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November 21, 1996

BY HAND DELIVERY

Ms. Blanca S. Bayó
Director, Records & Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 920260-TP

Dear Ms. Bayó:

Enclosed for filing on behalf of MCI Telecommunications Corporation in the above referenced docket are the original and 15 copies of MCI's post-hearing brief together with a WordPerfect 5.1 disk.

By copy of this letter this document has been provided to the parties on the attached service list.

Very truly yours,

Richard D. Melson

RDM/cc
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cc: Parties of Record

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Comprehensive review of the revenue requirements and rate stabilization plan of Southern Bell Telephone and Telegraph Company	)	Docket No. 920260-TP Filed: November 21, 1996

MCI's POST-HEARING BRIEF

MCI Telecommunications Corporation (MCI) hereby files its post-hearing brief.

EXECUTIVE SUMMARY

The Commission has an obligation under the order which approved the earlier settlement and implementation agreements in this docket (Order No. PSC-94-1072-FOF-TL, the "Implementation Order"), and under Section 364.385(3), Florida Statutes, to approve rate reductions which will result in a revenue reduction to BellSouth of $48 million. The Commission has been presented with two proposals to accomplish this end.

The Joint Proposal submitted by MCI, AT&T, Sprint, FIXCA, the Ad Hoc Telecommunications Users Committee and McCaw Communications ("Joint Proposal") presents the Commission with an opportunity to advance telecommunications competition in the state of Florida by eliminating one of the non-cost based rate elements of BellSouth's switched access interconnection charges -- thus hastening cost-based interconnection rates -- and by correcting a recognized pricing disparity for certain business services.

The Joint Proposal is to:

- Eliminate the Residual Interconnect Charge (RIC) - $35 million
- Approve an "Across the Board" rate reduction to PBX trunk services - $11 million
- Reduce Mobile Interconnection rates - $2 million

The proposal submitted by BellSouth ("BellSouth Proposal") is to reduce non-recurring charges and other rates for Non-Basic services and to implement deaveraged "zone priced" switched access charges.

- Non-Basic services - $32 million
- Deaveraged Switched Access prices - $16 million

As this Commission is aware from its discussion concerning BellSouth's ECS service in the 1995 proceedings in this docket, the Commission has limited control of the rates and charges over BellSouth services which are classified as Non-Basic services under Section 364.051, Florida Statutes. BellSouth may increase the rates for Non-Basic services on 15 days' notice by 6% or 20%, depending upon competitive conditions. Hence, approval of BellSouth's Proposal would not enable the Commission to fulfill its obligation under the Implementation Order and the statute to ensure that the rate reductions approved in this docket will result in a $48 million revenue reduction for BellSouth.

In addition, as discussed herein, the demand assumptions made by BellSouth to project the required revenue reductions are dubious, and the "strategic pricing" of these Non-Basic services proposed by BellSouth should be funded by BellSouth shareholders and not past captive ratepayers. BellSouth's proposal to deaverage switched access charges is discriminatory, has no basis in cost and is anti-competitive.

The Joint Proposal does not suffer these same flaws. The elimination of the Residual Interconnect Charge (RIC) affects BellSouth's switched access interconnection services which are classified as "Network Access" services and cannot be increased until after January 1, 1999. PBX trunk services, for which an $11 million reduction is proposed in the Joint Proposal, are not subject to BellSouth rate increases on 15 days notice. In addition, the demand for these services is relatively stable, and the revenue reductions associated with the proposed rate reductions are predictable.

The Commission has already found that the RIC -- which is a non-cost based rate element -- is no longer appropriate and should be eliminated. Elimination of this charge will move the Commission one step closer to cost-based switched access interconnection charges. Cost-based switched access interconnection charges are at the core of full service competition for Florida consumers.

ISSUE BY ISSUE ANALYSIS

ISSUE 1: **Below are listed the proposals of the various interested parties to this proceeding with respect to the disposition of the scheduled 1996 unspecified rate reductions. Which, if any should be approved?**

A) BELLSOUTH TELECOMMUNICATIONS INC.: [details of proposal omitted]

<u>MCI Position</u>: The Commission should reject BellSouth's proposal. It reduces rates for Non-Basic services over which this Commission no longer has jurisdiction; it relies on dubious demand assumptions; it involves "strategic pricing" that should be funded by BellSouth's shareholders and not by past overearnings; and there is no rational basis to deaverage the RIC and CCL, which have no basis in cost.

<u>BST's Proposal for Non-Basic Services</u>

1. BellSouth (BST) has put forward a proposal to this Commission to dispose of $48 million by reducing non-recurring service charges and other rates for services which are classified under Florida law as "Non-Basic" services. As a result, adoption of the BST proposal would not permit the Commission to fulfill its obligation under its Order Approving Stipulation and Implementation Agreement, entered on February 11, 1994 in this Docket 920260-TL (Order No. PSC-94-0172-FOF-TL, hereinafter referred to as "Implementation Order") and Section 364.385(3), Florida Statutes.

2. In its Implementation Order, the Commission approved a Stipulation and Implementation Agreement entered into between the parties to this docket which provided for rate reductions to some specific services, but, as is relevant to this proceeding, provided for a $48 million dollar revenue reduction to be implemented on October 1, 1996 by rate reductions to unspecified services. Paragraph 5(D) of the Stipulation, attached to the Implementation Order, provides that,

> On October 1, 1996, Southern Bell shall further reduce its gross revenues by $84 million on an annualized basis.

3. Section 364.385(3) of the 1995 rewrite of the Florida telecommunications statute expressly provides the Commission with the authority and obligation to enforce the terms of the Implementation Order to require BST to "reduce its gross revenues by $84 million on an annualized basis." The Commission, however, cannot be assured that this revenue reduction will take place if it approves the proposal of BST for reductions in non-recurring service charges and other rates for BST's Non-Basic services.

4. Each of the services for which BST proposes to reduce non-recurring service charges and other rates are classified as Non-Basic services under the price regulation provisions of Section 364.051(6), Florida Statutes. Under 364.051(6), BST may change the rates for Non-Basic services on 15 days' notice and may increase rates by 6% or 20%, depending on competitive conditions.

5. BST's proposal presents precisely the same "quandary" that the Commission found itself in when it approved BST's Extended Calling Service (ECS) to dispose of the $25 million in "unspecified" rate reductions in the 1995 proceedings in this Docket. The Commission had to determine that ECS service was a "basic service" under the 1995 rewrite of the Florida telecommunications statute in order to prevent BST from subsequently raising ECS rates and thereby frustrating the Commission's enforcement of the Implementation Order. <u>See</u>,

Colloquy between Commissioners Kiesling and Clark, Transcript of Agenda Conference, pg. 12-23, September 26, 1995, in Docket 920260-TL.

> COMMISSIONER KIESLING: Yes, but if we call it [ECS] non-basic, then come January 1, they can raise the rates.
>
> * * * * *
>
> But if they can raise those rates, then how does that impact the amount of dollars that they are supposed to be refunding via this mechanism.
>
> (Transcript of September 26, 1995 Agenda Conference, p.14)

6. In order to ensure that the effect of the Commission's decision in this case is to reduce BST's gross revenues by $48 million on an annualized basis, the Commission must adopt a proposal which deals with BST's services over which the Commission still retains some control and jurisdiction. The Joint Proposal presents the Commission with that opportunity.

7. Apart from the fact that the BST proposal deals with Non-Basic services, the proposal also targets new BST subscribers and present subscribers only to the extent that they subscribe to new services. As a result, unlike ordering rate reductions for services subscribed to by present customers where the demand is known and relatively stable (such as switched access services), the projected demand for BST's Non-Basic services used to "price out" or quantify the revenue reductions associated with BST's proposals are only as good as the marketing assumptions which underlie those demand projections.

8. An example of the uncertainty of these demand projections is provided in Hearing Exhibit 15 (BST's Response to AT&T's 1st set of Interrogatories). BST was asked to provide the underlying market assumptions which were used to support the "price out" of its proposal for PBX trunk term contracts, which BST claimed would result in a $13.5 million revenue reduction. With respect to the projected shift in customer demand from month to month services to a term contract, BST responded,

> Given BellSouth's high quality of service and reliability in the PBX trunk marketplace, economic price is typically the next variable which BellSouth customers use to make purchasing decisions.... Based on BellSouth's experience in the customer switching marketplace and the pricing structure proposed, 25% of current trunks are projected to remain under the month to month plan. 15% of BellSouth's trunks are projected to be placed under the 24-48 months term contract and 60% of PBX trunks are projected to be placed under the 48 to 60 months term contracts.
>
> (BST Response to Item No. 9)

9. The accuracy of BST's projection that its PBX term contract proposal will result in an annualized gross revenue reduction of $13,451,394 depends directly on BST's demand projections. The demand projections, in turn, depend directly on BST being able to convince 75% of its PBX trunk customer base to sign a term contract with BST and commit to take BST's service for a period of 2 to 6 years. BST's assumed marketing prowess must, at a minimum, be termed optimistic since these contractual commitments are assumed to take place during a period of an

emerging competitive market for PBX trunk services and competitive choices for these customers.[1]

10. Indeed, both Mr. Metcalf, on behalf of the Ad Hoc Telecommunications Users Committee and Mr. Gildea, on behalf of the U.S. Department of Defense and other Federal Executive Agencies, whose clients would be the prime beneficiaries of BST's proposal, have indicated that the BST proposal should be rejected.

> Ad Hoc and its members [which have been the principal advocate of business customers appearing before this Commission in telecommunications matters] have never communicated a desire to BST for this particular rate structure, and Mr. Varner [BST] has not discussed it with Ad Hoc or its members. Accordingly, the Commission should not be misled into believing that there is a large nucleus of business users advocating this particular BST rate structure [PBX trunk term contracts] based on a desire for this form of 'rate stabilization'.
>
> (Metcalf, Direct testimony, Tr. 82)
>
> * * * * *
>
> [BST] indicates that term contracts will respond to customer requests for lower rates and for rate stabilization. However, fixed charges for a contract term do not provide 'rate stabilization' unless there is a prevailing tendency for charges to <u>increase</u>. Because PBX rates are coming down, and further decreases are expected, fixed charges are of more benefit to the company [BST] than to its subscribers.

[1] Interestingly, in Docket No. 960846-TP, MCI's Arbitration proceeding, BST takes the position with respect to resale of retail services, that contract services offered by BST should not be subject to resale. If BST were successful in its marketing efforts, BST would effectively shield 75% of the PBX trunk market from resale competition.

(Gildea, Rebuttal testimony, Tr. 103-104, emphasis in original)

11. Furthermore, both Mr. Metcalf and Mr. Gildea have endorsed the Joint Proposal requesting an "across the board" reduction to PBX trunk rates of $11 million. Such an "across the board" rate reduction can be easily quantified and does not depend upon dubious marketing assumptions requiring BST to convince 75% of its customer base to sign term contracts. Furthermore, as Mr. Metcalf indicated,

> BST's proposed reduction in PBX and DID rates exceeds $15 million, while Ad Hoc's proposal would decrease business user rates by only $11 million. However, BST's reduction, although it is greater than that proposed by Ad Hoc and other parties to the Joint Proposal, is not an equitable reduction for BST's current business customers.
>
> (Metcalf, Direct testimony, Tr. 80, emphasis in original)

Similarly, Mr. Gildea indicated,

> If all other conditions were equal, I would prefer the larger $15 million reduction for these services. However, I believe the procedure for applying the reduction is more important than the $4 million difference in the two plans.
>
> (Gildea, Rebuttal testimony, Tr. 104)

12. Another example of BST's dubious demand projections is evident in its proposal to waive the secondary service charges for business and residential customers who purchase additional vertical services, such as Ringmaster and Touchstar. BST projects a revenue reduction of $3.6 million from its residential

subscribers and $2.2 million from its business subscribers. The secondary service charge presently applies as a non-recurring charge when an existing customer orders a new vertical service from BST.[2] (See, generally, Varner Direct testimony, Tr. 52-53)

13. BST's "price out" of the revenue reductions associated with waiving the secondary service charge is directly dependent on BST's ability to market vertical features to existing and new customers. A review of BST's price out[3] for residential customers shows present demand for these secondary service charges of 465,111 customers and a projected demand of 106,593. Thus, BST's marketing assumption is that it will be able to sell these vertical services to 358,918 customers who will take the additional services if the secondary service charge is waived. However, BST states quite frankly that it does "not have market research or empirical data that provides quantitative retention estimates" to support its demand projections.[4]

14. On the other hand, if BST is successful in marketing vertical services to approximately 359 thousand customers, the

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[2] It is apparent that BST's shareholders have "funded" the waiver of this secondary service charge for certain customers. Section A.4.2.4 E. of BST's Florida GSST contains a promotion which waives these charges through November 30, 1996. See also, Hearing Exhibit 5, May 31, 1996 tariff filing which contains BST's proposed tariff changes in legislative format and, Varner, Direct testimony, Tr. 52, "Existing quantities of service charges used for the analysis were reduced to include the effects of the service charge waiver for Complete Choice."

[3] Hearing Exhibit 6, June 10, 1996 supplement to tariff filing. Price out of A004 SERVICE CHARGES, pg. 1 of 4.

[4] Hearing Exhibit 6, Service Description and Rationale, Secondary Service Charges.

revenue gain from the vertical services, which are priced well in excess of cost, would most likely more than offset the projected revenue losses due to the waiver of the secondary service ordering charge. BST's projected $3.6 million dollar revenue reduction will be a "phantom" revenue reduction to BST and will not fulfill the obligation of this Commission to insure that BST reduce its gross revenues on an annualized basis by $48 million.

15. In addition to the fact that the Commission could not fulfill its obligation under the Implementation Order and Section 364.385(3) Florida Statutes by approving BST's proposal for Non-Basic services, the BST proposal, if adopted, would be anticompetitive and would return ratepayer dollars in an inequitable manner.

16. Regardless of how BST's Varner wishes to characterize this proceeding,[5] the Commission's obligation is to insure that "Southern Bell shall further reduce its gross revenues by $84 million on an annualized basis." Implementation Order, Stipulation, Paragraph 5(D). It is the rate payers who are contributing to BST's present revenue streams who should get the benefit of the rate reductions implemented to effect the revenue reductions required by the Implementation Order. As discussed previously, BST's proposal, to the extent that BST is successful in its marketing efforts, would benefit new customers and

[5] Mr. Varner's Rebuttal testimony quibbles with Mr. Metcalf's characterization, "Mr. Metcalf totally misunderstands the genesis of this docket. This is not a docket concerning a rate refund; rather it is a docket concerning a rate reduction." Varner, Rebuttal testimony, Tr. 68.

existing customers only to the extent that they subscribed to new services from BST.

17. This Commission has historically recognized that equity considerations require that rate reductions which occur as a result of required revenue reductions stemming from overearnings should be returned to the ratepayers who contributed to those overearnings.

> [I]t is Florida's current business customer's who have paid the high business and access rates in existence today. Their rates are the rates that should be lowered. However, BST's proposed rate structure targets <u>new</u> customers .... [BST's proposed] reduction badly misaligns costs and benefits -- a result which is just the opposite of that historically urged by BST's frequent reliance on principles of 'cost causation'. This proposal is simply inequitable.
>
> (Metcalf, Direct testimony, Tr. 82, emphasis in original)
>
> * * * * *
>
> Clearly, it is important to recognize that BST's past overearnings were generated by payments from ratepayers during the time period being studied. As a result, equity considerations dictate that going-forward rate reductions be targeted to existing ratepayers, or, at a minimum, <u>not</u> be specifically targeted toward future customers which BST wishes to attract.
>
> (Wood, Rebuttal testimony, Tr. 174, emphasis in original)

18. BST's proposal is anticompetitive and, if adopted, would permit BST to leverage its past monopoly position into an emerging competitive market. Hearing Exhibit 5 (May 31, 1996 Tariff Filing, Attachment B, Executive Summary, pg. 1 of 13)

demonstrates that approximately $24.7 million of BST's proposed $31.7 million reduction for Non-Basic services would benefit only new customers or those existing customers who subscribe to new BST services, as follows;

$ 5,812,971 -	Secondary Service Charge Waiver for Business and Residence customers who order additional vertical services.
$ 3,222,592 -	Reduce First Line Connection charges for new Business customers.
$13,451,394 -	PBX trunk rates for customers who sign long term contracts with BST
$ 2,254,140 -	Permit business customers to subscribe to Area Plus service.
$24,741,097 -	TOTAL

19. BST has described its pricing proposals for Non-Basic services as being part of its strategic pricing objectives. As previously noted, BST's proposal to waive the secondary service charge for customers who order additional vertical services will greatly enhance BST's revenue stream. BST also describes its proposal to reduce the monthly service charge for WATs and Toll Free Dialing (TFD) services as a "strategic pricing move". BST's PBX trunk term contract pricing proposal is being proposed "to implement some of the company's strategic pricing incentives". The proposal to reduce Rate Group 12 monthly business line rates "will facilitate negotiations with customers and promotional activities for the service". The proposal to permit business customers to subscribe to Area Plus service provides a

"combination local and intraLATA toll plan [which] is strategically priced".[6]

20. If adopted, the BST proposal would permit BST to implement its strategic pricing objectives, utilizing dollars obtained from Florida ratepayers during a period of earnings regulation to create future financial gains for its shareholders in a competitive market. This is anticompetitve and inappropriate.

> BellSouth is attempting to steer the stipulated reductions to services where they anticipate competition, and where the current rates are in jeopardy of being underpriced by new competitors with more cost-based pricing. While these prices must come down in order for BST to compete, it is inappropriate to allow the disposition of overearnings to place BST in a more competitive position with regard to the business market.
>
> (Vanderpool, Direct testimony, Tr. 129.)
>
> * * * * *
>
> The strategic nature of BST's proposed reductions is...clear... . Each of the proposed services for which BST is proposing to waive the [service order] charge is, without exception, priced to generate a significant margin... Clearly, BST shareholders will be better off if more end users subscribe to these services, and a decision to forego recovery of the nonrecurring costs associated with establishing service is one means of encouraging and increasing subscribership. Under BST's proposal, however, its shareholders need not forego anything; the lost nonrecurring costs will be made up -- dollar for dollar -- with funds that have been collected from existing ratepayers

[6] See Hearing Exhibit 6, June 10 1996 Supplement to Tariff filing, Service Description and Rationale

through past rates that were excessively high.

(Wood, Rebuttal testimony, Tr. 175-176.)

* * * * *

If BST is permitted to use the funds from past overearnings to provide strategically targeted benefits to customers and potential customers for which BST either experiences or expects to experience some level of competition, BST will have a distinct advantage in the marketplace. Such an advantage will not have been gained because of the willingness of BST managers to work harder or by the willingness of BST shareholders to take additional business risks, but will instead be entirely a function of BST's position as the former monopoly provider for these services....

BST's proposal, if adopted, would permit BST to leverage its past monopoly power well into the future at the expense of current ratepayers (who paid the excessive rates in the past but are now receiving no corresponding benefit) and future ratepayers (who will be denied the benefits of a competitive marketplace for those services for which effective competition would have otherwise developed).

(Wood, Rebuttal testimony, Tr. 179-180.)

* * * * *

To be absolutely clear, I am not suggesting that it is inappropriate for a firm to engage in strategic pricing practices (constrained, of course, by applicable antitrust laws)[7] in order to entice new customers to buy its product. Under such a scenario, the firms

[7] BST indicates in *Hearing* Exhibit 4, BST Response to Staff's 1st Interrogatories, Item No. 3.4 that the reduction in the first line connection charge for business lines reduces "this rate below cost" in apparent violation of Section. 364.338(1) Florida Statutes.

shareholders put their capital at risk[8] in hopes of receiving the expected future reward. If the rate reductions proposed by BST in this proceeding are adopted, however, BST shareholders will receive these benefits without incurring any corresponding risk."

(Wood, Rebuttal testimony, Tr. 180-181.)

<u>BST'S Proposal to Deaverage Switched Access Charges</u>

21. BST is proposing to deaverage its switched access rates in Florida with its proposal to "zone price" the Carrier Common Line (CCL), Residual Interconnect Charge (RIC) and Local Switching rate elements. This proposal would "divide Florida into three density zones" (Hendrix, Direct testimony, Tr. 28) and "allow BellSouth to strategically establish prices to meet competitive pressures ... ." (Hendrix, Direct testimony, Tr. 29)

22. While this proposal does not suffer from the same problems with projecting demand data for purposes of determining the revenue reduction as does BST's Non-Basic services proposal, it is inappropriate, unjustly discriminatory, anticompetitive and should be rejected.

23. BST's Hendrix cites the FCC's Expanded Interconnection Order in CC Docket 91-141 for support of BST's proposal to deaverage switched access rates. In that Order, BST states, the FCC granted BST "greater flexibility to price access to reflect traffic density." (Hendrix, Direct testimony, Tr. 28) However,

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[8] As discussed in footnote 2 supra, BST's shareholders were apparently willing to put their "capital at risk" when BST filed its previous promotional offering which waived the secondary service charge through November 30, 1996.

the FCC Order that Mr. Hendrix references authorized BST to establish zone or differential pricing only for those rate elements of switched access where there was a cost differential to support a different price. The FCC concluded that the costs to provide local transport varied by density zones and that it was appropriate to deaverage or zone density price the local transport component of switched access. That Order did not authorize BST to "zone price" either the local switching or other non-cost based rate elements of switched access services.

24. As discussed by Mr. Guedel:

> Zone density pricing should only be justified on the basis of cost. BellSouth's proposal fails to meet that standard.
>
> There is no apparent cost basis for applying a zone density pricing concept to ... Carrier Common Line, RIC and Local Switching.
>
> First, the incremental cost of providing either the Carrier Common Line or the RIC is zero. If the cost is absolute zero in all cases, it cannot be accurately argued that such a cost would ever vary by density zone. Therefore, a pricing arrangement that would vary prices for these services based on zone density must be considered to be unjustly discriminatory on its face and should be rejected by the Commission.
>
> Second, BellSouth has not offered any information demonstrating that the cost of local switching would vary by density zone. Indeed, it is not at all apparent that a forward looking cost analysis would find varying costs for this element as a function of density. BellSouth has made no attempt to justify its pricing recommendation of this element on the basis of cost. Without

supporting cost information,[9] the proposed price must be considered unjustly discriminatory (as with CCL and the RIC) and should be rejected by the Commission.

(Guedel, Direct testimony, Tr. 155-157.)

B) JOINT PROPOSAL OF AT&T, MCI, SPRINT COMMUNICATIONS, FIXCA, AS HOC AND McCAW COMMUNICATIONS: [details of proposal omitted]

<u>MCI Position:</u> The Joint Proposal should be approved for several reasons: by eliminating the RIC, it continues to implement switched access charge policy reform in Florida; by reducing PBX trunk rates, it corrects existing price inequities; by targeting rates that cannot be increased by BST in the short-term, it ensures a full $48 million revenue reduction; and it reduces rates to customers who paid the excessive rates that contributed to BST's overearnings.

24. The Commission has long recognized the need to reduce switched access interconnection rates to a level closer to the cost of providing the service. The Joint Proposal, which recommends the elimination of a non-cost based rate element of BST's switched access rate structure -- the Residual Interconnect Charge -- will permit the Commission to take an additional step towards this goal. The requirement to eliminate the non-cost based rate elements from BST's switched access rate structure has been accelerated by the passage of the federal Telecommunications Act of 1996 ("Act").

> Cost-based access charges, long the preferred policy, are now a policy imperative due to

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[9] <u>See also</u>, Hearing Exhibit 4, BST Responses to Staff's 1st set of Interrogatories, Item 3.1 and Hearing Exhibit 15, BST Responses to AT&T Interrogatories, Item No. 7, "BellSouth has performed no zone-specific cost studies."

the Federal Telecommunications Act of 1996 (Act).

(Gillan, Direct testimony, Tr. 107.)

* * * * *

The Commission stands at the brink of a new world founded on the Federal Telecommunications Act of 1996. One of the key underpinnings of the Act, and the competitive environment that it hopes to create, are cost based rates for the use of BellSouth's network by its rivals. For the full benefits of the Act to be realized, access charges must be based on cost like all other carrier to carrier charges.

(Gillan, Direct testimony, Tr. 123.)

25. It is apparent that BST's present rate levels, however, are priced well in excess of the cost to provide switched access interconnection services.

Information made available through Florida Public Service Commission Docket 950985-TP indicates that BellSouth's cost of providing switched access services is less than $.0025 per access minute of use - perhaps as low as $.002 or less... . [At present levels], BST will be enjoying a markup above cost of at least 1100% and possibly as much as 1400% in the provision of switched access services.

(Guedel Direct testimony, Tr. 151.)

26. The Joint Proposal requests that the Commission take an additional step towards cost based switched access rates by eliminating the Residual Interconnect Charge (RIC) from BST's switched access rate structure. The elimination of the Residual Interconnect Charge will result in a revenue reduction to BST of

approximately $34,980,774.[10] Even with the elimination of the RIC,

> BellSouth's average switched access charges [would be] approximately $.05 per MOU for two ends of access. This level is reasonably close to BellSouth's current interstate switched access rates - but notably still in excess of 10 times BellSouth's underlying cost.
>
> (Guedel, Direct testimony, Tr. 152.)

As previously discussed, the Commission's objective in the instant proceedings, as required by the Implementation Order and Section 364.385(3), is to implement rate reductions to affect a revenue reduction for BST of $48 million. The genesis of the proceedings leading up to the Implementation Order was, as this Docket is styled, a "Comprehensive review of the revenue requirements and rate stabilization plan" of BST. As a result of that review, it was stipulated by BST that a reduction of its revenue requirements, effective October 1, 1996 was appropriate.

28. This Commission has previously found that the RIC is a vestige of rate base, rate of return regulation and the establishment of the RIC was a revenue requirement issue. In its Order No. 96-0445-FOF-TP in Docket No. 950985, the Commission addressed the purpose of the Residual Interconnect Charge:

> The RIC is a charge created by the FCC when it restructured interstate local transport rates. When the rates were restructured, local transport and tandem switching rates were lowered. To compensate for the lost

[10] See, Hearing Exhibit 15, BST's Responses to AT&T's 1st Set of Interrogatories, Item No. 4.

> revenue, the RIC was implemented as a rate element to recover these revenues. When intrastate local transport rates were restructured in Florida, a similar rate was established for intrastate toll ... . (citations omitted)
>
> [BST] stated that the RIC recovers a portion of [BST's] revenue requirement ... [and] was established to recover the shortfall between the overall local transport revenue requirement and the revenues generated by this new and lower transport and tandem switching charges ... [BST] states that the collection of the RIC was a revenue requirement issue ... .
>
> (Order No. PSC-96-0445-FOF-TP at 18-19)

29. These proceedings are to dispose of the remaining $48 million in BST revenue reductions, stipulated to in the Implementation Agreement at a time when BST was subject to rate base, rate of return regulation. Since the RIC was established by the Commission to recover BST revenue requirements under the prior regulatory regime, it would be particularly appropriate to eliminate the RIC with $35 million in revenue reductions agreed to by BST during that regulatory regime. As the Commission concluded in its Order in Docket 950985-TP, albeit in a different context:

> We disagree with BellSouth's arguments. The collection of the RIC is no longer a revenue requirement issue. BellSouth is no longer rate base regulated; it is price regulated. Revenue requirements are a concept only applicable under rate base regulation; they are neither consistent with nor relevant to price regulation.
>
> (Order PSC-95-0445-FOF-TP at 19.)

30. These proceedings to effect the final phase of BST's stipulated revenue reductions under the Implementation Order, represent the Commission's last opportunity to mandate rate reductions to implement a revenue reduction from an era of rate-base regulation. As noted by the Commission, revenue requirements, and rate elements designed simply to collect revenue requirements, are neither consistent with nor relevant in the new price regulation environment.

31. Recently, in its Order in Docket No. 950985-TP dealing with local interconnection for GTEFL and United/Centel, the Commission concluded that the Residual Interconnect Charge was also inconsistent with a competitive telecommunications environment.

> Although we are not eliminating the RIC in this proceeding, we do not believe that the long term public interest is served when all competitive local exchange carriers are collecting the RIC from IXCs. We believe that none of them should collect it. The RIC should be phased out as soon as possible in the course of the scheduled switched access reductions required by Section 364.163(6), Florida Statutes.
>
> (Order PSC-96-0668-FOF-TP at 26)

32. With the widespread recognition that the RIC is a non-cost based rate element and an anachronism in today's regulatory and competitive environment, it is fully appropriate for the Commission to take this opportunity to apply approximately $35 million in unspecified rate reductions to the elimination of this charge.

33. In addition to the Commission's longstanding goal to reduce switched access charges to cost-based rates, the Commission has also long recognized the need to reprice and restructure BST's PBX trunk rates relative to the functionally equivalent services that BST offers with its ESSX service. Beginning with its Docket 881257-TL which was initiated in 1988, the Commission and its Staff have recognized the disproportionate rates charged to PBX users versus the pricing to BST's ESSX customer's for similar loop and electronic facilities and that the disproportionate levels of contribution from each service has resulted in anti-competitive pricing practices in the market for business services.[11]

34. In the Staff Recommendation in this Docket 920260-TP filed last year, the Staff recommended that from the available unspecified $25 million rate reduction for Year 2 under the Implementation Order, the balance of the available funds, after ECS reductions, "should be used to reduce the difference in pricing between ESSX loops, and PBX trunks and DID service rates."

35. The approval of the rate reductions contained in the Joint Proposal will also permit the Commission to fulfill its obligation under the Implementation Order and Section 364.385(3) Florida Statues. As discussed previously, BST's proposal is to

[11] While Mr. Varner attempts to dismiss this concern by noting that, "ESSX service is an obsolete offering," Varner, Rebuttal Testimony, Tr. 69, BST in fact still offers a Centrex-type service which competes with PBX offerings, as well as the provision of ESSX service to grandfathered customers and the disparate pricing practices continue to exist.

reduce non-recurring service charges and other rates for Non-Basic services. Under Section 364.051(6), BST may change the rates for Non-Basic services on 15 days' notice and may increase rates by 6% or 20%, depending on competitive conditions. Furthermore, as previously demonstrated, BST's projected revenue reductions from its proposal to reduce non-recurring service charges and other rates for Non-Basic services are based on demand assumptions which in turn are based on dubious marketing assumptions. The Joint Proposal does not suffer from these same flaws.

36. The Joint Proposal is to reduce rates for switched access and mobile interconnection services, both of which are classified as Network Access Services under Section 364.163. Under that section, these rates cannot be increased by BST on 15 days' notice, but instead are capped until January 1, 1999. Also, unlike the non-recurring service charge and other rate reductions for Non-Basic services proposed by BST for which the demand for such service is unknown and depends upon BST's success in marketing, the demand for switched access interconnection services are relatively stable and well known. Hence, the Commission can be reasonably assured that its action in implementing the Joint Proposal will result in a "gross revenue reduction to BST on an annualized basis" of the amount calculated -- $35 million for the elimination of the RIC and $2 million reduction in mobile interconnection charges.

37. Likewise, the Commission can be reasonably assured that adoption of the Joint Proposal to reduce rates for PBX trunk services "across the board" will result in an annualized revenue reduction to BST of $11 million, since PBX trunk rates are protected by Section 364.051(6)(a)(1) from increases in Non-Basic service rate increases.

38. Approval of the Joint Proposal would also be an additional step in the direction of developing full service competition in Florida. One of the many benefits that can accrue to Florida consumers from cost-based switched access interconnection charges is the development of competitively drawn local calling areas.

39. With the below-average local rates in Florida, competitors will be forced to compete by offering a package of services which blur the traditional distinctions between local and toll services and calling zones. But providers cannot compete along this important service dimension if the rates they pay for the use of BST's network depends upon BST's labeling of the call as toll or local. Switched access and interconnection charges must be equal in order for service-boundary competition to become a reality.

> The key is correctly pricing access/interconnection service so that a carriers cost to terminate a call is not dependent upon BellSouth's retail classification. If both access (for "toll") and interconnection (for "local") call termination charges are the same, then carriers will be free to design products with differing boundaries, with the goal to attract subscribers by offering a 'better'

> local calling area... . In this way, the market -- which is to say, consumers -- would decide the size and shape of the local calling area as carriers compete along this important dimension of service.
>
> (Gillan, Direct testimony, Tr. 110-111, emphasis in original.)

40. In order to develop full service competition, the Commission must move toward a non-discriminatory, cost-based interconnection charges for all providers of telecommunications services. With such non-discriminatory charges, carriers would be free to decide the scope of their own local calling areas, sizing these areas to match their own perception of market demands, and attempt to market the service.

41. While the Joint Proposal to eliminate the RIC does not achieve cost based switched access interconnection charges, it brings the Commission a step closer in that direction. In the Commission's upcoming proceedings to establish a competitively neutral, externally funded Universal Service mechanism, the Commission will be able to address the other non-cost based element of switched access charges -- the Carrier Common Line rate element. In conjunction with the elimination of the RIC in this proceeding, the Commission will be poised to establish cost-based switched access interconnection rates and realize the Act's promise of full service competition for Florida consumers.

C) PUBLIC COUNSEL: Establish a reserve fund to assist BellSouth Telecommunication, Inc. customers who have experienced problems with conversion to the 954 NPA.

MCI Position: The Commission should approve the Joint Proposal for the reasons discussed in Issue 1B, above.

D) FTCA: Eliminate non-recurring charges for interconnection trunks and special access circuits ordered by ALECs.

MCI Position: The Commission should approve the Joint Proposal for the reasons discussed in Issue 1B, above.

E) PALM BEACH NEWSPAPERS, INC./FLORIDA TODAY: Reduce usage rates for N11 service to $.02 per minute.

MCI Position: The Commission should approve the Joint Proposal for the reasons discussed in Issue 1B, above.

ISSUE 2: To the extent the Commission does not approve the plans proposed by BellSouth, Public Counsel, FCTA, Palm Beach Newspapers, Inc./Florida Today and AT&T, MCI, Sprint, FIXCA, Ad Hoc and McCaw, how should the Commission implement the scheduled rate reduction?

MCI Position: The Commission should approve the Joint Proposal. If it does not approve the Joint Proposal, it should ensure that the reductions are used to eliminate pricing anomalies and not to benefit BellSouth through strategic pricing or newly competitive services.

ISSUE 3: What should be the effective date of the rate reductions?

MCI Position: The rate reductions should be effective on the date of the Commission's vote.

RESPECTFULLY SUBMITTED this 21st day of November, 1996.

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