04.110) are available to injured customers. RCW 80.36.360 explicitly subjects competitive telecommunications companies to the state Consumer Protection Act.

FINDINGS OF FACT

Having discussed in detail the oral and documentary evidence and having stated findings and conclusions, the Commission

now makes the following summary of facts. Portions of the preceding detailed findings pertaining to the ultimate facts are incorporated by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington vested by statute with the authority to regulate rates, rules, regulations, practices, accounts, securities and transfers of public service companies, including telecommunications companies.

2. The Regulatory Flexibility Act became effective July 28, 1985. Under this Act, the Commission is empowered, after notice and hearing, to classify a telecommunications company as competitive if it is found that the services it offers are subject to effective competition. If a company is classified as a competitive telecommunications company, it is subject to minimal regulation.

3. AT&T, the petitioner, is engaged in the business of furnishing telecommunications services within the State of Washington, and, as such, is a public service company subject to regulation by the Washington Utilities and Transportation Commission.

4. On August 29, 1986, AT&T filed with the Commission a petition for classification as a competitive telecommunications company. It further requested waivers of various statutory and regulatory provisions governing: annual reports, valuation of public service property, budgets, depreciation and retirement accounts, excessive earnings to reserve fund, investigation of accidents, reports of accidents, lease of utility facilities, securities, transfers of property, affiliated interests, tariffs, tariff schedules, contracts filed with Commission, service offered, contract for service, discontinuance of service, and form of bills (See Appendix A).

5. Following a prehearing conference and a clarification proceeding, hearings were held on March 11, 1987 and on April 6, 7, and 8, 1987, after due and proper notice to all interested parties.

6. AT&T is a telecommunications company essentially offering long distance service/MTS, WATS, 800 service and channel service/private line. The relevant market is the interLATA interexchange telecommunications market in the State of Washington. A reasonable estimate of AT&T's market share is 75 percent, but AT&T has experienced a significant market share decline in recent years. Ease of entry into the market has been demonstrated.

Functionally equivalent or substitute services are readily available in the marketplace. AT&T's services are subject to effective competition from numerous competing interexchange telecommunications carriers. AT&T's customers have reasonably available alternatives and AT&T does not have a significant captive customer base. AT&T does not provide "bottleneck" service, i.e. access.

7. Due to remaining vestiges of market power in certain locations, AT&T will be subject to certain conditions as listed in Conclusion of Law No. 3.

8. Certain waiver requests are granted as listed in Conclusion of Law No. 4.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and the parties thereto.

2. The Commission concludes that AT&T is a competitive telecommunications company pursuant to Section 4 of the Regulatory Flexibility Act (RCW 80.36.320) in that its services are subject to effective competition. Numerous alternative providers of service are making functionally equivalent or substitute services readily available in the relevant market.

3. The Commission concludes that AT&T's petition for competitive classification shall be granted subject to the following conditions, which are to remain in effect until at least March 1, 1990, as described earlier:

(1) AT&T shall continue charging geographically uniform rates;

(2) AT&T shall continue providing service in all areas of the state;

(3) AT&T shall be restricted in its ability to change prices charged to customers using one hour of long distance service per month relative to the prices charged to customers using ten hours of long distance service per month; and

(4) AT&T shall be restricted from placing prohibitions or surcharges for resale or shared use of any interexchange service or facility.

AT&T shall also be required to cooperate in providing data for the Commission's annual report to the Legislature.

4. The Commission waives the following statutory and regulatory provisions:

| | |
|------------------------------------|--|
| budgets | RCW 80.04.300, .310, .320, and .330 and WAC chapter 480-140 |
| excessive earnings to reserve fund | RCW 80.04.360 |
| investigation of accidents | RCW 80.04.460 |
| reports of accidents | WAC 480-120-131 |
| lease of utility facilities | RCW 80.04.520 |
| securities | RCW chapter 80.08, WAC 480-120 036 (securities portion only) and WAC chapter 480-146 (securities portion only) |
| tariffs | WAC chapter 480-80, and WAC 480-120-026 |
| tariff schedules | RCW 80.36.100 |
| service offered | WAC 480-120-046 |
| contract for service | WAC 480-120-066 |
| form of bills | WAC 480-120-106 |

The remaining waiver requests are denied, as previously indicated.

5. AT&T shall be required to file price lists, rather than tariffs, which shall be effective after ten days' notice to the Commission and customers.

6. AT&T shall further comply on an annual basis with the minimal reports required of it as a competitive telecommunications company.

O R D E R

WHEREFORE, THE COMMISSION HEREBY ORDERS:

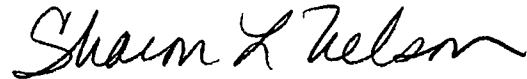
1. The petition of AT&T to be classified as a competitive telecommunications company is granted with the conditions as set forth in Conclusion of Law No. 3.

2. The petitioner shall file price lists rather than tariffs in the form prescribed in this order. Said price lists shall be effective after ten days' notice to the Commission and customers.

3. The waiver requests set forth in Conclusion of Law No. 4 are granted. The remaining requests are denied.

DATED at Olympia, Washington, and effective this 5th day of June, 1987.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION



SHARON L. NELSON, Chairman



ROBERT W. BRATTON, Commissioner



RICHARD D. CASAD, Commissioner

APPENDIX A
REQUESTED WAIVERS OF AT&T

| | |
|--------------------|---|
| RCW 80.04.080 | (annual reports) |
| RCW 80.04.250 | (valuation of public service property) |
| RCW 80.04.300 | (budgets) |
| RCW 80.04.310 | |
| RCW 80.04.320 | |
| RCW 80.04.330 | |
| RCW 80.04.350 | (depreciation and retirement accounts) |
| RCW 80.04.360 | (excessive earnings to reserve fund) |
| RCW 80.04.460 | (investigation of accidents) |
| RCW 80.04.520 | (lease of utility facilities) |
| RCW CHAPTER 80.08 | (securities) |
| RCW CHAPTER 80.12 | (transfers of property) |
| RCW CHAPTER 80.16 | (affiliated interests) |
| RCW 80.36.100 | (tariff schedules) |
| RCW 80.36.150 | (contracts filed with Commission) |
| WAC Chapter 480-80 | (tariffs) |
| WAC 480-120-026 | (tariffs) |
| WAC 480-120-036 | (securities, affiliated interests, transfers of property) |
| WAC 480-120-046 | (service offered) |

| | |
|---------------------|---------------------------------------|
| WAC 480-120-066 | (contract for service) |
| WAC 480-120-081 | (discontinuance of service) |
| WAC 480-120-131 | (reports of accidents) |
| WAC 480-120-106 | (form of bills) |
| WAC Chapter 480-140 | (budgets) |
| WAC Chapter 480-143 | (transfers of property) |
| WAC Chapter 480-146 | (securities and affiliated interests) |