

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Investigation into) DOCKET NO. 950813-TL
BellSouth Telecommunications,) ORDER NO. PSC-96-1040-FOF-TL
Inc.'s and ALLTEL Florida,) ISSUED: August 12, 1996
Inc.'s practices for pricing)
campus wiring associated with)
provision of ESSX/CENTREX)
services.)
_____)

The following Commissioners participated in the disposition of this matter:

SUSAN F. CLARK, Chairman
J. TERRY DEASON
JOE GARCIA
JULIA L. JOHNSON
DIANE K. KIESLING

NOTICE OF PROPOSED AGENCY ACTION
ORDER CONCLUDING INVESTIGATION INTO BELLSOUTH
TELECOMMUNICATIONS, INC.'S AND ALLTEL FLORIDA, INC.'S PRACTICES
FOR PRICING CAMPUS WIRING ASSOCIATED WITH PROVISION OF
ESSX/CENTREX SERVICES

BY THE COMMISSION:

NOTICE IS HEREBY GIVEN by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

BACKGROUND

On September 1, 1994, Siemens Rolm Communications Inc. (Rolm) filed a petition and complaint for an expedited proceeding for the immediate termination of the local exchange company (LEC) practice of placing multiple demarcation points on campuses. Rolm, which sells private branch exchange (PBX) equipment to private business and governmental agencies, directly competes with Southern Bell's ESSX and ALLTEL's Centrex services. Both PBX and ESSX/Centrex services provide call routing and management functions enabling an end user to make calls between customer stations within a campus system over the public switched network. Rolm alleged that the LECs, Southern Bell and ALLTEL in particular, had violated Rule 25-4.0345, Florida Administrative Code, by offering to install ESSX/Centrex services using multiple demarcation points in campus situations.

DOCUMENT NUMBER-DATE

08404 AUG 12 96

FPSC-REGISTRATION REPORTING

Through the use of multiple demarcation points, interbuilding wire on campus properties is treated as network wire by the LECs. In contrast, a customer who purchases a PBX system connects to the LEC network at a single demarcation point, and the interbuilding cable is treated as complex inside wire. The customer is then solely responsible for the wiring on the customer's side of the demarcation point, including the wiring between buildings.

The ESSX/Centrex treatment of interbuilding cable arises from how an ESSX/Centrex system is configured. These systems are configured so that all calls from one telephone line to another, including intercom calls, go from the originating station instrument to the serving central office, and then to the terminating station. Network cable may run physically from building to building, but in these instances the cable is used as a pass-through connection from a distant demarcation point to the central office. The network cable does not provide a direct "tie cable" functionality. An ESSX/Centrex call from one building to another on the same campus must traverse the distribution network to the central office, establish a switched connection to the second ESSX/Centrex service line, and traverse the distribution network back to the second building.

In its petition, Rolm also argued that differing accounting treatments for interbuilding wiring in pricing for PBX and ESSX/Centrex services competitively disadvantaged the PBX vendor. The difference in accounting treatment stems from the characterization of the interbuilding wiring. Because of the single demarcation point associated with PBX systems, the interbuilding wiring on the customer's side of the demarcation point is characterized as "inside wire" and deregulated. Thus, the customer is responsible for the investment as well as the associated expense of installation and maintenance of the wiring. On the other hand, the interbuilding wiring associated with ESSX/Centrex services is characterized as "network wiring" and is regulated. Rolm asserted that this characterization places the responsibility of the investment and the expenses associated with installation and maintenance on the general body of ratepayers. Rolm argued that the difference in accounting treatment directly affects its ability to compete with ESSX/Centrex services, because it must charge the PBX customer up front for the interbuilding wiring, hence escalating the overall bid price for the PBX system. In contrast, the LEC enjoys the advantage of recovering interbuilding wiring costs over time in its tariffed ESSX/Centrex rates.

Historically, LEC pricing of competitive services such as ESSX/Centrex has focused on ensuring that the direct costs of

providing the service are recovered in the rates charged. This does not always result in rates being designed that attribute 100% of the cost of a specific investment item (e.g., a distribution cable route from a central office to a facility) to a specific service. Whether or not 100% of such an investment is attributed to a single service depends upon whether that investment is fungible (i.e., reusable). If the investment is not fungible, then 100% of its cost should be attributed to and recovered through rates for the specific service. If the investment is fungible, while a pro rata cost associated with the portion of the investment used should be attributed to the specific service, it is not necessary to ensure recovery of the full cost from the single service. Since by definition the facility has alternative uses, it is not necessary to front load recovery of the investment from a single service. It is only necessary to ensure recovery, in the aggregate, from all services that do or will use it.

In our review of Rule 25-4.0345(1) in response to this complaint, we determined that the rule did not prescribe the location of the demarcation point or points in campus situations, nor did it specifically prohibit the use of multiple demarcation points. On July 19, 1995 in Order No. PSC-95-0879-FOF-TL we found that neither ALLTEL nor Southern Bell had violated the rule. We also ordered that a rulemaking docket be initiated to specify what, if any, additional regulations should be imposed on the LEC in pricing campus wiring, including the location of the demarcation point(s), associated with the provision of ESSX/Centrex. In response to that order, this docket was opened to investigate BellSouth Telecommunications, Inc.'s, d/b/a Southern Bell Telephone and Telegraph Company, and ALLTEL Florida, Inc.'s practices for pricing campus wiring associated with the provision of ESSX/Centrex services.

On July 11, 1995, the Commission's Division of Communications formally extended an Audit Service Request to the Commission's Division of Auditing and Financial Analysis (AFAD). The audit request included the following two primary objectives:

- 1) To determine if directly attributable interbuilding cabling expenses for ESSX/Centrex services, booked to regulated expense accounts, are fully recovered through revenue recognition.
- 2) To determine if Southern Bell and ALLTEL in their pricing of ESSX/Centrex services to customers, maintain consistency in their pricing philosophy from one bid to another. (i.e. use customer specific cost data for one case vs. average cost for another).

The audit service request also directed AFAD specifically to examine contract documents for ESSX/Centrex services provided to state correctional institutions by Southern Bell and ALLTEL. In addition, the request instructed AFAD to compare the services pricing in final contract documents to actual service billings to correctional facilities, as well as to LEC tariffs. Four correctional facilities served by Southern Bell were examined in the investigation: Brevard Correctional; Washington Correctional; Dade Correctional; and Everglades Correctional. ALLTEL, which currently serves one correctional facility, Hamilton Correctional, was also included in the investigation.

The audit was concluded February 15, 1996. In this order we will address the audit findings regarding the recovery of interbuilding cable investment through the tariffed rates charged by Southern Bell and ALLTEL for ESSX/Centrex services, and the companies' pricing practices for the provision of those services.

DECISION

Recovery of Costs

We find that Southern Bell and ALLTEL fully recover their cost of providing ESSX/Centrex services through the rates they charge.

Southern Bell

The Commission audit revealed that Southern Bell's costs for ESSX services are determined using a forward looking, long-run incremental costing methodology. The rationale for using this methodology is that traditional recovery of regulated costs on a fully distributed basis incorporates historical data, thus ignoring downward trends in cost associated with technological efficiency and economies of scale. Also, outside plant records cannot link a specific asset to the offering of a specific service; and thus embedded studies are of little value in evaluating the appropriate prices for services. As a result, where special service arrangements (SSA) were required, the company prepared cost studies to support rates specific to correctional institutions within the State of Florida. Typical contract periods for these institutions run 10 years. Southern Bell has the authority to review the contract every two years.

When special configurations are not required, the prevailing ESSX/Centrex tariff rates apply. Southern Bell billings were obtained for each of the individual correctional institutions. Rates charged to those facilities were compared to tariffed rates and SSA rates. In addition, billing rates were compared to the

cost of provisioning each service component. In only one instance did a non-recurring cost component exceed its billing rate, but further investigation revealed that even in that instance the component's associated recurring charge more than adequately recovered the shortfall.

ALLTEL

Correctional institutions that choose to purchase Centrex services from ALLTEL do so at prevailing tariff rates. ALLTEL stated that its tariffed rates are developed based on a total service approach, rather than on a customer-specific basis. In pricing such services, the estimated cost of providing the service is divided by an estimated demand. Since the forecast for Centrex service includes the demand for the total service offering, cost recovery from one customer may be greater than another; but in the aggregate the tariff rates cover all costs.

Correctional Facility Audit Results

Five correctional facilities were audited in the investigation: Everglades Correctional; Washington Correctional; Brevard Correctional; Dade Correctional; and Hamilton Correctional. Southern Bell serves the first four correctional facilities with ESSX services. Two of those four facilities are newly constructed (Everglades and Washington Correctional), while the other two are change-overs from PBX to ESSX service. The fifth facility, Hamilton Correctional Institution, is served by ALLTEL's Centrex service. The prison is undergoing a four phase construction modification. In the first phase, the "old" correctional facility was converted from PBX to Centrex service. The other three phases include construction of new dorms, which will be provided Centrex service when construction is completed.

Cost Recovery of Network Wire (Cable)

The three correctional facilities that were change-overs from PBX to ESSX/Centrex services used existing PBX pre-installed wire whenever possible, including but not limited to inside wire on the customer's side of the demarcation point. Visual inspection of invoices revealed charges for inside wire, jacks, and trunk conversion, and confirmed recovery of these costs using customer specific charges assessed to these institutions. In all three instances, no additional cable was installed from the central office for each of these facilities.

In the case of the two newly constructed correctional facilities, Washington and Everglades Correctional, special

construction charges were not applied in building out to the new facilities. Approximately 1,400 feet of new cable was required to connect the existing cable route passing by the Washington Correctional property to the facility itself. Likewise, an existing fiber route was already in service within a mile of the new Everglades Correctional Institution with significant growth forecasted directly across the street from the institution. While special construction charges were not assessed for the new facilities, investment recovery for interbuilding cable will be realized through tariffed rates. The same manner of investment recovery applies to interbuilding cable installed in converted facilities. The audit revealed no evidence that cable and wire costs will not be recovered over the long-term under a contract arrangement.

Termination Liability Charges

The key issue associated with the provision of ESSX/Centrex service is whether that portion of the investment in interbuilding network wiring which is sunk or non-reusable, is recovered through rates charged to the specific end user. Southern Bell has tariff conditions assessing termination liability charges for the unexpired portion of a contract period. A percentage of the remaining recurring monthly charges for intercom and loop rate elements are due upon contract termination prior to the fulfillment date. The contract period for Bell's SSAs to the prisons is 10 years. All four facilities served by Southern Bell are under contracts with termination liability provisions.

On the other hand, ALLTEL has agreed to supply, and the State has agreed to purchase, Centrex services for the Hamilton Correctional Institution using the current month-to-month Centrex tariffed rates. Initially, because ALLTEL had no other pricing alternative, the State agreed that the monthly tariffed rates would serve as interim rates until a standardized Centrex services contract could be finalized for all State correctional institutions. Since that time, the State has moved away from its standardized contract position with ALLTEL and will use the company's tariffed rates on a going forward basis with no provision for termination liability. This does not cause us serious concern, because, as mentioned previously, visual inspection of invoices revealed charges for inside wire, jacks, and trunk conversion, and confirmed recovery of customer specific charges assessed to the facility. In addition, the Hamilton facility is a PBX conversion to Centrex service, and ALLTEL is the only provider of that service in that territory. It is unlikely that the relationship will terminate any time in the near future.

On the basis of these findings, we conclude that Southern Bell and ALLTEL fully recover their direct costs of providing ESSX/Centrex services, including an attributable portion of fungible network wire, through the rates charged subscribers to these services. Furthermore, that portion of the interbuilding network wire investment which is sunk or non-reusable is recovered through the rates charged to the specific end user, although not necessarily as an up-front cost.

Consistent Pricing of ESSX/Centrex Services

We find that Southern Bell and ALLTEL assess their rates for ESSX/Centrex services consistently from one customer to another. The audit revealed that both Southern Bell and ALLTEL maintained consistent pricing practices from one customer to another, although each handles its pricing arrangements somewhat differently.

Southern Bell

The company employs cost studies that support rates for grouped tariffed services called Special Service Arrangements. The studies are predicated upon information provided by the State and include forecasts of growth for correctional facilities. Thus, the rates developed under SSAs are applicable only to correctional institutions within the State of Florida. Typical contract periods run 10 years, and Southern Bell has the authority to review the contract every two years for possible rate adjustments. Southern Bell relies upon Section A5 of its General Services Tariff, and FCC Tariff No. 4, to provide contract ESSX services with Special Service Arrangements. Any conflicting parts of the contract agreement are superseded by these tariffs. When special service arrangements are not required, the prevailing ESSX/Centrex tariff rates apply.

In the event that forecast demand is not achieved, the company, through its SSA contract language, may recover reasonable costs associated with the unfulfilled demand from the State. In addition, if the State cancels an agreement prior to completion, the State must pay all reasonable costs not to exceed the cost of the work completed.

ALLTEL

Any business desirous of ALLTEL's Centrex services purchases those services at prevailing tariffed rates. ALLTEL, unlike Southern Bell, does not have CSA authority. Therefore, the company does not perform cost studies specific to correctional

institutions, nor does it engage in any contract arrangements other than those authorized in the company's Centrex tariff.

We find no evidence of price discrimination by ALLTEL or Southern Bell. The rates charged by Southern Bell, although specific to correctional facilities in Florida, are consistently applied from one facility to the next. In addition, there are termination liability provisions in all the contracts. In a more simple arrangement, ALLTEL offers Centrex services to all businesses on an equal basis. A potential ALLTEL Centrex customer must buy at prevailing tariffed rates.

Accounting Treatment for Interbuilding Wire

We find that the authorized accounting treatment for ESSX/Centrex interbuilding wiring, when taken by itself, does not afford the LEC a material competitive advantage relative to a PBX vendor. Other terms and conditions that may be imposed on the PBX vendor could affect the economic feasibility of the PBX solution, but these factors are outside the jurisdiction of this Commission.

The difference in accounting treatment between a LEC and a PBX vendor stems from the characterization of the interbuilding wiring. Because of the single demarcation point associated with PBX systems, the interbuilding wiring on the customer's side of the demarcation point is characterized as "inside wire." The customer is responsible for the cost of the investment as well as the associated expense of installation and maintenance of the wiring. On the other hand, the interbuilding wiring associated with ESSX/Centrex services is characterized as "network wiring" and is regulated. As a result, the LEC has had the authority to place the investment in rate base, and recover its cost over time from the rates they charge. Rolm argues that this characterization places the responsibility for recovery of the investment and the expenses associated with installation and maintenance on the general body of ratepayers.

Our staff's inspection of invoices revealed charges for inside wire, jacks, and trunk conversion, and confirmed recovery of customer-specific charges assessed to the facility. The interbuilding wiring, although not always recovered up front, is fully recovered through rates charged for ESSX/Centrex services to the specific customer. Further, termination liability provisions help to ensure recovery of the investment in the event of contract default.

Although there may be instances where 100% of the costs associated with interbuilding wiring are not recovered from a

specific customer (either through direct charges to the customer, or through the markups on other services to which he subscribes), we do not believe that the authorized accounting treatment provides the LEC with any significant competitive advantage, although there may exist other, material disadvantages that confront a PBX vendor.

The authorized State PBX vendor is awarded that designation through the State's competitive bid process. Each PBX vendor submits a bid using standardized system specifications, and the lowest bidder is then awarded the state vendor designation. An agency of the state has two purchasing alternatives to select from: 1) the state authorized PBX vendor; or, 2) the serving LEC in the corresponding service territory. The rates for both services are openly published, so it is simply a matter of evaluating PBX services vs. ESSX/Centrex services and choosing one of the two options.

The Florida correctional institutions are generally autonomous with regard to their decision making capability. Many factors can influence a purchasing decision, including but not limited to: overall system cost including maintenance and upgrades and financing alternatives; system quality and performance; budget constraints, and individual need. The audit conducted in this case revealed several factors that provide further insight into the purchasing decision.

System cost and financing options

In evaluating and comparing the cost of PBX services to ESSX/Centrex services we could not draw a definitive conclusion regarding which service was least expensive. The rates for an ESSX/Centrex system include the cost of maintenance and repair services, services not necessarily included in the PBX offering. In addition, the ESSX/Centrex customer inherently becomes the beneficiary of any technological upgrades made in the central office. Thus, because ESSX/Centrex does not directly identify each of these cost components individually under contract or by tariffed rate, an "apples to apples" comparison to the cost of comparable PBX services is difficult. Also, terms and conditions affecting the configuration of the PBX system may cause system capacities to exceed demand. Consequently, the excess system capacity escalates the price of the PBX system, which can further disadvantage the PBX vendor.

Terms and conditions may also limit the availability of financing for the customer purchasing PBX systems. In contrast, ESSX/Centrex services may be purchased over time with minimal investment up-front. Perhaps the most attractive part of a

contract arrangement is the levelized annuity payment. State agencies that are dependent upon constrained sources of funding find the payment arrangement attractive for budgeting purposes.

System quality and performance

A major difference between PBX and ESSX/Centrex pertains to the physical location of the switch. The PBX switch is physically located on the customer's side of the demarcation point on the campus property. The ESSX/Centrex switch is physically located off campus in a remote switching facility on the LEC's network side of the demarcation point. The location of switching equipment can be a concern in situations where correctional facilities experience numerous lightning strikes. The fencing surrounding the facilities is extremely conductive and acts as a virtual lightning rod, posing a threat to telecommunication switching equipment located within the fenced-in area. Consequently, correctional institutions with PBX systems have historically experienced high maintenance costs and extended periods of down time as a result of lightning strikes. As mentioned previously, three of the correctional facilities in the State of Florida have requested a conversion from PBX to ESSX/Centrex service. A combination of moving the switch to a location off campus, coupled with a significant reduction in maintenance cost, has made ESSX/Centrex services extremely attractive for these institutions.

Individual need

A PBX system maintained by the vendor on a time and materials basis can be a costly proposition. It also creates additional budgeting and administrative problems. An alternative is to maintain the telephone system using internal resources. Correctional facility administrators have openly expressed their desire not to have the responsibility of maintaining the telephone system. This would include not only the cost of maintaining the system but the supervision of any staff associated with the repair and maintenance of the system. The ESSX/Centrex system allows correctional facility administrators to operate independently of the telephone system without accountability for associated personnel or unbudgeted maintenance and repair expense.

The authorized accounting treatment for ESSX/Centrex interbuilding wiring, when taken by itself, does not afford the LEC a material competitive advantage relative to a PBX vendor. Yet, as discussed above there is no question that there can be significant competitive barriers for the PBX vendor. However, these other terms and conditions which may impose restrictions on the PBX

vendor and affect the economic feasibility of the PBX solution are not factors within our jurisdiction.

CONCLUSION

The audits conducted in this case did not reveal any evidence that LEC pricing of ESSX/Centrex, on balance, failed to recover their associated costs, or that the LECs were engaging in price discrimination for these services. Accordingly, we believe that no Commission-imposed pricing rules applicable to ESSX/Centrex service are warranted. The authorized accounting treatment for ESSX/Centrex interbuilding wiring does not, in and of itself, afford the LEC a material competitive advantage relative to a PBX vendor. To the extent that the LEC accounting treatment effectively reduces the amount of up-front costs to a potential purchaser, this aspect may be beneficial to certain customers. While there are other factors that may, depending upon a customer's specific situation, presently constitute material disadvantages to a PBX vendor, those factors are beyond our regulatory purview.

Due to the recent authorization of widespread competition in the telecommunications industry and the resulting proliferation of providers and provider types, it would be difficult for this Commission to formulate rules quickly to cover all foreseeable system configurations. Moreover, in part due to the passage of the Telecommunications Act of 1996, the Federal Communications Commission (FCC) currently is considering revisions to its demarcation rules. In our comments filed in the FCC proceeding, we indicated our desire that certain federal standards be developed, which could then be adopted and enforced by the various states. We will delay consideration of any modifications to our demarcation rules, pending the outcome of the federal proceeding.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that BellSouth Telecommunications, Inc.'s and ALLTEL Florida, Inc.'s practices for pricing campus wiring associated with the provision of ESSX/CENTREX services are approved. It is further

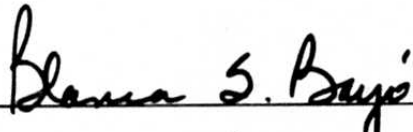
ORDERED that this investigation is closed. It is further

ORDER NO. PSC-96-1040-FOF-TL
DOCKET NO. 950813-TL
PAGE 12

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective unless an appropriate petition, in the form provided by Rule 25-22.036, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED that in the event this Order becomes final, this Docket shall be closed.

By ORDER of the Florida Public Service Commission, this 12th day*of August, 1996.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

(S E A L)

DLC/MCB

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by

ORDER NO. PSC-96-1040-FOF-TL
DOCKET NO. 950813-TL
PAGE 13

Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on September 2, 1996.

In the absence of such a petition, this order shall become effective on the day subsequent to the above date as provided by Rule 25-22.029(6), Florida Administrative Code.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on the date described above, any party substantially affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or wastewater utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.