

PREPARED REMARKS OF  
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PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA

FOR

14-EAST TEC CONFERENCE  
WINTER MEETING OF THE  
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS  
FEBRUARY 27, 1989, 9:00 AM TO 12:30 PM

"CHARTING A NEW ROLE FOR  
STATE REGULATION IN TELECOMMUNICATIONS"

INTRODUCTION

GOOD MORNING. WELCOME TO OUR CITY. AS YOU ARE ALL AWARE  
THERE ARE A NUMBER OF EXCITING AND INTERESTING ACTIVITIES THAT CAN  
BE EXPERIENCED HERE IN THE DISTRICT OF COLUMBIA. I HOPE YOU WILL  
BE ABLE TO ENJOY THEM WHILE YOU ARE HERE.

THERE ALSO ARE MANY EXCITING AND INTERESTING CHALLENGES FACING  
STATE REGULATORS TODAY. I WOULD LIKE TO TALK TO YOU ABOUT MY VIEW  
OF HOW THESE CHALLENGES ARE CHANGING THE ROLE OF STATE COMMISSIONS.  
AS THE RESULT OF A NUMBER OF DEVELOPMENTS, SUCH AS THE DIVESTITURE  
OF AT&T, THE COMPETITIVE POLICIES OF THE FCC, AND THE EMERGENCE OF  
NEW TECHNOLOGIES, STATE REGULATORS ARE NOW CALLED UPON TO EXAMINE  
COST ISSUES AND COMPETITIVE ISSUES THAT OUR STATE REGULATORY

PREDECESSORS SIMPLY DID NOT HAVE TO FACE. FURTHER, WITH THE EMERGENCE OF THIS "NEW" ENVIRONMENT, STATE REGULATORS ARE NOW FORCED TO ADVOCATE POSITIONS IN FORUMS SUCH AS THE FEDERAL COURTS, THE FEDERAL COMMUNICATIONS COMMISSION, AND THE CONGRESS.

PERSONALLY, I HAVE BEEN HONORED TO BE A COMMISSIONER FOR ALMOST NINE (9) YEARS. LOOKING BACK ON 1980 WHEN I JOINED THE D.C. COMMISSION, I SIMPLY AM AMAZED AT THE CHANGES THAT HAVE OCCURRED. AND, YES, I HAVE CHALLENGED THOSE ADVOCATING THE CHANGES TO PROVE TO ME THAT CHANGE WAS NECESSARY FOR THE WELL BEING OF THE LOCAL D.C. RATEPAYERS. I FIRMLY BELIEVE THAT ACCEPTING CHANGE FOR THE SAKE OF CHANGE IS INAPPROPRIATE. THERE MUST BE SOME PUBLIC BENEFIT RESULTING FROM THE PROPOSED CHANGE.

WHO WOULD HAVE THOUGHT IN 1980 THAT STATE COMMISSIONERS WOULD BE INVESTIGATING THE RELATIVE VIRTUES OF COMPETITION. WHO WOULD HAVE THOUGHT THAT STATE COMMISSIONERS WOULD BE FACING, AND UNDERSTANDING, SUCH ACRONYMS AS "ISDN," "ONA," "MFJ," "SLCs," "LANs," AND "SS-7." NOT ONLY HAS THE LANGUAGE CHANGED, THE

LANDSCAPE HAS CHANGED AS WELL. WE NOW HEAR FROM "ESPs" AND "OSPs," IN ADDITION TO EQUIPMENT MANUFACTURERS, NETWORK SERVICE PROVIDERS, AND, OF COURSE, THE TELEPHONE COMPANIES WHICH WE HAVE TRADITIONALLY REGULATED.

I DO NOT NEED TO BELABOR THE POINT. THE REGULATORY ENVIRONMENT HAS UNDERGONE A DRASTIC TRANSFORMATION AND AS A RESULT SO HAVE OUR RESPONSIBILITIES. I WOULD LIKE TO DISCUSS WITH YOU THREE AREAS I VIEW TO BE OF GREAT IMPORTANCE TO WE REGULATORS IN THE NEW REGULATORY ENVIRONMENT: (1) COST ALLOCATION; (2) COMPETITION AND ANTI-TRUST; AND (3) THE ROLE OF THE STATE REGULATOR VIS A VIS THE FEDERAL GOVERNMENT -- THE FCC, THE COURTS, AND THE CONGRESS.

#### COST ALLOCATION

ONE OF THE MOST SIGNIFICANT NEW ISSUES WHICH STATE COMMISSIONS, INCLUDING THE D.C. COMMISSION, MUST NOW FACE IS THE NEED TO DEVISE METHODS OF ALLOCATING COSTS AMONG INTRASTATE SERVICES. THE REASON WHY I FEEL THAT THIS IS SUCH AN IMPORTANT

ISSUE IS THE EMERGENCE OF SO-CALLED COMPETITION FACING THE COMPANIES WHICH WE HAVE TRADITIONALLY REGULATED. A BYPRODUCT OF THIS "COMPETITION" IS THE PRESSURES PLACED ON THE COMPANIES TO USE THEIR EXISTING PLANT IN NEW AND, POSSIBLY, INNOVATIVE WAYS -- WAYS WHICH MAY NOT BE CONSIDERED WITHIN THE AMBIT OF THE PROVISION OF LOCAL SERVICE. TO THE EXTENT THAT THESE SERVICES USE EXISTING PLANT BUT WHOSE COSTS ARE DECIDED NOT TO BE RECOVERABLE FROM THE "CAPTIVE" RATEPAYER, SOME METHOD OF COST ALLOCATION MUST BE DERIVED.

IN THE PAST, TELEPHONE COMPANIES PROVIDED A BASIC TELEPHONE SERVICE ALONG WITH EQUIPMENT OFFERINGS AND PRIVATE LINE SERVICES. THESE SERVICES WERE NOT SUBJECT TO COMPETITION NOR DID THEY GENERALLY MAKE USE OF JOINT OR COMMON PLANT. AS A RESULT, ALTHOUGH THE COST OF COMMON PLANT HAD TO BE ALLOCATED BETWEEN INTERSTATE AND INTRASTATE JURISDICTIONS, THE PROCEDURES USED TO ALLOCATE INTRASTATE COSTS AMONG RATE ELEMENTS WERE FAIRLY STRAIGHT FORWARD. TELEPHONE COMPANIES FILED STUDIES SHOWING THE COMPANIES' TOTAL

EMBEDDED COSTS, SEGREGATED INTO BROAD CATEGORIES OF SERVICE. THE COMMISSIONS WOULD AUDIT THE TOTAL COSTS TO DETERMINE WHETHER THEY WERE ACCURATE, COMPARED ONE YEAR'S COSTS WITH PAST YEARS' COSTS, AND DETERMINED WHETHER THE REVENUES FROM AN ENTIRE CATEGORY, E.G., PRIVATE LINE, EXCEEDED ITS EMBEDDED COSTS. THERE WERE JOINT COSTS ASSOCIATED WITH PLANT USED TO PROVIDE MORE THAN ONE SERVICE, FOR EXAMPLE, THE USE OF SWITCHES TO PROVIDE BOTH BASIC AND CENTREX SERVICES. HOWEVER, SINCE NEITHER SERVICE WAS SUBJECT TO COMPETITION, THESE JOINT COSTS COULD BE ALLOCATED BASED ON HISTORICAL USAGE.

HOWEVER, SINCE THE DIVESTITURE OF THE BELL SYSTEM COMPANIES FROM AT&T AND THE FCC'S COMPUTER III DECISION, THERE HAVE BEEN A NUMBER OF NEW SERVICES OFFERED BY THE TELEPHONE COMPANIES WHICH MAKE USE OF JOINT AND COMMON PLANT, ESPECIALLY COMPUTER-ENHANCED SERVICES. IN ADDITION, THERE IS COMPETITION FROM OTHER ENTITIES BOTH FOR TOLL SERVICE AND FOR COMPUTER-ENHANCED FEATURES, AND THE TELEPHONE COMPANIES HAVE, IN SOME JURISDICTIONS, EVEN BEEN

SUBJECTED TO LIMITED COMPETITION FOR LOCAL SERVICE. THE TELEPHONE COMPANIES ARE PROMISING EVEN MORE SERVICES AND FEATURES BASED ON NEW TECHNOLOGIES. AS A RESULT, NEW COST ALLOCATION METHODS ARE REQUIRED TO PERFORM FUNCTIONS THAT WERE NEVER PREVIOUSLY REQUIRED. THESE METHODS MUST BE ADEQUATE TO PREVENT TELEPHONE COMPANIES FROM ACTING IN AN ANTI-COMPETITIVE MANNER AND TO PREVENT BASIC SERVICE USERS FROM BEING REQUIRED TO SUBSIDIZE COSTLY EXISTING AND NEW COMPETITIVE SERVICES. AT THE SAME TIME, THE METHODS CANNOT BE SO ONEROUS AS TO PREVENT TELEPHONE COMPANIES FROM PROVIDING SERVICES WHICH THEY ARE TECHNICALLY CAPABLE OF PROVIDING AND WHICH THE PUBLIC REQUIRES.

THERE ARE MANY IDEAS OF HOW JOINT COSTS SHOULD BE ALLOCATED. I WOULD LIKE TO DISCUSS THREE COST ALLOCATION METHODS. I WILL CALL THE FIRST METHOD, THE FCC METHOD.

AS A RESULT OF ITS DETERMINATION IN THE COMPUTER III PROCEEDING THAT THE TELEPHONE COMPANIES SHOULD BE PERMITTED TO PROVIDE COMPUTER ENHANCED SERVICES WITHOUT THE NEED FOR STRUCTURAL

SEPARATION, THE FCC INSTITUTED AS YOU KNOW ITS JOINT COST PROCEEDING IN WHICH IT DEvised A METHOD FOR ALLOCATING ALL TELEPHONE COMPANY COSTS BETWEEN REGULATED AND NON-REGULATED SERVICES. ALTHOUGH THE REPORT AND ORDER IN THAT PROCEEDING WAS RELEASED IN EARLY 1987, THE PROCESS OF DEVELOPING A COST METHODOLOGY AND TESTING THAT METHODOLOGY ARE STILL FAR FROM COMPLETE. THE FCC'S REPORT AND ORDER REQUIRED THE TELEPHONE COMPANIES TO FILE COST ALLOCATION MANUALS. THE BELL OPERATING COMPANIES (BOCS) FILED THEIR ORIGINAL MANUALS IN SEPTEMBER 1987. THE FCC HAS REQUIRED THE BOCS TO REVISE THEIR MANUALS AND THE MOST RECENT REVISIONS FILED HAVE NOT YET BEEN ACTED UPON.

AS YOU KNOW, THE FCC'S METHOD OF COST ALLOCATION SPELLED OUT IN ITS PART 64 RULES, IS BASICALLY AN ACCOUNTING METHOD BY WHICH THE COMPANIES' TOTAL ACCOUNTING COSTS ARE ALLOCATED BETWEEN REGULATED AND NON-REGULATED SERVICES BASED ON VARIOUS "COST-CAUSATIVE FACTORS". THESE FACTORS INCLUDE RELATIVE USE OF PLANT AND TIME REPORTING. IN ADDITION, COSTS THAT CANNOT BE ALLOCATED

ON A USAGE BASIS ARE DISTRIBUTED BASED ON THOSE EXPENSES WHICH CAN BE SO ASSIGNED OR ATTRIBUTED. THE MOST SIGNIFICANT EXCEPTION TO THIS FULLY DISTRIBUTED ACCOUNTING COST METHOD IS THAT ALL NETWORK INVESTMENT IS ALLOCATED BASED ON THE TELEPHONE COMPANIES' FORECAST OF USAGE OVER A THREE-YEAR PERIOD. UNDER THE FORECAST, ONCE PLANT IS ALLOCATED TO A NON-REGULATED SERVICE, IT CANNOT BE REALLOCATED UNLESS A WAIVER IS GRANTED; ONCE IT IS ALLOCATED TO A REGULATED SERVICE, IT CAN ONLY BE REALLOCATED AT BOOK VALUE ALONG WITH A PAYMENT OF AN INTEREST CHARGE TO REFLECT THE TIME VALUE OF MONEY. THE PURPOSE OF THE FORECAST WAS TO PREVENT THE COST OF NEW UNREGULATED SERVICES FROM BEING IMPOSED ON REGULATED USERS SIMPLY BECAUSE MOST OF THE INVESTMENT WAS USED BY REGULATED SERVICES IN THE PAST PERIOD. HOWEVER, IT IS NOT CLEAR HOW A SUBSTANTIAL PORTION OF NETWORK INVESTMENT WILL BE TREATED. THE JOINT COST ORDER PROVIDES THAT TARIFFED SERVICES WILL BE CHARGED TO THE CARRIER'S NON-REGULATED SERVICES AT TARIFF RATES. SINCE TARIFFED SERVICES INVOLVE USE OF IMPORTANT COMPONENTS OF NETWORK PLANT, SUCH



AS CABLE AND WIRE FACILITIES AND TRANSMISSION EQUIPMENT, THOSE COMPONENTS ARE DIRECTLY ASSIGNED TO REGULATED SERVICES, INSTEAD OF BEING PROPERLY ALLOCATED BETWEEN REGULATED AND NONREGULATED SERVICES BASED ON SOME FORECASTING METHOD.

THERE ARE SIGNIFICANT REASONS WHY THE FCC'S JOINT COST METHODOLOGY SHOULD BE CLOSELY EXAMINED BY STATE COMMISSIONS PRIOR TO ADOPTING IT TO ALLOCATE COSTS BETWEEN RATE ELEMENTS, OR BETWEEN REGULATED AND NON-REGULATED SERVICES. FIRST, AS STATED ABOVE, MANY UNCERTAINTIES AS TO ITS APPLICATION HAVE YET TO BE RESOLVED BECAUSE OF THE ONGOING PROCESS OF REVIEWING THE MANUALS SUBMITTED BY THE TELEPHONE COMPANIES. SECOND, THE USE OF HISTORICAL DATA AS A BASIS OF ALLOCATING COSTS RUNS THE RISK THAT MOST OF THE HISTORICAL COSTS OF THE COMPANIES WILL BE ALLOCATED TO BASIC SERVICES, EVEN THOUGH THE COMPETITIVE SERVICES MAY GROW IN FUTURE YEARS. THIRD, THE ONLY ASPECT OF THE FCC JOINT COST ORDER WHICH TAKES FORECASTS INTO ACCOUNT MAY NOT BE USED EXTENSIVELY, SINCE IT IS APPLIED TO NETWORK INVESTMENT, MUCH OF WHICH IS DIRECTLY ASSIGNED TO REGULATED

SERVICES. FOURTH, THE USE OF HISTORICAL DATA AVOIDS THE QUESTION OF WHETHER THE COSTS ALLOCATED TO COMPETITIVE SERVICES BEARS ANY RELATIONSHIP TO THE ABILITY OF THE TELEPHONE COMPANIES TO COMPETE IN THOSE MARKETS. OF COURSE, THE FCC COST MANUALS ARE NOT INTENDED TO BE USED TO SET COMPETITIVE RATES; BUT INSTEAD ARE ONLY TO BE USED TO SEPARATE REGULATED FROM NON-REGULATED COSTS. HOWEVER, THE STATE COMMISSIONS CANNOT IGNORE THE COSTS THAT ARE ALLOCATED TO INDIVIDUAL SERVICES IF THESE SERVICES ARE STILL REGULATED. FINALLY, THE FCC INTENDS TO RELY ON POSITIVE CERTIFICATIONS FROM INDEPENDENT AUDITORS, HIRED BY THE TELEPHONE COMPANIES, THAT THE METHODS AND PROCEDURES IMPLEMENTED AND PERFORMED BY THE COMPANIES CONFORM WITH THE OBJECTIVES, APPROACHES, AND PROCEDURES OF THE COST MANUAL. A SIMILAR APPROACH TAKEN BY A STATE COMMISSION, IN MY OPINION, WOULD ALLOW THESE AUDITORS TO MAKE JUDGMENTS AND EVALUATE FORECASTS THAT SHOULD APPROPRIATELY BE DONE BY THE REGULATING AUTHORITIES. ANY STATE COMMISSION WHICH ADOPTS A NEW COST ALLOCATION MANUAL OR USES THE FCC'S MANUAL MUST, THEREFORE, BE

PREPARED TO COMMIT THE RESOURCES NECESSARY TO SECURE SUFFICIENT DATA TO PERFORM ADEQUATE AUDITS AND TO CONDUCT THE COMPLIANCE AUDITS OF EACH TIER 1 OPERATING COMPANY.

THE D.C. COMMISSION HAS YET TO ADOPT PART 64 TYPE RULES. HOWEVER, WE DID ADOPT A DIFFERENT COST ALLOCATION APPROACH TO TRACK COSTS IN CONNECTION WITH CENTREX SERVICE THROUGH AN EMBEDDED COST MANUAL. OVER 40% OF ACCESS LINES IN THE DISTRICT OF COLUMBIA ARE CENTREX LINES. FOR THE DISTRICT OF COLUMBIA, THIS REPRESENTS 32% OF INTRASTATE BUSINESS REVENUES GENERATED BY THE EXISTING TELEPHONE COMPANY. UNTIL RECENTLY, CENTREX HAD A VIRTUAL MONOPOLY ON SYSTEMS IN EXCESS OF 2000 LINES. HOWEVER, IN THE LATE 1970'S AND EARLY 1980'S TECHNOLOGICAL ADVANCES PERMITTED PBX VENDORS TO COMPETE FOR THESE CUSTOMERS. IN ADDITION, THE FCC'S ACCESS CHARGE RULES PLACED CENTREX AT A COMPETITIVE DISADVANTAGE WITH PBXs. IN 1985, THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY (C&P) SUCCESSFULLY ARGUED BEFORE THE COMMISSION THAT CENTREX WAS A DECLINING SERVICE. IN ORDER FOR THE TELEPHONE COMPANY'S CENTREX SERVICE TO BE ABLE TO

COMPETE WITH PBX SERVICE, THE D.C.COMMISSION AUTHORIZED A NUMBER OF NEW APPROACHES SUCH AS RATE STABILITY PLANS AND INDIVIDUAL CASE BASIS CENTREX TARIFFS, AND ALLOWED THE COMPANY TO USE AVOIDABLE COSTS TO PRICE SERVICES.

SUBSEQUENTLY, IN 1987, C&P PRESENTED TO THE D.C. COMMISSION A PLAN TO DEPLOY DIGITAL SWITCHES FOR CENTREX, EITHER IN RESPONSE TO CUSTOMER REQUESTS FOR DIGITAL FACILITIES OR TO ACHIEVE COST SAVINGS. THE D.C. COMMISSION BELIEVED THAT THE DIGITAL SWITCHES DEPLOYED BECAUSE OF THE REQUESTS OF CENTREX CUSTOMERS SHOULD BE PAID FOR BY THOSE CUSTOMERS. MOREOVER, WE WANTED TO MAKE SURE THAT THE ADDITIONAL NETWORK COSTS RESULTING FROM THE DEPLOYMENT WOULD NOT INCREASE THE COSTS OF NON-CENTREX CUSTOMERS.

GIVEN THE IMPORTANCE OF CENTREX REVENUE, THE D.C. COMMISSION HAD TO DETERMINE THE APPROPRIATE TREATMENT OF THE SERVICE, THAT IS, WHETHER TO ADOPT FLEXIBLE REGULATION, DETARIFFING, OR DEREGULATION. THE COMMISSION CONCLUDED THAT IT NEEDED MORE COST INFORMATION FROM THE COMPANY BEFORE WE COULD DECIDE WHETHER OR NOT TO ADOPT ANY OF

THESE ALTERNATIVES. WE ALSO NEEDED A COST STUDY TO DETERMINE WHETHER THERE PRESENTLY EXISTED A REVENUE DEFICIENCY FOR CENTREX, EITHER DIGITAL OR NON-DIGITAL, WHICH SHOULD BE ABSORBED IN PART, OR TOTALLY, BY C&P'S SHAREHOLDERS.

THEREFORE, THE D.C. COMMISSION REQUIRED THAT C&P DEVELOP AN EMBEDDED COST STUDY. THE STUDY HAS TWO SEPARATE SERVICE CATEGORIES FOR CENTREX -- EMBEDDED BASE CENTREX, AND DIGITAL AND ENHANCED CENTREX. THIS WAS TO ENABLE THE COMMISSION TO DISTINGUISH THE PRE-ACCESS CHARGE INSTALLATIONS WHICH WERE POTENTIALLY SUBJECT TO REPLACEMENT BY PBX SYSTEMS FROM THE POST-ACCESS CHARGE SYSTEMS FOR WHICH C&P WOULD BE INVESTING CAPITAL AND ACQUIRING PLANT.

IN THIS STUDY, TOTAL LOOP PLANT WAS TO BE ALLOCATED BASED ON RELATIVE USE, RELATIVE COST (TO THE EXTENT THAT UNIT COSTS MAY VARY ACROSS DIFFERENT CATEGORIES AS A RESULT OF FACTORS SUCH AS LOOP LENGTH, CABLE SIZES, AND OTHER COST-CAUSATIVE FACTORS), AND SPARE CAPACITY (WHICH WOULD BE ALLOCATED BASED ON WHETHER THE DEMAND IS STABLE, DECLINING, OR GROWING). IN ADDITION, CENTREX LOOP COSTS

WERE TO BE ALLOCATED BETWEEN INTERCOM AND EXCHANGE ACCESS SERVICES  
BASED ON A TRUNK EQUIVALENCY FORMULA.

IN THE STUDY, C&P ALSO WAS REQUIRED TO SUPPORT ITS ALLOCATION  
OF CENTRAL OFFICE EQUIPMENT AND JOINT AND COMMON OVERHEAD.  
MOREOVER, THE COMPANY WAS REQUIRED TO INDICATE HOW THE COST OF THE  
EMBEDDED CENTREX BASE HAS BEEN REDUCED AS A RESULT OF  
DISCONNECTION, AND THE COMPANY WAS ALSO REQUIRED TO PRESENT AN  
ALTERNATIVE REALLOCATION PLAN BY WHICH THE RESOURCES (INCLUDING  
SPARES) WHICH ARE NO LONGER NEEDED BY CENTREX MUST REMAIN IN THAT  
CATEGORY UNLESS THEY ARE UTILIZED BY OTHER, IDENTIFIABLE SERVICES.  
ANY SUCH DEPLOYMENT TO OTHER SERVICES HAS TO BE JUSTIFIED ON THE  
GROUNDS THAT THE NEED FOR SUCH PLANT COULD NOT BE MET OUT OF SPARE  
CAPACITY PREVIOUSLY ASSIGNED TO NON-CENTREX SERVICES.

THUS, THE D.C. COMMISSION'S METHOD OF ALLOCATING CENTREX COSTS  
GOES FURTHER THAN DOES THE FCC METHOD. THE EMBEDDED COST STUDY  
WILL DEMONSTRATE WHETHER CENTREX SERVICES ARE BEING CROSS -  
SUBSIDIZED BY BASIC SERVICES. MOREOVER, UNLIKE THE FCC JOINT COST

METHOD, OUR METHOD INCORPORATES, TO A LARGE DEGREE, CHANGES IN DEMAND. IN ADDITION, THE D.C. COMMISSION HAS REQUIRED C&P TO PERFORM AN INCREMENTAL COST STUDY TO DETERMINE THE FLOOR FOR INDIVIDUAL CASE BASIS RATES. OUR INCREMENTAL COST STUDY ENSURES THAT GROWING SERVICES PAY FOR THE ENTIRE COST OF NEW FACILITIES THAT WOULD NOT BE BUILT BUT FOR THE SERVICE, WHILE AT THE SAME TIME PERMITTING NEW SERVICES TO USE EXISTING PLANT WITHOUT INCURRING ADDITIONAL ACCOUNTING COSTS IF ADDITIONAL ACTUAL COSTS WILL NOT BE REQUIRED. WE THINK THAT THIS PROCEDURE BALANCES THE RELEVANT OBJECTIVES INVOLVED.

A THIRD METHOD OF COST ALLOCATION IS WHAT IS KNOWN AS THE "STAND ALONE" METHOD. IT ISOLATES ONE CLASS OF SERVICE IN ORDER TO DETERMINE WHAT ITS COST WOULD BE IF IT WAS THE ONLY SERVICE PROVIDED BY THE COMPANY. IN DEVELOPING THIS METHOD, COSTS ARE ASSIGNED TO THE SERVICES BASED ON THE COST OF PROVIDING THE SERVICE ON A "STAND-ALONE" BASIS, AND COMMON COSTS ARE ALLOCATED BASED ON THE RATIO OF "STAND-ALONE" COSTS TO TOTAL COSTS. ACCORDING TO ITS

SUPPORTERS, THIS METHOD ENSURES THAT NEW PLANT IS CHARGED TO THOSE WHO BENEFIT FROM IT. HOWEVER, THIS METHOD DOES FAIL TO CONSIDER THE EFFECT OF DEMAND ON RATES AND WOULD REQUIRE THAT RATES BE FROZEN EVEN THOUGH THE DEMAND FOR A SERVICE HAD CHANGED. I BELIEVE THAT THE USE OF AN OVERALL METHOD WHICH PLACES LIMITS ON THE MARKET TO AVOID CROSS-SUBSIDIZATION BUT ALLOWS RATES TO BE SET BASED ON MARKET FORCES IS MORE REALISTIC AND PERMITS COMPETITIVE SERVICES TO MAKE A CONTRIBUTION TO USERS OF BASIC SERVICE.

AS THE DISCUSSION HAS INDICATED, THE COST ISSUES NOW FACING STATE COMMISSIONS DEMAND GREAT ATTENTION AND I WOULD URGE THOSE WHO HAVE YET TO ADDRESS THESE PROBLEMS, TO DO SO QUICKLY. LET ME NOW MOVE ON TO ANOTHER AREA, THE REGULATORY CONSEQUENCES OF EMERGING COMPETITION.

#### COMPETITION

STATE COMMISSIONS ARE NOW CONFRONTING THE ISSUE OF "COMPETITION" ON THE STATE LEVEL AND, TO SOME EXTENT, ON THE LOCAL LEVEL. AT LAST COUNT, AT LEAST SEVENTEEN (17) STATES HAVE



INVESTIGATED THIS ISSUE. THE D.C. COMMISSION INITIATED AN INVESTIGATION TO DETERMINE WHETHER THE LARGEST SERVICE PROVIDER IN D.C., THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY, FACES SUFFICIENT COMPETITION TO WARRANT SOME FORM OF RELIEF FROM TRADITIONAL RATE OF RETURN REGULATION. AS PART OF THE INVESTIGATION, THE D.C. COMMISSION STAFF (STAFF) FILED AT THE END OF 1988, A VERY LENGTHY REPORT ON THE DEGREE AND NATURE OF COMPETITION WITHIN THE DISTRICT OF COLUMBIA FOR TELECOMMUNICATIONS SERVICES.

STAFF'S REPORT IS BROKEN DOWN INTO EIGHT (8) CHAPTERS INCLUDING A DISCUSSION OF TECHNOLOGICAL CHANGE IN TELECOMMUNICATIONS WITHIN THE DISTRICT OF COLUMBIA, BYPASS, AND ALTERNATIVE REGULATORY STRUCTURES. STAFF SUGGESTS THAT THE FIRST STEP IN ANY ANALYSIS OF COMPETITION IS TO DEFINE THE TERM "COMPETITION," THE RELEVANT MARKET, AND THE FACTORS TO DETERMINE THE MARKET POWER OF FIRMS WITHIN THAT MARKET. ACCORDING TO THE REPORT, ONCE THIS FRAMEWORK IS DEVELOPED, APPLICATION OF THE

FRAMEWORK TO DETERMINE WHETHER COMPETITION EXISTS WITHIN A GIVEN MARKET CAN THEN BE UNDERTAKEN.

WHILE NOT PASSING ON THE STAFF'S POSITION, STAFF SUGGESTS THAT THE U.S. DEPARTMENT OF JUSTICE MERGER GUIDELINES SHOULD BE USED TO DETERMINE THE RELEVANT PRODUCT MARKET. THE STAFF ALSO SUGGESTS THAT CONCENTRATION SHOULD BE PLACED ON THE SUBSTITUTABILITY AMONG SERVICES, AND ON CRITERIA FOR DETERMINING WHETHER ANTI-COMPETITIVE ACTIVITY EXISTS.

WITH REGARD TO THE CRITERIA FOR DETERMINING SUBSTITUTABILITY OF SERVICES, THE REPORT SUGGESTS AN EXAMINATION OF A NUMBER OF FACTORS. INCLUDED IN THESE FACTORS ARE: (1) THE PERFORMANCE OF AN ELASTICITY OF DEMAND STUDY IN ORDER TO ASSIST THE DRAWING OF APPROPRIATE MARKET BOUNDARIES; (2) AN EXAMINATION OF THE END-USER'S ABILITY TO RECEIVE A FUNCTIONAL, QUALITATIVE, AND CONTRACTUAL EQUIVALENT OF ALTERNATIVE SERVICES; (3) AN EXAMINATION OF THE EASE OF THE END-USER TO ACCESS SUCH SERVICES; AND (4) AN EXAMINATION OF THE FINANCIAL WELL-BEING OF THE ALTERNATIVE SERVICE PROVIDER AS

WELL AS THE EQUIVALENCE OF ITS SYSTEM TO DELIVER THE SERVICES. FINALLY, THE REPORT SUGGESTS THAT, IN LIGHT OF THESE FACTORS, THE APPROPRIATE MARKET BOUNDARIES CAN BE DETERMINED BY ASKING "CAN A 5% INCREASE FOR ALL FIRMS INCLUDED IN THE MARKET BE SUSTAINED WITHOUT FINANCIAL HARM FOR ONE YEAR?"

WITH REGARD TO INVESTIGATING ANTI-COMPETITIVE CRITERIA, THE REPORT SUGGESTS THAT SIX (6) FACTORS BE DEVELOPED TO ASCERTAIN WHETHER ANTI-COMPETITIVE ACTIVITY EXISTS. INCLUDED IN THESE CRITERIA ARE: (1) INTERVIEWS WITH THE VARIOUS MARKET FIRMS IN ORDER TO DEVELOP A "SNAP SHOT" OF THAT COMPANY'S OPERATIONS AND FINANCIAL WELL-BEING; (2) ESTIMATES OF THE CURRENT MARKET SHARE FOR EACH SUCH FIRM; (3) DOCUMENTATION OF PAST AND CURRENT ANTI-COMPETITIVE ACTIVITIES; (4) EXAMINATION OF THE POTENTIAL FOR INCIDENTS OF PRICE DISCRIMINATION AND CROSS-SUBSIDIZATION, AMONG OTHER ANTI-COMPETITIVE ACTIVITIES; (5) EXAMINATION OF ENTRY AND EXIT BARRIERS AND THE EFFECT THESE MAY HAVE ON ANTI-COMPETITIVE ACTIVITIES; AND (6) THE PERFORMANCE OF FORWARD-LOOKING COST STUDIES IN ORDER TO

EVALUATE THE EXTENT OF POSSIBLE CROSS-SUBSIDIZATION, ECONOMIES OF SCALE, AND PRICE DISCRIMINATION.

TODAY'S REGULATORY ENVIRONMENT SEEMS RIPE FOR ECONOMISTS ARGUING THE VARIOUS ECONOMIC THEORIES SURROUNDING MARKETPLACE COMPETITION. BUT AS WE ALL KNOW, "COMPETITION" IS NOT NEW AT THE STATE LEVEL. AS I INDICATED EARLIER, SEVENTEEN (17) STATES ARE OR HAVE ALREADY ANALYZED THE ISSUE. THESE STATES HAVE GENERALLY FOCUSED THEIR ANALYSIS ON SIX (6) FACTORS: SUBSTITUTABILITY OF SERVICES; THE MARKET SHARE OF THE VARIOUS ENTITIES; THE EXISTENCE OF ENTRY BARRIERS; THE ABILITY OF THE COMPANY TO ENGAGE IN ANTI-COMPETITIVE ACTIVITY; THE AFFILIATION BETWEEN THE COMPANIES INVOLVED; AND A CATCH-ALL CATEGORY OF OTHER INDICIA SUCH AS THE UNIQUE CHARACTERISTICS OF THE COMPANY AT ISSUE.

WHAT THIS ALL MEANS FOR THE STATES IS CHANGE -- CHANGE IN TRADITIONAL WAYS OF REGULATORY REVIEW, CHANGE IN MARKET CONDITIONS DUE TO TECHNOLOGICAL CHANGE, CHANGE IN THE AREAS OF EXPERTISE UPON WHICH THE COMMISSIONS WILL NEED TO RELY, AND CHANGE IN STATE

COMMISSION EFFORTS TO PROTECT ALL OF ITS RATEPAYERS FROM SUBSIDIZING THE ENTREPRENEURIAL VENTURES OF THE COMPANIES WE REGULATE. THE D.C. COMMISSION IS CURRENTLY ANALYZING STAFF'S REPORT. NEVERTHELESS, I MENTION THE REPORT AS ILLUSTRATIVE OF THE TYPE OF CONCERNS WHICH EACH STATE COMMISSION MIGHT CONSIDER IN CARRYING OUT ITS REGULATORY MANDATES TO ASSURE THAT SERVICES AND FACILITIES ARE REASONABLY SAFE AND ADEQUATE AND THAT RATES ARE IN ALL RESPECTS JUST, REASONABLE, AND NON-DISCRIMINATORY.

THERE IS ONE LAST ITEM I WOULD LIKE TO MENTION CONCERNING THE ISSUE OF COMPETITION. THE FLIP-SIDE OF COMPETITION, FROM A REGULATORS PERSPECTIVE, ARE ANTI-TRUST CONCERNS. WHEN NEW SERVICE PROVIDERS COME KNOCKING AT YOUR DOORS, AND I PREDICT THAT THEY WILL, ARGUING THAT THEY ARE FALLING PREY TO MARKET TACTICS OF A LARGER SERVICE PROVIDER, OR THAT THE REGULATED COMPANY IS ENGAGING IN PREDATORY PRICING, THEN YOU, AS A STATE REGULATOR, HAVE VENTURED INTO THE ROLE OF ENFORCING ANTI-TRUST LAWS. ANALYZING WHETHER THE DOMINANT FIRM WITHIN A GIVEN MARKET IS USING THAT POSITION UNFAIRLY

TO DRIVE OUT COMPETITION WITHIN THE MARKET POSES VERY INTERESTING AND NOVEL CONCERNS FOR MOST STATE COMMISSIONS. THIS AREA INCREASINGLY WILL BECOME A CHALLENGE TO STATE COMMISSIONS AS COMPETITION FOR SERVICES DEVELOPS.

FEDERAL PARTICIPATION

FINALLY, I WOULD LIKE TO DISCUSS THE CHANGING ENVIRONMENT IN THE CONTEXT OF THE FCC, THE COURTS, AND THE CONGRESS. I KNOW THAT YOU HAVE EXPERIENCE INTERACTING WITH THE VARIOUS BRANCHES OF GOVERNMENT IN YOUR STATES. I WOULD SUGGEST, TO THE EXTENT POSSIBLE, THAT YOU ALSO PARTICIPATE IN THOSE PROCEEDINGS BEFORE THE FCC, THE COURTS, AND THE CONGRESS.

A NUMBER OF STATES HAVE TAKEN AN ACTIVE ROLE BEFORE THE FCC. I BELIEVE THAT IN THOSE CASES WHERE OUR VOICES HAVE BEEN STRONG, SUCH AS IN THE "PRICE CAP" DOCKET, OUR CONCERNS HAVE BEEN, TO SOME DEGREE, ADDRESSED. THERE ARE PRESENTLY A NUMBER OF VERY IMPORTANT MATTERS BEFORE THE FCC WHICH ULTIMATELY WILL AFFECT YOUR JURISDICTION. FOR EXAMPLE, THE FCC'S ONGOING MONITORING DOCKET (CC

DOCKET NO. 87-339), THE FCC'S PRICE CAP DOCKET (CC DOCKET NO. 87-313), SINCE RUMOR HAS IT THAT THE FCC WILL BE ISSUING A FURTHER NOTICE RELATING TO THE APPROPRIATE PRODUCTIVITY FACTOR FOR THE LOCAL EXCHANGE CARRIERS, THE NOTICE OF INQUIRY CONCERNING THE CABLE TELEVISION/TELEPHONE CROSS-OWNERSHIP RESTRICTION (CC DOCKET NO. 87-266), AND, IN GENERAL, COST-RELATED OR COST-ALLOCATION PROCEEDINGS, ESPECIALLY THOSE IN WHICH COMPANIES UNDER YOUR JURISDICTION ARE INVOLVED. FOR EXAMPLE, THE FCC HAS ON-GOING PROCEEDINGS CONCERNING THE PART 64 COST ALLOCATION MANUALS FOR, AMONG OTHERS, EACH OF THE REGIONAL BELL OPERATING COMPANIES. FOR EXAMPLE, FOR BELL ATLANTIC, THE DOCKET IS AAD 7-1671, FOR BELLSOUTH, THE DOCKET IS AAD 7-1677, AND FOR NYNEX, THE DOCKET IS AAD 7-1678. WITH REGARD TO THESE PROCEEDINGS, I WOULD SUGGEST THAT YOUR COMMISSION REQUIRE YOUR REGULATED COMPANIES TO PROVIDE ESTIMATES ON THE IMPACT ON YOUR SPECIFIC JURISDICTION AND THEN REVIEW AND ANALYZE THE RELEVANT DATA TO ASSURE THAT YOUR LOCAL JURISDICTION IS ADEQUATELY PROTECTED.

SIMILAR ENERGIES NEED TO BE FOCUSED BEFORE THE FEDERAL COURTS. THE MFJ PROCEEDING AND THE COURT CASES RELATED TO THE FCC'S ATTEMPTS TO PREEMPT TRADITIONAL STATE REGULATION ALL NEED TO BE ASSESSED IN TERMS OF WHAT IMPACT THOSE DECISIONS WILL HAVE ON THE ABILITY OF YOUR COMMISSION TO REGULATE THE LOCAL UTILITIES. I WOULD SUGGEST TO YOU THAT IT IS IMPORTANT TO ADVOCATE YOUR POSITION, INDEPENDENTLY OR IN CONJUNCTION WITH OTHER STATES.

FINALLY, IT IS VERY IMPORTANT THAT YOU AND YOUR COMMISSION TAKE AN ACTIVE ROLE BEFORE THE CONGRESS. IT IS IMPORTANT TO BE AWARE OF THE PROCEEDINGS ON CAPITOL HILL, TO KNOW YOUR CONGRESSMEN AND SENATORS, AND THE MEMBERS ON THE TELECOMMUNICATIONS AND ENERGY COMMITTEES. WHEN NARUC REQUESTS THAT ACTION LETTERS TO CONGRESS BE SENT, MAKE EVERY EFFORT TO COMPLY WITH THAT REQUEST.

#### CONCLUSION

NEEDLESS TO SAY, OUR JOB IS NOW DIFFERENT THAN THAT WHICH WE UNDERTOOK JUST A VERY FEW SHORT YEARS AGO. HOWEVER, THE NEW ISSUES CONFRONTING US ARE, INDEED, INTERESTING, EXCITING , AND MORE



IMPORTANTLY, THEY ARE CRUCIAL TO THE SURVIVAL OF A VIABLE TELECOMMUNICATIONS NETWORK. I HOPE THAT MY COMMENTS WILL SPUR ADDITIONAL THOUGHT AND DIALOGUE AMONG YOUR COLLEAGUES, AND PROVIDE THE NECESSARY INCENTIVE TO ALLOCATE THE REQUIRED RESOURCES. THE CHANGING REGULATORY ENVIRONMENT WHICH PRESENTS US WITH NEW CHALLENGES, ALSO PRESENTS NEW OPPORTUNITIES. LET US SEIZE THE OPPORTUNITIES AND GO FORWARD TOGETHER.

