SERVICE DATE

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant,	)	CAUSE NO. U-85-23 et al.
PACIFIC NORTHWEST BELL TELEPHONE COMPANY, et al. Respondents.	)	SEVENTEENTH SUPPLEMENTAL ORDER (PROPOSED ORDER)

NATURE OF PROCEEDING: By order of consolidation and notice of prehearing conference dated July 3, 1985, the Washington Utilities and Transportation Commission (hereafter, WUTC or Commission) consolidated Cause Nos. U-85-23, U-85-25, U-85-27, U-85-28, U-85-29, U-85-30 and U-85-34. On July 31, 1985, Cause No. U-85-46 was added to the proceeding. The Fifteenth Supplemental Order (March 7, 1986) in this cause disposed of those issues directly presented by the tariff filings in Cause U-85-23. By the Sixteenth Supplemental Order (March 28, 1986) tariff filings made pursuant to a proposed "IntraLATA Telecommunications Plan" (Cause Nos. U-86-07 through U-86-25, inclusive, and Cause Nos. U-86-28 and U-86-29) were consolidated in this proceeding. Finally, a motion was made and granted to consolidate in this proceeding the tariff filings of the Washington Exchange Carrier Association (WECA Tariff WN U-1) which were suspended under Cause No. U-86-80. As the Commission noted in its Fifteenth Supplemental Order, these cases all relate to the question of how long distance revenues should be divided among the various telecommunications companies which currently provide these services in the state of Washington.

HEARINGS: Following prehearing conferences, the matter was called for hearing pursuant to due and proper notice on January 13 and 14, 1986 at Olympia, Washington (Cause U-85-23 issues only). The record in Cause U-85-23 was completed on February 4 and 5, 1986 at Olympia. Hearings addressing other issues of this consolidated case were held at Olympia on January 15 through 17, 1986, March 19 through 20, April 28 through May 1, 1986, and June 23 through 25, 1986. Testimony was received from the general public at specially scheduled hearings held on May 2, 1986 at Seattle, May 8, 1986 at Richland, May 9, 1986 at Yakima, and May 13, 1986 at Everett. In addition, the record includes testimony submitted in connection with a tariff filing of AT&T Communications of the Pacific Northwest Inc., (AT&T) in Cause U-85-68. Hearings were

before Chairman Sharon L. Nelson, Commissioner Robert W. Bratton, and Commissioner Richard D. Casad. The Commission was assisted by its accounting advisor, James G. Ainey, Jr. and Administrative Law Judges Ernest A. Heller and Alice L. Haenle of the state Office of Administrative Hearings.

APPEARANCES: It should be noted that the various telecommunications companies listed below appeared in various capacities in the consolidated proceeding, being in some instances complainants, respondents, or otherwise interested parties. With that understanding, the following appearances are noted:

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PROPOSED ORDER: Although a proposed order is not required by law, the Commission has directed that the presiding administrative law judge (now regulatory affairs administrator) publish a proposed order. This unusual procedure is designed to elicit (by way of exceptions) the identification of practical problems which might be caused by the proposed access charge system. This order is, therefore, merely a proposal and should not be construed as one approved by the Commission. The industry and the Commission are exploring new frontiers in regulation. There are many "unknowns" which justify a careful decision-making process. The record, lengthy as it is, does not provide assurance that any of the plans offered by the parties will achieve an acceptable result. A "minor" error in judgment could profoundly harm the public, or injure a vulnerable company.

Therefore, the parties are encouraged to carefully review this proposed order and invite the Commission's attention particularly to the practical problems which can be identified. Philosophical and legal arguments are well-known. It is more important to now focus on the mechanical concerns. Where the record may be inadequate to explain such practical problems, the parties may seek to supplement the record by stipulation or official notice. This is encouraged. Although the exception process may delay this proceeding, the importance of the task justifies this cost.

HISTORICAL PERSPECTIVE

In the beginning there was Alexander Graham Bell. His Bell Telephone Company which later became American Bell and finally the American Telephone and Telegraph Company (AT&T) developed the telephone from a curious invention into a vital central nervous system of this country and the world. Although

independent telephone companies have been permitted to participate in this telephone system for many years, only in the last 20 years has competition become a significant concern to the telephone industry, an industry which used to be characterized as a natural monopoly.

Since 1968, decisions by the Federal Communications Commission and the federal courts have compelled the telephone industry and state regulators to modify the basic philosophies of operating and regulating. Of relevance to this proceeding is the method of providing for the joint use of telephone equipment for the provision of long distance service in this state. When the Bell system was intact, the question of how these calls would be completed was simple. For most calls, a local Bell Operating Company (BOC) would receive the request from the originating customer. The BOC central office would transfer the call to a toll trunk provided by the Long Lines Department of AT&T for forwarding to another BOC and delivery of the message to the terminating end of the call. The only question under this system was "how much of the toll charge should be left in the BOC's account and how much should go to AT&T's account?" This was a manageable problem. Only slightly more difficult was the problem of sharing revenues when an independent local exchange company (LEC) was involved in the call. Because the BOCs dominated the local business and AT&T dominated the toll business, it was logical for each BOC to administer a negotiated settlement between the Bell system and the LECs. In the state of Washington, Pacific Northwest Bell Telephone Company (PNB) has historically served as administrator of the intrastate toll revenue settlements. As decisions at the federal level made competition in the toll business a reality, PNB's role as administrator of toll revenues became increasingly inappropriate. As a competitive carrier of toll traffic (intraLATA) PNB should be placed in a position of equality with other carriers or resellers such as MCI, Sprint, Allnet, etc. This equality is absent in the present system. Therefore, the primary purpose of this proceeding is to eliminate the present system of intrastate toll settlements in favor of a system more suited to today's increasingly competitive intrastate telecommunications industry. The parties unanimously favor adoption of a nondiscriminatory tariffed access charge as the method for toll revenue sharing. The level and structure of those charges are the primary issues in dispute. Before turning to the various proposals, it is important to understand the present system of revenue distribution.

PRESENT SYSTEM

The WUTC has been actively involved in the effort to meet the changing needs of the industry. The present system of intrastate toll settlements, for better or worse is a result of

that effort. Cognizant of the fact that historical arrangements to divide toll revenues would end on December 31, 1983, the WUTC adopted rules to allow PNB to collect traffic sensitive charges and non-traffic sensitive charges (TS and NTS) from interexchange carriers and use these revenues to pay to the local companies their traffic sensitive revenue requirement, and also make a contribution toward a non-traffic sensitive revenue fund.[1]

Local companies were authorized to charge a flat fee (CALC) to each subscriber up to $2 per line per month to cover costs not covered by the NTS fund. These CALC charges which ranged from a $1.39 to $2 per line were short-lived. The WUTC rescinded its CALC rules in Cause U-83-62. (The rules were temporary and actually expired by their own terms on April 30, 1984). Instead of collecting additional revenues from a flat customer charge (CALC) the companies were directed by the Third Supplemental Order in Cause No. U-83-62 to draw from a "special pool" designed to provide high cost companies with an additional contribution. Although this special pool arrangement addressed the initial problem of eliminating the CALC charges which were very unpopular, it was evident from the reaction of the industry that a long-term solution to the problem of dividing long distance revenues and allocating costs between the joint providers of the service had not been achieved.

An excellent explanation of the present settlement system is set forth in exhibit T-100. The system consists of three agreements: (1) the intraLATA toll services agreement (Exhibit 103); (2) the non-traffic sensitive fund administration agreement (Exhibit 104); and (3) the special toll revenue pool agreement.

Under these agreements, PNB receives the intraLATA toll revenues of each LEC. PNB pays each LEC its intraLATA traffic sensitive revenue requirement (calculated at a 12.75

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[1] The distinction between traffic sensitive costs and non-traffic sensitive costs is fraught with disagreement. In theory, traffic sensitive costs are those which vary directly with usage as compared with non-traffic sensitive costs which are fixed. Non-traffic sensitive costs are primarily the costs of the local loop which connects the central office and the customer's telephone equipment together with certain non-traffic sensitive portions of the central office itself. However, the current system has many anomalous elements thrown into the "catchall" accounts known as NTS.

percent rate of return). PNB uses a portion of the toll revenues to partially fund a revenue pool into which PNB pays $.03 per minute for all originating and terminating intraLATA traffic. Also added to this revenue pool is a portion of the interLATA, carrier common line charge (NTS charge). The result is the non-traffic sensitive fund which is used to help pay each carrier's residual intrastate toll revenue requirement. Additional funds can then be obtained by qualifying LECs from the special toll revenue pool. Only companies with special revenue needs are able to receive these funds.

Obviously, these agreements result in LECs receiving revenues that bear little relationship to the amount of toll business which actually takes place in their respective exchanges. In theory, a company whose customers neither originated or terminated any calls during a year and made no contribution of revenues into the pools, could claim and receive substantial revenues based on the company's investment in telephone plant.

All of the parties agree that this system is not suitable to the present telecommunications industry. These agreements put PNB in the position of administering agreements which both benefit and burden PNB. These conflicts have generated (and will continue to generate) complaints. The historical reasons for using a pooling mechanism (such as the inability of LECs other than PNB to do the necessary billing of access charges) are no longer an obstacle to a comprehensive access charge plan. The time for a change is unquestionably at hand.

PROPOSED PLAN OF WITA, PNB, AND AT&T

To better understand how the "industry plan" came into being, a brief review of the procedural history of this filing may be helpful.

On April 9, 1985, PNB filed certain tariff revisions (WUTC No. UTF 85-122) designed to reduce the rates for PNB's WATS 800 service (a response to new competition from AT&T's intraLATA service) and offset this reduction with increases in special channel (private line rates). Included in the filing were reductions to the intrastate carrier common line charge for premium access and special access service charges. The WUTC suspended this tariff filing by complaint and order dated May 8, 1985 (Cause No. U-85-23).

On or about May 24, 1985, AT&T Communications of the Pacific Northwest, Inc. (AT&T) brought a complaint under RCW 80.04.110 and 80.36.140 against United Telephone Company of the Northwest, Inc. (United) (Cause No. U-85-25), Pacific Northwest Bell Telephone Company, Inc. (PNB) (Cause No. U-85-27), General

Telephone Company of the Northwest, Inc. (GTNW) (Cause No. U-85-28), Continental Telephone Company of the Northwest and companies designated "ECA" companies (WITA) (Cause No. U-85-29), and Telephone Utilities of Washington, Inc. (TU) and Inter-Island Telephone Company (Inter-Island) (Cause No. U-85-30). These complaints contend that the charges for access and for billing and collection services were unnecessarily high and in some cases discriminatory and anticompetitive.

PNB responded to the AT&T complaints with a petition of its own (designated Cause No. U-85-34) which sought WUTC approval of a plan for determining and collecting the TS and NTS revenue requirements through tariffed usage based and lump sum based access charges. The plan was ostensibly designed to be revenue-neutral as applied to the local exchange companies.

On July 3, 1985, the WUTC consolidated each of the above-described proceedings for hearing, reserving the right to issue separate orders as might be appropriate (Order of Consolidation and Notice of Prehearing Conference).

On or about July 24, 1985, the Washington Independent Telephone Association (WITA) filed a complaint (designated Cause No. U-85-46) also seeking a WUTC order establishing a division of revenues for jointly provided service under RCW 80.36.160. The WITA plan would preserve the existing separations structure but eliminate the special pool agreement, reduce the CCLC, authorize increased local exchange rates, and lower PNB's intra-LATA toll rates. The WITA complaint was consolidated with the previously consolidated proceedings. (See prehearing conference order and notice of hearing dated July 29, 1985 and served July 31, 1985).

With the intervention of various interested parties (as identified previously) the consolidated case moved forward toward a January 13, 1986 hearing date. Then, at a prehearing conference in Olympia on December 6, 1985, PNB, WITA, and AT&T presented a proposed "intraLATA telecommunications plan" (ITP) to satisfy the concerns of the local exchange companies and AT&T. The ITP (see Exhibit 209) provided for a reduction in CCLC (carrier common line charge i.e., NTS carrier access charge) in an amount estimated at $48 million per year for the next two years. ($38 million from intraLATA and $10 million from interLATA). To offset these reductions would require a $2 per month increase in local rates (similar to the unpopular CALC but not identified as such) increasing to $4 in the second year. The ITP proposed a two-part CCLC (25 percent usage based, 75 percent lump sum market share based). The "Plan" also provided for a "universal service fund" designed to subsidize companies

with loop costs of more than 115 percent of statewide average loop costs.

The ITP identifies PNB as the "designated" intraLATA carrier, but does not give PNB a monopoly on such traffic. PNB is simply delegated the responsibility of drafting and filing (subject to Commission review) toll rates for interexchange intraLATA traffic. The plan contemplates that these rates will be substantially below present rates due to the shift of NTS contribution from toll to local exchanges which is one of the principal features of the ITP. Each LEC would file traffic sensitive and non-traffic sensitive access tariffs. The traffic sensitive tariffs would be based upon each LEC's projected revenue requirements and would be the same for both interLATA and intraLATA intrastate traffic.

The NTS access charge would be in two parts. One based on a lump sum billing (75 percent) and one part based on minutes of use (25 percent). Essentially, the NTS plan begins with each LEC establishing its NTS revenue requirement. In establishing the NTS revenue requirement each LEC would shift from toll to local a "transition amount" of a minimum of $2 per access line per month or so much as needed to achieve an intrastate gross allocator of either 25 percent or the company specific SLU. The "transition amount" may (at the LEC's option) exceed $2 per month per access line. Companies (such as PNB) which now have a Subscriber Plant Factor (SPF) below 25 percent or SLU agree not to transition up to 25 percent or SLU (with the exception of Asotin Telephone Company which is allowed to phase-up to a 25 percent gross allocator). The amount thus determined to represent the appropriate contribution from intrastate toll to defray NTS costs will be collected in two ways. Seventy-five percent of this amount will be divided among all of the interexchange carriers (IECs) based upon their respective market shares and billed to those carriers in a lump sum (bulk bill). The remaining 25 percent of the NTS requirement will be used to calculate the usage-based element.

The LEC's are given the option of pooling both the bulk-billed and usage-based elements. An additional amount which is added to the usage-based element to fund a Universal Service Fund (USF) is mandatory and must be pooled. A pool administrator is required, but the plan does not specify how the administrator is determined or funded.

The ITP does not provide specifically for a Customer Access Line Charge (CALC). However, the concept of a $2 per line per month "transition amount" implies that each LEC will need to increase local rates in a like amount in order to have an opportunity to achieve its authorized rate of return.

To see how the ITP would work in practice, it is helpful to review PNB's implementing tariff filing (Advice 1728) as described by witness Charles A. Lenard in Exhibit T-138. PNB sought an increase in local exchange rates equal to $2 per access line per month thus increasing revenues by $34.9 million. PNB's costs of access in terms of payments to independent companies was estimated to decrease by $8.4 million. The total amount of revenue thus obtained ($43.3 million) would be offset by $17.5 million in reduced carrier access charges and $25.8 million in reduction to intrastate toll rates (including WATS). (See Exhibit 139).

PNB's usage-based element for carrier access would be $.007607/minute. The bulk bill would be derived by multiplying PNB's NTS requirement by .75 times the relative market share of the specific carrier. The combined effect of the two elements of the CCLC would be comparable to a CCLC of 3.16 cents per minute (TR 1166). (This would include a contribution to the Universal Service Fund.) The same analysis for the combined WITA companies derives a 4.11 cent per minute CCLC.

An anomaly of the ITP is the failure to account for intraLATA toll provided within a company, e.g., PNB to PNB. There is no provision for PNB toll services to make a specific NTS revenue requirement contribution to PNB Local Exchange Services. If one were to analyze the NTS revenue requirement of PNB established under the ITP and compared that to the estimated minutes of use, an implicit CCLC of 1.91 cents per MOU for PNB to PNB calls could be derived. (TR 1179). Obviously, the potential for PNB to underprice its toll services vis-a-vis its new competitors is a cause for concern.

UNIVERSAL SERVICE FUND (USF)

An important element of the ITP is the Universal Service Fund, the purpose of which is to provide partial support for LEC's whose NTS loop costs exceed the state average. Companies (with loop costs 115 percent or more of the statewide average) whose unseparated revenue requirement per loop is less than the statewide average loop unseparated revenue requirement are eligible to receive support from the USF in an amount per line equal to 25 percent of the difference.[2/] By totalling these support amounts for all LEC's and dividing by the total intrastate access minutes, a USF surcharge is derived. According to witness Lenard, the USF usage charge is $.0012/MOU.

[2/] A special provision provides additional support during the 1986 interim period.

POOL ADMINISTRATOR

The ITP points out the need for a pool administrator but fails to specify who that administrator should be. In Mr. Lenard's testimony (TR 1216) there is reference to the possible need for an auditing neutral party to resolve disputes regarding the lump sum billing process, but the balance of the testimony implies that PNB will continue to account for billed minutes of use as it has in the past. This ambiguity is especially troublesome when one recalls that one of the primary goals of this proceeding was to free PNB from the arguably inappropriate role of state toll pool administrator.

ULAS PLAN

Public counsel has sponsored an alternative access charge plan known as the Universal Local Access Service (ULAS) tariff. This plan is not accompanied by the sort of detail found in the ITP. The plan begins by requiring the Commission to set an NTS allocation to be assessed against interexchange carriers. That total dollar amount is then divided among each participating IEC based upon that carrier's relative potential for using the local network. That potential is determined by a calculation of the channel capacity of the carrier. In determining channel capacity, private lines are taken into account, recognizing that these lines are a form of bypass, and further recognizing that they may ultimately access the local network either overtly or covertly (using a "leaky" PBX).

COMMISSION STAFF PROPOSAL

After determining that a "demand availability" analysis supports an allocation of 25 percent of NTS costs to intrastate toll, Commission staff advocates a lump sum assessment of these costs against IECs based on market share rather than channel capacity. Market share could be determined on the basis of either minutes used or revenues, and new entrants in the market could be assessed an estimated amount based upon the allocation of the smallest existing toll carriers.

The Commission staff proposes that those companies which now have a Subscriber Plant Factor (SPF) greater than 25 percent utilize the $2 per line per month transition methodology of the ITP to phase toward a 25 percent gross allocator. Therefore, the majority of LEC's in the state would experience the $2 per month CALC proposed by the ITP. Commission staff proposes an alternative treatment for PNB allowing PNB to "phase-up" to 25 percent over an eight-year period similar to a technique used in Idaho. This "phase-up" would offset an expected "phase-down" of PNB's interstate SPF. Presumably Asotin Telephone company,

which also has a SPF below 25 percent, could "phase-up" to 25 percent immediately.

COMPARISON OF THE THREE PLANS

The obvious similarity between these three plans is their endorsement of a lump sum assessment of all or a substantial portion of the NTS cost allocation to the IECs. The rationale for this method includes the following considerations: (1) using a method of assessment not directly related to usage is consistent with the non-traffic sensitive nature of the costs; (2) the lump sum assessment discourages bypass; (3) the lump sum assures the LECs of a stable revenue stream; and (4) the lump sum assessment allows IECs to package discount toll plans to further meet the threat of bypass.

The lump sum methods are opposed by the IECs other than AT&T. The fact that the dominant IEC does not oppose the approach gives credence to the primary objection of the other carriers. This objection is that any lump sum plan has a tendency to favor the dominant carrier. For example, Sprint argues that AT&T could easily characterize its fixed payment of access costs as a "fixed cost" for purposes of marginal cost pricing and thereby justify "marginal cost" pricing of competitive toll services at rates low enough to stifle competition. These "underpriced" rates would be subsidized by overpriced rates charged to customers in areas where AT&T has retained "market power". (Sprint brief at p. 16.) The ULAS method is even more frightening to these IECs because the mathematics of determining channel capacity is such that the carrier with the larger number of channels has a disproportionate increase in efficiency. (For example, a company with 50 trunks has more than 10 times as much capacity to handle traffic as a company with five trunks).

In addition to this primary objection, the IECs (other than AT&T) object to the fact that a lump sum assessment is like a tax, and guarantees that the LECs will receive their revenue requirement even though bypass or other factors actually cause revenues to decline. LECs would not have an incentive to improve their services to avoid these lost revenues. This argument has been persuasive to the FCC. (See In re Petition for Waiver of Various Sections of Part 69 of the Commission's rules FCC 86-145, released April 28, 1986.)

Other objections noted by MCI and Sprint go to the particular features of the ULAS plan which tend to combine interstate facilities with intrastate facilities in determining the channel capacity shares and arbitrarily allocate to private lines a responsibility to the switched network not justified on the record. Intervenor TRACER agrees that the lump sum distribution

of 75 percent or more of NTS access charge poses the risk of remonopolization of the toll market. (TRACER brief p. 33.)

In its brief, WITA responds to these objections by stating that it is too soon to decide whether AT&T will abuse the lump sum method in its pricing decisions and AT&T would take advantage of a minutes of use based access charge as well. PNB responds that every carrier who increases usage will enjoy a decrease in average costs under the ITP. (This does not truly address the concerns regarding anticompetitive effects.) AT&T agrees that the ULAS plan has defects, but does not respond to the allegations by MCI, Sprint and TRACER regarding AT&T advantages in all lump sum plans. Public counsel also fails to respond to the anticompetitive tendencies of the plans other than to echo WITA's view that the Commission can deal with such issues as they arise. Public counsel also argues that only the lump sum plans deal with the bypass problem, an ironic argument given the fact that public counsel has consistently downplayed the severity of the bypass threat. Commission staff offered no response to these arguments.

ANALYSIS

Bypass

At the heart of the various controversies in this case is the issue of bypass. Although definitions vary, bypass occurs whenever a customer obtains telecommunications services without using the public switched telephone network. This phenomenon is not inherently harmful. If a bank finds it useful to use a private (unswitched) telephone line to send communications (voice or data) between branches and if the decision is based on considerations not related to inappropriate pricing of the various options, bypass has occurred even though the local exchange company is providing the service.[3/]

Under this hypothetical, the public network has lost a valuable customer, but for sound business reasons which most people would accept. "Uneconomic" bypass occurs when a customer leaves the

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3/This particular example is what has been referred to as "service bypass" and is probably the most common form of bypass. Less common forms of bypass include "carrier bypass" where a customer obtains its own connection to a toll company's point of presence (POP) and private facilities bypass where a user constructs its own system (Exhibit 905, pages 29-30).

public switched network due to inappropriate pricing. In the previous hypothetical, if the bank chose a private line because the public switched network was being overpriced to subsidize other services, this would be an "uneconomic" bypass and the switched network would have unnecessarily lost a valuable customer.[4]

Critics of the present system of access charges argue that the incremental cost of access is so much lower than the access charges themselves, that large users will rationally seek ways of bypassing the switched network. These ways are increasingly available due to new technologies in microwave, fiber optics, and satellite communications.

Although each party has a different view of the nature and degree of the bypass threat, most would agree that there is a potential for prejudice of the general public if the access charge system were to encourage customers who were otherwise satisfied with the public switched network, to leave that system. Each proposal now before the Commission attempts to address the bypass threat in some fashion. In evaluating these proposals, it is important to remember that the power of a state commission to control bypass is extremely limited. Much bypass relates to interstate toll traffic regulated by the federal government. Much of the intrastate bypass relates to customer service requirements. Only that residual amount of intrastate bypass which is driven by "inappropriate" pricing of access is truly controllable. Evidence pertaining to the amount of this "controllable" bypass which is occurring or which is likely to occur is uncertain. It should also be remembered that the issue of bypass is not new to the Commission. Neither is it unique to the telephone industry. All utilities which invest in property to serve the public run the risk that the equipment will be "stranded" when customers

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[4] It should not be overlooked that the LEC can price its private line in such a way as to provide revenues to support the LEC's general and administrative requirements. Therefore, this form of "uneconomic" bypass is less threatening to the well being of the public switched network than "carrier" bypass or "private facility" bypass which completely avoid any contribution to LEC revenues. In fact, the Ernst and Whinney study (Exhibit 905, part 2 and 3) does not treat "service bypass" as bypass at all since local exchange plant continues to be used to generate local exchange revenues (see Exhibit 905, part 1 Commission report page 4).

exercise another service option. This happens to trucking companies when shippers decide to use their own trucks. It happens to gas companies when customers switch to other fuels. In each case, the Commission must make a judgment as to: (1) whether the "stranding of investment" will occur; (2) whether it is a bad thing; and (3) whether there is anything the Commission can do about the problem.

In deciding whether investment will be stranded, the Commission must be concerned not only with the likelihood of customers leaving the utility, but also with the potential for putting the property once used by that "lost" customer to other useful purposes. This two-part analysis plays a part in a debate among the parties as to whether the anticipated drop-off in customers due to bypass will be offset in whole or in part by growth in LEC business. Public counsel, for example, argues that even in a "stagnant" economy and in spite of increased competition for customers, LEC revenues have actually grown. It follows that switches and even some of the outside plant will be in constant and increasing demand. Although a particular customer "service drop" may be rendered surplus and "stranded" if that customer leaves the network, much of the cable, switching, and associated plant will remain used and useful in spite of bypass. It also follows that the LEC, while not enjoying the degree of growth it might hope for, will continue to be profitable and healthy so long as revenue growth exceeds revenue erosion. Although its revenues have not declined, PNB argues that the LECs are entitled to experience projected growth, and the average ratepayer will be better off if the public network continues to grow, enhancing the network and providing more service or more efficient service to the customers.

This record supports a finding that the most prevalent form of bypass in the state of Washington is "service bypass" which does not represent the threat to the public network which is characteristic of other forms of bypass. By this statement, we do not mean to suggest that bypass is not a problem. It is a potential harm to the public switched network, but it is not the imminent danger suggested by some of the parties. Having so concluded, the next question is whether there are mechanisms at the Commission's disposal to solve the problem. The two mechanisms presented are: (1) structural (e.g., use of a bulk-billed access charge); and (2) economic (e.g., reducing the level of NTS access charges).

STRUCTURE OF ACCESS CHARGES

We are not pleased with the adequacy of response by various proponents of lump sum access charges to the anticompetitive potentials of these plans. We also have concerns regarding

the administrative difficulties of such plans. In particular, the role of the Commission in monitoring market share information has not been specified. The ULAS plan is especially fraught with uncertainty. The Commission must acknowledge those state commissions which have taken on the challenge of employing the innovative ULAS method. Their bold efforts will provide us with an opportunity to evaluate the workability of such systems. In the meantime, this Commission should take advantage of the opportunity to adopt a more conventional and conservative approach. The wisdom of such an approach seems obvious. We have concluded (supra) that the threat of bypass is not an imminent danger. The goal of allowing competition to develop is at least as important as the goal of mitigating bypass. Bypass, after all, is another form of competition, and to the extent that it can be controlled, there are only narrow areas where it should be controlled. These areas should be identified and treated with surgical techniques, not the general medication provided by these plans which is likely to have adverse side effects.

The record supports a finding that a 100 percent bulk-billed access charge poses a substantial threat to toll competition in this state. This fact together with the potential administrative problems in a market share determination weigh against the emphasis placed on bulk-billing in all of the proposals. At the same time, having the bulk-billing mechanism in place would provide the Commission with the flexibility to respond quickly to changing market conditions. Therefore, it is prudent to adopt the basic structure of the ITP with modifications including a de-emphasis of bulk-billing. This conclusion recognizes that the ITP is the product of a laudable effort by the drafters to resolve a difficult conflict without confrontation. The ITP is unquestionably the most carefully considered proposal of its kind yet placed before the Commission. Therefore, the ITP, with modifications as needed, provides the best vehicle for implementing the Commission's policies.

The first structural modification is a shift of the emphasis from the bulk-billed element toward the usage-based element. Initially, the bulk-billed element should represent 25 percent of the total access charge, with the remaining 75 percent reflected in the usage-based element. These ratios will be subject to revision annually upon a showing of need.

The second structural change to the ITP is the specification of an administrative body to relieve both PNB and the Commission of day-to-day responsibility for administering the ITP. This order proposes that a State Toll Administrative Committee (STAC) be established consisting of five members, PNB, AT&T, WITA, the WUTC staff, and IECs. In the absence of an IEC organization, the WUTC will annually designate AT&T's largest Washington interLATA

competitor as the IEC member. Each member will bear its own specific costs associated with STAC and joint administrative expenses will be shared equally by the five members (i.e., 20 percent each). Any complaint regarding a decision of STAC may be brought before the Commission and will be considered as if it were a complaint regarding a regulated utility, to be resolved by a final Commission order subject to review under RCW chapter 34.04.

The next structural change in the ITP is a provision for a nonpremium discount for IECs who are not able to obtain equal access. A discount of 50 percent applicable to both the usage and bulk-billed charges is appropriate.

Access charges now in place at the federal and state level provide a discount for carriers who are not able to access their customers in a fashion substantially equal to that made available to AT&T. The so-called "premium" access available to AT&T is characterized by the ability to reach the carrier by dialing 1 plus an area code and appropriate seven digit number. In addition, the premium access provides the interexchange carrier with a number of other beneficial features such as automatic number identification and ability to use rotary dialed telephones. Although there was much argument on the record and in brief regarding the relative importance of these features and the reasonableness of the current discount (approximately 50 percent), we find the arguments of MCI and Sprint most persuasive. PNB's argument that it is rapidly switching over its offices to provide equal access and since a nonpremium discount remains in place for traffic sensitive calling the total cost to the IECs is approximately $80,000 begs the question. If the IECs are really receiving $80,000 less in value, why should they pay that amount to PNB or anyone else? Moreover, PNB is not the only telephone company in the state of Washington. Independent companies do not have the same time-table for converting to equal access as does PNB. In fact, some smaller independent company central offices may never have to provide equal access and MCI and Sprint as well as other carriers and resellers will indefinitely be burdened by inferior access to the local network. Therefore, it is outrageous to contend that they should pay an equal access charge for inferior service. The record in this proceeding is not sufficient to make a determination as to whether the current nonpremium discount is a reasonable one. It may well be that a 50 percent discount is excessive. However, for the meantime, the Commission should insist that the present discount for nonpremium access be maintained in both traffic sensitive and non-traffic sensitive tariffs issued pursuant to this order. (It should be noted that the discount should not apply in exchanges where equal access is available but IECs choose not to use it.)

Finally, the ITP must be modified to explicitly recognize that PNB is to be treated like any other IEC. This means that PNB's toll services must account for an access charge equivalent contribution to local exchange services so that PNB and its intraLATA competitors can "compete on a level playing field". PNB should not be allowed to pass on to nontoll customers those toll costs which PNB's competitors must reflect in their toll rates. To do otherwise would discourage competition in derogation of the legislative mandate contained in Chapter 450, Laws of 1985 (The Regulatory Flexibility Act).

To the extent that any of these modifications require refinement over time, STAC is charged with the responsibility to present these needed refinements (via the WUTC staff representative) to the Commission for consideration and approval or disapproval. In this way, STAC will become a self-steering device which, with the Commission's approval, will adjust the industry's course in the changing winds of telecommunications.

LEVEL OF ACCESS CHARGE

The previous discussion of various plans for imposing an access charge alluded in part to the goal of preventing bypass. The concept of bypass is even more critical to the issue of determining the level of access charge which is appropriate. The fundamental question facing the Commission is what is the appropriate contribution which can be expected from toll carriers to defray the costs of maintaining a local telephone distribution system. Related to this question is the issue of how high an access charge can be maintained without forcing these carriers and the customers they serve to seek ways of avoiding the use of or the contribution to the local exchange network. This leads us again to the question of "bypass".

LOWERING THE ACCESS CHARGE

To the extent that large volume toll users can obtain access to a toll carrier at a cost lower than the current access charge, there is an obvious incentive to do so. The FCC has recently recognized that it is particularly convenient and economical to avoid switched access on the initiating end of a toll call. If the user requires the ubiquitous terminating access unique to the switched network, it will be more difficult to avoid an access charge on the terminating end (see Report and Order CC Docket No. 86-1, released March 21, 1986). The logical response to this characteristic was to lower the charge for initiating access as opposed to terminating access. The secondary advantage to this approach to bypass is that it fits neatly with the notion that cost causers should pay for the cost of access. Arguably, one who receives a call does not bear the same causal relationship

to the costs of that call as the one who initiated the call. If "initiators" are the primary cost causers it is logical that they pay for both initiating and terminating access.

Arguably, if the NTS access charges are reduced (and local rates increased) equally at both ends of a call the party who places the call receives a partial subsidy from the party who receives the call. The FCC method for reducing the NTS access charge will tend to avoid this unnecessary subsidy and is deserving of further consideration for use in this state. Unfortunately, this issue was raised too late in these proceedings to be given full review by the Commission staff or interested parties. Therefore, it is appropriate to tender this issue to Commission staff for further review and presentation to the Commission as may be warranted. In the meantime, adopting the same conservative philosophy expressed in the earlier portion of this order, it is our conclusion that a modest lowering of access charges as proposed by Commission staff is appropriate. We reject the arguments presented by some of the proponents of the industry plan to the effect that toll carriers should make no contribution whatsoever to the cost of maintaining local exchange plant. It is self-evident that the toll carriers want that local exchange plant to exist and they want that plant to be well-maintained and suitable to the various types of transmissions which they wish to complete. It is to the mutual advantage of the toll carriers, the local exchange companies and the public that the local loop be maintained, and where necessary, upgraded and expanded. To this end, toll carriers and the customers they serve should continue to be expected to make a contribution in a reasonable amount not likely to encourage substantial amounts of bypass. The testimony presented in this record supports the proposal presented by Commission staff to set that reasonable amount at a 25 percent gross allocator. We note that the present subscriber plant factor (SPF) of General Telephone Company is approximately 25 percent and the SPF of PNB is approximately 17 percent. Commission staff's alternative proposal that these companies both be allowed to establish their access charges based upon their current SPF is acceptable. This Commission has been presented with no legal or factual justification for allowing PNB to reduce the level of toll contribution below its current SPF. In fact, PNB should, in future cases, bear a strong burden of proof should it seek an increase in local exchange rates without increasing its NTS access charges. The staff's proposed eight-year "phase-up" of PNB's SPF to a 25 percent gross allocator should not be imposed until after the ITP has been in place for at least a year. Then, upon the filing of a general rate case or upon a complaint duly filed by the Commission or another proper party complainant, the appropriate NTS gross allocator for PNB should be reconsidered.

BILLING AND COLLECTION CHARGES

Included in the ITP is a provision providing LECs the option of providing billing and collection services for long distance carriers under contract or under WUTC approved tariff. The proposed plan does not address the issue of an appropriate level for billing and collection. In its original complaint, AT&T had argued that there was no justification for setting billing and collection rates at levels above those approved by the FCC (see testimony of John F. Sumpter, Exhibit T-19, page 15). We find this testimony unrefuted in the record, and therefore conclude that each LEC should by approved WUTC tariff establish a billing and collection charge no greater than that set forth in applicable FCC tariffs. The ITP should be modified accordingly.

AT&T REVENUE REQUIREMENT

Much was said in this record regarding the present revenue deficiency of AT&T. AT&T argues that even with the additional revenues derived from recent rate increases approved by the Commission, AT&T has an intrastate revenue deficiency of approximately $16 million. The Commission staff disputes the calculation of the $16 million figure but concedes that AT&T has a revenue shortfall of $10.2 million per year.

This controversy is relevant only to the question of whether AT&T's access costs should be lower. If we assume, arguendo, that AT&T needs $16 million more per year, AT&T can either lower its costs, raise its rates, do both, or suffer a shortfall. Since access costs are the primary operating cost of AT&T, and since AT&T would hope to avoid raising rates in the face of competition and bypass threats, it logically follows that AT&T would like to lower its access costs.

This order has already endorsed a reduction in the NTS revenue requirement of numerous small companies with a transition amount of $2 per line per month. AT&T's main provider of access, however, is PNB and we have found that PNB's NTS revenue requirement should <u>not</u> be reduced and in the future may need to be <u>increased</u>. It follows that the ITP as modified will not satisfy even the agreed revenue need of $10.2 million. Since a resolution of the dispute between the $16 million figure and the $10.2 million figure is not necessary to this decision, it should be deferred until such time as AT&T seeks rate relief. At such time, AT&T's needs may be greater or less than they are now and the public will have a better opportunity to observe the rate setting process in its proper context.

SUMMARY

The undersigned proposes that the Commission, upon a review of all the evidence and legal arguments, determine as follows:

1. The present system of intrastate toll settlements is unreasonable in the telecommunications industry as it now exists and must be replaced.

2. The division of revenues from jointly provided toll services should be based upon nondiscriminatory traffic sensitive and non-traffic sensitive access charges.

3. There is no sound reason for distinguishing between the intrastate access charges for interLATA and intraLATA calls.

4. The need to avoid encouraging bypass does not justify resort to a largely bulk-billed method of assessing access charges. The method now employed which is based on minutes of use has been satisfactory and should be emphasized at this time. Further study of the current FCC approach (weighted toward terminating minutes) is warranted.

5. The cost of access should bear a reasonable relationship to the quality of access. It follows that where equal access is not available a differential for nonpremium access should be retained in both the traffic sensitive and non-traffic sensitive access charges.

6. The concept of nondiscriminatory access charges requires that LECs who engage in the interexchange toll business charge the toll portion of their business with an access charge equal to the charge assessed to other interexchange carriers.

7. The allocation of NTS costs to intrastate toll, interstate toll, and local exchange is not susceptible to a scientific formula. It is inevitable that an arbitrary division must be made. The staff's suggestion to use a gross allocator of 25 percent (25 percent intrastate toll, 25 percent interstate toll and 50 percent local exchange) for determining the intrastate access charge for each LEC is at least as appropriate as any other proposal. Recognizing that PNB now has a subscriber plant factor (SPF) of approximately 17 percent, staff suggested that this level of allocation may be retained at least on a temporary basis. This is acceptable, however, the allocation should be reviewed by the Commission staff for adjustment if appropriate after the provisions of this order have been in effect for one year.

8. Billing and collection charges should reflect their costs and will be deemed reasonable if they mirror those charges approved by the FCC.

9. The proposed reductions in access charges/billing and collection will reduce revenues for LECs in varying amounts. This record is inadequate to determine the extent of any revenue deficiency which will be experienced by specific LECs. Therefore, the proposed tariff revisions must be rejected in their entirety. Each company may refile specific tariffs consistent with this order. After said tariffs and supporting documents are reviewed by the Commission staff, the tariffs may become effective by operation of law if not suspended by this Commission. The effective date of the provisions of this order should provide enough time for each company to file appropriate tariffs to coincide with the implementation of the access charges authorized herein.

10. With the modifications identified in the body of this order, the ITP should be adopted.

11. Due to the nature of this order, it will not be necessary to address the question of AT&T's alleged revenue deficiency. The Commission should address that issue in a separate proceeding if it is necessary.

12. To provide some direction for these refilings, the Commission should address the volume discount proposals of PNB. The concept of volume discounts is rational, consistent with the development of competition in this state, and can be nondiscriminatory if properly designed. It would appear that the requirement of this order, that PNB bill itself for access in the same manner it bills its competitors, will require PNB to reconsider its proposed volume discount plans. The Commission will have a better opportunity to examine the volume discount proposals when and if they are re-filed.

13. Universal service. The judgments which have been made in this case were to a large extent driven by a commitment to preserve universal service. This commitment is shared by the Legislature as shown in the Washington Regulatory Flexibility Act. We believe that the federal regulators also share this commitment although many may disagree as to their methods for achieving the goal. For what its worth, the goal appears to be secure. Recent data on the lack of "consumer drop off" from the network are promising. The statistics referenced in Exhibit T-149 at page 6 show telephone penetration rates up 1.8 percent to 95.3 percent as of November 1985 in spite of recent rate increases. This decision will avoid the proposed $4.00 per month rate increase for many of the customers who would be least able to afford such

an increase. We recognize that a telephone is a vital link to the world and many impoverished people would sacrifice comfort or nutrition to keep that telephone. We also recognize that this order will probably cause some local rate increases in high cost areas. The Universal Service Fund of the ITP will ameliorate this impact. We hope any increases will be relatively small. The Commission will monitor the local rate increases for reasonableness. As to those individuals who actually suffer from the impact of rate increases brought about by this order, the Commission can work with the Legislature and other interested parties to design an appropriate "lifeline" program for low-income consumers in the state of Washington.

PUBLIC TESTIMONY

The Commission held hearings at four locations (Seattle, Everett, Richland, and Yakima) to receive public comment regarding this case. Representatives from business, government, community service organizations, and private citizens offered valuable information about the importance of both local and toll services to the citizens of this state. A total of 53 public witnesses appeared and written statements from many more individuals were added to the record in exhibit form. Without reciting all of this input, it is sufficient to note that there are many citizens who have already experienced hardships from increased costs of telephone service, a service which is a necessity for many. Their concerns were well expressed and perhaps the testimony of Representative Seth Armstrong of Seattle speaks for a majority of those who spoke.

> There has never been a documentation that the local ratepayer is not paying his and her fair share of the cost. That has been requested innumerable times from the industry and has never been forthcoming.
>
> If you are concerned about this undocumented phantom (bypass) then I would hope that the Commission would address the issue by rate design change. Imposition of this access charge would, I believe, reap the whirlwind. It is so unjust and so undocumented that the Legislature will reverse it. (TR 2318)

The public testimony exhorts the Commission to place a heavy burden on the proponents to justify a shift of costs from toll to local services. By this order, the Commission has responded accordingly.

Having generally discussed the evidence of record and having made preliminary findings and conclusions, the following specific Findings of Fact and Conclusions of Law are entered.

FINDINGS OF FACT

1. The complaining companies and the respondent companies as previously identified are telecommunications companies doing business in the state of Washington.

2. Said companies are engaged in (among other things) the joint provision of long distance telecommunications services in the state of Washington within and/or between local access and transport areas as defined by RCW 80.04.010.

3. The Washington Utilities and Transportation Commission is an agency of the state of Washington, charged by statute with the duty to regulate telecommunications companies in this state in the public interest. The Commission has the authority to require telecommunications companies to provide toll services jointly and may establish a reasonable division of reasonable "joint rates" under RCW 80.36.160.

4. The industry compensation structure for jointly provided toll services must be changed to conform to the requirements of a competitive intrastate (interLATA and intraLATA) telecommunications industry. The proposal in the IntraLATA Telecommunications Plan (ITP) to replace the existing settlements contracts with a system based on the use of tariffed access charges applied in a nondiscriminatory manner to all intrastate toll carriers meets these requirements. Modifications of some of the provisions of the ITP and addition of some provisions as detailed herein will reduce the anti-competitive potentials of the ITP as submitted and provide an administrative mechanism to fine-tune the plan.

5. The proposal to transfer $4 per access line per month over a two-year period from NTS revenue requirement to local would have the effect of reducing the toll supported intrastate NTS revenue requirement of the state's largest local exchange company (PNB) to less than 2 percent.

6. The availability of the local loop to interexchange companies is an asset equal in value to interstate carriers as it is to intrastate carriers. An allocation of NTS costs 50 percent to local exchange, 25 percent to interstate toll, and 25 percent to intrastate toll, as proposed by Commission staff is reasonable.

7. The public interest does not require that companies which now have a Subscriber Plant Factor (SPF) below 25 percent (GTNW, PNB, and Asotin Telephone Company) be required to transition up to 25 percent at this time.

8. The annual transition amount of $2 per access line per month noted in the ITP is a reasonable phase in mechanism for companies whose intrastate SPF now exceeds 25 percent.

9. The threat of bypass in this state is not so imminent as to require the substantial NTS cost shift proposed by the ITP. Neither does the threat of bypass require an emphasis on bulk-billing of access charges. The moderate NTS shifts and bulk-billing features of the modified ITP will be sufficient to address current conditions and may, upon a demonstration of public interest, be adjusted to meet future needs.

10. The 75 percent bulk-billed element of the ITP is excessive and a potential threat to competition. This threat will be minimized by lowering the proportion of bulk-billing to 25 percent. The usage-based element will then represent 75 percent of the total NTS access charge.

11. To be applied on a nondiscriminatory basis, access charges must be applied to all interexchange carriers (IECs) uniformly. This requires modification of the ITP to explicitly provide for companies such as PNB which provide both exchange and toll services to account for an access charge payable by the toll services accounts to the local exchange accounts.

12. To avoid unfair and anti-competitive impacts on new IECs, a nonpremium discount mirroring that approved by the FCC must be incorporated into the ITP. The nonpremium discount must apply to both the bulk-billed and the usage-based elements of the access charge. The discount should not be available to IECs which choose nonequal access when equal access is available.

13. Due to the substantial modifications to the ITP recited above, the revenue impacts on the LECs will vary. Therefore, tariffs filed herein are not supported by this record and have not been shown by a preponderance of the evidence to be fair, just and reasonable. If refiled in a manner consistent with the guidelines of this order, tariffs will be fair, just and reasonable.

14. Toll rate reductions of PNB, likewise, are based upon the proposed ITP and are not supported by the record given the modifications to the ITP required by this order.

15. The concept of volume discounts to customers who are potential "uneconomic bypassers" has merit and is not inherently discriminatory. The use of such discounts to discourage uneconomic bypass is worthy of consideration.

16. If those LECs who shift NTS costs under the ITP as modified herein reduce access charges accordingly, the result should be no net increase or decrease in revenues to the LEC.

17. The moderate cost shifts incorporated in this order when further modified by the Universal Service Fund of the ITP will not be inconsistent with the state policy of fostering universal service.

18. The ITP proposal for transition to intrastate traffic sensitive charges is fair, just and reasonable.

19. The provision of the ITP applicable to billing and collection charges as modified herein are fair, just, reasonable, and consistent with Commission policy.

20. As part of the ITP, PNB will continue to serve in its present role as the designated carrier of intraLATA toll among its own exchanges, among its exchanges and those of the other local exchange companies, and among the exchanges of the other local exchange companies, and to continue to serve as "carrier of last resort" for intraLATA toll customers not served by other intraLATA carriers. These roles do not preclude other carriers from the intraLATA toll market, or preclude the other local exchange companies from becoming the carrier of toll traffic to or from their exchanges. As designated carrier, PNB will file intraLATA toll tariffs in which other local exchange companies may, but are not obligated, to concur. These responsibilities of PNB under the terms of the ITP as modified are in the public interest and are not anti-competitive.

21. The cost savings to AT&T from the ITP as modified are not quantified in this record, but are clearly less than the AT&T intrastate revenue deficiency as evidenced by this record. Therefore, the Commission need not resolve the dispute between AT&T and Commission staff as to whether the deficiency is $10.2 million or $16 million. To resolve this dispute now might disadvantage interested parties in subsequent proceedings. The Commission should, therefore, defer a decision on AT&T's revenue requirement at this time.

22. To implement the ITP will require an ongoing administrative body to gather data, determine market shares, and distribute pooled funds. To leave these responsibilities in the hands of an interested party is inappropriate. Therefore a State

Toll Administrative Committee must be created as detailed in the body of this order.

23. The pleadings raise additional issues of discrimination among the parties, however, specific evidence of discriminatory activity has not been presented and said allegations must be deemed abandoned.

24. Although a proposed order is not required in this case, the Commission deems it advisable to receive comment prior to implementing a plan with far-reaching consequences. To allow optimum opportunity for such comment a 30-day exception period and an additional 10 days for replies to exceptions is appropriate.

CONCLUSIONS OF LAW

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

2. The ITP as modified in the body of this order conforms to the guidelines of RCW 80.36.160 and provides a reasonable arrangement for the sharing of revenues and expenses related to jointly provided intrastate toll services.

3. All tariffs filed herein are without sufficient evidentiary support upon which to base a conclusion of reasonableness. Each should be rejected, revised, and refiled in a manner consistent with the ITP as modified.

4. All matters raised by the pleadings not specifically addressed in this order lack evidentiary support and are deemed abandoned.

5. All rulings on evidence and procedure made in the course of this proceeding are affirmed.

6. The parties are asked to file exceptions to this proposed order and the time limits for filing initial exception is extended to 30 days, replies to be filed within 10 days thereafter. Otherwise, the filing of exceptions should be governed by the provisions of WAC 480-08-230.

Wherefore having made the above proposed Findings of Fact and Conclusions of Law the following proposed order is entered.

O R D E R

1. The intraLATA telecommunications plan (ITP) as modified in the body of this order is hereby approved and adopted as the procedure for implementing the revisions of RCW 80.36.160.

2. All tariffs filed in this consolidated cause are hereby rejected in their entirety, subject to being refiled if appropriate in a manner consistent with the ITP as modified.

3. Except as specifically addressed in the ITP, as modified herein, all complaints and petitions in this consolidated proceeding are hereby dismissed and/or rejected.

4. All rulings on evidence and procedure made in the course of this proceeding are affirmed.

5. All parties are asked to file exceptions to this proposed order, and the time limit for filing exceptions is extended to 30 days; replies to be filed within 10 days thereafter. Otherwise the provisions of WAC 480-08-230 shall apply.

DATED at Olympia, Washington and effective this 22nd day of September, 1986.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Ernest A. Heller

ERNEST A. HELLER
Presiding Administrative
Law Judge
(now Regulatory Affairs
Administrator)