Finding the Balance in State Long Distance Regulation

As you are all aware, one of the results of the divestiture was to divide the United States into Local Access and Transport Areas or LATAs. The control of inter and intra LATA calls which were wholly intrastate was placed within the purview of the state regulatory bodies. Since then, the handling of these calls has been a source of controversy. Telephone companies which fail to resolve LATA cases to their satisfaction, will blame the LATA system and attack it as being arbitrary, nonsensical and unsuitable. The only portion of the Court's LATA decision that has not been subjected to a large scale assault by the telephone companies is Judge Greene's remark that lack of competition in the intra-LATA market would not be tolerable. This somewhat casual comment by a Federal judge has become a sword held over the heads of state regulators, reinforced by the threat that the FCC may be called in to exert less gentle persuasion. However, the states have repeatedly denied competition on an intra-LATA basis and the federal governement has not intervened. According to a NARUC study in November of 1984, only 8 states allowed intra-LATA competition (Florida, Iowa, Maryland, Montana, New York, Texas, Washington and Wyoming).

A recent opinion which denied competition on an intra-LATA basis was issued by the state of Michigan on May 9, 1985. MCI and Sprint had filed a petition to provide intrastate exchange service on both an inter and intraLATA basis.

MCI argued that the LATAs were "artificial" and did "not represent appropriate technical or economic boundaries" for

restricting competition. It was joined by Sprint in its contention that intra-LATA competition was contemplated by Judge Greene and that failure to allow it could result in federal intervention and fragmentation of LATAs. Sprint denied that such competition would increase basic service rates and cause stranded investment, as many had argued. Clark Telecommunications, Inc. (Clark) joined in these arguments, stating that the LATAs did "not provide a reasonable or rational basis for... restricting interexchange carriers".

ATTCOM favored competition in the intraLATA market.

Michigan Bell does not oppose it "if the Commission is prepared to take appropriate action to allow it and other local carriers to compete on full, fair and equal terms.

General Telephone (Gen Tel) took the position that such competition would jeopardize universal service due to "cream-skimming

The ALJ recommended that intraLATA competition be allowed after July 1, 1986 which is the date for the implementation of an intraLATA access charge.

The Commission concluded that "the public interest would not be served" by intraLATA competition at this time. It stated that it had to preserve a monopoly in some area or jeopardize the local telephone system. It held that LATAs provided the only structure to do this. Further, it did not agree with the ALJ that the criteria for such competition should be the implementation of intraLATA access charges or the repricing of toll and local services. These are important but they are not the only items to be considered. Equal access is also a prerequisite to intraLATA competition.

California also did not allow intraLATA competition in a 1984 opinion which arose from a Pacific Bell complaint that MCI, Sprint and Western Union were unlawfully providing intrastate services. ATTCOM, once again, supported intraLATA competition even though it had never applied for authority to provide such service.

The companies offered Texas as proof that such competition would not threaten universal service. According to them, between 1975 and 1979, the OCC market share in Texas rose from 0% to 5%, where it stabilized. During that period, local exchange rates did not change any faster than they did in states in which toll service was not competitive. "The pro-competition camp states that the best way to ensure universal service is to provide any needed subsidy out of general tax revenues or a gross receipts tax on the industry".

The parties opposing intraLATA competition are the local exchange companies, Staff, Toward Utility Rate Normalization (TURN) and San Diego and San Francisco (Cities). These parties contend that intraLATA toll revenues support local exchange costs and that competition would eliminate such support and drive up the cost of basic telephone service.

According to Pacific Bell, the Texas LATA situation is totally different than that in California. Texas local calling areas are enormous and intraLATA toll is relatively insignificant. The support that Pacific Bell provides to local service from IntraLATA toll is more than Texas's total intraLATA revenues. Further, California's local calling areas have deliberately been reduced to preserve low basic exchange rates and intraLATA toll is important to the preservation of basic service. Also, Texas has

experienced a dramatic fall-off in the growth of intrastate toll message.

The opponents also argue that if such competition is allowed, the companies will only offer service over high-density routes and at reduced rates. The local exchange company would have to match those rates or perish. Slashing rates only on selected routes would be the end of the Commission's goal of uniform statewide toll rates.

Further, if intraLATA entry is allowed and the companies undercut intraLATA toll rates, traffic will be diverted to the new companies and the local facilities will be idle. One of the great unknowns is how much of the local plant will be standard.

The California Staff recommended that intraLATA competition be allowed for private line services for the following reasons:

1. Private line revenue is less than 2% of Pacific's total local service revenue. Pacific's toll private line revenue is only 2.3% of post-divestiture revenues, less if access charges are figured in.

2. Such competition would not threaten universal service.

3. Private line users may want to connect to the network and could be charged an access charge.

4. Switched and non-switched services are distinct and can be treated differently.

5. It would encourage advancement in high-speed data transmission.

6. A restriction would be almost impossible to enforce due to the "rusty switch" principle. This is a situation where

a local private line terminates on a switch which would be used to connect to an interstate line. Also, carriers have gotten FCC preemption of such lines even though the line may never handle any interstate traffic. The FCC estimates that at least $\frac{1}{3}$ of the private lines currently under state jurisdiction will be preempted by January 1, 1984.

7. Competition may ease the private line consumer's dissatisfaction with current service.

8. Competition will allow Pacific Bell to remove itself from private line services that are not compensatory.

The purpose of Staff's recommendation is to encourage competitive data transmission facilities. However, it is not possible to allow data transmission while disallowing voice transmission because it is not possible to determine what type of transmission is being made.

Pacific Bell took the position that allowing private lines which interconnect the public network to enter the competitive market would result in bypass. It stated that businesses with substantial toll traffic would shift to private lines and that the result would be the same as allowing wholesale intraLATA competition. IntraLATA toll revenues would go to alternate carriers who had no interest in supporting local service.

The California Commission ruled that "the risks and market uncertainties" were too large to authorize intraLATA competition at this time. However, it found merit in Staff's recommendation to allow such competition for private lines due to the nature of private line services and the fact that such services are a "miniscule" portion of Pacific's revenues. Therefore, the Commission opened

this area to competition which was limited to the provision of high-speed data transmission service. The Commission further noted that the facilities of the local exchange company may not be well suited to the provision of such specialized services.

The denial of intraLATA competition resulted in a larger problem. How to enforce the ban?

In Michigan, the ALJ recommended that MCI and Sprint not be allowed to charge their customers for intraLATA calls. The companies objected on the basis that 1) they could not distinguish intraLATA calls from interLATA calls and 2) not charging for intraLATA calls would only encourage customers to make more of them.

Staff suggested that the companies double-bill such calls and remit the extra funds to the local exchange company whose boundaries had been violated.

The Commission noted that both MCI and Sprint were aware of their inability to distinguish inter and intraLATA calls because the companies had the same problem with interstate and intrastate calls. Yet, the companies do not attempt to discourage customers from making unauthorized calls. If directly asked, they will explain what calls are not authorized, but they actually encourage such calls by crediting them towards the companies' volume discounts. The Commission believed that this practice would continue in the intraLATA market.

The Commission rejected the recommendations of both Staff and the ALJ. It felt that Staff's idea would penalize the customer

without regard to whether the unauthorized call was knowingly placed. Further, both recommendations would be difficult to enforce and unauthorized intraLATA calls would not be a problem after the implementation of equal access. This is true because equal access would allow the local company to automatically prevent such calls.

Therefore, the Commission ordered that MCI and Sprint shall not advertise the availability of intraLATA service, shall not quote rates for intraLATA calls, and shall develop literature for distribution which clearly explains that the companies are not allowed to provide intraLATA service. The language used should be so plain that the customer will know what an intraLATA call is.

In California, Pacific Bell suggested that the prohibition against intraLATA service be enforced by requiring the companies to "block" intraLATA calls. Cities suggested that the equivalent of blocking could be achieved through rate structures. The Commission could require that OCC rates be equal or higher than Pacific's rates. In addition, the OCC would be required to advertise this fact. Another solution would be that the revenues collected from unauthorized calls could be used to support universal service.

The Commission found that implementing blocking would require considerable resources and time. Further, the OCCs argued that blocking could be easily evaded. MCI stated that a person who wanted to avoid blocking did not need to be clever. All one needed was a "PBX sitting in a closet". Further, there was a strong possibiltiy that authorized calls would be accidently blocked. Nevertheless, the Commission ordered that blocking be instituted coincident with

equal access. Further, the OCCs shall not advertise the availability of intraLATA service and must inform their customers that intraLATA calls are strictly prohibited.

Other problems faced by the states are whether the OCCs will be required to provide service statewide and the extent to which they are regulated.

When Sprint and MCI sought permission to do business in Michigan, they requested that the state Commission "streamline" its regulation. The companies wanted flexible tariffs which specified a range of minimum and maximum rates and a schedule of actual rates which was tied to the federal tariffs. Sprint argued that nondominant carriers should be permitted to vary their rates, within the specified limits, upon one day's notice. Any modifications to the minimum and maximum rates should be presumed valid and should automatically become effective 14 days after filing unless the Commission acted. MCI supported these arguments.

The Staff recommended that rates be specific and approved by the Commission. Any changes would be effective 30 days after filing, unless the Commission acted.

Clark argued that the Commission should exercise limited regulation of MCI and Sprint. The companies should not be subjected to traditional rate of return regulation, should be allowed to file tariffs which are presumed lawful, and should be allowed to implement the rates after a minimal notice period.

ATTCOM maintains that MCI and Sprint should be afforded reduced

regulation not because they have any particular set of competitive advantages or disadvantages and not because of the characteristics of any of their competitors, but because the market permits easy entry. According to ATTCOM, reduced regulation should be afforded to all competitors, including ATTCOM. It maintains that all interexchange carriers should be relieved from many aspects of traditional telephone regulation, especially rate of return.

The ALJ concluded that reduced regulation was appropriate because the market would be competitive. He also found that:

1. Traditional rate of return regulation was not necessary.

2. MCI and Sprint's proposed rates were reasonable and should be adopted.

3. There was no reason why MCI and Sprint could not adjust their rates as they saw fit. However, rate increases could not be implemented without a hearing. Even so, the companies should be allowed to extend their geographic areas, offer new services, and establish initial rates without Commission approval. Further, MCI and Sprint should be permitted to discontinue service on 30 days notice.

4. MCI and Sprint need not keep their book and records according to the Uniform System of Accounts.

5. The Commission has no interest in MCI's and Sprint's depreciation procedures.

6. Quality of service need not be regulated.

The Commission found that, due to the competitive market, traditional regulation of MCI and Sprint would not be necessary.

all access charge revenues, including all NTS and TS elements, should be pooled for at least 2 years. At that time, the Commission would consider voluntary pooling of TS elements. The ALJ stated that intra-LATA access charge revenues should be pooled regardless of the companies involved in a particular call, but the portion related to transmission should not be included.

Objections to these recommendations focused on three issues:

1) Sprint's argument that the subscriber access line rate should be de-averaged by exchange area.

2) Rochester Telephone's proposal to remove itself from the pool and file its own carrier access service tariff for traffic originating and terminating in the Rochester LATA.

3) recommendations that transmission revenues not be included in the pool.

The real issue focuses on the portion of the toll calling burden inherent in NTS connection costs assigned to toll. In other words, the importance of de-averaging lies mainly in the redistribution of NTS cost responsibility and, considering the examiner's recommendation that NTS costs gradually be removed from access charges, whether the public interest requires subscribers in high cost areas to bear the full responsibility for their expensive connections. The Commission found that this issue warranted further consideration and declined to make any findings.

The examiner recommended rejection of Staff's proposal that all intraLATA toll revenues be pooled because he found it "undesirable" to intermingle toll transmission revenues with accesss revenues.

He recommended that only the access portion be pooled. This would be difficult to implement mainly because the distinction between transmission revenues and transport revenues is not clear. Therefore, the Commission modified the recommendation to include transmission revenues as well as the access charge portion of intraLATA toll revenues in the pool.

The Florida Commission rejected pooling in favor of "Bill and Keep" because it believed that the latter provided greater incentives for efficiency.

Southern Bell submitted a proposal for bill and keep known as the "end office responsibility plan". Under this plan the LEC providing access service bills the IXC. All elements except the transport element are retained by the LEC. The transport element is shared with other participating LECs based on relative investment in transport facilities.

Others proposed a "meet-point billing" approach in which the LEC billed the IXC directly for whatever portion of its services the IXC uses.

The Commission adopted a modified form of Southern Bell's plan. The LECs would divide the revenues from the transport element on the basis of minutes of use, not the amount of the company's investment in transport facilities. The Commission characterized this as "rough justice", but stated that it was appropriate until the LECs developed a contract on the splitting of this element.

Since the implementation of bill and keep would impact local rates, the Commission decided to increase the fees for directory

assistance and coin telephones in order to compensate for any shortfall. Therefore, an end user charge of .25¢ will apply to each local directory assistance call which exceeds the monthly allowance of 3 calls with 2 calls per request. Each long distance directory assistance call would be .25¢. The coin telephone rate increased from 10¢ to 25¢.

If there is still a revenue deficiency, basic exchange rates would be increased up to maximum representing the weighted statewide average rate for R1 Service. If a shortfall still remains, then a statewide subsidy pool will be developed. The basic policy is to keep the companies in the same financial position they were in prior to bill and keep.

As to the charge for directory assistance, an inquiry was made whether toll matching should continue. Toll matching is a provision in some tariffs whereby a customer can make a long distance directory assistance call in addition to their allowed number of free calls, without being charged. This is because the LEC matched the toll directory assistance call with any toll call the customer made within the same billing period.

The Commission accepted the reasoning of Southern Bell and ATTCOM that competition makes it unreasonable to assume that a request for a long distance number over a carrier's facilities will result in a toll call for that carrier. Thus, toll matching was discontinued.

The final problem is whether a local company may terminate local usage solely due to the customer's failure to pay his/her long distance bill.

The Florida Commission believed that granting LEC's disconnect authority would reduce the bad debts for toll charges and, thus, would benefit all subscribers.

An LEC was granted disconnect authority only if it provided billing services for the IXC. It was not necessary that the LEC own the IXC's accounts receivable.

Any partial payment received would first be applied to local service. If the customer has more than one IXC, the partial payments shall be applied to each IXC on a prorated basis which coincides with that IXC's percentage of the total bill.