PUC BULLETIN

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NOTE: March 1990's Bulletin contained an error in the Table of Contents. The telephone docket should have read "Docket No. 9135 — GTE Southwest Inc." instead of "Docket No. 8805 — GTE Southwest Inc."

Public Utility Commission of Texas

7800 Shoal Creek Boulevard · Suite 400N
Austin, Texas 78757 · 512 458-0100

Jo Campbell
Commissioner

Marta Greytok
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INQUIRY INTO WATS COMPETITION ON MULTI-JURISDICTIONAL WATS ACCESS LINES	§ § §	DOCKET NO. 7330

August 30, 1989

The Commission rejected the examiner's recommendation to discontinue the reservation of 1+ IntraLATA WATS and 800 Service traffic and/or revenues to the local exchange companies. Motions for rehearing denied by operation of law.

[1] JURISDICTION--TELECOMMUNICATIONS--NON-DOMINANT UTILITIES
REGULATION OF NON-DOMINANT UTILITIES

The Commission lacks the statutory authority to order a non-dominant IXC not to provide services within geographical areas in instances in which a certificate of convenience and necessity is not required to provide the service. (p. 1614)

[2] If the Commission's reasoned balancing of the competing policy objectives set forth in PURA § 18(a) necessitated the implementation of LEC tariffs that had the practical effect of restricting the ability of non-dominant IXCs to provide service within certain geographic areas, such action would not exceed the Commission's statutory authority under PURA. (p. 1614)

[3] RATEMAKING--RATE DESIGN--DISCRIMINATORY RATES
COMPLAINTS AND DISPUTES--ANTI-COMPETITIVE PRACTICES

The protection of universal service and the prevention of discriminatory and anticompetitive conduct are not mutually exclusive concepts. Under the standard enunciated in *Amtel*, the Commission must strive to effectuate the policy interests inherent in preventing anticompetitive and discriminatory conduct as *well* as those inherent in the preservation of universal service. Where it has been demonstrated that elimination of discriminatory or anticompetitive conduct can be achieved without jeopardizing the affordability of present or future local exchange rates or any other policy objective, there exists no policy conflict which necessitates the discounting of the policies underlying PURA Sections 38, 45 and 47. (p. 1670)

[4] RATEMAKING--RATE DESIGN--TELEPHONE--PRICING CONCEPTS--GENERAL CONCEPTS
RATEMAKING--RATE DESIGN--TELEPHONE--PRICING CONCEPTS--RESIDUAL PRICING

The term "universal service" means making basic local exchange service affordable to the largest percentage of the population that one can reasonably achieve. (p. 1734)

[5] RATEMAKING--RATE DESIGN--TELEPHONE--PRICING CONCEPTS--GENERAL CONCEPTS
RATEMAKING--RATE DESIGN--TELEPHONE--PRICING CONCEPTS--RESIDUAL PRICING

The Commission's policy of pricing non-basic local exchange services substantially in excess of their direct long run incremental costs furthers the goal of universal service. (p. 1735)

[6] RATEMAKING--RATE DESIGN--TELEPHONE--INTRALATA POOLING

The IntraLATA MTS/WATS toll pool rate of return is not a valid measure of overall profitability of LECs because rates for these services have intentionally been set at a level intended to provide large contributions to joint and common costs. (p. 1735)

[7] RATEMAKING--RATE DESIGN--DISCRIMINATORY RATES
RATEMAKING--RATE DESIGN--TELEPHONE--WATS/800 SERVICES

The LEC practice of stripping, carrying and billing all 1+ IntraLATA WATS traffic originating over interstate WATS access lines, though preferential, was found not to be unreasonably discriminatory, given the validity of the policy and fairness arguments advanced by LECs in support of that practice. (p. 1742)

[8] RATEMAKING--RATE DESIGN--TELEPHONE--WATS/800 SERVICES

Statutory policy considerations mandated by PURA Section 18(a) warrant the continued reservation of 1+ IntraLATA WATS and 800 Service traffic and/or revenues to the LECs. Continuation of that practice does not produce any significant anticompetitive or discriminatory effect upon IXCs. (p. 1745)

Public Utility Commission of Texas

7800 Shoal Creek Boulevard · Suite 400N
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Marta Greytok
Chairman

Jo Campbell
Commissioner

Bill Cassin
Commissioner

May 25, 1989

TO ALL PARTIES OF RECORD

RE: Docket No. 7330--Inquiry into IntraLATA WATS Competition on Multijurisdictional WATS Access Lines

Ladies and Gentlemen:

Enclosed is a copy of my Examiner's Report and proposed final Order in the above referenced docket. The Commission will consider this case at an open meeting scheduled to begin at 9:00 a.m. on Thursday, June 22, 1989, at the Commission offices, 7800 Shoal Creek Boulevard, Austin, Texas. Exceptions, if any, to the Examiner's Report must be filed in writing by 4:00 p.m. on Tuesday, June 6, 1989. Replies, if any, to those exceptions must be filed in writing by 4:00 p.m. on Friday, June 16, 1989. An original and eight copies must be filed with the Commission filing clerk, and a copy served on the Commission general counsel and every party of record.

Pursuant to Commission Procedural Rule 21.143, requests for oral argument must be filed with the Commission and served on all parties by 5:00 p.m. on Friday, June 16, 1989. If a request for oral argument is made, parties may call Ms. Lisa Ruedas at (512) 458-0266 after 9:00 a.m. on Wednesday, June 21, 1989 to learn if the Commissioners will allow oral argument. If oral argument is not granted, the Commissioners may still have questions they want to address to the parties.

Your presence at the final order meeting is not required, but you are welcome to attend if you want to. A copy of the signed Order will be mailed to you shortly after the final order meeting.

Summary of the Examiner's Report

This proceeding presents the Commission with very difficult and technically complex issues concerning the appropriate role of local exchange companies in the provisioning of intraLATA WATS and 800 Services. The issues presented in this docket were severed from two prior Commission proceedings, Docket No. 7020 and 7160, which concerned respectively, SWB tariff changes designed to permit the carriage of intrastate WATS traffic over multijurisdictional WATS access lines (UWALs), and SWB tariff changes designed to permit interexchange carriers (IXCs) other than AT&T to provide 800 Service.

The Commission severed from those dockets and reserved for consideration in this proceeding the issue of whether 1+ intraLATA WATS and 800 Service traffic should belong to the LECs. With respect to WATS Service, the ultimate

issue in this proceeding is whether the present serving arrangement, under which the LECs are the sole carriers of 1+ intraLATA WATS traffic originating over UWALs, should be continued. With respect to 800 Service, the ultimate issue is whether the current arrangement, under which a revenue replacement rate is applied by the LECs to IXC intraLATA 800 Service traffic in lieu of access charges, should be continued.

The examiner has found, contrary to the IXC's allegations in this proceeding, that reservation by the Commission of all 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs would not contravene the prohibition against state-created monopolies embodied in Article I, Section 25 of the Texas Constitution, nor would such action contravene the due process provisions of Article I, Section 19 of the Texas Constitution or necessarily exceed the Commission's statutory authority under PURA. However, the examiner has found that the current *status quo* with respect to 1+ intraLATA WATS and 800 Service is unreasonably discriminatory and anticompetitive. The examiner has also found that there exist no contervailing policy considerations which would necessitate continuation of the current *status quo* in the face of its discriminatory and anticompetitive effects upon IXCs.

The examiner has recommended that the LECs be afforded six months in which to reprogram their central office switches and make any hardware additions necessary to enable the LECs to route 1+ intraLATA WATS traffic originating over UWALs to IXCs upon customer request. However, that requirement is limited solely to those areas served by switches that need not be replaced or which do not require generic software modifications in order to route 1+ intraLATA WATS traffic to the IXCs. The examiner has further recommended that those customers subscribing to WATS services provided over UWALs be afforded the choice of having their LEC or their 1+ interLATA WATS carrier transport and bill their 1+ intraLATA WATS traffic. The examiner has recommended that the parties to this proceeding be required to develop a joint proposal for implementing a procedural mechanism whereby limited 1+ intraLATA WATS presubscription can be accomplished. Finally, the examiner has recommended that the present intraLATA 800 service revenue replacement rate be eliminated and replaced by current LEC access charges.

If you have any procedural questions about this matter, do not hesitate to contact my office at 458-0233.

Sincerely,

Mark W. Smith
Administrative Law Judge

nsh

DOCKET NO. 7330

INQUIRY INTO WATS COMPETITION ON MULTI-JURISDICTIONAL WATS ACCESS LINES	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

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ALJ	Administrative Law Judge
AT&T	American Telephone and Telegraph Company
BOC	Bell Operating Company
CCN	Certificate of Convenience and Necessity
CCS	Common channel signalling
CIRRPL	Current interstate NTS revenue requirement per loop (same as frozen SPF)
Claydesta	Claydesta Communications, Inc.
CPE	Customer premise equipment
DMS	Digital multiplex system
ESS	Electronic switching system
FCC	Federal Communications Commission
G.A.	Gross allocator
GTE	General Telephone Company of the Southwest, Inc.
HCA	High cost assistance
HCAPL	High cost assistance per loop
HCF	High cost fund
ICAC	Interexchange carrier access charge
interLATA	Services which originate and terminate in different local access and transport areas (LATAs)
intraLATA	Services which originate and terminate in the same local access and transport area (LATA)
IXC	Interexchange telecommunications carrier
LATA	Local access transport area
LDS	Long Distance Service
LEC	Local exchange carrier
MCI	MCI Telecommunications Corp.
MFJ	Modified final judgment
MOU	Minutes of use
MTS	Message telecommunications service
NIRRPL	25% gross allocator + HCF interstate NTS revenue requirement per loop
NPA	Numbering plan area

NTS	Non-traffic sensitive
OCC	Other common carrier
PBX	Private branch exchange
POI	Point of interface
POP	Point of presence
POTS	Plain old telephone service
PURA	Public Utility Regulatory Act
REA	Rural Electrification Administration
ROE	Return on equity
RTB	Rural Telephone Bank
SMSA	Standard metropolitan statistical area
SPF	Subscriber plant factor
Sprint	US Sprint Communications Company
SWB	Southwestern Bell Telephone Company
TECA	Texas Exchange Carriers Association
TEXALTEL	Texas Association of Long Distance Telephone Companies
TIER	Times interest earned ratio
TSTCI	Texas Statewide Telephone Cooperative, Inc.
URRPL	Unseparated NTS revenue requirement per loop
USOA	Uniform system of accounts
UWAL	Universal WATS access line
WAL	WATS access line
WALE	WATS access line extension
WATS	Wide area telecommunications service
WSO	WATS serving office
1+	A dialing pattern with which toll calls are originated by dialing 1 before dialing the area code and POTS number
10XXX	A five-digit dialing option which allows a customer to access an interexchange carrier's WATS access line, in lieu of dialing 1+

DOCKET NO. 7330

INQUIRY INTO WATS COMPETITION ON MULTI-JURISDICTIONAL WATS ACCESS LINES	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

EXAMINER'S REPORT

I. Procedural History

This docket was created on January 6, 1987, by an order of severance issued by Administrative Law Judge K. Crandall McDougall in Docket No. 7020, *Application of Southwestern Bell Telephone Company for Authority to Implement Rates for IntraLATA Service Provided Over Multijurisdictional WATS Access Lines* (March 25, 1987). MCI Telecommunications Corporation (MCI) had sought in that docket to litigate the local exchange carriers' (LEC) claim of right to all intraLATA 1+ traffic originated over multijurisdictional (also referred to as universal) WATS access lines (UWALs). However, Judge McDougall ruled that the issue was outside of the scope of the docket. That ruling was subsequently appealed to the Commission. On December 18, 1986, after consideration of the appeal, the Commission upheld Judge McDougall's ruling, directed that the issue be severed from Docket No. 7020, and ordered the establishment of the instant docket, wherein the issue would be litigated under Section 42 of the Public Utility Regulatory Act (PURA), Tex. Rev. Civ. Stat. Ann. art. 1446c (Vernon Supp. 1989).

On January 13, 1987, the scope of this proceeding was enlarged as a consequence of the entry of an order of severance in Docket No. 7160, *Application of Southwestern Bell Telephone Company for Authority to Implement Rates and Regulations for Intrastate Interim 800 Service* (April 29, 1987). That order granted General Telephone Company of the Southwest's (GTE) motion to sever from that proceeding the issue of whether intrastate 800 Service (IntraLATA and InterLATA) should be provided by interexchange carriers (IXCs) at access service charges, as proposed by MCI. It also granted SWB's motion to

limit the scope of Docket No. 7160 to evaluation of SWB's Interim Intrastate 800 Service tariff proposal with the assumption that all intraLATA Interim 800 Service traffic would be reserved to the LECs. The parties were advised that upon petition by any party, the issue severed from Docket No. 7160 would automatically be consolidated with the instant proceeding.

By examiner's order dated January 14, 1987, all LECs were joined as necessary parties to the proceeding. MCI was designated by Judge McDougall as the applicant or moving party. A copy of Judge McDougall's order and notice of prehearing conference was mailed to all LECs, all IXCs registered with the Commission in accordance with P.U.C. SUBT. R. 23.61(i) and (j), all parties to Docket Nos. 7020 and 7160, and the Office of Public Utility Counsel. Finding that notice to be sufficient under P.U.C. PROC. R. 21.25, Judge McDougall did not require the issuance of further notice by the parties.

On April 23, 1987, MCI filed a formal petition in this proceeding in which it requested that the Commission: 1) consider the issues severed from Docket Nos. 7020 and 7160; 2) conduct a hearing and receive evidence concerning those issues; 3) order Southwestern Bell Telephone Company (SWB) to allow IXCs to carry intraLATA WATS and 800 service traffic and receive revenues for such carriage; and 4) require the LECs to file the tariffs necessary to implement the requested relief.

A prehearing conference was convened on April 29, 1987, at which Judge McDougall limited the scope of the issues strictly to those issues severed from Docket Nos. 7020 and 7160. Because Judge McDougall construed the issues as constituting policy questions the resolution of which did not require litigation of LEC rates and revenues from a cost of service standpoint, the burden of proof was assigned in accordance with common law rules. MCI and aligned parties were assigned the burden of persuasion and that of filing a

prima facie case, on the basis that granting the relief sought would constitute a change in the Commission's current policy.

An examiner's order was issued on May 5, 1987, memorializing the procedural schedule and other rulings made at the April 29, 1987 prehearing conference. The order also granted motions to intervene filed by AT&T Communications of the Southwest, Inc. (AT&T), US Sprint Communications Company (Sprint), Long Distance Service (LDS) and Claydesta Communications, Inc. (Claydesta). General counsel appealed the order because the procedural schedule set by Judge McDougall deviated substantially from the agreed schedule proposed by the parties. However, the procedural schedule was subsequently revised in response to a motion for reconsideration and general counsel withdrew its appeal.

On May 15, 1987, MCI filed an amended petition. In addition to the relief previously requested, MCI urged that if SWB and the other LECs were to be permitted to compete in the carriage of intraLATA WATS and 800 Service traffic, they be ordered to segregate their operations in a manner which would prevent them from leveraging their monopoly power into WATS and 800 Service, in order to assure competition in the relevant marketplaces. Additionally, MCI requested that the independent LECs be required to implement flat-rate access charges for WALs, consistent with the access charge structure established for SWB in Docket No. 6200, SWB's last rate case. Motions to dismiss or, in the alternative, to strike MCI's amended petition were filed by Texas Statewide Telephone Cooperative, Inc. (TSTCI) and Brazoria Telephone Company et al. on May 26 and June 8, 1987, respectively.

Judge McDougall issued an order on June 11, 1987, in which he characterized MCI's amended petition as an improper attempt to invoke PURA Section 43, to force an examination of LEC rates, and to modify access charges for intrastate WALs. Accordingly, Judge McDougall granted TSTCI's motion to strike with respect to those three points. He emphasized that rates were not at issue in this docket. He further emphasized that the focus of the docket would be upon UWALs rather than intrastate WALs. The order also granted an unopposed motion

to intervene by the Texas Association of Long Distance Telephone Companies (TEXALTEL).

By examiner's order dated June 25, 1987, Judge McDougall granted a motion to withdraw filed by Claydesta.

By examiner's order dated September 29, 1987 in Docket No. 7614, *Application of Southwestern Bell Telephone Company for Authority to Implement Rates and Regulations for Intrastate Interim 800 Service* (April 1, 1988), if the issue of whether all intraLATA 800 Service traffic and revenues should in fact belong to SWB and the other LECs, or whether the IXCs should ultimately only be required to pay access charges in lieu of an intraLATA 800 Service usage rate was severed from that docket for consideration in the instant proceeding.

On October 13, 1987, the Director of Hearings issued an order cancelling the hearing on the merits scheduled for November 9, 1987, and indefinitely suspending the procedural schedule. That order was necessitated by Judge McDougall's resignation from Commission employment. The instant proceeding was assigned to the undersigned examiner on March 23, 1988.

A prehearing conference was convened on April 4, 1988, at which time a new procedural schedule was established. The hearing on the merits was scheduled for August 22, 1988.

By examiner's order dated June 8, 1988, the examiner delineated the extent to which certain Bell Operating Company (BOC) 800 Data Base issues raised in MCI's prefiled testimony would be deemed relevant to the proceeding, and established a deadline for updating SWB testimony on those issues.

A settlement conference was convened by the undersigned examiner on August 15, 1988, at which time the parties agreed to hearing procedures designed to shorten the length of the hearing. The more significant of the procedures were

the alignment of the LEC and IXC participants into two factions, and the parties' agreement that no cross-examination of a witness sponsored by an aligned party would be permitted by any other party similarly aligned.

The hearing on the merits was convened on August 22, 1988, with the undersigned examiner presiding, and was adjourned on September 14, 1988. During that period, testimony was taken on twelve days. The following parties and representatives made appearance during all or parts of the hearing on the merits:

PARTY	REPRESENTATIVE
MCI	Neal Larsen
AT&T	Van H. Cline
Sprint	Helen M. Hall and Michael Ball
TEXALTEL	Clarence L. Cheshier
SWB	Edwin Eckhart and Kirk Kridner
GTE Southwest, Inc. (GTE)	Angela M. Demerle and Cody Wilbanks
TSTCI	Don Richards
Central Telephone Company of Texas; Kerrville Telephone Company; Lufkin-Conroe Telephone Exchange, Inc.; Cameron Telephone Company (Centel et al.)	Brook B. Brown
Brazoria Telephone Company; Byers-Petrolia Telephone Company; Fort Bend Telephone Company; Lake Dallas Telephone Company; Muenster Telephone Company; San Marcos Telephone Company; Valley View Telephone Company (Brazoria et al)	John F. Bell
General Counsel	Carol Vogel and Martin Wilson

Following the conclusion of the hearing on the merits, the parties were permitted until October 11, 1988, to file post-hearing briefs and until November 1, 1988 to file reply briefs. Post-hearing briefs were filed by MCI, AT&T, Sprint, SWB, GTE, TSTCI, Centel, et al., and Brazoria, et al. With the exception of Brazoria, et al., each of those entities also filed reply briefs. Due to the admission of two late-filed exhibits into the evidentiary record, the parties were permitted to, and AT&T and SWB did in fact file brief supplemental briefs addressing the significance of those exhibits.

The Commission has jurisdiction over the matters raised in this proceeding pursuant to PURA Sections 16(a), 18, 37, 42 and 83.

II. Overview of the Case

The style of this case, *Inquiry Into IntraLATA WATS Competition on Multijurisdictional WATS Access Lines*, is misleading in at least three respects. First, the case is not a Commission inquiry, as is implied by the case style. Rather it is a complaint proceeding initiated by MCI and joined in by other IXCs. Second, the case is not limited to IntraLATA WATS Service but rather involves IntraLATA Interim 800 Service as well. Third, as to 800 Service, the scope of the proceeding cannot be limited to the provision of service over UWALs because the service is not restricted to that type of terminating access and the issue severed from Docket No. 7614 was not restricted by the severance order solely to service terminated over a UWAL. The style of the case remains unchanged since the inception of the docket in order to avoid confusion by persons monitoring the proceedings. However, the reader should recognize that the issues are much broader than is apparent from the case style.

This docket generally concerns the extent to which intraLATA WATS and 800 service traffic and/or revenues can or should, as a matter of public policy, be reserved to the LECs. With respect to WATS service, the ultimate issue is whether the present serving arrangement under which the LECs are the sole

carriers of intraLATA WATS traffic originated over UWALs using the 1+ dialing pattern (as opposed to the 10-XXX) dialing pattern should be continued. With respect to 800 service, the ultimate issue is whether the current interim arrangement, under which a revenue replacement rate is applied by the LECs to IXC intraLATA 800 Service traffic in lieu of access charges, should be continued.

Determination of these issues necessitates an examination of the extent to which Commission action may be deemed to create a monopoly in contravention of Article I, Section 26, of the Texas Constitution. Further, it requires examination of the proper balance between the competing statutory objectives of providing equal opportunity to all telecommunications utilities in a competitive marketplace, insuring efficient telecommunications service, and promoting the universal availability of telecommunications service at just, fair and reasonable rates. The Commission's resolution of the case will affect every LEC in the State, by virtue of the fact that all LEC intraLATA toll revenues are pooled on a statewide basis. All IXCs operating within the State will also be affected since the outcome of the case will control the extent and quality of permissible IXC competition with LECs for the provisioning of WATS and 800 services within the intraLATA arena.

Two Federal Communications Commission (FCC) actions provided the backdrop for this proceeding. The first was a May 20, 1986 Federal Communications Commission (FCC) *Memorandum Opinion and Order* in CC Docket No. 86-181, in which the FCC determined that interstate WALs should be accorded tariff treatment similar to other forms of voice grade special access, and that all restrictions on use not applicable to other forms of voice grade special access should be eliminated. Prior to that FCC order, WATS and 800 Services using LEC provided WALs were required to be jurisdictionally pure. In other words, a WATS or 800 Service customer who desired to make or receive both intrastate and interstate calls had to have two WALs: an intrastate WAL for intrastate traffic, and an interstate WAL for interstate traffic. That requirement apparently limited the attractiveness of WALs to OCCs, given that OCCs could

obtain unrestricted calling scope without the need for two access lines by the use of a special access connection. However, the FCC's order removing the jurisdictional restrictions on interstate WALs substantially increased the attractiveness of interstate WALs to OCCs because UWALs could provide a more cost effective means of access than special access lines for lower volume customers.

The second FCC action was the approval in 1986 of interstate tariffs for Interim 800 NXX Service. That service offering, which was necessary to satisfy the BOCs' equal access obligations with respect to 800 service, enabled OCCs to provide 800 Service for the first time. Because LECs were incapable of determining the jurisdiction of 800 Service traffic under the Interim 800 NXX arrangement and could not insure jurisdictional purity as to such traffic, the LECs were required to implement tariffs at the intrastate level as well, which would apply to the intrastate portion of such traffic.

Three Commission dockets, 7020, 7160 and 7614, set the stage for this proceeding. Docket Nos. 7020 and 7160 involved SWB tariff filings related to the above FCC decisions. Docket No. 7020 concerned rates for intrastate traffic on UWALs. Docket No. 7160 involved similar issues, but in addition, it implemented SWB's Intrastate Interim 800 Service offerings. Because SWB sought in those two dockets to require the OCCs to offer their WATS and 800 services under the same arrangements as had developed between AT&T and SWB after divestiture, wherein the intraLATA traffic was reserved to the LECs, a number of IXCs contested the filings. However, the Commission precluded the IXCs from litigating in those dockets the LECs' claim of ownership to that traffic by severing the issue for litigation in this docket.

The LEC intraLATA traffic ownership issue arose again in Docket No. 7614, a docket which involved the appropriate manner in which to calculate the 800 Service replacement rate for traffic terminated over common lines. Again, the issue of ownership of intraLATA 800 Service traffic and/or revenues was reserved for consideration in this docket. Pending the resolution of this

docket, the LEC WATS and 800 Service offerings are structured based upon the assumption that the LECs possess the exclusive rights to 1+ intraLATA WATS and 800 Service traffic and/or revenues.

The LECs take the position in this proceeding that, since divestiture, the Commission has consciously chosen as a matter of public policy to reserve 1+ intraLATA WATS and 800 Service traffic to the LECs. The LECs assert that that policy has fostered competition for toll services within the intraLATA arena and that, absent that policy, the "competitive *status quo*" between between the LECs and the IXCs could not be maintained. Were 1+ WATS and 800 Service traffic and/or revenues no longer to be reserved to the LECs, the LECs believe that they would lose the vast majority of their intraLATA WATS and 800 Service customer base, and that a substantial portion of their intraLATA MTS traffic could also be lost through customer migration to IXC toll services. Such developments would in the LECs' view adversely affect intraLATA competition for toll services, result in inefficient use of telecommunications facilities within the State, cause severe revenue losses for the LECs, and pose a long term threat to the goal of universal service, particularly with respect to the rural areas served by the independent LECs.

The IXCs have raised a number of arguments in opposition to continuance of the current *status quo*. The IXCs contend that the Commission has never enunciated a policy that 1+ intraLATA WATS and 800 Service traffic should be reserved to the LECs. Further, AT&T asserts that the Commission could not implement such a policy without violating the Texas Constitution's prohibition against public creation of monopolies. The IXCs assert that LEC "monopolization" of intraLATA WATS and/or 800 Service constitutes anticompetitive conduct which discriminates against IXCs and impairs their ability to compete within the intraLATA arena, in total contravention to the procompetitive thrust of PURA. The IXCs maintain that LEC "monopolization" of intraLATA 1+ WATS and 800 Service has resulted in reduced choices for consumers, higher prices, and the stifling of product innovation.

The IXCs argue that elimination of the LECs' "monopolization" of intraLATA 1+ WATS and 800 Service would not, even under the worst case scenario, result in revenue reductions of sufficient magnitude to adversely impact the financial condition of the LECs, nor would the goal of universal service be threatened in any fashion. Rather, the IXCs assert that the stimulation of access charge revenues which will be occasioned by the introduction of full and free competition for the provisioning of 1+ WATS and 800 Service within the intraLATA arena can be expected to more than offset any revenue reductions attributable to the loss of the LECs' intraLATA monopolies over those services.

The Commission staff and general counsel concur in the LECs' position.

As a preliminary matter, the examiner would note that the parties disagree as to what the outcome of this docket can be in the event the Commission finds that the relief requested by the IXCs should be granted. The parties' confusion stems from the fact that in early procedural orders in this docket, Judge McDougall indicated that this proceeding was initiated to determine Commission policy with respect to 1+ intraLATA WATS and 800 Service rather than to litigate LEC rates. The LECs take the position that if the Commission determines as a mater of policy that the revenue replacement rate currently applied by the LECs to IXC intraLATA 800 Service traffic in lieu of access charges should not be continued, the LECs should be afforded an opportunity to litigate an appropriate alternative rate in a subsequent proceeding. The IXCs believe that, since there is no basis for application of the special revenue replacement rate to IXC intraLATA 800 Service traffic in lieu of access charges, other than the assumption that the LECs as a matter of Commission policy are entitled to the ownership rights to 1+ intraLATA trffic, the rate must be eliminated and replaced by current LEC access charges in the event the Commission finds that LECs are not entitled as a matter of Commission policy to ownership of all 1+ intraLATA traffic.

It is important to note that in Docket No. 7160 the issue severed for consideration in this docket expressly concerned whether the LECs were entitled

to ownership of intraLATA Interim 800 Service traffic or whether the IXCs should be permitted to carry that traffic and pay access charges. Judge McDougall indicated in a May 5, 1987 order that the scope of the proceedings in this proceeding included the issues severed from Docket No. 7160. Further in Docket No. 7614, the issue of whether IXCs should ultimately only be required to pay access charges in lieu of a special intraLATA 800 Service revenue replacement rate was precluded from being litigated in that docket on the basis that it was being considered in this proceeding.

The ambiguities in Judge McDougall's early orders has generated unnecessary confusion in this proceeding. The examiner concurs with Judge McDougall that this is primarily a policy making proceeding. However, it is apparent that determination of the Commission's policy with respect to intraLATA 800 Service also determines the validity of the intraLATA 800 Service revenue replacement rate. The examiner finds that, since there exists no basis for continuing the intraLATA 800 Service revenue replacement rate other than the policy determination that LECs are entitled to ownership of all intraLATA 800 Service traffic and/or revenues, should the Commission find as a matter of policy that the LECs are not entitled to such ownership rights the rate must be eliminated and the LECs limited to charging rates only for the actual service provided in connection with that traffic. The only service provided is access. Thus, were the IXCs to prevail in this proceeding, the only rates which the LECs should be permitted to charge are current LEC access rates.

Resolution of the issues in dispute in this proceeding requires some knowledge of the manner in which WATS and 800 Services are technically configured, and of the Commission's past policy with respect to intraLATA WATS and 800 Service. Therefore, the next two sections of the report will provide the reader with that necessary background information. The report will then address the IXC's legal arguments concerning the Commission's authority to reserve 1+ intraLATA WATS and 800 Service traffic to the LECs. Finally, the report will discuss at length the record evidence as it relates to the appropriate balance between the competing policy objectives mandated by PURA.

III. Description of WATS and 800 Services

In order to evaluate the merits of certain arguments raised by the IXCs and the LECs discussed in Section VII of this report, it is essential that the reader fully comprehend the nature of WATS and 800 services and the manner in which those services are configured. Because the services are technically quite different, a separate discussion of each service follows.

A. Description of Wide Area Telecommunications Service (WATS)

WATS, also commonly referred to as OutWATS, is a discounted bulk-rated toll service which originated in the early 1960's as a service offering of AT&T and the Bell Operating Companies (BOCs). The service, which is designed for business customers whose calling volumes are relatively large and whose usage is relatively predictable, provides one-way calling from the subscriber's premises to any zones within the country to which the subscriber wishes to have calling capability.

WATS and regular message telecommunications service (MTS) are very similar from a technical standpoint. The primary technical distinction between the services is that a WATS customer accesses the LEC network via a WAL rather than a common line. A WAL is a dedicated access line which runs from the customer's premises to the LEC central office. It is technically no different than a common line connecting a customer to a central office, with the exception that incoming calls cannot be received over the line. Thus, a WATS customer who desires to have regular local exchange service must be connected to the central office by both a common line and a WAL.

WATS is a switched access service. In other words, WATS calls are screened by a LEC central office switch to determine how they are to be routed. The screening function for WATS traffic must be performed by a WATS Serving Office

(WSO). If the switch in the central office serving the WATS customer is a digital or electronic switch, the central office will function as the WSO. If the central office is not capable of serving as a WSO, the WATS traffic is routed via shared inter-office trunk facilities to a central office which is capable of serving as a WSO. The shared trunk facility between the central office and the WSO is known as a WAL extension (WALE).

The primary functions of a WSO are the determination of the geographic destination of WATS traffic and the recording of billing data. The WSO screens all WATS traffic and routes the interLATA traffic, either directly or via a LEC access tandem, to the designated IXC's point of presence (POP) for transportation over the IXC's facilities. The WSO routes all 1+ intraLATA traffic to the LEC for transportation and termination over the LEC's facilities. If an IXC chooses to make the 10-XXX dialing option available to its WATS customers and a customer dials the IXC's 10-XXX code in lieu of 1+, the WSO automatically routes the call to the IXC for transportation over the IXC's facilities, irrespective of the geographical destination of the call.

IntraLATA WATS traffic routed to the LEC by a WSO is billed directly to the WATS customer by the LEC. If the WATS customer has subscribed to the LEC's intraLATA WATS offering, or to a WATS offering jointly provided by the LEC and an IXC, the customer is bulk billed at the applicable LEC WATS rates for the customer's intraLATA usage. If the customer does not subscribe to a LEC WATS offering, the customer is billed by the LEC for the 1+ traffic originated over the customer's WAL at the LEC's applicable rate for intraLATA MTS. All interLATA WATS traffic routed to an IXC by a WSO is billed by the IXC. The LEC, however, bills the IXC access charges on that traffic.

As alternatives to WATS service, IXCs can and do provide "WATS-like" services. The only technical difference between WATS and WATS-like services is that, in lieu of a WAL, the access connection between the customer and the IXC's POP is accomplished via a customer or IXC-owned facility or a special

access facility leased from the LEC. Since traffic carried over such facilities bypasses the LEC switched network, all 1+ intraLATA WATS-like traffic originating over those types of facilities are transported solely by an IXC.

B. Description of 800 Service

800 Service, also commonly referred to as InWATS, is a bulk-rated toll service in which the called party, rather than the calling party, subscribes to the service and pays for calls. It is in essence a mechanized reverse charge service. The subscriber can restrict the calling scope of the service to specific geographical zones, or can choose to receive calls from any location within the country. The name "800 Service" results from the fact that all 800 Service customers are assigned an 800-NXX-XXXX telephone number which must be utilized by those wishing to call the customer on a toll-free basis. The service provides businesses and other organizations a means of providing potential customers, or other persons with whom they wish to communicate, a convenient and free method of contacting them. The service was first introduced by AT&T in 1967, and has proven to be a highly popular and fast growing service offering.

Although there are similarities between WATS and 800 Service, the technical configuration of 800 Service is far more complex than that of WATS. 800 Service traffic originates over common lines connecting calling parties to the LEC switched network. From a technical standpoint, 800 Service traffic is not restricted to termination over a WAL. 800 Service traffic can be terminated at the customer's premises using a common line, a WAL, a special access line, or a dedicated private facility installed by an IXC or the 800 Service customer.

Unlike WATS, only one dialing plan can be used in conjunction with 800 Service. An individual desiring to access an 800 Service location must do so by dialing 1+800-NXX-XXXX. An IXC's 10-XXX access code cannot be used in lieu of 1+ to reach an 800 number.

Because the "800" special access code occupies the same position in the dialing sequence as would an area code (NPA), the 800 Service number does not contain the requisite information for a LEC switch to identify either the jurisdiction of the call or the specific access line over which the call is to be terminated. An 800 Service call must therefore first be routed to an 800 Service database which translates the 800-NXX-XXXX number dialed by the calling party into the NPA-NXX-XXXX "plain old telephone service" (POTS) number which has been assigned to the access line at the 800 Service customer's called terminating location.

At the time of divestiture, the BOCs retained all intraLATA 800 Service traffic and AT&T retained all interLATA traffic. However, the 800 Service database which converts 800-NXX-XXXX codes to POTS numbers for routing and billing purposes was designated as an AT&T asset. Because BOCs could not provide 800 Service without an 800 database, AT&T was required to permit BOCs to use its database for the provision of the BOCs' intraLATA 800 Service offerings until the BOCs could develop their own databases. AT&T was not required to share its 800 database with any OCCs. Since divestiture, SWB has been under an obligation to provide equal access to 800 Service to all IXCs. That obligation was fulfilled by SWB's introduction of Interim 800 Service which was approved at the intrastate level by final order dated March 1, 1987, in Docket 7160.

Under the 800 NXX plan as it is currently implemented in Texas, an IXC can offer 800 Service under either of two options. First, the IXC can enter into a joint service arrangement with the LEC (joint option), under which the IXC carries and bills the interLATA portion of the 800 Service traffic and the LEC carries and bills the intraLATA portion of the traffic. Second, an IXC can offer the service on a stand-alone end-to-end (non-joint option) under which the IXC carries and bills all of the traffic regardless of its interLATA or intraLATA character. Under that option, the IXC must pay the LEC a special revenue replacement rate, in lieu of access charges, for all intraLATA 800

Service access minutes of use (MOU) carried by the IXC. The revenue replacement rate, which was litigated in Docket No. 7160 and relitigated in Docket No. 7614, is designed to approximate the net revenue which the LEC would have obtained had it carried and billed the intraLATA portion of the 800 Service traffic itself.

Interim 800 Service works as follows. Each IXC ordering 800 Service is assigned a separately identifiable NXX code or codes which become a part of the 1+800-NXX-XXXX numbers used by calling parties to originate 800 Service calls. When an individual initiates an 800 Service call, the switch in the LEC central office serving that individual screens the 800 NXX portion of the number, recognizes that it is an 800 Service call, and routes the call to the designated IXC's POP either directly or via a LEC access tandem.

If the IXC's POP contains only a network point of interface (POI) and has no switching capability (facility POP), the call is carried from the facility POP to a POP which possesses switching capability (switched POP). The switched POP either performs the 800 number-to-POTS number translation using switch-resident memory, or holds the call while it queries a remotely-sited 800 Service database over a common channel signaling (CCS) network to obtain the 800 number-to-POTS number translation. After the 800 number is translated, the manner in which the call is routed depends upon the service arrangement between the LEC and the IXC. If the IXC is providing 800 Service with the LEC under the joint option, and the call is intraLATA in nature, the IXC switch routes the call back to the same LEC tandem from which the IXC received it and the LEC then transports and terminates the call over LEC facilities. If the call is interLATA in nature, or if the IXC is providing 800 Service under the non-joint option, the IXC switch routes the call over the IXC network to the POP closest to the 800 customer's terminating location. Depending upon the type of terminating facility arranged by the IXC, the call is either transferred to the LEC at an access tandem for termination over LEC provided WAL, common line, or special access line, or terminated directly by the IXC over a dedicated private facility connecting the IXC POP to the customer's premises.

IV. Prior Commission Policy

It is useful to identify the Commission's past policy, if any, with respect to WATS and 800 Service before undertaking an evaluation of what the Commission's future policy should be. The LECs have argued throughout this proceeding that the Commission's traditional policy has been to reserve ownership of all 1+ intraLATA traffic to the LECs. The LECs rely upon five Commission dockets to substantiate their claim: Docket Nos. 5113, 6200, 7020, 7160 and 7614. After review of the Commission's actions in those proceedings, the examiner is convinced that the Commission has never affirmatively established a policy position on the issue.

With respect to the first docket, Docket No. 5113, *Petition of the Public Utility Commission of Texas for an Inquiry Concerning the Effects of the Modified Final Judgment and the Access Charge Order upon Southwestern Bell Telephone Company and the Independent Telephone Companies of Texas, 13 P.U.C. BULL. 493* (May 14, 1984), the LECs rely upon Finding of Fact No. 102 as evidence that the Commission affirmatively intended to reserve ownership of all 1+ intraLATA traffic to the LECs. That finding reads as follows:

> 102. After January 1, 1984, all one-plus calls will continue to be routed over the same network as it existed prior to that date; interLATA calls are AT&T's and intraLATA calls are SWB's.

SWB witness Eugene Springfield testified that the issue of 1+ intraLATA presubscription was a hotly contested issue in Docket No. 5113 and that the above finding represented the Commission's resolution of that issue. The examiner strongly disagrees. Without reviewing the evidence presented in Docket No. 5113, the examiner cannot make any representations regarding what issues were or were not raised by the parties during that proceeding. However, it is clear from a review of the Examiners' Report in that docket that the examiners did not discuss the issue of intraLATA presubscription in the report

nor did they make any recommendations to the Commission on the issue. Finding of Fact No. 102 represents nothing more than a description of how traffic would be split between AT&T and SWB under the MFJ, once divestiture occurred. The following two paragraphs constitute the text of the Examiner's Report which underlies Finding of Fact No. 102:

> While SWB is prohibited from providing intrastate interexchange (interLATA) service, AT&T is not prohibited by the MFJ from providing intraexchange (intraLATA) service. At the present time, the only obstacle to AT&T providing such service is the network configuration. All one-plus call will continue to be routed over the same network as it existed prior to January 1, 1984. If the call originates in one LATA and terminates in a different LATA (interLATA), it is identified and billed as AT&T traffic; if it originates and terminates within the same LATA (intraLATA), it is identified and billed as Southwestern Bell traffic. Until equal access, customers will continue to get SWB or AT&T automatically if they dial one-plus.
>
> Furthermore, the OCCs are not directly affected by the MFJ; the LATA boundaries do not restrict where they may carry toll traffic or provide telecommunications services. Insofar as the MFJ defines the exchange access services which the BOCs must provide on a non-discriminatory basis to all interexchange carriers, there could be a question as to whether SWB must provide such exchange access services to OCCs carrying toll traffic within a LATA; however, since the exchange companies cannot identify the destination of OCC traffic, they will treat it all as exchange access.

(Id. at pp. 25-26. Emphasis added).

As is evident from the above passage, the examiners were not attempting in Finding of Fact No. 102 to address how 1+ intraLATA traffic would or should be handled after equal access was fully implemented. Rather, they were simply describing how it would be handled under the MFJ prior to the availability of equal access. It is further evident that the examiners recognized the existence of, but were not addressing, issues relating to the LECs' access obligations to OCCs in the context of intraLATA toll services. For the foregoing reasons, the examiner cannot accept the LECs' contention that Docket

No. 5113 reflects a statement of Commission policy to the effect that all 1+ intraLATA traffic should be reserved to the LECs.

With respect to Docket No. 6200, *Petition of Southwestern Bell Telephone Company for Authority to Change Rates* (June 26, 1986; on rehearing September 24, 1986), SWB asserts that the Commission upheld the policy decision made in Docket No. 5113 by choosing not to grant MCI's request for 1+ intraLATA presubscription, and by approving through the compliance tariff process SWB's intrastate intraLATA WATS tariff. However, a review of the final order in Docket No. 6200 reveals that the Commission made no findings regarding intraLATA 1+ presubscription. Undoubtedly, a primary reason why the Commission did not address the issue was that it was raised by MCI at the last minute in MCI's brief and in its motion for rehearing. It appears that the issue was never the subject of litigation during the hearing phase of the case and that no evidence on the issue was ever presented by the parties. In the examiner's opinion, the failure of the Commission to address the issue does not constitute the creation of an affirmative Commission policy favoring reservation of all 1+ intraLATA traffic to the LECs.

As regards the Commission's approval of SWB's IntraLATA WATS Tariff following the entry of the final order in Docket No. 6200, the examiner submits that that ministerial action must be placed in perspective. The specific tariff language relied upon by SWB is as follows:

Section 1, Sheet 1, Revision 1: Intrastate WATS Tariff

1.2 Outward WATS - Service components for dial-type telecommunications from an Outward WATS access line to intraLATA toll points within the State of Texas will be furnished in accordance with the regulations and schedules of rates and charges set forth in this Tariff, except as provided in 1.3 and 1.4 following:

1.3 InterLATA dial-type telecommunications from an Outward WATS access line provided by the Telephone Company is furnished by an interexchange carrier. Any interexchange carrier may provide interLATA service using the Telephone

> Company-provided WATS access line, subject to the availability and compatibility of the service components of the Telephone Company and the interexchange carrier.
>
> 1.4 If the subscriber to interLATA WATS does not subscribe to intraLATA WATS, calls made within the same LATA over facilities wholly provided by the Telephone Company via the Telephone Company-provided WATS access line will be billed at charges for long distance messages as specified in the Company's Long Distance Message Telecommunications Service Tariff.

According to SWB, Paragraphs 1.2 and 1.4 reflect that all 1+ intraLATA WATS traffic is reserved to the LECs. The examiner submits that the above language is exceedingly vague and is subject to multiple interpretations. The Commission's approval of that tariff language, which comprised a very small part of a voluminous compliance tariff filing, cannot in the examiner's opinion reasonably be construed as an affirmative Commission declaration of policy with respect to the ownership of 1+ intraLATA WATS traffic .

With respect to Docket No. 7020, *Application of Southwestern Bell Telephone Company for Authority to Implement Rates for IntraLATA Service Provided Over Multi-Jurisdictional WATS Access Lines* (March 25, 1987), the LECs rely upon pronouncements by Judge McDougall that Commission policy is to reserve all 1+ intraLATA traffic to the LECs. On page 5 of the Examiner's Report in Docket No. 7020, Judge McDougall stated:

> The issue as formed by the parties was one of the proper scope of intraLATA competition and much too complicated and important from a policy perspective to be addressed in this docket. The ALJ found the Commission's previous approval of SWBT's intrastate WATS tariff for intrastate WALs to be a policy statement with respect to allowing intrastate intraLATA WATS traffic to be switched and routed by the LECs, and he therefore limited the scope of this docket to the determination of the rate to be charged under the proposed tariff.

The finding to which Judge McDougall referred was made in an October 30, 1986 order which excluded the 1+ IntraLATA WATS issue from the scope of Docket No. 7020. That order was subsequently appealed and heard by the Commission at an open meeting convened on December 17, 1989. At that time the Commission gave no indication that it agreed with Judge McDougall's contention that there existed a Commission policy requiring the reservation of 1+ intraLATA traffic to the LECs. The Commission upheld the exclusion of the issue from Docket No. 7220. However, it appears from the transcript of that meeting that it did so, not out of deference to any standing policy of the Commission, but rather out of caution, given that serious allegations had been made concerning the effect which the issue might have on the independent LECs. Rather than recognizing the existence of any current Commission policy, the Commission directed the initiation of the instant docket for the purpose of formulating a policy applicable to 1+ intraLATA traffic originating over UWALS.

With respect to Docket No. 7160, *Application of Southwestern Bell Telephone Company for Authority to Implement Rates and Regulations for Intrastate Interim 800 Service* (April 29, 1987), SWB asserts that the Commission's policy regarding ownership of 1+ intraLATA traffic was reiterated by the Commission's approval of tariffs which reserved the revenues from intraLATA 800 service traffic to SWB and the other LECs. That contention is wholly without merit. In that docket, the issue of LEC ownership of intraLATA 800 service traffic, all of which must necessarily originate using the 1+ dialing pattern, was specifically severed and reserved for consideration in this docket. The examiner in that proceeding did not at any time find or indicate in either an order or the Examiner's Report that there existed a Commission policy in favor of reserving 1+ intraLATA traffic to the LECs, nor did the Commission make any statements to that effect at the open meeting of the Commission at which the Examiner's Report was considered or in the final order entered in that docket. In fact, because the rates and basic structure of the service offering were stipulated to by the parties, the final order specifically states that the order is not to be regarded as a binding or precedential holding.

With respect to Docket No. 7614, the examiner can only again observe that the issue of LEC ownership of intraLATA 800 Service traffic was severed from that docket for consideration from a policy standpoint in this docket. The examiner did find that the Commission had in Docket Nos. 7160 and 7020 evidenced a policy of protecting the intraLATA revenue stream pending resolution of this proceeding. However, the examiner expressly recognized that the Commission had not as yet enunciated any policy on the issue of LEC ownership of 1+ intraLATA traffic.

In summary, the examiner believes that the LECs' contention that the Commission has in the past consciously adopted a policy of bestowing on LECs the ownership rights to 1+ intraLATA traffic is incorrect. Prior to this proceeding, the issue had never been presented directly to the Commission in a fashion that would have permitted the Commission to develop a policy. The purpose of this docket is to formulate the Commission's policy, not to revisit the continued merit of past policy.

V. The Unconstitutional Monopoly Argument

A threshold issue which must be addressed in this proceeding is AT&T's assertion that the Texas Constitution forbids the reservation of all 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs or any other entity. AT&T argues that such action would constitute the grant of a monopoly to the LECs with respect to 1+ intraLATA WATS and 800 Service in violation of Article I, Section 25 of the Constitution, which provides as follows:

> Sec. 26. Perpetuities and monopolies are contrary to the genius of a free government, and shall never be allowed, nor shall the law of primogeniture or entailments ever be in force in this State.

It is undisputed that the monopolies denounced by this provision are those created by the state or a political subdivision thereof. *Gerst v. Cain*, 379

S.W.2d 699 (Tex. Civ. App.--Austin 1964), *aff'd*, 388 S.W.2d 168 Tex. (1965). It is also undisputed that the prohibition is applicable to grants of monopolies for the provision of utility services. *City of Garland v. Texas Power & Light Co.*, 295 S.W.2d 925 (Tex. Civ. App.--Dallas, 1956); *Lea County Electric Cooperative, Inc. v. City of Plains*, 373 S.W.2d 90 (Tex. Civ. App.--Amarillo, 1963, writ ref'd n.r.e.); *Brenham v. Brenham Water Co.*, 4 S.W. 143 (Tex. 1887).

Thus, it is clear that if the reservation of 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs constitutes the creation of a prohibited monopoly, there is no need to ponder policy issues in this docket. The Commission would have no option but to grant the relief requested in MCI's petition since any attempt to reserve 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs would be not merely *ultra vires*, but absolutely void. *Edwards County v. Jenings* 35 S.W. 1053 (Tex. 1896). The real question then is whether in fact such a reservation would constitute the grant of a prohibited monopoly.

Texas case law defining the term "monopoly" within the intended meaning of the constitutional prohibition is quite scarce. In *MacDonell v. I.&G.N.R. Co.*, 60 Tex. 590 (1884), the court held that an essential element to any finding of monopoly is the conveyance of an exclusive right or privilege to one person or association of persons by which it has the sole authority to pursue a given business. Similarly, in *Brenham Water*, the court held that a grant which gives one person or an association of persons an exclusive right to buy, sell or use a given thing or commodity, or to pursue a given employment, creates a monopoly.

Moreover, in *Jones v. Carter*, 101 S.W. 514 (Tex. Civ App.--Houston, 1907, writ ref'd), the court held that a monopoly is not confined strictly to granting to a few an exclusive right to something which was before a common right. The court found that the concept embraces any combination or contract that tends to prevent competition in its broad and general sense and to control

prices to the detriment of the public. In *Conley v. Daughters of the Republic of Texas*, 151 S.W. 877 (Tex. Civ. App.--San Antonio 1912), *rev'd on other grounds*, 156 S.W. 197 (Tex. 1913), the court held that a "monopoly" in the sense forbidden by the Constitution consists of the ownership or control of so large a part of the market supply of a given commodity as to stifle competition, restrict the freedom of commerce, and give the monopolies control over prices.

It is readily apparent that Texas case law with respect to this issue is rather dated, and it is difficult to judge how a modern court might address the issue. A fair characterization of the above cases is that, in attempting to define "monopoly", the courts by and large relied upon generally accepted definitions of the day, resorting for instance to such sources as Black's Law Dictionary and the Encyclopedia of Law. Therefore, the examiner believes that the precise phraseology utilized in those cases should not be viewed as sacrosanct. The Commission should appropriately look, in determining whether state action would create a constitutionally prohibited monopoly, to whether that action would vest an entity or entities with monopoly power of the kind which the framers of the constitution desired to prohibit.

In order to evaluate whether the reservation to the LECs of all 1+ WATS and 800 Service traffic and/or revenues would contravene the constitutional prohibition against state created monopolies, it is essential that the relevant geographical and product markets against which to measure the effect of such action must be determined. AT&T has framed its constitutional argument in a way which would appear to make the relevant markets obvious, to wit: a geographical market coterminous with LATA boundaries, and a product market comprised of 1+ WATS and 800 Service. However, determination of the appropriate geographic and product markets requires more than mere assertion by AT&T. A discussion of the evidence and relevant case law as it relates to determination of appropriate geographical and product markets follows.

A. The Geographical Market

The LECs assert that the relevant geographical market for toll services is statewide in scope. SWB witness Eugene Springfield testified that the creation of LATAs did not serve to create new markets. Mr. Springfield noted that, in order to assume that intraLATA markets were created by the establishment of LATA boundaries, it must first be assumed that there are potential customers who are aware of the limits of the LATA boundaries. As LATA boundaries do not correspond to area code boundaries or to any recognized political or geographical boundaries with which customers can associate, Mr. Springfield concluded that there exist few, if any, customers who are aware of the territory within which they could call if they purchased intraLATA services and thus, there can be no intraLATA market for telecommunications services.

Mr. Springfield's testimony was not contradicted on this point. MCI witness Mark Bryant's testimony on cross-examination reflects that he does not recognize the existence of an intraLATA-only market. In fact, even AT&T witness William O'Neal testified that AT&T believes there is only one interexchange market.

PURA also lends support for this position. PURA Section 3(c)(2)(B) provides in relevant part that "A telecommunications market shall be statewide until January 1, 1985. After this date the commission may, if it determines that the public interest will be served, establish separate markets within the state." Further, PURA Section 100(b) provides that, for purposes of determining market dominance under that section, service markets shall be geographically statewide.

However, in discussing the issue of geographical scope, the court in *Brenham Water* held that "the right to exercise the exclusive privilege need not extend to all places; it is enough that it is to operate in and to the hurt of one community." This clearly suggests that the fact that an exclusive

right is confined to only a portion of the generally accepted geographical market area would not preclude such an exclusive right from constituting a monopoly of the kind prohibited by the Texas Constitution. This result is wholly consistent with contemporary federal antitrust law. In a number of such cases, the courts have held that the relevant geographical market is the "area in which the alleged restraints affect." *See, e.g., United States v. Columbia Steel Co.*, 334 U.S. 495 (1948); *Hecht v. Pro-Football, Inc.* 570 F.2d 982 (D.C. Cir. 1977), *cert. den.*, 436 U.S. 956 (1978).

The LATA boundaries define the areas in which the LECs operate. For legal reasons with respect to SWB and GTE, and for practical reasons with respect to the other LECs, the LATAs are the LECs' market. The LATAs also constitute the areas in which the LECs and IXCs compete in the provision of toll services. As the LATAs are the area which the alleged restraints affect, the examiner concludes that, for purposes of evaluating AT&T's constitutional argument, the LATAs must constitute the relevant geographic market.

B. The Product Market

The determination of the relevant product market is essential because, to the extent that competition from related products limits the market power of an entity with a dominant position in one product, such an entity is less likely to be found to hold monopoly power. Thus, in resolving the proportion of the "market" controlled by an entity, courts look to the range of commodities reasonably interchangeable for the same purposes. *United States v. E.I. DuPont & Co.*, 351 U.S. 377 (1956).

The relevant product market is a factual issue to be determined from the record evidence. The preponderance of the evidence suggests that the relevant product market for purposes of resolving AT&T's monopoly claims consists of all intraLATA toll services. MCI witness Mark Bryant was cross-examined extensively on the issue of product market definition. In Dr. Bryant's

opinion, there exists only one product market because of the existence of supply-side substitutability, which he defined as the IXCs' ability to reconfigure their networks at will to provide different kinds of services that are essentially substitutable or interchangeable. Dr. Bryant agreed that the market cannot be divided realistically between WATS, 800, MTS, or other such services, and that viewing the various services of the IXCs as separate service markets makes little sense. U.S. Sprint witness Paul Fuglie similarly testified on cross-examination that there is substantial substitutability between toll services. In fact, the record reflects that Sprint currently markets an MTS offering as a WATS service.

No party disputes that toll calling can be accomplished using MTS in lieu of WATS-type services, or that reverse-charge calling can be accomplished without resort to 800 Service. The testimony of the IXC witnesses constitutes persuasive evidence that, for purposes of evaluating AT&T's monopoly argument, the product market should be viewed as the aggregation of all toll services.

An argument can be made that the toll market should be further subdivided into discrete submarkets for purposes of measuring monopoly power. However, such subdivisions would not in the examiner's opinion appropriately recognize the inherent limitation which demand-side substitutability places upon the potential ability of LECs to exercise monopoly power, especially since LEC prices and product offerings are heavily regulated. If one were to recognize the existence of discrete submarkets, the only submarkets for which support from the record could be found would be WATS and WATS-like services on the one hand and 800 Service on the other. The basis for recognizing those product groupings as submarkets would be practical indications such as: 1) The distinct business customer orientation of the offerings; 2) the substantial distinction in pricing between those services and traditional MTS offerings; and 3) the very different service characteristics of WATS and WATS-like services in comparison to 800 Service. Those distinctions, however, are in the examiner's opinion insufficient to justify the recognition of product submarkets, in light of the high substitutability of toll services generally.

The 1+ WATS product market implied by AT&T's monopoly argument is wholly indefensible. Even AT&T witness O'Neal, who was reluctant to agree that all toll services are fully substitutable, testified that WATS and WATS-like services compete with each other as a market and are substitutable for each other. In order to find that 1+ WATS constitutes an appropriate submarket, one would have to ignore not only the testimony of AT&T's own witness, but also the existence of WATS traffic which originates by use of the 10-XXX dialing option rather than 1+. The fact that the 10-XXX dialing option requires the customer to dial four extra digits is not sufficient to require that 1+ be viewed as a separate service market. For the class of customers primarily targeted by WATS-type services, the evidence shows that digital PBXs and automatic dialers can make those extra digits transparent to the customer. And to the extent one dubiously assumes that 1+ dialing constitutes a distinct submarket, one would still come back to the fact that WATS-like services utilize 1+ dialing.

In summary, the examiner finds that the relevant product market, for purposes of resolving AT&T's monopoly claims, consists of aggregated toll services.

Third, even though IXC 800 Service offerings are burdened by the revenue replacement rate, no IXC offers intraLATA-only services. Thus, any competitive disadvantage which that rate may create within the intraLATA arena *vis a vis* the LECs is somewhat mitigated by the IXCs' ability to average the disparate interLATA and intraLATA costs incurred in providing the integrated service.

In summary, the examiner finds that AT&T's constitutional arguments are without merit. A commission decision in this proceeding to implement on a permanent basis the *status quo* with respect to 1+ intraLATA WATS and 800 Service, or even to further constrain IXCs with respect to 800 Service, would not contravene the constitutional prohibition against state-created monopolies.

C. Non-Existence of Monopoly Effect

The record does not support AT&T's contention that a Commission-mandated reservation of all 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs would give the LECs monopoly control over the intraLATA toll market. Even were one to recognize the existence of WATS/WATS-like and 800 Service submarkets, the evidence would not support AT&T's contention.

The LECs presently bill and carry all 1+ intraLATA WATS traffic to the exclusion of the IXCs, yet there exists substantial competition between the LECs and the IXCs in the provisioning of that type of service. For instance, the following WATS-like services are offered by Sprint: Sprint Advanced WATS, Sprint Banded WATS, and Sprint Ultra WATS. Similarly, MCI offers MCI WATS, HOTEL WATS, PRISM I, and PRISM II. AT&T offers MEGACOM.

Each of those WATS-like offerings allows the IXC to carry and bill the 1+ intraLATA traffic originated over those services. Additionally, Sprint offers a WATS service entitled Sprint Advanced WATS Plus which permits the carriage of intraLATA traffic using the 10-XXX dialing option. MCI offers a WATS service entitled PRISM III which could also carry intraLATA WATS traffic using the 10-XXX option if MCI chose to offer that dialing option to its customers. There is no indication in the record that any of the IXC WATS and WATS-like service offerings are unsuccessful, nor is there any evidentiary basis for concluding that the viability of those offerings would be compromised if the *status quo* were perpetuated.

The record reflects that the IXCs' WATS-like service offerings tend to attract the higher volume business customers. This would suggest that the IXCs have a substantial presence in that portion of the IntraLATA toll market. Unfortunately, there is no firm evidence confirming that suggestion. The IXCs could have, but did not, offer evidence quantifying the intraLATA WATS and WATS-like traffic carried by IXCs as a percentage of total intraLATA WATS and WATS-like traffic. In fact, a lack of evidence prevents relative market share

from being quantified with respect to any facet of the intraLATA toll services product market. The examiner would observe, however, that as AT&T shares the burden of proof in this proceeding, it was incumbent upon AT&T to produce such evidence if it desired to convincingly demonstrate a likelihood that LEC monopolization of any realistically defined product market would result from reservation of 1+ intraLATA WATS and 800 Service traffic to the LECs.

With respect to 800 Service, a Commission prohibition of IXC provisioning of that service within LATA boundaries would not, in the examiner's opinion, create a LEC monopoly, because 800 Service constitutes only a small portion of the intraLATA toll market and because the LECs could not leverage their control of that market segment into control of the overall intraLATA toll market. The LECs could not prevent the entry of competitors into the toll market. Nor could they thereby adversely manipulate prices--either in the market as a whole or specifically within the 800 Service market segment, given the existence of LEC price regulation.

Only if one recognized the existence of a distinct intraLATA 800 Service submarket and found that it constitutes the relevant product market against which to judge AT&T's monopoly claims--a fact situation which the weight of the evidence does not support--could the prohibition of competition in the provisioning of 800 Service create a constitutional problem.

The prospect of a Commission-mandated prohibition against the provisioning of intraLATA 800 Service by IXCs is, however, an abstract concern in this proceeding. The LEC tariffs do not presently prohibit any IXC from offering 800 Service on an intraLATA basis, and none of the LECs have requested that their tariffs be modified in the future in order to require that all intraLATA 800 Service be carried and billed by the LEC. Indeed, SWB witness Eugene Springfield specifically promised that SWB would not make such a request in the future. AT&T, Sprint and MCI can and do offer 800 Service within the intraLATA arena. Sprint offers Sprint Direct 800 and Sprint Ultra 800. MCI offers Business Line 800. AT&T offers Megacom 800 and Readyline 800.

Under the stipulation reached by the parties in Docket No. 7160, IXCs are free to carry intraLATA 800 Service traffic but they are required to pay the LECs a revenue replacement rate which is designed to compensate the LECs for the net revenues which the LECs would have earned if they carried and billed the intraLATA portion of the 800 Service traffic themselves. AT&T has argued in brief that Commission affirmation of that rate structure on a permanent basis would violate the Constitutional prohibition against state-created monopolies because the compensation requirement creates the financial effect of a monopoly. AT&T asserts that it violates the Constitution to achieve by indirection that which the Constitution forbids to be done directly. In support of this argument counsel for AT&T cites the testimony on cross-examination of a staff witness with no legal expertise and a case from the El Paso Court of Civil Appeals which is totally irrelevant to the issue.

The evidence convinces the examiner that the revenue replacement rate could not in fact provide the LECs with monopoly control of the 800 Service aspect of the intraLATA toll market. There are three basic reasons for this conclusion, all of which are reflected in the direct testimony of SWB witness Springfield. First, the rates for the LEC intraLATA 800 service offerings have traditionally been set by the Commission pursuant to a residual pricing policy designed to minimize local exchange rates. That procedure results in rates for discretionary services which can be substantially in excess of the incremental costs of providing the services. That rate design policy can place LECs at a disadvantage in relation to the IXCs who, with the exception of AT&T, have the abiity to change rates at will and charge cost-based rates.

Second, the LECs are prohibited from offering 800 Service outside of the LATAs, while the IXCs are free to offer 800 Services without geographical restriction. As customers are generally unaware of LATA boundaries, and most LATAs contain only one major metropolitan area, the IXCs can easily leverage their statewide market presence to their advantage by marketing an integrated 800 Service offering which permits calls to be received from any and all areas in which the customer is interested.

Third, even though IXC 800 Service offerings are burdened by the revenue replacement rate, no IXC offers intraLATA-only services. Thus, any competitive disadvantage which that rate may create within the intraLATA arena *vis a vis* the LECs is somewhat mitigated by the IXCs' ability to average the disparate interLATA and intraLATA costs incurred in providing the integrated service.

In summary, the examiner finds that AT&T's constitutional arguments are without merit. A commission decision in this proceeding to implement on a permanent basis the *status quo* with respect to 1+ intraLATA WATS and 800 Service, or even to further constrain IXCs with respect to 800 Service, would not contravene the constitutional prohibition against state-created monopolies.

VI. Sprint's Unlawful Geographical Restriction Argument

Sprint asserts that the Commission is without authority to geographically restrict the ability of a non-dominant IXC to provide telecommunications services. Sprint's argument rests upon both statutory and constitutional grounds. Before addressing the merits of Sprint's assertion, it is essential to observe that no party to this proceeding has advocated that the Commission prohibit the IXCs from providing WATS and 800 Service within the intraLATA arena, nor has the Commission ever purported to undertake such an action. IXCs currently can provide both intraLATA WATS and 800 services within the intraLATA arena.

Sprint's legal argument is directed solely at intraLATA 800 Service. The relevance of the argument springs from Sprint's contention that there exists no

justification for charging IXCs a revenue replacement rate which is predicated upon the assumption that the LECs possess an exclusive ownership right to intraLATA 800 Service, given that the Commission lacks the authority to restrict the provisioning of intraLATA 800 Service by non-dominant IXCs.

A. Sprint's Statutory Argument

The starting point of Sprint's statutory argument is the proposition that the Commission's authority to limit or restrict the operations and services of a non-dominant IXC is no greater than that granted by PURA, since an administrative agency has only such powers as are expressly granted to it by statute together with those powers necessarily implied from the authority conferred or the duties imposed by statute. The examiner submits that this proposition is so obvious as to be beyond reasonable dispute.

Sprint then notes that PURA Section 18(c) severely limits the Commission's jurisdiction over non-dominant IXCs, and that no language within that section can be construed as authorizing the Commission to prevent IXCs from providing toll services within any geographical areas. Further, Sprint notes that while Section 18(r) provides that the requirements of Subsections 18(d), (l), (m), (n), (o), (p), and (q) apply to non-dominant IXCs, those subsections are equally incapable of being construed as granting the requisite authority to the Commission. The examiner fully agrees with this assessment.

Sprint observes that the Legislature has never chosen to adopt any restrictions on the geographic scope of non-dominant IXC operations or to require such IXCs to obtain certificates of convenience and necessity (CCNs). Sprint then opines that, if the Legislature had intended to grant the Commission the power to restrict the geographical operations of non-dominant IXCs, it would have done so in clear and direct language.

The logic of Sprint's argument is compelling. However, Sprint's conclusion that the Commission lacks authority under PURA to geographically restrict the operations and services of a non-dominant IXC is overly broad. Sprint's analysis is incomplete in that it fails to consider the ramifications of the Commission's jurisdiction and authority with respect to dominant utilities.

[1] The examiner agrees with Sprint that, as a consequence of the Commission's limited jurisdiction over non-dominant IXCs, the Commission has no authority to order such an IXC not to provide certain services within specific geographical areas. This does not mean, however, that the Commission necessarily lacks the authority to take actions with respect to the operations or services of other utilities over which it has full jurisdiction which might have the consequence of preventing IXCs from providing toll service within designated geographical areas. For instance, the Commission unquestionably has the authority to establish local exchange area boundaries. If the Commission chose, in response to Extended Area Service concerns, to expand SWB's local exchange area boundaries such that they were coterminous with LATA boundaries (an unlikely occurrence), that action would be within the Commission's statutory authority yet it would effectively result in the inability of the IXCs to provide intraLATA toll services.

PURA Sections 18(b) gives the Commission broad jurisdiction over the business and property of dominant utilities. The Commission's regulation of the rates, operations, and services of dominant utilities for the purpose of carrying out the policy objectives set forth in PURA Section 18(a) may substantially impact the services or operations of non-dominant IXCs. Whether specific action taken by the Commission is lawful depends upon the factual circumstances which surround the action, and the Commission's underlying intent. If the Commission's reasoned balancing of the competing policy
[2] objectives set forth in PURA Section 18(a) necessitated the implementation of LEC tariffs which had the practical effect of restricting the geographical area in which a non-dominant IXC could provide a service, the examiner has no doubt

that the Commission's action would in that instance fall squarely within its lawful authority under PURA.

B. Sprint's Constitutional Argument

Sprint also asserts that any Commission actions that would serve to restrict the geographical area in which a non-dominant IXC can provide a toll service would violate Article I, Section 19 of the Texas Constitution, which provides in pertinent part that "No citizen of this State shall be deprived of life, liberty, property, privileges or immunities, or in any manner disfranchised, except by the due course of law."

This provision affords substantive as well as procedural protection. See *City of New Braunfels v. Waldschmit*, 109 Tex. 302, 207 S.W. 303 (1918). However, substantive due process protection applies solely to vested property rights. *Coulter v. Melady*, 489 S.W. 2d 156 (Tex. Civ. App.--Texarkana 1972, writ ref'd n.r.e.), cert. denied, 94 S. Ct. 123 (1973). Sprint argues that its reliance on the lack of any prior Commission attempt to act in a fashion which would restrict the geographical area in which IXCs could provide a service, and the anticipation of Sprint customers that Sprint will carry all their toll traffic, together serve to create a vested property right to the provision of unrestricted statewide toll services. However, to constitute a vested right, a right must be more than a mere expectation based on an anticipation of the continuance of an existing law. It must have become a title, legal or equitable, to the future enjoyment of property. *DuPre v. DuPre*, 271 S.W.2d 829 (Tex. Civ. App.--Dallas 1954, no writ). Under this standard, Sprint's claim cannot stand.

Regulation of utility rates and tariffs is a legislative function, and the authority to exercise that function cannot be alienated or forfeited by the action or lack of action of the regulatory agency. Sprint's reliance argument constitutes no more than an anticipation of the continuance of a past pattern

of conduct and as such, that reliance is insufficient to meet the vested interest test. To accept Sprint's argument, one would have to accept that the Commission's authority to exercise regulatory control over LEC operations and tariffs diminishes with the passage of time merely because the necessity of exercising authority in a particular fashion does not arise and private interests rely upon the continued lack of exercise of that authority in the future.

Even were a vested property right to be assumed, it must be recognized that all property rights are subject to the valid exercise of police power. *City of Dallas v. Halbert*, 246 S.W.2d 686 (Tex. Civ. App.--Dallas 1952, writ ref'd n.r.e.) The right of the state to regulate the rates and practices of a public utility is referable to the police power of the state. *State v. Lone Star Gas*, 86 S.W.2d 484 (Tex. Civ. App. 1935, writ ref'd).

In exercising that police power, the means adopted to accomplish the legislative purpose must be suitable to the end in view, must be impartial in operation, must have a real and substantial relation to such purpose, and must not interfere with private rights beyond the necessities of the situation. *Texas Power & Light Co. v. City of Garland*, 431 S.W.2d 511 (Tex. 1968). Under those guidelines, were a vested right assumed to be involved, it would be possible to lawfully take action which had the effect of restricting the geographical area in which a non-dominant IXC could offer a given service provided the social necessity the action was to serve outweighed the adverse effect of the action on vested property rights.

C. Conclusion

The specific focus of Sprint's geographical restriction argument is the Commission's authority to restrict a non-dominant IXC from providing intraLATA 800 Service. As such action has never been taken or proposed, there exists no factual predicate with which to judge that action. However, if the

Commission's reasoned balancing of the competing policy objectives set forth in PURA necessitated the implementation of LEC tariffs which had the practical effect of restricting the geographical area in which a non-dominant IXC could provide a service, that action would violate neither PURA nor the Texas Constitution.

VII. Evaluation of Competing Interests

The IXCs assert in this proceeding that the reservation of intraLATA 1+ WATS and 800 Service traffic and/or revenues is fundamentally at odds with PURA Sections 38, 45 and 47. Those statutory provisions provide in pertinent part as follows:

> Sec. 38. It shall be the duty of the regulatory authority to insure that every rate made, demanded, or received by any public utility, or by two or more public utilities jointly, shall be just and reasonable. Rates shall not be unreasonably preferential, prejudicial, or discriminatory, but shall be sufficient, equitable, and consistent in application to each class of consumers. . . .
>
> Sec. 45. No public utility may, as to rates or services, make or grant any unreasonable preference or advantage to any corporation or person within any classification, or subject any corporation or person within any classification to any unreasonable prejudice or disadvantage. No public utility may establish and maintain any unreasonable differences as to rates of service either as between localities or as between classes of service.
>
> Sec. 47. No public utility may discriminate against any person or corporation that sells or leases equipment or performs services in competition with the public utility, nor may any public utility engage in any other practice that tends to restrict or impair such competition.

These three statutory provisions together constitute a strong policy statement against discriminatory and anticompetitive conduct by either public utilities or this Commission. Were the appropriateness of continuing the current *status quo* with respect to 1+ intraLATA WATS and 800 Service to be

decided solely on the basis of whether there are discriminatory or anticompetitive aspects to the current *status quo*, the resolution of this case would be a simple task. There exist, however, additional considerations which are relevant to the issue.

In *Amtel Communications v. P.U.C. of Texas*, 687 S.W. 2d 95 (Tex. App.--Austin 3rd Dist. 1985, no writ), the court observed that PURA embodies conflicting public policies which the Commission is charged with effectuating. The court found that the antitrust and antidiscrimination policies underlying PURA Sections 38, 45 and 47 are not absolute, and that in evaluating whether an action is unlawfully discriminatory or anticompetitive, the Commission is allowed discretion and judgment because the Commission is also charged with effectuating other competing policies.

With respect to the antitrust concerns embodied in PURA Section 47, the court concluded that "it cannot reasonably be doubted that the Legislature intended the Commission to make, where desirable in the particular case, whatever adjustments and accommodations it considers necessary to effectuate the public interests underlying *both* competition and monopoly power. . . . In whatever context they arise, it is the Commission's task to assess the competing policies and decide where the *public* interest lies . . ." *Id. at 101.*

With respect to the antidiscrimination criteria embodied in PURA Sections 38 and 45, the court observed that some degree of discrimination may be in the public interest in some circumstances and that in such instances unequal treatment is not violative of PURA. The court noted that the lawfulness of discrimination generally depends upon the reasonableness of the distinguishing features relied upon as justification for departing from equal treatment and found that, within the range of possible distinguishing factors, there is included to some extent the achievement of social policies.

Amtel thus stands for the proposition that, in deciding whether the current *status quo* with respect to WATS and 800 Service should be continued, the Commission must balance against the antitrust and antidiscrimination policies inherent in PURA Sections 38, 45 and 47 other competing policy objectives mandated by PURA.

The competing public policies upon which the LECs rely to support the continuation of the current *status quo* are embodied in PURA Section 18(a), which provides as follows:

> It is the policy of this state to protect the public interest in having adequate and efficient telecommunications service available to all citizens of the state at just, fair, and reasonable rates. The legislature finds that the telecommunications industry through technical advancements, federal judicial and administrative actions, and the formulation of new telecommunications enterprises has become and will continue to be in many and growing areas a competitive industry which does not lend itself to traditional public utility regulatory rules, policies, and principles; and therefore, the public interest requires that new rules, policies, and principles be formulated and applied to protect the public interest and to provide equal opportunity to all telecommunications utilities in a competitive marketplace. It is the purpose of this section to grant to the Commission the authority and the power under this Act to carry out the public policy herein stated.

The LECs rely upon three policy goals evident in Section 18(a): 1) universal service; 2) adequate and efficient telecommunications service; and 3) provision of equal opportunity to all telecommunications utilities in a competitive marketplace. The LECs assert that when these policy objectives are considered and properly balanced against the IXCs' claims of unlawful discrimination and anticompetitive conduct, the public interest lies with the continuation of the current *status quo*.

The validity of the parties' arguments cannot be resolved without resorting to the factual record. Consequently, a discussion follows regarding the record evidence as it relates to the nature and magnitude of the discriminatory and anticompetitive effects of the *status quo* on the IXCs, and the countervailing technical and policy considerations which the LECs assert mitigate in favor of continuation of the *status quo*.

A. Effects of the *Status Quo* on IXCs

Because the *status quo* with respect to WATS Service and 800 Service is very different, it is necessary to discuss each service separately in order to avoid confusing the facts as they relate to each.

1. IntraLATA WATS

Under the current *status quo*, all intraLATA 1+ WATS traffic is carried and billed by the LECs. As discussed earlier in this report, that traffic is automatically stripped from UWALs purchased from the LECs by the IXCs and routed over the LEC network. That process discriminates against and competitively disadvantages the IXCs by forcing them either to require their customers to use an inferior dialing pattern for intraLATA calling than is available for use by LEC customers, or bear the adverse consequences of LEC carriage of the intraLATA WATS traffic generated through IXC marketing efforts.

a. *10-XXX Dialing Option*

The 10-XXX dialing option is disadvantageous because it requires an IXC customer to dial a minimum of four more digits than would have to be dialed using the 1+ dialing pattern. According to MCI witness Bryant's testimony on cross-examination, if the customer is dialing a number which is associated with a terminating location in a different area code than the caller, the customer must dial four more digits using the 10-XXX dialing pattern. However, if the

caller and the terminating location are both located within the same area code, use of the 10-XXX dialing pattern requires that seven extra digits be dialed, because the area code must be dialed in all instances when the 10-XXX dialing pattern is used. It is not unreasonable to assume that a substantial percentage of intraLATA calls would originate and terminate within the same area code.

An IXC customer need not use the 10-XXX in connection with interLATA calls. However, SWB witness Springfield testified on cross-examination that, since customers are generally unfamiliar with LATA boundaries and could not be expected to know whether a called number in fact terminated within the same LATA in which it originated, customers would as a practical matter have to use the 10-XXX in all instances regardless of the interLATA or intraLATA nature of the call.

Dr. Bryant testified that, in his opinion, it could not realistically be assumed that a large percentage of WATS customers would be willing to go to the trouble of dialing extra digits in order that their preferred carrier handle their intraLATA calls. MCI witness Bruce Yasitis testified on cross-examination that the extra digits are especially a problem in connection with WATS applications where speed of calling is important.

The record reflects that it is possible to eliminate or substantially mitigate the inconvenience of dialing extra digits in many instances. SWB witness Springfield testified that by the use of auto-dialers, the extra digits required under 10-XXX can be made totally transparent to the end user. Similarly, MCI witness Yasitis testified on cross-examination that the extra digits can be made transparent to the caller by the use of adjunct equipment on digital PBXs or by front-end processors for PBXs.

Sprint witness Paul Fuglie testified that Sprint currently offers a WATS product which uses the 10-XXX dialing pattern, and that Sprint also markets

auto-dialers to its customers. Although AT&T currently does not utilize the 10-XXX dialing option with respect to any of its toll services, AT&T witness O'Neal testified that the decision not to offer it was not based upon the need to dial extra digits, which he viewed as not a "big deal today with the dialers, etcetera", but rather upon the fact that it requires a different marketing and advertising approach than AT&T cares to use.

PBXs and auto-dialers are not inexpensive. But WATS is a business offering and, in that context, the expense of the equipment may be acceptable from an economic standpoint, especially for those businesses which already utilize PBXs. Those customers for whom speed of calling is essential will surely possess such equipment regardless of whether the 10-XXX option is used. Mr. Yasitis testified on cross-examination that customers with traffic volumes in the WAL range may well wish to purchase auto-dialers. He cautioned, though, that the cost of such equipment can affect the cross-over point at which a WATS offering becomes more economical than MTS.

Mr. Yasitis' point is well taken. Due to the expense of auto-dialers and PBXs, the examiner believes that a customer would have to have a strong desire for particular IXC WATS service options to incur that expense solely to obtain those service options for the intraLATA portion of the customer's traffic, unless a large percentage of the customer's traffic is intraLATA in nature, or the customer has large volumes of WATS traffic. Further, with respect to the large customers who can most easily afford such equipment, a WATS-like service may in fact prove to be more economical than WATS as suggested by Mr. Yasitis.

IXC witnesses identified two other perceived disadvantages associated with the 10-XXX dialing pattern. First, although it is apparent from the testimony of GTE witness Joe Lee that WATS services are currently being provided in some instances from non-equal access end offices, Dr. Bryant and AT&T witness Arthur Lerma both noted on cross-examination that the 10-XXX dialing pattern is not available in non-equal access end offices. Thus, the availability of the

10-XXX dialing pattern is not as broad as the availability of WATS service. Second, MCI witnesses Yasitis and Bryant both testified that if an IXC offered the 10-XXX dialing pattern to its customers, a customer could reach any IXC over the WAL, instead of solely the IXC which purchased the WAL.

The examiner finds that neither of these two disadvantages can be viewed as being of major consequence. The second reflects that no significant detriment can be expected to result from the fact that WATS service can be provided by IXCs in areas served by non-equal access end offices but the 10-XXX option is not available in those areas. MCI witness Steve Holden testified on cross-examination that OCCs cannot provide WATS service in an area served by a non-equal access end office without obtaining a WAL extension from the non-equal access end office to a WSO which has been converted to equal access. According to Mr. Holden, the cost of that WAL extension is usually such that it is not economical for the customer to purchase the WATS service. Thus, the non-availability of 10-XXX in such areas is inconsequential from the OCCs' standpoint.

As AT&T can provide WATS service in non-equal access areas, the non-availability of the 10-XXX option could constitute a legitimate disadvantage for that carrier. However, it is highly unlikely that the lack of availability of the 10-XXX option in non-equal access areas can be a significant consideration for AT&T given that AT&T has never chosen to use the 10-XXX option with respect to any of its services.

Further, it must be recognized that the equal access conversion process is at an advanced stage. SWB and GTE, both of whom are obliged to convert to equal access, together account for over 97 percent of the WALs in Texas. According to GTE witness Lee, 80 percent of GTE's access lines have been converted to equal access and further conversions will occur as electro-mechanical central office switches are retired and replaced with digital switches. The record does not reflect the percentage of SWB's access

lines that have been converted to equal access, although SWB witness Deere testified that only 8 percent of SWB's access lines are served by electro-mechanical switches which cannot provide equal access. It is not unreasonable to expect that equal access may soon be ubiquitous within the geographical areas for which there exists customer demand for WATS services.

With respect to the concern that under the 10-XXX option a customer could reach an IXC other than the IXC which purchased the UWAL, the examiner would simply observe that a WATS customer would have no incentive to use the WAL in that fashion. The purpose of subscribing to WATS is to obtain discounted rates for toll calls. If a customer made a toll call over the WAL using the 10-XXX code of an IXC other than the IXC providing the WATS service, the customer would be billed at an undiscounted MTS rate.

In conclusion, the examiner finds that the need to dial extra digits to complete toll calls under the 10-XXX plan is the only competitive disadvantage asserted by the IXCs which has any real significance. The ability to eliminate or substantially mitigate the inconvenience of dialing extra digits through the use of PBXs or auto-dialers diminishes the competitive disadvantage associated with use of the 10-XXX dialing pattern. However, the examiner finds that acquisition of that ability is not necessarily a viable economic option unless the customer is large, the customer has an unusually high percentage of intraLATA traffic, or the customer already possesses such equipment. Absent the use of such equipment, the examiner finds it unlikely that the majority of people making intraLATA calls would suffer the inconvenience of dialing extra digits. The examiner concludes from the preponderance of the evidence that reservation of the 1+ dialing pattern for the exclusive use of the LECs is a discriminatory practice which impairs the ability of IXCs to compete for the carriage of intraLATA WATS traffic.

b. *LEC Carriage of IntraLATA Traffic*

For those IXCs which choose not to offer the 10-XXX dialing pattern, the IXCs assert that a number of distinct disadvantages arise from the resulting

carriage of the 1+ intraLATA WATS traffic by the LECs, aside from the obvious problem of the IXCs' loss of intraLATA WATS revenues.

First, MCI witness Yasitis testified that, as to the intraLATA traffic carried by the LECs, MCI's customers cannot obtain all of the WATS features which MCI provides to its customers in connection with their interLATA WATS traffic. The record reflects that those features relate to pricing, billing, and blocking. For instance, MCI provides call detail on interLATA WATS traffic but the LECs may not. Also, MCI offers "virtual banding", under which each WATS call is priced individually according to the geographic distance of the call, rather than on the basis of traditional WATS bands. Virtual banding eliminates the need to configure a variety of trunk groups for different bands of coverage. Finally, it appears from MCI witness Steve Holden's testimony on cross-examination that MCI offers the customer the ability to block all intraLATA calls, something the LECs apparently do not offer.

The examiner finds however, that the only enhanced features cited by MCI which have any real significance in the context of intraLATA WATS traffic are the billing features. MCI's concern over the unavailability of virtual banding is specious. That feature may be quite useful for interLATA and interstate calling because of the ability to avoid using different trunk groups for different calling bands. However, all intraLATA calls would be in the same WATS band anyway. The LEC carriage of the intraLATA portion of the customer's WATS traffic does not require special configuration of the customer's trunks or in any way impede the effectiveness of an IXC virtual banding option.

Similarly, the unavailability of the blocking feature noted by MCI witness Holden cannot be of major consequence to the IXCs. It is conceivable that a customer might want such a service. However, the examiner believes it highly unlikely that an intraLATA blocking feature could be widely desired. To the extent that it is, it seems unlikely that IXCs would be strongly motivated to offer or aggressively market such an option since it would prevent them from

carrying the very type of traffic they are aggressively seeking the right to carry in this proceeding.

The lack of availability of call detailing or similar billing features for the intraLATA portion of a customer's WATS traffic is likely a significant inconvenience from the IXC customers' viewpoint. However, it must be kept in mind that the lack of availability of this type of feature capability can be overcome by the customer's use of the 10-XXX option. If AT&T and MCI were to offer the 10-XXX option, as Sprint has done, then the customer could obtain those features if the customer found them sufficiently useful to warrant the use of the 10-XXX dialing pattern. It must also be observed that the unavailability of these specialized WATS features is disadvantageous to the customer rather than to the IXC. The examiner would note that IXCs could have but did not sponsor testimony from any IXC WATS customer to the effect that the inability to obtain IXC blocking, pricing or billing features for intraLATA WATS traffic caused undue inconvenience or hardship for that customer.

The second asserted disadvantage associated with LEC carriage of all 1+ intraLATA WATS traffic is the IXCs resulting inability to provide end-to-end service to customers. According to MCI witness Yasitis, in order to remain competitive in the marketplace, an IXC must be able to provide a wide range of telecommunications services and have the ability to package the services in new ways. According to Mr. Yasitis, to market an integrated package of services, customers must be able to deal with a single point of contact for design, pricing, ordering, installation, maintenance and billing of the service package. Mr. Yasitis testified that the forced involvement of multiple LECs would prevent MCI from meeting customer expectations and significantly inhibit MCI's ability to market such services.

Without end-to-end service capability, the IXCs assert that there exists unnecessary potential for problems to emerge. According to MCI witness Holden, a customer with a line problem may call the LEC when in fact the trouble is

with the IXC, or vice versa. If the IXC carries all the traffic, the customer will not be confused as to who to call to resolve service problems. Similarly, Mr. Yasitis testified that the receipt of two WATS bills, one from the IXC and one from the LEC, may cause customer confusion and may make it more difficult for customers to verify and audit billings. Mr. Yasitis testified that if something goes wrong with service, the confusion and division of responsibility resulting from the current arrangement could damage the reputation of MCI and the hard-won relationship between MCI and its customers.

The examiner is wholly unpersuaded by the assertion that the lack of ability to provide end-to-end service inhibits the IXCs' ability to market their products in the competitive telecommunications market. The lack of end-to-end service capability cannot reasonably be viewed as inhibiting an IXC's ability to market its services *vis a vis* other IXCs since all IXCs share the same disadvantage. An IXC's ability to market its services *vis a vis* the LECs is not inhibited, since the LECs also lack end-to-end service capability. The ability of the IXCs to offer a broad range of services, most of which have both intraLATA and interLATA scope, is a far more valuable marketing edge than is the intraLATA-only LEC toll service offerings.

With respect to the customer confusion argument, the examiner does not believe that the receipt of two bills by a WATS customer, or the fact that one entity is not responsible for resolution of all service problems, engenders any significant amount of confusion. First, Mr. Yasitis conceded on cross-examination that, at the time a WATS service is sold to the customer, the customer is fully apprised of the fact that the LECs will carry the intraLATA portion of the customer's WATS traffic. Second, WATS customers are sophisticated telecommunications users who can reasonably be expected to understand the mechanics of the LEC/IXC joint provisioning arrangement. Third, to the extent that a problem develops with respect to an aspect of the service provided by the LEC and the customer is dissatisfied, the examiner has no doubt but that the IXC would make it clear that the fault lay with the LEC. The

interjection of the LECs into the relationship between the IXC and the customer may be a problem, but the examiner does not view it as a substantial one. The competitive disadvantage which it creates, if any, is mitigated to some extent by the fact that the disadvantage is shared equally by all IXCs.

The third and final disadvantage associated with LEC carriage of all 1+ intraLATA WATS traffic is Mr. Yasitis' assertion that the LECs are afforded a cost advantage over the IXCs by virtue of the stripping of all 1+ intraLATA traffic from UWALs purchased by IXCs, and the fact that the LECs do not contribute to the costs incurred by the IXCs to purchase UWALs. However, the IXCs, who bear the burden of persuasion in this proceeding failed to present any evidence regarding comparative IXC and LEC costs of providing WATS Service. Absent such evidence, the examiner cannot find in favor of the IXCs on this issue.

In summary, the three disadvantages which the IXCs assert are associated with LEC carriage of 1+ intraLATA WATS traffic in instances where the IXCs choose not to make the 10-XXX option available have not been proven to be significant. Any IXC can remedy the problems complained of by offering the 10-XXX dialing option to its customers. To the extent that the IXC is unwilling to offer that dialing option, or that customers are unwilling to use it, the IXCs still have the ability to provide 1+ calling capability, via their WATS-like service offerings. To the extent that the IXCs WATS-like offerings are not economically viable options for a particular customer, the IXCs cannot be viewed as being competitively disadvantaged to any significant degree by the inability to provide special service features on intraLATA traffic or by the inability to provide end-to-end service because all IXCs and all LECs suffer from those same disadvantages.

c. *Conclusion*

The current *status quo* with respect to intraLATA WATS service disadvantages IXCs by forcing them to employ an inferior dialing pattern or alternatively, forego the carriage of intraLATA WATS traffic. The requirement

that IXC intraLATA WATS customers use an inferior dialing pattern impairs the ability of the IXCs to compete for the carriage of intraLATA WATS traffic *vis a vis* the LECs. Aside, however, from the loss of potential earnings from intraLATA WATS traffic, those IXCs which choose not to offer the 10-XXX dialing pattern suffer no significant competitive disadvantage by virtue of that fact.

2. IntraLATA 800 Service

The LECs presently lack the ability to provide intraLATA 800 Service without the assistance of an IXC because they have no means of determining the terminating jurisdiction of an intraLATA 800 Service call. The LECs will not have that ability until such time as a planned nation-wide BOC 800 database is deployed. The FCC is currently considering that issue. Pending implementation of the BOC 800 database, the LECs rely upon the IXCs' 800 databases in order to provide intraLATA 800 Service. AT&T, MCI and Sprint are presently the only IXCs which possess 800 databases and hence the ability to provide 800 Service.

Under the current *status quo*, LEC tariffs give the IXCs who wish to provide 800 Service the choice of providing the service on either a joint or non-joint basis. Under the joint service option, the IXC performs the 800 number-to-POTS number translation for all of the traffic generated by the IXC and routes back to the LEC all of the intraLATA traffic for carriage and billing by the LEC. Under the non-joint service option, the IXC is permitted to carry and bill all of the 800 Service traffic which it generates. However, on the intraLATA portion of that traffic, the IXC must pay the LEC a special rate in an amount intended to equal the net revenue the LEC would have obtained from that intraLATA traffic had the IXC turned the traffic over to the LEC. AT&T is the only IXC which provides 800 Service jointly with the LECs. MCI and Sprint provide 800 Service only under the non-joint option.

The IXCs that compete with the LECs in the carriage of intraLATA 800 Service traffic are disadvantaged under the current arrangement by having to pay a higher rate to the LECs in the areas where the LECs and IXCs compete in the provisioning of 800 Service than in the areas where the LECs do not

compete, even though the access service being provided by the LECs is the same in both instances. The record indisputably reflects that there exists no technological or cost basis for charging the IXCs a higher rate for intraLATA traffic than is charged for interLATA 800 Service traffic. The IXCs assert that this is the very type of anticompetitive and discriminatory conduct made possible by control of bottleneck monopoly facilities which the MFJ was designed to prevent at the interLATA level. The examiner in large part agrees with that characterization.

MCI has asserted in this proceeding that the fact that it must build into its retail 800 Service rates the profits which the LECs would have made on intraLATA traffic makes it impossible for IXC 800 Services to be competitive with LEC 800 Service offerings. That, however, does not appear to be a true statement. The record reflects that AT&T, MCI and Sprint each have multiple 800 Service offerings, and that those services have grown despite the cost handicap caused by the imposition of a LEC revenue replacement rate on IXC intraLATA 800 Service traffic. Further, it appears from Exhibit No. 2 to SWB witness Springfield's testimony that the 800 Service rates of the IXCs are generally lower than those charged by SWB.

The respective intraLATA 800 Service market shares of the LECs and the IXCs cannot be determined from the record. Nor can it be determined whether all of the IXC 800 Services are in fact profitable. AT&T witness O'Neal testified that AT&T's non-joint 800 Readyline service offering, which has experienced phenomenal growth since its introduction, is currently losing money on intraLATA traffic. However, the service as a whole is profitable due to the margin AT&T makes on its interLATA traffic.

The examiner does not accept the contention that IXC 800 Service offerings cannot compete if burdened with the LEC revenue replacement rate. However, the imposition of that rate unquestionably makes the non-joint IXC 800 Service offerings less competitive with the traditional joint LEC/AT&T 800 Service

offerings than they otherwise would be. Further, it can be assumed that continued application of the rate may generally suppress demand for the IXC offerings. The IXC witnesses could not warrant that IXC 800 Service rates would drop if the revenue replacement rate were eliminated, but AT&T witness O'Neal testified that if the rate is continued AT&T will be forced to raise its 800 Readyline rates.

The fact that the 800 Service market segment is competitive even though the revenue replacement rate is applied by the LECs in areas in which the LECs and IXCs compete reflects that the burden which application of the rate imposes upon the IXCs can in fact be borne, but it does not in the examiner's opinion eliminate the fact that the rate is prejudicial to the IXCs and impairs free competition by imposing an artificial cost handicap on the IXCs.

B. Countervailing Considerations

Having established that the reservation of 1+ intraLATA WATS traffic to the LECs is a discriminatory action which places the IXCs at a competitive disadvantage in their efforts to garner intraLATA WATS traffic, and that the special revenue replacement rate assessed on all intraLATA 800 Service traffic carried by the IXCs in lieu of access charges similarly discriminates against and competitively disadvantages the IXCs, it is necessary to consider countervailing technical or policy considerations which may provide a reasonable basis for the discrimination or may serve to justify any anticompetitive effects attributable to the current *status quo*. The policy considerations raised by the LECs are: 1) the likelihood that universal service may be adversely affected by granting the relief sought by the IXCs; 2) the need to promote efficient telecommunications service; and 3) the need to insure that the LECs are afforded equal opportunity within a competitive telecommunications marketplace. The only technical consideration raised by the LECs concerns the limitations inherent in the generic software of LEC switches. A discussion of each of these considerations follows.

1. Preservation of Universal Service

Universal service is a term that has long been used within the telephone industry, yet no witness in this proceeding offered a precise definition of the term. SWB witness Springfield testified that it simply means making basic local exchange service affordable to the largest percentage of the population that one can possibly achieve. Mr. Springfield testified that universal service has for all intents and purposes been achieved, noting that in Texas the household penetration rate is in the range of 95 to 98 percent. No party to this proceeding has disputed that assessment.

The parties addressed universal service considerations from both short term and long term perspectives. The short term perspective focuses upon whether modification of the current WATS and 800 Service *status quo* would likely result in revenue losses of sufficient magnitude to jeopardize the financial condition of the LECs or necessitate sharp increases in local exchange rates. The long term perspective focuses upon whether the loss of a revenue source that provides a substantial contribution to joint and common costs of the LECs and subsidizes the provision of telephone service to rural areas will place long term upward pressure on urban or rural local exchange rates.

a. Short Term Effect of Revenue Losses

SWB witness Springfield testified that the issue in this docket is strictly a policy question which should not be determined based on how well or poorly a company is earning. According to Mr. Springfield, it would be "absurd" to argue that if a LEC were earning poorly no IXC competition should be allowed.

Similarly, GTE witness Alan Arthur testified that it would be inappropriate to practice rate of return regulation in this docket by taking away the business of the LECs. However, in Docket Nos. 7220 and 7160, the LECs represented to the Commission that the failure to reserve ownership of 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs would seriously impair the financial condition of the LECs. Those representations were a factor in the Commission's decision to initiate this proceeding. It was also because of those representations that Judge McDougall directed the parties to address the issue in this docket. The financial effect on the LECs caused by modification of the current *status quo* is indeed a relevant issue in this proceeding.

AT&T witness Arthur Lerma and MCI witness Randy Klaus both presented testimony addressing how elimination of the *status quo* would affect the LECs. Mr. Lerma's analysis addressed the financial effect upon the industry as a whole. Mr. Klaus's analysis primarily addressed the financial effect upon the individual LECs. The analyses do not reflect separate quantifications of the financial effects of losing either WATS Service or 800 Service revenues because many of the LECs were unable to provide the IXCs with financial data segregated in that manner.

i. The Lerma Analysis

The analysis performed by Mr. Lerma sets forth his estimation of the financial impacts on the LECs which would have occurred if various percentages of the LECs' 1986 1+ intraLATA WATS and 800 Service traffic had been provided by the IXCs. The financial data upon which he relied was provided by the LECs. The analysis assumes no stimulation in WATS and 800 Service traffic as a consequence of provision of those services by the LECs, nor does it assume that any customer migration from other LEC offerings to WATS or 800 Service would occur.

All intraLATA toll services are provided jointly by the LECs, and the revenues collected by the LECs are pooled on a statewide basis. Mr. Lerma's analysis reflects that if the LECs had lost 100 percent of their WATS and 800 Service traffic to the IXCs in 1986, the intraLATA MTS/WATS toll pool would have lost billed revenues totaling $61,451,064, or approximately 9.315 percent of the $659,656,064 in billed revenues paid into the pool in 1986. However, that loss would have been offset by $26,219,614 in access charges paid to the LECs by the IXCs for that IXC WATS and 800 Service traffic, resulting in a net loss to the LECs of only $35,231,450.

According to Mr. Lerma, the Texas intraLATA MTS/WATS toll pool rate of return on net investment in 1986 was approximately 19.90 percent. Were the replacement access charge revenues paid into the pool, the $35,231,450 net loss associated with loss of 100 percent of the WATS and 800 Service traffic would have decreased the pool's 1986 return by 1.24 percent, resulting in a 1986 return of 18.66 percent. Had the LECs lost only 10 percent of their WATS and 800 Service traffic to the IXCs, a figure which Mr. Lerma considered to be more likely than 100 percent, the LECs would have sustained a net loss in 1986 of only $2,493,717, resulting in a reduction to the 1986 toll pool rate of return of only 0.53 percent.

The record reflects that in Docket No. 5113, the targeted rate of return, or settlement ratio, was 11.94 percent. Mr. Lerma testified that the toll pool rate of return, or settlement ratio, is an appropriate means of assessing the collective rate of return earned by the LECs in the provision of intraLATA MTS, WATS and 800 Service and that the ratio has definite earnings implications. TSTCI witness Roger Hutton testified that the loop adjustment adopted in Docket No. 5113 distorts any measure of profitability the ratio might have. However, the examiner finds that assertion to be without merit. MCI witness Klaus testified that the original purpose of the loop adjustment was to maintain the same level of NTS cost recovery from interLATA toll calls that had existed prior to divestiture. The access line or loop adjustment is the mathematical amount which resulted from dividing the difference between the LECs' intraLATA

revenue requirements and the amount of revenues produced from the then existing intraLATA calls by the access lines in service at the time. According to Mr. Klaus the loop adjustment is a means of shifting costs from the intraLATA arena to the interLATA arena and as such is a "separations like" adjustment. Those shifted costs are recovered through pooled ICAC revenues.

The examiner finds that the toll pool rate of return has definite earnings implications with respect to MTS, WATS and 800 Services. However, it is not a valid measure of overall profitability of LECs, because MTS, WATS and 800 Service rates have traditionally been set at a level intended to provide a large contribution to LEC joint and common costs. While the rate of return for the toll pool is certainly higher than the level targeted in Docket No. 5113, it cannot be concluded from that fact that overall LEC rates of return have similarly increased. The comparison of toll pool rates of return both with and without the loss of WATS and 800 Service revenues is a valid means of determining the relative impact of the loss of those revenues on the overall industry.

The examiner finds that the conclusions which can be drawn from Mr. Lerma's analysis are limited. With the exception of the ICAC rate element, access charge revenues are not pooled. Rather, they are billed and kept by the LEC that provides the originating or terminating access to the IXC. Thus, while it may be appropriate to offset the reduction to toll pool revenues with replacement access charges in order to show the net revenue loss to the industry, it must be recognized that the overall industry revenue losses will be borne disproportionately by the smaller LECs that do not originate or terminate much WATS or 800 Service traffic.

That fact is demonstrated by Schedule 3a to Mr. Lerma's prefiled testimony. The schedule reflects that in 1986, had the LECs lost 100 percent of the 800 Service traffic to the IXCs, SWB would have lost approximately $26,307,846 in settlement revenues from the toll pool, but would have gained

$14,609,851 in replacement access charge revenues for a net revenue loss of only $11,609,995, or 44 percent of WATS and 800 Service settlement revenues. On the other hand, the independent LECs would have lost approximately $14,410,070 in settlement revenues from the toll pool and gained only $1,444,930 in replacement access charges for a net loss of $12,965,140, or almost 90 percent of the 800 Service revenues which those LECs would have gotten from the toll pool. This anomaly is attributable to the fact that 90 percent of the WALs in Texas are located in SWB's service territory.

ii. The Klaus Analysis

Unlike Mr. Lerma's analysis, the company-specific analysis performed by MCI witness Klaus provides insight into the effect which modification of the *status quo* could be expected to have on individual LECs. The approach taken by Mr. Klaus was to determine: 1) the extent to which access charges would have replaced, dollar for dollar, the level of settlement revenues received by each LEC from the intraLATA MTS/WATS and Private Line pools for WATS and 800 Service traffic during the years 1986 and 1987, had the LECs lost 100 percent of their intraLATA WATS and 800 Service traffic to the IXCs during those years; and 2) the extent to which lost WATS and 800 Service revenues might have needed to be replaced from other sources.

The revenue data contained in Mr. Klaus' analysis was provided by the Texas Exchange Carriers Association (TECA). Mr. Klaus testified that TECA recomputed the fourth quarter 1986 settlements from both the MTS/WATS and Private Line pools for each LEC based on the assumption that the local exchange industry ceased carrying all intraLATA WATS and 800 Service traffic. TECA removed the WATS and 800 revenues of all LECs as well as the expenses, investment and taxes of those LECs whose separations effects would have had the most profound effect upon the pools. According to Mr. Klaus, that step had the effect of reducing the settlement revenues of most LECs as well as the associated settlement ratio upon which the settlements would have been based.

The difference between the actual settlements for the fourth quarter and what the settlements would have been had the LECs not carried any WATS and 800 traffic during the fourth quarter was annualized to yield a projected annual "lost toll revenue" amount for each LEC. Mr. Klaus testified that he then determined the amount of access revenues the LECs would have received if the IXCs had carried all of the WATS and 800 traffic. The difference between the "lost toll revenue" amount and the increase in access charge revenues yielded the net revenue effect for each LEC.

In order to measure the impact of the net revenue change that would have been experienced by each LEC, Mr. Klaus calculated the return on equity (ROE) and times interest earned ratio (TIER) which would have resulted for each LEC. The information used by Mr. Klaus to perform those calculations was in most cases obtained from the LECs' 1986 annual reports filed with the Commission. ROE is a measure of the annual rate of return earned on capital provided by stockholders, or members, for those LECs which are cooperatives. The TIER measures the number of times a LEC would be capable of paying its interest obligations. Both Mr. Klaus and TSTCI witness Roger Hutton agree that TIER can be a more useful financial indicator than ROE for companies that are highly leveraged, as are a number of the smaller LECs.

Through a supplemental filing, Mr. Klaus updated his financial analysis using 1987 data rather than 1986 data. The results of his updated analysis are attached hereto as Examiner's Attachment No. 1. The attachment sets forth, for each LEC, the net revenue effect associated with loss of all WATS and 800 service revenues, the LEC's actual 1987 ROE and TIER as well as the ROE and TIER which would have resulted from the loss of all WATS and 800 revenues, the LEC's number of access lines, the net loss expressed in terms of loss per access line per month, and the LEC's one-party residential rates. Examiner's attachment No. 2 presents a summary of the financial analysis performed by Mr. Klaus for the years 1986 and 1987.

Mr. Klaus' analysis reflects that, after factoring the net revenue loss or gain for each company which would have resulted from loss of all WATS and 800 Service revenues, the total industry average ROE and TIER, excluding SWB and GTE, would likely have been approximately 20.3 percent and 5.6, respectively, for both 1986 and 1987.

To put the figures into perspective, Mr. Klaus noted that the Rural Electrification Act prohibits the REA from making Rural Telephone Bank loans unless the borrower has a TIER of at least 1.5. Fifty of the Texas LECs borrow from REA. Examiner's Attachment No. 1 reflects that under Mr. Klaus' analysis only two of the Texas LECs, Tri-County Telephone Cooperative and XIT Telephone Cooperative, would not have met the minimum TIER level required by REA in 1987. However, their actual TIERs were below that level in 1987 in any event.

Mr. Klaus testified that in setting rates for electric cooperatives, the Commission has in several recent cases established authorized TIERs of approximately 2.0. Mr. Klaus testified that on the basis of the Commission's rate setting practices with respect to electric cooperatives, the LECs who are REA borrowers would likely have a difficult time justifying their existing revenue levels in a Commission rate proceeding. The record does not reflect any basis for belief that appropriate TIER levels for electric cooperatives should not also be appropriate for telephone cooperatives, especially in light of the fact that they both borrow through REA.

Of the fifteen Texas LECs which are not REA borrowers, all would likely have experienced ROEs in excess of the 14.2 percent ROE authorized for SWB in Docket No. 6200 after factoring in the net revenue losses, with the exception of SWB, which would have earned a ROE of 11.8 percent instead of 12.2 percent, and Lake Livingston, which would have experienced a ROE of 11.3 percent. However, Lake Livingston is one of the LECs which would have recieved increased revenues as a consequence of the carriage of WATS and 800 Service traffic by the IXCs. Lake Livingston's actual ROE for 1987 was 7.3 percent. The mean and

median TIERs for the non-REA LECs in 1987, assuming the loss of all WATS and 800 traffic to the IXCs, was projected by Mr. Klaus to be 10.8 and 6.7, respectively.

The results of Mr. Klaus' analysis reflect that if one were to assume that the worst case scenario of 100 percent loss of LEC WATS and 800 Service revenues were to have occurred in 1987, that the revenues lost by the LECs had to be replaced in order for the LECs to have recovered their revenue requirements, and that the revenues had to be recovered through increases in local exchange rates as opposed to increases in rates for other services, the magnitude of the changes in local exchange rates would have ranged from a decrease of $2.78 to the monthly one-party residential rates of Lake Livingstone Telephone Company to an increase of $6.87 to the monthly one-party residential rates of Tatum Telephone Company. The impacts on SWB and GTE would have equated to monthly increases of $0.31 and $0.70, respectively. The average impact on the industry, excluding SWB and GTE, would have equated to an increase of $0.66 per month per one-party residential access line.

Mr. Klaus testified, however, that the fact that some LECs would experience revenue losses as a consequence of the elimination of the current *status quo* with respect to WATS and 800 Service did not mean that LEC rate increases would be warranted to recoup those lost revenues. Mr. Klaus testified that the overwhelming majority of the LECs have never had their revenue requirements established by the Commission. The local exchange rates that those LECs are currently charging are therefore the same as they charged in 1975. Mr. Klaus emphasized that the toll rate increases granted to SWB in prior rate cases have been implemented by the independent LECs as well through concurrence tariffs and that those increases have generated additional toll pool settlement revenues for the independent LECs without the revenue requirements of those LECs ever having been scrutinized.

Based on the results of his financial analysis, Mr. Klaus testified that even under what he termed the "most extreme" assumption that the LECs would

lose all WATS and 800 Service traffic to the IXCs, most of the LECs would be only nominally affected in terms of their existing financial condition. Mr. Klaus concluded that the Commission's decision in this docket should be based upon issues other than the likely revenue effect on the LECs.

The validity of Mr. Klaus' analysis was challenged in several respects by LEC witnesses. TSTCI witness Roger Hutton criticized Mr. Klaus' analysis on the grounds that the calculations are based upon unaudited financial statements. Mr. Hutton stated that audited statements which had been normalized and adjusted for pro-formas would be required in order to calculate rates of return in rate cases. However, as noted by Mr. Klaus in his rebuttal testimony, the financial statements on which he relied were filed with the Commission and the REA by the officers of the LECs with a representation and an attestation that they accurately reflected the companies' financial results. The examiner therefore does not find that Mr. Klaus' use of such financial statements detracts from the validity of his analysis.

GTE witness Alan Arthur claimed that Mr. Klaus' ROE and TIER calculations are overstated due to the use of an unadjusted historical test period; failure to recognize current depreciation rates; failure to recognize the impact of USOA changes and separation changes; the deregulation of inside wire, billing and collection, and CPE; as well as other changes in current expense levels. However, Mr. Klaus testified that there were also adjustments which he did not make which would have increased the earnings of the LECs. For instance, recognition of increased access revenues generated from conversion of end offices to equal access, and the transfer of expenses out of the intrastate jurisdiction to the interstate jurisdiction.

In response to Mr. Arthur's criticisms, Mr. Klaus presented on rebuttal the results of a third analysis which he undertook to ascertain whether changes in costs and revenues which have occured over time have affected the ongoing level of earnings for the LECs. The results of that analysis reflect LEC financial ratios for 1985 which are very comparable to those in 1986 and 1987.

Mr. Klaus testified that his ROE calculations are if anything understated, due to the fact that he did not make adjustments to the equity capital of the LECs for the purpose of removing equity capital used to finance non-utility or unregulated LEC activities, such as the maintenance and installation of inside wire or the sale and/or maintenance of CPE.

The examiner finds that the calculations made by Mr. Klaus do not have the precision of those necessary for calculating financial ratios on which rates would be established in a rate case. However, the calculations are straightforward and unbiased, and for purposes of this proceeding, they provide a usefull gauge of the changes in financial condition which the individual LECs would likely have experienced in the years studied had all LEC WATS and 800 Service toll pool settlement revenues been lost during those years and offset with applicable access charges.

iii. Validity and Likelihood of Worst Case Scenario

Although the analyses performed by Mr. Lerma and Mr. Klaus assumed the possibility that the LECs would lose all intraLATA WATS and 800 Service revenues, both witnesses testified that that worst case scenario was unlikely to occur. Mr. Lerma suggested that if any LEC losses in fact occurred, the loss of 10 percent of LEC WATS and 800 Service revenues was a far more realistic assumption than a loss of 100 percent of those revenues. Mr. Klaus estimated that a 20 percent loss would be a more reasonable scenario than would a 100 percent loss. Those estimates appear to be based in large part upon the assumption that AT&T has no intention of migrating customers away from the joint WATS and 800 Services AT&T currently provides in conjunction with the LECs. The IXCs further argue that any lost WATS and 800 Service revenues would likely be recovered by the LECs as a consequence of stimulated access charge revenues attributable to normal market growth and the effects of increased competition.

On the other hand, SWB witness Springfield testified that the worst case scenarios projected by Mr. Lerma and Mr. Klaus are far more realistic than the assumed loss of 10 percent or 20 percent of LEC WATS and 800 Service revenues. According to Mr. Springfield, even the worst case scenarios are conservative because they fail to account for the migration of traffic which Mr. Springfield believes would occur from LEC intraLATA MTS to IXC WATS and 800 Service offerings. Mr. Springfield testified that much of the access revenue "stimulation" projected by the IXCs would actually represent lost LEC MTS traffic.

There is no way of determining what percentage of the LECs' current WATS and 800 Service revenues would in fact be lost were the relief requested by the IXCs to be granted in this docket. However, AT&T witness William O'Neal testified that AT&T will continue to offer and promote the WATS and 800 Services it is currently providing jointly with the LECs. MCI witness Yasitis testified on cross examination that it would not be in AT&T's interest to engage in an aggressive migration strategy. It appears that those joint service offerings comprise a very large share of total WATS and 800 Service traffic within the state. Were the relief requested by the IXCs granted, it is reasonable to assume that AT&T would market its non-joint WATS and 800 Service offerings more heavily than the joint offerings. It is also reasonable to expect that customers would over time migrate from the joint offerings to non-joint IXC offerings.

In regard to AT&T's 800 services, AT&T has not implemented an aggressive plan to migrate customers from its joint 800 Service offering to its non-joint 800 Readyline service or to its non-joint Megacom 800 Service. It is apparent from SWB Springfield's testimony, however, that since the introduction of AT&T's Readyline 800 service, 8 percent of SWB's intraLATA 800 Service customer base has migrated to Readyline 800 Service. There can be no doubt but that migration to that service will likely continue to some extent in the future given the fact that termination of Readyline 800 Service over common lines avoids the expense of purchasing a separate WAL over which to terminate

traffic. The record does not reflect that migration has occurred from the joint AT&T/SWB 800 Service offering to the non-joint Megacom 800 Service since the introduction of that service, but it is not unreasonable to assume that migration to that service offering could occur in the future.

With respect to the joint 800 Service offering, it must be recognized that any migration from the joint AT&T/SWB 800 Service to 800 Readyline Service will not result in revenue losses for SWB, for two reasons. First, 800 Readyline Service generates substantially more access charge revenues on the interLATA portion of the traffic than does the joint 800 Service offering, due to the fact that 800 Readyline terminates over common lines. SWB would lose 800 Service revenues, as well as $49.65 per month for each WAL lost but that loss would be more than made up by the increased access charge revenues. Second, since access charges are not pooled, SWB would retain all of the replacement revenues rather than sharing them with the other LECs through the intraLATA toll pool. Of course, that also means that the smaller LECs that do not have any 800 service customers would lose toll pool settlement revenues without gaining replacement access charge revenues.

Although migration from the joint AT&T/SWB 800 Service offering will surely occur, it must be observed that the LECs can expect to gain intraLATA 800 Service traffic and revenues at such time as the BOC 800 Database is implemented. That development will permit smaller IXCs which do not possess 800 databases to provide 800 Service jointly with the LECs. In the examiner's opinion, the entry of additional IXCs into the market will stimulate new demand for 800 Services.

With respect to the AT&T WATS services, the record reflects that AT&T has recently implemented a WATS service provided over UWALs known as the Texas Business Plan. While that service is currently limited in scope to interLATA WATS traffic, there is no reason not to assume that AT&T will expand it to include intraLATA traffic in the event the IXCs are permitted to carry 1+

intraLATA WATS traffic. If that event is realized, some migration from the LECs' intraLATA WATS offerings to the Texas Business Plan can be expected.

The examiner is convinced that migration of customers to non-joint IXC offerings must be assumed in the future if the relief requested by the IXCs is granted. However, the examiner is also convinced that some portion of the current jointly provided WATS and 800 Service customer base would remain. Further, new joint 800 Service offerings can be expected to generate additional LEC traffic and revenues at such time as the BOC 800 Database is implemented.

With respect to potential loss of LEC MTS revenues, Mr. Springfield is correct that the Lerma and Klaus analyses do not take into consideration the revenue loss that could occur if LEC MTS traffic migrated to WATS and 800 Service. However, the record cannot support a finding that a significant amount of migration from MTS to WATS and 800 would in fact occur. With respect to WATS, it must be emphasized that the service is aimed at customers with calling volumes higher than those of residential and small business users. Thus, there is no migration potential for residential customers and little if any potential with respect to small volume business users.

Staff witness John Costello testified that it would not be unreasonable to assume that IXCs could conceivably introduce WATS or WATS-like services which would compete for, and dilute almost entirely, the whole LEC intraLATA toll business. However, Mr. Costello offered no factual support whatsoever for that position and the weight of the evidence does not suggest that such an event could even be remotely possible.

With regard to large volume MTS users who could potentially migrate to a WATS offering, it cannot be found with any certainty that the economic cross-over point between MTS and WATS would be substantially lowered were the IXCs to be permitted to carry 1+ intraLATA WATS traffic. The LECs obviously doe not believe that would happen since they all argue that enhanced

competition would not lead to lower prices. Absent a substantial reduction in the economic cross-over point between MTS and WATS, there would be no basis for assuming any traffic migration from MTS to WATS. If one assumed that the carriage of 1+ intraLATA WATS traffic by the IXCs would in fact lead to a substantial reduction in that cross-over point, the LECs would lose some intraLATA MTS traffic. The LECs have referred to this as MTS cream-skimming. However, the examiner is convinced from the testimony of AT&T witness O'Neal that any increased demand for WATS services would in fact stimulate overall toll call volume within the state, thereby generating substantial additional access revenues for the LECs. The examiner does not accept that any substantial migration of MTS traffic is likely. However, to the extent that any MTS migration occurred, the examiner finds that additional access revenues generated by stimulation of toll call volumes within the state would provide replacement revenues.

With respect to 800 Service, SWB witness Springfield testified that, absent an 800 number, customers would use MTS to call a business. However, as noted by AT&T witness O'Neal, the assertion that callers will make as many toll calls for which they must pay as they will if the calls are free is contrary to common sense. Mr. O'Neal testified that one of the main selling points of 800 Service to businesses is that the toll free feature will stimulate the number of end user calls they will receive, and thus their business. Based on the record evidence, the examiner cannot conclude that increased 800 Service traffic represents to any significant degree lost MTS. In fact, 800 Service appears to have tremendous potential for generation of new toll traffic. The examiner does not believe that potential traffic migration from MTS to 800 Service is a significant problem. The examiner further believes that the growth in overall toll traffic volume within the state as a consequence of growth in 800 Service offerings will generate substantial new revenues for the LECs.

iv. Summary

The examiner does not find that the worst case scenarios projected by Mr. Lerma and Mr. Klaus are overly conservative by virtue of their lack of consideration of the potential for traffic to migrate from the LECs' MTS offerings to IXC WATS and 800 Service offerings. It is unlikely that any substantial migration of LEC MTS traffic to non-joint WATS and 800 Service offerings is likely. In any event the failure of the Lerma and Klaus analyses to consider the potential for lost MTS is more than compensated for by their failure to consider the stimulation of overall toll traffic volumes that would occur were the economic cross-over point between MTS and WATS substantially lowered, and the stimulation that will inevitably result from growth in 800 Service offerings.

The record does not suggest that the worst case scenario would in fact be realized if the relief requested by the IXCs were to be granted in this docket, although the examiner does agree with SWB witness Springfield that the loss of all WATS and 800 Service revenue would be a more realistic assumption than the loss of only 10 percent or 20 percent. The examiner finds that even if the worst case scenario were realized, the resulting financial effect upon the LECs would not be sufficient to warrant denial of the relief requested by the IXCs on that basis.

b. The Long Term Perspective

The LECs and general counsel have asserted that there are long term LEC impacts associated with granting MCI's petition which may adversely affect the Commission's future ability to maintain local exchange rates at reasonable rates.

According to Mr. Springfield, it is not SWB's position that the Commission's decision in this docket will endanger universal service by making

local exchange service unaffordable. Rather, SWB believes that removing the LECs from the retail intraLATA WATS and 800 Service business will limit the revenue sources that the Commission can consider in designing overall telephone company rates, and ultimately, limit to some degree the Commission's ability to maintain reasonably priced rates for local exchange services.

Mr. Springfield testified that the Commission has historically set WATS and 800 Service revenues at levels significantly above cost so that the contribution produced by those offerings could be used to help reduce or eliminate the necessity to raise local exchange rates. For example, Mr. Springfield noted that the incremental cost per MOU for WATS and 800 Service is $0.0197 and $0.01567 respectively, compared to an average revenue per MOU of $0.45 for WATS and $0.38 for 800 Service. Even if access charges of $0.14 per MOU were imputed to and considered to be the cost of WATS and 800 Service, the services provide a significant contribution.

Mr. Springfield asserts that in the highly competitive post-divestiture telecommunications environment, the LECs have few service categories over which to spread any future rate increases. Moreover, because the categories that remain are increasingly subject to competition, Mr. Springfield believes that the Commission's ability to acheive high levels of contribution from such services in support of local exchange service rates is limited. Mr. Springfield believes that if WATS and 800 Service revenues are eliminated, the Commission will have fewer discretionary service revenue sources available to it in the rate design phase of a rate case, causing further upward pressure on remaining discretionary services.

An additional problem which SWB believes will result from the inability of the LECs to provide competitive WATS and 800 Services is the loss by the independent LECs of the substantial revenues which they receive as a consequence of the pooling of LEC WATS and 800 Service revenues. According to Mr. Springfield, those revenues help keep the basic local exchange rates of the

LECs lower than they would otherwise have to be. However, it is not at all clear from Mr. Springfield's testimony that SWB really perceives the loss of those revenues by the independent LECs as a problem. Mr. Springfield observed that in Docket No. 5113, pooling was envisioned as only an interim measure, and that the Commission has directed general counsel to conduct an inquiry into the desirability of continuing intraLATA pooling, an inquiry which has not to date been initiated. SWB would have a financial interest in discontinuing the pool, since it pays substantially more money into the pool than it receives back in the form of settlement proceeds.

GTE's position in this proceeding is identical to that taken by SWB. According to GTE witness Alan Arthur, regardless of what any company's earnings may be at a particular point in time, if the revenue contribution made by WATS and 800 Service is lost, sooner or later it will have to be made up by an increase in local rates.

Similarly, staff witness John Costello testified that although Mr. Klaus' analysis indicates that the present financial condition of the LECs would not be severely impacted, the advent of competition in the 1+ intraLATA WATS and 800 Service market risks diluting a substantial source of revenue for SWB and GTE, depending upon the elasticities of demand and the magnitude of growth with respect to those services, and would provide for significant losses to some of the smaller LECs. Mr. Costello testified that, to the extent that the rates for those services are providing a contribution to local exchange services, there is an uncertain and potentially adverse impact on local exchange services. Mr. Costello further observed that the advent of competition with respect to intraLATA WATS and 800 Service could provide a precedent that the IXCs could use in attempting to establish competition for the entire intraLATA toll market.

TSTCI witness Roger Hutton testified that if the revenue contributions from WATS and 800 Service were lost, the independent LECs would be forced to make up

the losses through increased local rates. According to Mr. Hutton, that could eventually have an adverse effect on universal service. Mr. Hutton testified that in Texas there exist vast amounts of rural areas with very high cost subscriber loops. Given those circumstances, Mr. Hutton believes that the subsidy received by the independent LECs from pooled WATS and 800 Service revenues must not be eliminated. Mr. Hutton testified that most of the independent LECs have very few other services from which they can recover lost WATS and 800 Service settlement revenues.

The LECs are correct in their assertion that if the LECs lost all WATS and 800 Service traffic the number of discretionary LEC revenue sources available in the rate design phase of a case would be reduced. Had divestiture never occured and had competition in the provisioning of toll services never been permitted, the LECs would currently have many more discretionary services over which to spread future rate increases. But the evolving changes in the basic structure of the telecommunications industry cannot be undone.

Even were the current *status quo* with respect to WATS and 800 Service maintained indefinitely, the LECs' WATS and 800 Service offerings likely could not be relied upon to generate substantial additional revenues due to the availability of competitive alternatives to the LEC services. Increases in WATS rates would enhance the competitiveness of WATS-like services for lower volume customers and increase the attractiveness of the 10-XXX dialing option. That in turn would result in loss of LEC WATS customers. Similarly, increases in LEC 800 Service rates would drive LEC customers to the non-joint 800 Services provided by the IXCs. Thus, the argument that the loss of all LEC WATS and 800 Service traffic would reduce the number of discretionary services over which rate increases could be spread in the future is not highly persuasive.

With respect to the revenue replacement rate which the LECs currently charge for non-joint 800 Service traffic carried by the IXCs, the only service

being provided in exchange for the revenues generated by that rate is network access. The access provided is identical to that provided for the IXCs' interLATA non-joint 800 Service traffic. Thus, although the rate is billed under the LECs' WATS Services tariff rather than the Access Services tariff, it is conceptually the same as access services. Any loss of that revenue could not reasonably be viewed as the loss of a separate discretionary service category over which rate increases could be spread.

The fact that rate design will be made more difficult for the Commission does not mean that local exchange rates will over time rise to unacceptable levels. Regardless of who carries the traffic, WATS and 800 Service traffic will continue to exist. As long as that traffic exists, LEC revenues can be generated from it, regardless of whether those revenues take the form of WATS and 800 Service rates or access charges.

It should also be observed that the LECs' argument falsely assumes that LEC discretionary services will diminish in number but will not increase. Technical innovation in the telecommunications industry can reasonably be expected to provide the LECs with additional revenue sources in the form of new and innovative service offerings. That may well serve to increase the Commission's rate design flexibility over the long term.

With regard to universal service concerns in rural areas, it is undisputably true that, unlike the larger LECs with more populous service territories, the rural LECs tend to have very high subscriber loop costs. The examiner does not accept, however, Mr. Hutton's contention that because of that fact the loss of WATS and 800 Service settlement revenues could eventually adversely affect universal service in rural areas.

Mr. Hutton testified that the subsidy afforded the rural LECs by the pooling of LEC WATS and 800 Service revenues is neccessary in order for those LECs to pay for their extraordinarily high subscriber loop costs. However, MCI

witness Klaus testified that each new year brings with it an ever increasing allocation of non-traffic sensitive (NTS) costs to the interstate jurisdiction for the overwhelming majority of the rural LECs and that, absent rate reductions in the Texas intrastate jurisdiction, the earnings of those companies will more than likely only continue to improve.

According to Mr. Klaus, on April 16, 1987, the FCC adopted a Federal-State Joint Board recommendation in CC Docket Nos. 80-286 and 86-297 which modified the allocation of NTS costs between the interstate and intrastate jurisdictions. In addition to phasing in a 25 percent gross allocation of NTS costs to the interstate jurisdiction, LECs with NTS costs in excess of the national average loop cost will allocate varying amounts of additional NTS cost to the interstate jurisdiction via an "expense adjustment". Mr. Klaus testified that, as a result of these separations procedures, smaller LECs with extraordinarily high NTS costs will allocate far more NTS costs to the interstate jurisdiction than was the case under the previous allocation methodology (frozen SPF).

For LECs with 200,000 access lines or less, 100 percent of the NTS cost in excess of 150 percent of the national average will be allocated to the interstate jurisdiction once it is fully phased in in 1993. Mr. Klaus used Dell Telephone Company as an example of how this separations change will affect LECs with high cost loops since Dell's annual unseparated NTS revenue requirement per loop (URRPL) of $2,486.27 is the highest in Texas. Based upon frozen SPF, $815.75 per loop per year would have to be recovered from the intrastate jurisdiction. In 1993, however, when the gross allocator and the NTS expense adjustment are both fully phased in, 92.2 percent of Dell's NTS costs would be shifted to the interstate jurisdiction, leaving only $194.79 per loop to be recovered from the intrastate jurisdiction.

Mr. Klaus testified that the Federal-State Joint Board's report reflects that Texas NTS costs are declining dramatically for all but a couple of LECs

doing business in Texas. Examiner's Attachment No. 3 is an analysis prepared by MCI which reflects the impact of the separations change on each LEC which is considered a high loop cost company. Mr. Klaus observed from the analysis that all but four LECs will have proportionately less NTS costs to recover from the intrastate jurisdiction, based upon 1985 costs, when both the high cost assistance and the gross allocator are fully phased in. The average subscriber loop costs to be recovered in the Texas intrastate jurisdiction is projected to decline by $9.48 per loop by 1993 based on 1985 costs. Subscriber loop costs which must be recovered from Texas intrastate rates will decline from a range of $10.55 to $67.98 under the frozen SPF to $11.98 to $19.16 per month, based upon the 1985 data which served as the basis for the Joint Board's report.

It is interesting to note that the parties engaged in virtually no cross-examination of Mr. Klaus on this separations issue, even though Mr. Klaus' testimony invalidates Mr. Hutton's thesis that the subsidy provided by pooled LEC WATS and 800 Service revenues is essential because of the high loop costs of the rural LECs. The examiner is convinced from Mr. Klaus' analyses that any immediate revenue losses suffered by the rural LECs as a consequence of lost WATS and 800 Service toll pool settlements would not jeopardize affordable local exchange rates in the short term, and that from the long term perspective, changes in the separations process will substantially eliminate any cost disadvantages associated with high subscriber loop costs.

To the extent that the interstate subsidy provided high cost rural LECs is considered insuffient, the examiner would note that PURA Section 98 provides for the establishment of a universal service fund to assist LECs in providing basic local exchange rates at reasonable rates in high cost rural areas. Further, Link-Up America and the Telecommunications Service Assistance Program are both available to assist in keeping local exchange service affordable for needy subscribers.

c. Conclusion

The examiner concludes that, from a short term perspective, the revenue losses which the LECs would likely experience under the worst case scenarios projected by Mr. Lerma and Mr. Klaus would not have a substantial adverse effect upon the financial conditions of the LECs.

The examiner finds that the worst case scenarios projected by Mr. Lerma and Mr. Klaus are not overly conservative by virtue of their lack of consideration of the potential for traffic to migrate from LEC MTS offerings to IXC WATS and 800 Service offerings. The examiner further finds that it is unlikely that the worst case scenario would in fact occur were the relief requested herein by the IXCs to be granted.

From a longer term perspective, the examiner finds that loss of WATS and 800 Services by the LECs would not reduce the Commission's rate design options to any significant degree because the introduction of competition with respect to those services prevents the Commission from relying upon them as categories over which future revenue increased could be spread. Further, loss of the 800 Service revenue replacement rate would not represent the loss of a discretionary service category over which future rate increase could be spread, since it is conceptually the same as access service. Additionally, it cannot be assumed that technical innovation within the industry will not lead to additional discretionary service categories as a consequence of the introduction of new and innovative service offerings.

The examiner finds that the loss of WATS and 800 Service settlement proceeds by the independent LECs will not endanger the long term affordability of local exchange rates in rural areas because of the increasing allocation of NTS costs to the interstate jurisdiction for high cost companies, the availability of the Texas Universal Service Fund, and the existence of assistance programs for needy telecommunications service subscribers.

2. Promotion of Efficient Telecommunication Service

According to GTE witness Joe Lee the provision of 800 Service by IXCs does not create additional network inefficiencies under the current 800-NXX Plan since the LECs' present inability to determine jurisdiction on 800 calls necessitates back-hauling of traffic in all instances. However, both Mr. Lee and SWB witness Deere testified that network efficiency suffers when IXC trunking via a tandem is used to complete an intraLATA WATS call. According to Mr. Deere, to use the IXC POP switch to complete an intraLATA call requires that the call be switched from the WSO to the LATA access tandem unless there is a direct trunk connection between the originating end office and the IXC POP. The tandem must then switch the call to the POP. The POP must switch the call back to the access tandem, and the tandem must then switch the call to the destination end office. That requires that the call be trunked two times between the tandem and the POP and that the call be switched two more times than if the call is completed by the LEC.

According to Mr. Deere, the extra trunking and switching associated with this back-hauling of traffic delays the completion of the call, reduces the transmission quality, and increases the overall cost of completing an intraLATA WATS call. The LECs assert that the back-hauling of 1+ intraLATA WATS traffic is contrary to the public interest inherent in "efficient" telecommunications service.

The examiner finds that this argument cannot reasonably serve as a legitimate justification for the reservation of 1+ intraLATA traffic to the LECs. On cross-examination Mr. Deere concluded that there is no degradation in transmission signal by virtue of the fact that a call is routed through an IXC POP. He testified that transmission over both fiber and copper cable travels at the speed of light, or 186,000 miles per second. Mr. Deere also testified that microwave signals travel at the same speed and that the delay in transmitting a call over a distance of 1,000 miles caused by microwave repeating equipment would probably not be noticeable by the human ear. It is apparent from Mr. Deere's testimony on cross-examination that the concerns he

expressed in his prefiled testimony with respect to call delay and signal deterioration from IXC handling of intraLATA WATS calls are meritless.

The cost concerns expressed by Mr. Deere are similarly without merit. As far as capacity of facilities is concerned, there is no evidence that routing an intraLATA call through an IXC POP would necessitate the installation of additional trunking facilities. In fact, it is apparent from Mr. Deere's testimony on cross-examination that there is currently a substantial amount of fiber optic cable in place in Texas which is used by both LECs and IXCs, and that the capacity of that fiber is expandable through the use of more powerful loop electronics. The LECs have not asserted that the additional switching which results from routing an intraLATA call through an IXC POP will overload central office switch facilities either. Further, the cost of any additional switching required in routing a call through an IXC POP is recovered by the LECs through access charges.

Any inefficiency resulting from IXC processing of intraLATA traffic is transparent to the customer. To the extent it causes more switching and routing by the LECs, the LECs cannot complain that they are not compensated for that effect. From the IXC network standpoint, the IXCs argue convincingly that efficient use of their network does not mean that the shortest route from point A to point B is utilized in completing a call, but rather that the call is processed in the most cost effective way. Back-hauling is the economically efficient way for IXCs to handle traffic. Further, there is no evidence that it is detrimental from the perspective of either the customer or the LECs. Therefore, invocation of the statutory policy in favor of adequate and efficient telecommunications service cannot reasonably serve as a legitimate justification for the reservation of 1+ intraLATA WATS traffic to the LECs.

3. Equal Opportunity for LECs to Compete

The LECs have asserted that the reservation of all 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs is necessary in order to insure that the LECs can maintain a viable market presence with respect to those

services. The LECs assert that they are handicapped in their ability to compete for two reasons. First, the MFJ precludes SWB and GTE from providing interLATA service, yet customers want a broader WATS and 800 Service calling scope than that defined by LATA boundaries. Second, regulation of LEC toll rates prevents the LECs from responding appropriately to the competitive initiatives of the IXCs, especially in light of this Commission's practice of residually pricing local exchange service. The LECs argue that PURA Section 18(a) mandates that the Commission provide equal opportunity to all telecommunications utilities in a competitive marketplace, and that reservation of 1+ intraLATA WATS traffic to the LECs is necessary to insure that the LECs are afforded an equal opportunity to compete.

a. *Geographical Restrictions on LEC Service*

Pursuant to the consent decrees entered into by SWB and GTE, those LECs are precluded from providing interLATA services. The IXCs assert that an LEC WATS or 800 service offering can be viable even if restricted by LATA boundaries. MCI witness Bryant testified that it is not unreasonable to assume that there exists some demand for stand-alone intraLATA offerings. According to Dr. Bryant, certain businesses whose calling patterns are concentrated in the immediate area of their location may wish to purchase an intraLATA-only WATS or 800 service and, for that type of customer, the LECs could offer considerable competition to the IXCs, whose service offerings generally are not tailored to such limited geographic areas. However, Dr. Bryant conceded that the overall demand for an intraLATA-only offering could not be expected to be nearly as great as the demand for an integrated interLATA/intraLATA offering.

MCI witness Yasitis testified that the LECs would have a marketing advantage with respect to intraLATA-only services for two reasons. First, the LECs have a high degree of name recognition. This is especially true for SWB, which was permitted to retain the Bell System logotype after divestiture. Second, the LECs have what Mr. Yasitis characterizes as "perfect" market information, by virtue of the fact that the LECs already have every potential intraLATA toll customer as a local exchange customer. The examiner would

observe, however, that those marketing advantages are useless unless there exists a reasonable market for intraLATA only services.

The examiner does not find the IXC's assertions regarding the success potential for stand-alone intraLATA WATS and 800 services to be persuasive. No IXCs participating in this proceeding offer any intraLATA-only toll services. There is a good reason for that. Customers generally have no idea where LATA boundaries are. Also, since LATA boundaries were deliberately drawn in such a manner that, to the extent possible, none would contain more than one SMSA, an intraLATA-only offering would not permit businesses to access any of the other major business centers within the state. GTE and SWB are the only LECs with customers subscribing to intraLATA-only WATS services. The industry total number of out-WATS WALS as of March 1988 was 421. It appears that there are presently no stand-alone intraLATA 800 Service customers within Texas. While there may be some small demand for an intraLATA-only offering, it appears that the vast majority of customers desire a calling scope which is broader than that afforded by LATA boundaries.

However, the small demand for stand-alone intraLATA WATS and 800 Services does not mean that the LECs cannot maintain a presence in the market. For the reasons previously discussed in connection with universal service concerns, the examiner believes that the LECs will continue to maintain some market share percentage by virtue of the current AT&T/LEC joint service offerings provided over intrastate WALS. Also, implementation of the BOC 800 Database will provide more opportunities for LECs to provide joint 800 Services with IXCs which do not possess 800 databases.

It must be emphasized that SWB and GTE are the only two Texas LECs which cannot provide interLATA services. The intraLATA only geographical restriction was imposed on SWB and GTE with their agreement, as evidenced by the fact that the consent decrees were voluntary settlements of pending antitrust suits. The remaining Texas LECs are not legally restricted from providing interLATA WATS and 800 Services.

The independent LECs argue that they are subject to geographically restricted offerings as a practical matter due to: (1) their small size; (2) their association with the SWB LATAs; and (3) this Commission's orders in Docket No. 5113. Those assertions are, however, meritless.

The examiner finds that the independent LECs are no more disadvantaged by size than are any similarly sized IXCs. If they have the desire to provide interLATA WATS and 800 Services and can obtain financial backing, they are as free to provide those services as is any IXC. It is not the Commission's function to insure that all telecommunication utilities enjoy equal financial resources.

With respect to TSTCI witness Hutton's assertion that the LECs' association with SWB LATAs precludes the independent LECs from providing interLATA services, the examiner would observe that their association with SWB LATAs does not preclude them from constructing, purchasing or leasing facilities over which they could transport interLATA traffic. The independent LECs' association with SWB LATAs is irrelevant to the issue of their practical ability to carry interLATA traffic.

Mr. Hutton testified that the Commission's orders in Docket No. 5113 are practical impediments to the provisioning of interLATA services by the independent LECs. However, he did not elaborate on the reasoning by which he reached that conclusion. MCI witness Bryant testified that his review of Docket No. 5113 revealed no Commission orders which would have that effect and the examiner cannot fathom Mr. Hutton's reasoning. Certainly, the pooling arrangement for intraLATA toll revenues crafted in Docket No. 5113 would not impede the provisioning of interLATA services by the independent LECs. Absent a credible explanation of Mr. Hutton's conclusions, the examiner cannot accept them.

It should be noted, however, that the fact that most LECs are not subject to any legally imposed geographical restrictions on their WATS offerings is of little practical significance since virtually all of the WALs in Texas are

located in the service territories of SWB and GTE. Exhibit No. 2 to Dr. Bryant's testimony reflects that, of the 68 LECs in Texas, 30 do not have a single WATS customer. Of the 38 that do, only 10 have more than 8 WALs. The top three are SWB with 25,147, GTE with 2,415 and Lufkin Conroe with 161. None of the LECs provide interLATA services outside of their service territories, nor have any evidenced an intent to do so, though two apparently have indirect ownership interests in an IXC through affiliate corporations.

b. *Regulation of LEC Toll Rates*

Regulated LEC toll rates can also in the examiner's opinion constitute a significant competitive handicap. There can be no question but that when one entity saddled with price regulation is placed in direct competition with an entity which is not subject to regulation, the ability of the regulated entity to timely and appropriately respond to competition from the unregulated entity will be impaired. There is always some degree of regulatory lag associated with requests for changes in rates, or for modifications to service terms and conditions.

However, the Texas legislature, in recognition of the problem, enacted PURA Section 18(e), which grants the Commission the power to promulgate rules and establish procedures applicable to the LECs for determining the level of competition in specific telecommunications markets and submarkets and providing appropriate regulatory treatment to allow LECs to respond to significant competitive challenges. In the examiner's opinion, PURA Section 18(e) provides an adequate mechanism for minimizing or entirely eliminating the disadvantages associated with price regulation of LEC toll services.

GTE questioned in its brief the LECs' ability to obtain timely Commission approval for a competitive pricing structure for WATS and 800 Services in light of the fact that P.U.C. SUBST. R. 23.27 precludes the LECs from petitioning the Commission to declare WATS and 800 Services a market subject to significant

competition earlier than 18 months after the effective date of that rule. However, the rule initially became effective on March 14, 1988. The LECs could therefore petition the Commission on or after August 15, 1989. That does not in the examiner's opinion constitute significant impediment to timely regulatory relief as that date is fast approaching.

IntraLATA WATS is the only LEC service for which the potential exists for loss of LEC traffic over the short term in the event the examiner's recommendations are adopted by the Commission. The delay in the LECs' ability to petition the Commission to declare that service to be subject to substantial competition would not pose a problem for the LECs because, as discussed later in this report, were the relief requested by the IXCs granted, it would take the LECs four to six months to reprogram LEC switches to route 1+ intraLATA WATS traffic to the LECs.

c. *Creation of Equal Opportunity*

Having established that the legal inability of SWB and GTE to provide interLATA WATS and 800 Services constitutes a substantial impediment to the LECs' ability to compete effectively in the provisioning of WATS and 800 Services, it is necessary to address the LECs' assertion that maintenance of the current *status quo* is warranted in order to further the policy objective of insuring the provision of equal opportunity to all telecommunications utilities in a competitive market place.

With respect to 800 Service, the current *2status quo* permits IXCs to carry intraLATA 800 traffic in exchange for paying the LECs a special revenue replacement rate. Alternatively, the IXCs can provide 800 service via a joint IXC/LEC offering whereby the LECs carry the intraLATA portion of the traffic. No one has proposed in this proceeding that IXCs be deprived of the non-joint service option and the record certainly does not support the appropriateness of such action given that it would entirely foreclose competition for intraLATA 800 Service in contravention of the policy objective upon which the LECs rely.

Given the fact that IXCs can and do carry intraLATA 800 Service traffic under the current *2status quo*, the examiner cannot accept that IXC payment of a revenue replacement rate serves to provide equal competitive opportunity to the LECs. The record reflects that the existence of the revenue replacement rate under the non-joint option has not induced any IXCs to enter into new joint service arrangements with the LECs. Nor does the record reflect that the revenue replacement rate has served to stimulate intraLATA traffic volumes under the joint AT&T/LEC 800 Service offering.

The revenue replacement rate does not afford the LECs equal opportunity in a competitive market or enhance their competitive standing. It merely gives them more money. The Commission's mandate under PURA Section 18(a) is to afford equal opportunity to compete in a competitive marketplace. It is not to compensate the LECs for their inability to provide interLATA service by affording them the revenues they would have made if they had garnered 100 percent of the traffic within the areas in which they are authorized to compete.

The examiner finds that if continued imposition of the revenue replacement rate is at all justifiable, preservation of universal service must constitute the basis for that rate rather than the policy objective of providing equal opportunity within a competitive marketplace.

With respect to WATS Service, the examiner does not accept that maintenance of the current *status quo* is warranted in order to further the policy objective of providing equal opportunity within a competitive market place. Reservation of all 1+ intraLATA WATS traffic to the LECs does not afford the LECs an equal opportunity to compete for the provisioning of WATS services. In fact, it affords them a substantial advantage in the areas in which they provide WATS service. The LECs argue that the 1+ dialing advantage is necessary to compensate for the disadvantages associated with their offerings.

The Commission's mandate under Section 18(a) however, is not to balance the advantages and disadvantages borne by various utilities in order to insure that everyone succeeds equally. Rather it is to insure that everyone has an equal opportunity to join in the competition. That should be done by removing artificial barriers to competition where possible, not by creating barriers to free competition.

This view point is supported by PURA Section 18(e)(3), which authorizes the Commission to facilitate a LEC's ability to compete effectively through such actions as approving a range of rates for specific services, approving customer specific contracts, and detariffing rates. Each of these actions is directed at lessening the constraints upon the LECs rather than imposing artificial contraints on the LEC's competitors.

The Commission cannot remove the geographical restriction on the WATS Services offered by SWB and GTE. That restriction can be lifted only by action at the federal level. However, the disadvantage associated with that restriction can be substantially mitigated without taking affirmative action to competitively handicap the IXCs by affording LECs an equal opportunity to compete for WATS traffic within the geographical areas in which they are legally permitted to provide service.

The examiner cannot accept that relegating SWB and GTE to the provision of WATS Service solely to those customers which have no interLATA calling needs affords these LECs an equal opportunity to compete. The demand for that type of service is likely very close to being non-existent. Similarly, for those WATS customers that have need for interLATA calling scope, purchasing a second WAL over which intraLATA WATS traffic could be carried by a LEC does not constitute a viable competitive opportunity. The cost of the second WAL would not likely be cost effective for the WATS customer. This is especially true, given that LECs can only offer intrastate WALs which are substantially more

expensive than UWALs. In addition to the added cost, the inconvenience of using a second line for intraLATA calling, combined with customer lack of familiarity with LATA boundaries would present an insurmountable obstacle to the viability of such an offering.

The examiner agrees with SWB witness Deere that a presubscription mechanism, whereby the customer can select a different 1+ WATS carrier at the intraLATA level than the carrier that provides 1+ WATS at the interLATA level, is necessary if SWB and GTE are to have an equal opportunity to compete for intraLATA WATS traffic. As discussed later in connection with LEC software limitations, the cost of full 1+ intraLATA presubscription capability is prohibitive. However, the examiner believes that an adequate mechanism for limited presubscription can be made available without incurring the costs associated with modifying the generic software of all LEC switches.

The examiner's discussion of LEC software limitations later in this report reveals that 1+ intraLATA WATS traffic can in fact be routed to an IXC in most instances without the necessity of generic software modifications or the incurrence of substantial expense. Further, the LECs' present ability to strip and carry 1+ intraLATA WATS traffic cannot be doubted. It is apparent that customers can be afforded the choice of having their 1+ intraLATA WATS traffic carried by either their 1+ interLATA WATS carrier or by the LEC, without the need for full blown 1+ intraLATA presubscription capability, given that the testimony of Mr. Lee and Mr. Deere reflects that UWALs would have to be modified line by line to route 1+ intraLATA WATS traffic to an IXC. It would appear that each individual line could be modified or not, depending upon the customer's preference. The fact that the customer could not designate anyone other than the LEC or the interLATA carrier to handle 1+ intraLATA traffic is not fatally offensive, since it is the LECs rather than other IXCs that suffer the disadvantageous geographical restriction.

The examiner believes that the policy objective of insuring an equal opportunity within a competitive marketplace demands that the Commission

undertake to afford all customers subscribing to WATS offerings provided over UWALs an opportunity to select either the LEC or the 1+ interLATA carrier to carry their 1+ intraLATA WATS traffic. The examiner believes it further incumbent upon the Commission to insure a competitive rate design for LEC intraLATA WATS offerings.

Those actions will provide SWB and GTE equal opportunity to compete. If they have a product as good or better than the products marketed by the IXCs, the LEC offerings should be able to maintain a fully viable presence within the intraLATA arena. Beyond this the Commission should not go under the guise of providing an equal competitive opportunity to the LECs. When it is considered that a UWAL is an access facility purchased by an IXC in order to provide a service which the IXC has marketed and sold to the end user customer, affording LECs the opportunity to carry the 1+ intraLATA traffic over that access facility if the customer so desires constitutes exceedingly fair regulatory treatment.

The examiner believes that reservation of all 1+ intraLATA WATS traffic to the LECs cannot be justified on the basis that it promotes the policy objective of insuring the provision of equal opportunity to all telecommunications utilities in a competitive marketplace. The justification, if any, for continuing the *status quo* would have to be founded upon universal service concerns.

4. Software Limitations

There currently exist no LEC software limitations which would hamper the ability of LEC switches to route intraLATA 800 Service traffic to IXCs. But, there are software problems in connection with IXC carriage of 1+ intraLATA WATS traffic.

Each LEC end office which allowed 1+ intraLATA WATS traffic to be routed to an IXC would require some switch reprogramming. MCI Witness Steve Holden stated in his prefiled testimony that the LECs could easily reprogram their central office switches to permit 1+ intraLATA calls to be routed to either the IXCs or to the LECs. According to Mr. Holden, that could be done by creating an additional WATS band or changing an existing WATS band. Mr. Holden characterized that suggestion as a simple solution which could be implemented by the LECs in short time with little expense. However, both SWB witness William Deere and GTE witness Joe Lee testified that Mr. Holden was in error. According to Mr. Deere, the method suggested by Mr. Holden would not work because WATS band screening is performed after the switch has determined whether it should route the call to the LEC or an IXC. Mr. Lee concurred in Mr. Deere's testimony on that issue and it in fact appears that Mr. Holden's suggestion is unworkable.

Both Mr. Deere and Mr. Lee indicated that the extent of any necessary reprogramming or software modifications is dependent upon the type of switch in question. According to Mr. Deere, in the No. 1/1A ESS and No. 2/2B offices it is possible to create a new class of service that will override the designation of the intraLATA codes. In the No. 5 ESS offices, Mr. Deere indicated that it is possible to create a class of service that uses a different screening table to determine if a called number is interLATA or intraLATA. Mr. Deere cautioned on cross-examination, however, that there is no guarantee that the procedures would necessarily work in the future following the issuance of any subsequent generic software updates by the manufacturer.

With regard to the DMS-10, DMS-100 and DMS-200 switches manufactured by Northern Telecom, Mr. Deere testified that there presently exists no method of routing 1+ intraLATA WATS traffic to IXCs. GTE witness Lee agreed with Mr. Deere on that point. But, the Northern Telecom switches are not used in connection with UWALs due to the inability of those switches to properly handle international calls. As this docket concerns solely WATS service provided over

UWALs, the DMS-100 family of switches is not a significant problem. They would, however, pose a serious problem with respect to WATS provided over intrastate WALs because DMS-10 and DMS-100 switches are used in the provision of WATS service over those WALs. DMS-200 switches are not used as WSOs, even in connection with intrastate WALs.

Mr. Lee testified that GTE's GTD-5 EAX switches could route 1+ intraLATA traffic to the IXCs through use of a special class mark. Under that procedure, the data base for each WATS line for which traffic is to be routed to the IXCs would have to be changed to uniquely identify it. In addition, at least three additional screening tables would be required in each switch.

With respect GTE's GTD-2 EAX switches, Mr. Lee testified that 1+ intraLATA traffic could not be routed to an IXC unless the manufacturer modified the generic software. Thus, those switches are a significant problem. Mr. Lee testified on cross-examination, however, that in most instances WATS traffic originating over UWALs would be processed by the GTD-5 EAX switches. It is not possible to quantify from the record what percentage of WATS traffic originating over UWALs would have to be handled by the GTD-2 EAX switches.

Mr. Lee indicated that GTE also uses certain step-by-step electromechanical switches for WATS screening purposes which cannot route 1+ intraLATA traffic to an IXC. But, end offices with those switches have not been converted to equal access. Those switches consequently would not serve as a practical impediment to the carriage of 1+ intraLATA WATS traffic by the OCCs. As previously discussed, it is not an economically viable proposition for IXCs to provide WATS service in areas served by non-equal access end offices due to the added expense of a WALE from the non-equal access end office to the nearest equal access end office. Those switches, however, constitute a serious impediment to the carriage of 1+ intraLATA WATS traffic by AT&T.

GTE has a number of Stromberg Carlson DCO central office switches which presently do not provide WATS services due to their inability to record the traffic in a manner which allows proper billing. However, Mr. Lee testified that GTE is currently negotiating with the manufacturer for a generic software update which would allow the provision of WATS service from those switches. When the new software is installed, the routing of 1+ intraLATA WATS traffic to IXCs would require the same procedures as would be followed for the GTD-5 EAX switches.

The examiner has no basis for concluding that the cost of reprogramming those switches which would not require generic software changes would be unreasonable. The only testimony addressing that issue is that of Mr. Lee, who testified that establishing and maintaining the new class mark and screening tables would increase labor costs and would require additional memory, necessitating hardware additions in some central offices. Those expenses presumably are not extraordinarily high or the LECs would have so indicated.

To the extent, however, that it is necessary to modify the generic programming of a switch, the record reflects that it is quite expensive to do so. Mr. Deere testified that generic program modifications must be made by the equipment manufacturer. Depending upon the size of the switch and the particular feature package desired, or the type of generic update needed, the front-end cost of the modification would range from a low of $50,000 to $70,000 per switch to a high of several hundred thousand dollars per switch. Additionally, a monthly fee would be charged per switch by the manufacturer.

For those switches which do not require generic software modifications to route 1+ intraLATA WATS traffic to the IXCs, it appears that for each line that is modified to route 1+ intraLATA traffic to an IXC, the IXC which carries the 1+ interLATA WATS traffic must also carry the 1+ intraLATA traffic. This is because the generic software for those switches was not designed to permit intraLATA presubscription. Mr. Deere opined that, if WATS is to be provided on

a fully competitive basis within the intraLATA arena, the customer should be afforded the option of subscribing to one carrier for interLATA WATS service and another carrier or a LEC for intraLATA WATS service. That would require that a second presubscription code be designed into all of the operating programs for switches presently in use. Both Mr. Lee and Mr. Deere indicated that no manufacturers of switches used by SWB or GTE have as yet undertaken program modifications which would allow intraLATA presubscription. The examiner finds that intraLATA presubscription capability is not essential to the LECs' technical ability to route 1+ intraLATA traffic to IXCs.

The examiner finds that there exists no substantial technical barrier to the IXC carriage of 1+ intraLATA traffic over UWALs except in connection with the GTD-2 EAX switches and the GTE electro-mechanical switches that serve as WSOs. As to the remaining LEC switches used to provide WATS service over UWALs, the examiner finds that switch software limitations cannot serve as a legitimate basis for treating IXCs and LECs in an unequal manner by allowing the LECs to be the carrier of intraLATA WATS traffic originated over UWALs through use of the 1+ dialing pattern.

Were it deemed necessary to implement an intraLATA presubscription capability for WATS service, it appears that the LECs would incur tremendous costs due to the necessity of modifying the generic software of all of the LEC switches and that those costs would constitute a legitimate basis for treating the IXCs and LECs unequally. However, for the reasons discussed earlier in this report, the examiner believes that providing 1+ intraLATA presubscription capability in the manner envisioned by Mr. Deere is unnecessary to a fair resolution of the issues in dispute.

GTE witness Lee testified that, as to those switches which would not require generic software modifications in order to route 1+ intraLATA WATS traffic to IXCs, it would take four to six months to reprogram the switches and make any necessary hardware additions and memory reallocations. Therefore, if

the Commission concludes that the IXCs should be afforded the opportunity to carry 1+ intraLATA WATS traffic, the examiner recommends that the LECs be granted a six month implementation period following the entry of the Commission's final order in this docket.

C. The Public Interest Test

The preponderance of the evidence supports the conclusion that the current *status quo* with respect to 1+ intraLATA WATS and 800 Service is contrary to the PURA Section 47 prohibition against anticompetitive practices. The inability of the IXCs to carry 1+ intraLATA WATS traffic, and the artificial cost handicap imposed by the intraLATA 800 service revenue replacement rate, together tend to impair free competition within the intraLATA area.

The evidence further supports the conclusion that the intraLATA 800 Service revenue replacement rate is not just and reasonable but rather unreasonably preferential to the LECs and unreasonably prejudicial and discriminatory to the IXCs for three reasons. First, the rate is based on the false assumption that the LECs are entitled to ownership rights to intraLATA 800 Service regardless of whether they in fact carry the traffic. Second, there is absolutely no difference between the LEC access service provided to the IXCs for intraLATA and interLATA 800 Service traffic. Third, there exists no social policy objective that serves as a reasonable basis for unequal rate treatment of the interLATA and intraLATA 800 Service traffic carried by the IXCs.

With respect to WATS service, the record demonstrates that the LEC practice of stripping, carrying and billing all 1+ intraLATA WATS traffic originating over UWALs is unreasonably discriminatory. In the areas served by LEC end offices with switches that have the capability to route 1+ intraLATA traffic to IXCs without the necessity for generic software modifications, there exists no substantial technical impediment that would justify the unequal treatment of the IXCs and the LECs inherent in the reservation of all 1+ intraLATA traffic

to the LECs. So long as WATS customers within those areas are afforded the choice of whether they wish the LEC or their interLATA carrier to handle their 1+ intraLATA WATS traffic, there exists no reasonable basis for the unequal treatment afforded LECs and IXCs with respect to 1+ intraLATA WATS traffic.

The preponderance of the evidence reflects that no statutory policy considerations mandated by PURA warrant the continuation of the current *status quo* with respect to WATS and 800 Service in the face of its anticompetitive and discriminatory effect upon the IXCs. Were the Commission to find that maintenance of the current *status quo* is warranted under the balancing principle enunciated in *Amtel*, the examiner believes that the only policy consideration upon which the Commission could rely would be the goal of preserving universal service.

In policy matters this Commission has consistently found that the public interest favors the preservation and furtherance of universal service over the fostering of competition. In both Docket No. 5113 and Docket No. 5220, the Commission construed PURA Section 18(a) as reflecting the Legislature's determination of policy priorities: first, protection of universal service; and second, providing competitive opportunities.

[3] However, although the Commission has traditionally taken an aggressive stance with respect to the protection and furtherance of universal service, PURA's express prohibitions against anticompetitive and discriminatory conduct must not be ignored. The protection of universal service and the prevention of discriminatory and anticompetitive conduct are not mutually exclusive concepts. Under the standard enunciated in *Amtel*, the Commission must strive to effectuate the policy interests inherent in preventing anticompetitive and discriminatory conduct *as well as* those inherent in the preservation of universal service. Where it has been demonstrated that elimination of discriminatory or anticompetitive conduct can be achieved without jeopardizing the affordability of present or future local exchange

rates or any other policy objective, as is the case in this docket, there exists no policy conflict which necessitates the discounting of the policies underlying PURA Sections 38, 45 and 47.

The examiner believes that elimination of the intraLATA 800 Service revenue replacement rate and the implementation of a limited presubscription procedure with respect to 1+ intraLATA WATS traffic in areas served by end offices with switches that can route 1+ intraLATA WATS traffic to IXCs without the necessity of generic software modifications, is fully consistent with the court's holding in *Amtel*. The examiner's recommendation effectuates the policy interests inherent in preventing anticompetitive and discriminatory conduct without adversely affecting any other policy which PURA charges the Commission with effectuating in its administration of the statute. In the examiner's opinion no further public interest analysis is necessary to the proper resolution of this case.

However, as the IXCs bear the burden of proof in this proceeding, the LECs have asserted that the IXCs must prove by a preponderance of the evidence that tangible public benefits will result from granting the relief requested by the IXCs. The LECs argue that it has not been demonstrated that toll rates will be lowered, that new and innovative service offerings will be introduced or that IXCs will expand their service offerings to less populated areas of the state in the event the relief requested is granted. Thus, the LECs conclude that the IXCs have failed to satisfy their burden of proof on the public interest issue.

The examiner strongly disagrees with the LECs' burden of proof contentions. *Amtel* does not require that tangible benefits be proven to accrue to the overall body of ratepayers. Having demonstrated that the *status quo* is discriminatory and anticompetitive in nature, and that elimination of the discriminatory and anticompetitive effects of the *status quo* can be had without substantial adverse impact on any other policy objective, the IXCs are not required to prove anything further as a

precondition to obtaining relief. The LECs' tangible benefits argument wholly fails to recognize the public interest inherent in the prevention of discriminatory and anticompetitive conduct.

To the extent that one believes that the IXCs must be held to the standard of proof advocated by the LECs, the record reflects that several tangible public benefits can be expected to result from granting the relief requested by the IXCs. First, AT&T witness O'Neal testified that unless the relief requested is granted, AT&T will raise its 800 Readyline rates. Similarly, MCI witness Bryant testified that MCI is losing money on its intrastate 800 Services since it is currently charging interstate rates in Texas which have not been adjusted to compensate for higher Texas access costs. When MCI establishes intrastate rates for the service, the existence of the revenue replacement rate will affect the extent to which MCI's current rates must be increased. The examiner finds that increased rates would suppress demand for non-joint 800 services, and that reduced demand would in turn make less toll free numbers available for use by the public. The examiner finds that maximizing the availability of toll free numbers by avoiding suppression of demand is beneficial to the public because consumers are given more choices of toll free shopping and greater access to toll free information sources.

Second, AT&T witness O'Neal testified that 800 Readyline Service can be cost effective for the smaller businesses that one expects to find in rural areas. The examiner finds that use of the service can expand the marketing area of a rural business which in turn can help the business prosper, grow, and provide employment opportunities and a larger tax base for rural areas. Therefore, encouraging stimulation of demand for such services by removing artificial costs which put upward pressure on prices for such services can tangibly benefit rural areas.

Third, the examiner finds that eliminating the intraLATA 800 Service revenue replacement rate will permit the current growth in 800 Services to

continue, thus producing overall growth in toll traffic volumes and generating increased LEC access charge revenues.

Fourth, Mr. O'Neal testified that elimination of the current practice of reserving all 1+ intraLATA WATS traffic to the LECs benefits WATS customers by permitting them greater choice as to their intraLATA WATS carrier. If they are dissatisfied with service, they can change carriers without being burdened in the process with an inconvenient dialing pattern. Affording that choice is in the examiner's opinion a tangible benefit to the body of customers that utilize WATS services.

Finally, the examiner finds that elimination of the discriminatory and anticompetitive aspects of the current *status quo* can be expected to induce the LECs to aggressively seek to enhance the attractiveness of the LEC WATS and 800 Services, which will redound to the benefit of LEC WATS and 800 Service customers, and to aggressively promote enhanced access services, which will redound to the benefit of the general body of ratepayers.

In summary, the tangible benefits produced by removing artificial constraints upon competition for WATS and 800 Service within the intraLATA arena are the same as those generally perceived to flow from competition, to wit: lower prices, better service, more customer choice, increased demand and incentives for efficient operation and product innovation.

The examiner concludes on the basis of the evidentiary record herein that the public interest lies with the elimination of the discriminatory and anticompetitive effects inherent in the current *status quo*.

VIII. Conclusion and Recommendations

MCI and the aligned IXCs have sustained their burden of proof in this proceeding to the following extent. They have demonstrated by a preponderance

of the evidence that the reservation of all 1+ intraLATA WATS traffic to the LECs in areas served by central office switches which can route 1+ intraLATA traffic to IXCs without the need for generic software modifications or switch replacement, and the assessment of a special revenue replacement rate in lieu of access charges on all intraLATA 800 service traffic carried by the IXCs, are unreasonably discriminatory and anticompetitive practices. Based upon the examiner's analysis of the facts as set out in this report, the examiner concludes that sanctioning the continued reservation of 1+ intraLATA WATS traffic to the LECs would be violative of PURA Sections 35(b), 37 and 38, and that sanctioning the continued application of the intraLATA 800 Service revenue replacement rate in lieu of access charges, would violate PURA Section 38.

With respect to intraLATA WATS service, the record reflects that in those central offices where modification of generic switch software is not necessary, reprogramming the switches to route 1+ intraLATA traffic to IXCs upon request will take a substantial amount of time. Therefore, the examiner recommends that the LECs be allowed a grace period of six months following the entry of the final order in this docket in order to permit LEC central office switches to be reprogrammed in an orderly and cost efficient manner. The examiner further recommends that, during the six month grace period, existing WATS customers be given the choice of selecting their LEC or their 1+ interLATA WATS carrier as their carrier of choice for 1+ intraLATA WATS traffic. After the expiration of the grace period, new WATS customers should be required to designate their preferred 1+ intraLATA WATS carrier prior to initiation of the customer's WATS service. Existing WATS customers should be afforded the opportunity to switch their designated 1+ intraLATA WATS carrier on an ongoing basis.

The examiner recommends that the LECs and the IXCs be afforded sixty days from the date of the final order herein to file a joint proposal for establishing the procedural mechanism whereby WATS customers will designate their preferred 1+ intraLATA WATS carrier. The examiner suggests that the

joint proposal be treated as a Commission project, assigned a project number, and handled expeditiously by the Commission.

With respect to 800 Service, the examiner recommends that the intraLATA 800 Service revenue replacement rate be terminated without delay since it is an unlawful rate, the only basis for which is the false assumption that the LECs should possess the ownership rights to intraLATA 800 Service traffic. In the absence of that rate, the LECs, of course, shall be entitled to charge the IXCs for network access provided by the LECs for that traffic at the LECs' currently tariffed access rates.

IX. Findings of Fact and Conclusions of Law

The examiner further recommends that the Commission adopt the following findings of fact and conclusions of law.

A. Findings of Fact

1. This proceeding was initiated by order of the Commission on December 18, 1986, for the purpose of resolving the issue of whether interexchange carriers (IXCs) should be allowed to carry and bill 1+ intraLATA WATS traffic originating over UWALs, or whether all such traffic should be reserved to the local exchange carriers (LECs).

2. The scope of the proceeding was subsequently expanded to include the issue of whether all intraLATA 800 Service traffic and/or revenues should be reserved to the LECs or whether IXCs should be permitted to carry and bill such traffic, subject only to the payment of access charges.

3. Prehearing conferences were held in this docket on April 29, 1987, April 4, 1988, April 19, 1988, and August 15, 1988. The hearing on the merits was convened on August 22, 1988 and adjourned on September 14, 1988. Numerous

parties participated in the docket, as reflected in the procedural history set out in Section I of this report.

4. Notice of the pendency of this proceeding was mailed to all LECs, all IXCs registered with the Commission in accordance with P.U.C. SUBST. R. 23.61(i) and (j), all parties to Docket Nos. 7020 and 7160, and the Office of Public Utility Counsel.

5. The IXCs bear the burden of persuasion in this proceeding.

6. By examiner's order, two post-hearing exhibits were admitted into evidence without objection.

7. Wide Area Telecommunications Service (WATS) is a discounted toll service designed for business customers whose calling volumes are relatively large and whose usage is relatively predictable.

8. The primary technical distinction between WATS and regular message telecommunications service (MTS) is that a WATS customer accesses the LEC network via a WATS access line (WAL) rather than a common access line.

9. WATS is a switched access service, and thus WATS calls are screened by a LEC central office switch to determine how they are to be routed.

10. The screening function for WATS traffic must be performed by a WATS Service Office (WSO).

11. If the central office at which a WAL terminates is not capable of serving as a WSO, the WATS traffic is routed via shared interoffice trunk facilities to a central office which is capable of serving as a WSO. The shared trunk facility between the central office and the WSO is known as a WAL extension (WALE).

12. The WSO screens all WATS traffic and routes the interLATA traffic to the designated IXC's point of presence for transportation over IXC facility. The WSO routes all 1+ intraLATA traffic to the LEC for transportation and termination over the LEC's facilities.

13. If an IXC chooses to make the 10-XXX dialing option available to its WATS customers and a customer dials the IXC's 10-XXX code in lieu of 1+, the WSO automatically routes the call to the IXC for transportation over the IXC's facilities, irrespective of the geographical destination of the call.

14. The only technical difference between WATS and WATS-like services is that, in lieu of a WAL, the access connection between the customer and the IXC's POP is accomplished via a customer or IXC-owned facility or a special access facility leased from the LEC.

15. Since WATS-like services bypass the LEC switched network, all 1+ intraLATA WATS-like traffic is transported solely by an IXC.

16. 800 Service is a mechanized reverse charge service which permits interested parties to dial an 800 Service customer without being billed for the call.

17. 800 Service traffic originates over common lines connecting calling parties to the switched network.

18. 800 Service traffic can be terminated at the customer's premises using a common line, a WAL, a special access line, or a dedicated private facility installed by an IXC or the 800 Service customer.

19. Unlike WATS, only one dialing plan can be used in conjunction with 800 Service.

20. An 800 Service number cannot be used by LEC switches to connect a calling party with the 800 Service customer, nor can call jurisdiction be determined from the 800 Service number.

21. Before a calling party can be connected with an 800 Service customer, the dialed 800 Service number must first be translated by an 800 Service database into the ten digit POTS number assigned to the 800 Service customer's called terminating location.

22. AT&T, MCI and Sprint are the only IXCs that own 800 Service databases, although the Bell Operating Companies (BOCs) plan to deploy their own 800 Service database in the near future.

23. After an 800 number is translated to a POTS number, the manner in which the call is routed depends upon the service arrangement between the LEC and the IXC.

24. If the IXC is providing 800 Service pointly with the LEC and the call is intraLATA in nature, the IXC switch routes the call back to the LEC for carriage and billing by the LEC.

25. If the IXC is not providing 800 Service jointly with the LEC, the IXC switch routes all 800 calls over the IXC network for carriage and billing by the IXC, but the IXC must pay the LEC a revenue replacement rate, in lieu of access charges, for each intraLATA 800 Service minute of use carried by the IXC.

26. This Commission has in the past never consciously adopted a policy of bestowing upon LECs the ownership rights to 1+ intraLATA WATS and 800 Service traffic.

27. Although the geographical market for toll services should logically be statewide in scope, it is necessary to assume an intraLATA geographical market for purposes of analyzing whether the reservation of 1+ intraLATA WATS and 800 Service traffic to the LECs would contravene the constitutional prohibition against state-created monopolies, since LATA boundaries define the areas in which the LECs operate, LATAs constitute the areas in which the LECs and IXCs

directly compete in the provision of toll services, and LATAs are the areas affected by the competitive constraints alleged by the IXCs.

28. The toll market cannot be divided realistically between WATS, 800 Service, MTS, or other such services because the IXCs have the ability to reconfigure their networks at will to provide different kinds of services that are essentially substitutable or interchangeable.

29. Were one to recognize the existence of discrete product submarkets, the only submarkets for which support from the record could be found would be WATS and WATS-like services on the one hand, and 800 Service on the other.

30. The fact that the 10-XXX dialing option requires a WATS customer to dial four extra digits in order to have an IXC carry an intraLATA WATS call is not sufficient to require that 1+ be viewed as a separate service market.

31. For purposes of analyzing claims of monopoly, there exists only one product market, to wit: the aggregation of all toll services.

32. Although the LECs presently bill and carry all 1+ intraLATA WATS traffic to the exclusion of the IXCs, there exists substantial competition between the LECs and the IXCs in the provisioning of WATS-type services.

33. A lack of evidence prevents relative market share from being quantified wth respect to any facet of the intraLATA toll services product market.

34. A Commission prohibition of IXC provisioning of intraLATA 800 Service would not create a LEC monopoly because 800 Service constitutes only a small portion of the intraLATA toll market and because the LECs could not leverage their control of that market segment into control of the overall intraLATA toll market.

35. The LECs cannot prevent the entry of competiters into the toll market, nor can they adversely manipulate prices, given the existence of price regulation.

36. Tariffs do not presently prohibit any IXC from offering 800 Service on an intraLATA basis, and none of the LECs have requested that their tariffs be modified in the future in order to require that all intraLATA 800 Service be carried and billed by LECs.

37. AT&T, Sprint and MCI can and do offer 800 Service within the intraLATA arena.

38. Under the stipulation reached by the parties in Docket No. 7160, IXCs are free to carry intraLATA 800 Service traffic but they are required to pay the LECs a revenue replacement rate which is designed to compensate the LECs for the net revenues which the LECs would have earned if they carried and billed the intraLATA portion of the 800 Service traffic themselves.

39. The intraLATA 800 Service revenue replacement rate could not provide the LECs with monopoly control of the 800 Service aspect of the intraLATA toll market because: 1) the rates are regulated and priced substantially in excess of the incremental costs of providing the service; 2) the LECs are prohibited from offering 800 Services outside of LATA boundaries and this, the IXCs can leverage their statewide market presence by marketing an integrated 800 Service offering which permits calls to be received from any and all areas in which the customer is interested; and 3) the competitive disadvantage which the revenue replacement rate places upon IXCs is mitigated by the IXCs' ability to average their disparate interLATA and intraLATA costs incurred in providing the integrated service.

40. A Commission decision to implement on a permanent basis the (status quo) with respect to 1+ intraLATA WATS and 800 Service, or even to further constrain IXCs with respect to 800 Service, would not contravene the constitutional prohibition against state-created monopolies.

41. The Commission has no authority to order an IXC not to provide non-local exchange services within specific geographical areas. That does not mean, however, that the Commission necessarily lacks the authority to take actions with respect to the operations or services of other utilities over which it has full jurisdiction which might have the consequence of preventing IXCs from providing toll services within designated geographical areas.

42. PURA Sections 38, 45 and 47 together constitute a strong policy statement against discriminatory and anticompetitive conduct by either public utilities or this Commission.

43. The practice of stripping and carrying all 1+ intraLATA WATS traffic originating over UWALs discriminates against and competitively disadvantages the IXCs by forcing them either to require their customers to use an inferior dialing pattern for intraLATA calling than is available for use by customers, or bear the adverse consequences of carriage of the intraLATA WATS traffic generated through IXC marketing efforts.

44. The 10-XXX dialing option is disadvantageous because it requires an IXC customer to dial a minimum of four more digits that would have to be dialed using the 1+ dialing pattern.

45. Because customers are generally unfamiliar with LATA boundaries and could not be expected to know whether a called number in fact terminates within the same LATA in which it originates, customers using the 10-XXX dialing option would as a practical matter have to use that dialing pattern in all instances regardless of the interLATA or intraLATA nature of the call.

46. It cannot realistically be assumed that a large percentage of WATS customers would be willing to go to the trouble of dialing extra digits in order that their preferred carrier handle their intraLATA calls.

47. Dialing extra digits is a special problem in connection with WATS applications where speed calling is important.

48. It is possible to eliminate or substantially mitigate the inconvenience of dialing extra digits through use of auto-dialers, adjunct equipment on digital PBXs, or front-end processors for PBXs.

49. Sprint is the only IXC participating in this proceeding that offers the 10-XXX dialing option to its WATS customers.

50. The cost of PBXs and auto-dialers can increase the cross-over point at which a WATS offering becomes more economical than MTS.

51. For large customers that can most easily afford equipment which makes the extra digits associated with the 10-XXX dialing option transparent to the calling party, a WATS-like service may prove to be more economical than WATS.

52. The 10-XXX dialing pattern cannot be used in non-equal access end offices.

53. If an IXC offered the 10-XXX dialing pattern to its WATS customers, a customer could reach any IXC over the WAL, instead of solely the IXC which purchased the WAL.

54. A cost of a WAL extension is usually such that it is not economical for a customer served by a non-equal access end office to purchase WATS service. Accordingly, the non-availability of 10-XXX in such areas is inconsequential from the OCCs' perspective.

55. It is unlikely that the lack of availability of the 10-XXX option in non-equal access areas can be a significant consideration for AT&T given that AT&T has never chosen to use the 10-XXX option in connection with any of its services.

56. Equal access should soon be ubiquitous within the geographical areas for which there exists customer demand for WATS services.

57. A WATS customer would have no incentive to use the 10-XXX code of an IXC other than the IXC providing WATS service to the customer because, if the customer did so, the call would be billed at MTS rates rather than at the discount afforded by WATS service.

58. Acquisition of the ability to make the extra digits associated with the 10-XXX option transparent to the calling party is not necessarily a viable economic option unless the customer is large, the customer has an unusually high percentage of intraLATA traffic, or the customer already possesses such equipment.

59. Reservation of the 1+ dialing pattern for the exclusive use of the LECs is a discriminatory practice which impairs the ability of IXCs to compete for the carriage of intraLATA WATS traffic.

60. If a LEC carries 1+ intraLATA WATS traffic originated over UWALs, enhanced pricing, billing and blocking features offered by IXCs in connection with interLATA WATS traffic will not be available to the customer in connection with the customer's intraLATA traffic.

61. The only enhanced IXC WATS features that have any real significance in the context of intraLATA WATS traffic are billing features.

62. The lack of availability of enhanced WATS feature capability can be overcome by the customer's use of the 10-XXX option.

63. The nonavailability of enhanced WATS feature capability is far more disadvantageous to the customer than it is to an IXC.

64. The lack of an IXC's ability to provide end-to-end service to its WATS customers, in instances where the 10-XXX dialing option is not offered by the IXC, does not inhibit an IXC's ability to market it services (vis a vis) other IXCs since all IXCs share the same disadvantage. An IXCs' ability to market its services (vis a vis) the LECs is not inhibited since the LECs also lack end-to-end service capability.

65. WATS customers are sophisticated telecommunications users who can reasonably be expected to understand the mechanics of the LEC joint WATS provisioning arrangement.

66. The interjection of the LECs into the relationship between the IXC and the customer is not a significant competitive disadvantage for IXCs.

67. There is no evidence from which it can be concluded that the LECs obtain a cost advantage over IXCs in the provisioning of intraLATA WATS as a consequence of the fact that LECs do not contribute to the costs incurred by IXCs to purchase WALs.

68. To the extent that an IXC is unwilling to offer its customers the 10-XXX dialing option, or that customers are unwilling to use it, the IXCs still have the ability to provide 1+ calling capability via their WATS like service offerings.

69. Aside from the loss of potential earnings from intraLATA WATS traffic, those IXCs which choose not to offer the 10-XXX dialing pattern suffer no significant competitive disadvantage by virtue of that fact.

70. The LECs presently lack the ability to provide intraLATA 800 Service without the assistance of an IXC because they have no means of determining the terminating jurisdiction of an intraLATA 800 Service call, and they will not have that ability until such time as a planned nation-wide BOC 800 Database is deployed.

71. AT&T is the only IXC which provides 800 Service jointly with the LECs MCI and Sprint provide 800 Service only under the non-joint option.

72. The IXCs that compete with the LECs in the carriage of intraLATA 800 Service traffic are disadvantaged under the current arrangement by having to pay a higher rate to the LECs in the areas where the LECs and IXCs compete in the provisioning of 800 Service than in the areas where the LECs do not compete, even though the access service being provided by the LECs is the same in both instances.

73. There exists no technological or cost basis for charging the IXCs a higher rate for intraLATA 800 Service traffic than is charged for interLATA 800 Service traffic.

74. The 800 Service rates of the IXCs are generally lower than those charged by SWB.

75. AT&T's non-joint 800 Readyline service offering is currently losing money on intraLATA traffic but the service as a whole is profitable due to the margin AT&T makes on its interLATA traffic.

76. IXC 800 Service offerings can be competitive even if burdened with the intraLATA revenue replacement rate.

77. Continued application of the intraLATA 800 Service revenue replacement rate will likely suppress demand for IXC 800 Service offerings.

78. If the intraLATA 800 Service revenue replacement rate is not eliminate,d AT&T will be forced to raise its current 800 Readyline rates.

79. The fact that the 800 Service market segment is competitive even though the revenue replacement rate is applied in areas in which the LECs and IXCs

compete reflects that the burden which application of the rate imposes upon the IXCs can in fact be borne, but it does not eliminate the fact that the rate is prejudicial to the IXCs and impairs free competition by imposing an artificial cost handicap on the IXCs.

80. The LECs asserts that three countervailing policy consideration which they believe together provide a reasonable basis for the discrimination and or may serve to justify the anticompetitive effects attributable to the current status quo:1) The likelihood that universal service may be adversely affected by granting the relief sought by the IXCs:2) the need to promote efficient telecommunications service; and 3) the need to insure that the LECs are afforded equal opportunity within the competitive telecommunications marketplace.

81. Universal service means making basic local exchange service affordable to the largest percentage of the population that one can reasonabl achieve.

82. Universal service has for all intents and purposes been achieved in Texas, in light of the fact that the household penetration rate is in the range of 95 to 98 percent.

83. All intraLATA toll services are provided jointly by the LECs and the revenues collected by the LECs are pooled on a statewide basis.

84. Had the LECs lost 100 percent of their WATS and 800 Service traffic to the IXCs in 1986, the intraLATA MTS/WATS toll pool would have lost billed revenues totaling $61,451,064, or approximately 9.315% of the total revenues paid into the pool in 1986. However, that loss would have been offset by $26,219,614 in access changes paid to the LECs by the IXCs for that WATS and 800 Service traffic, resulting in a net loss to the LECs of only $35,231,450.

85. The Texas intraLATA MTS/WATS toll pool rate of return on net investment in 1986 was approximately 19.90 percent. Were the replacement access charge revenues paid into the pool, the $35,231,450. net loss associated with loss of 100 percent of the WATS and 800 service traffic would have decreased the pool's 1986 return by only 1.24 percent, to 18.66 percent.

86. In Docket No. 5113, the targeted rate of return or settlement ratio for the intraLATA MTS/WATS toll pool was 11.94 percent.

87. The loop adjustment adopted in Docket No. 5113 does not distract any measure of profitability the intraLATA MTS/WATX toll pool rate of return has, because the costs which the loop adjustment which to the interLATA average are recovered through pooled ICAC revenues.

88. The intraLATA MTS/WATS toll pool rate of return has definite earnings implications with respect to MTS, WATS and 800 Services but it is not a valid measure of overall profitability of LECs because rates for those services have intentionally been set at a level intended to provide large contributions to joint and common costs.

89. The comparison of toll pool rates of return both with and without the loss of WATS and 800 Service revenues is a valid means of determining the relative impact of the loss of those revenues on the industry as a whole.

90. The overall industry revenue losses which would result if the LECs lost all WATS and 800 Service traffic will be borne disproportionately by the smaller LECs that do not originate or terminate much WATS or 800 Service traffic, since access charges are billed and kept by the LEC that provides originating or terminating access to IXCs.

91. Had the LECs lost 100 percent of their 800 Service traffic to the IXCs in 1986, SWB would have lost $26,307,846 in settlement revenues from the toll pool

but would have gained $14,609,851 in replacement access charge revenues, for a net loss of only 44 percent. On the other hand, the independent LECs would have lost $14,410,070 in settlement revenues from the toll pool and gained only $1,444,930 in replacement access charges, for a net loss of almost 90 percent of the 800 Service revenues those LECs would have gotten from the toll pool.

92. 90 percent of the WALs in Texas are located in SWB's service territory.

93. The company-specific analysis performed by MCI witness Klaus provides insight into the effect which modification of the (status quo) could be expected to have on individual LECs.

94. After factoring the net revenue loss or gain for each Texas LEC that would have resulted had they lost their WATS and 800 Service revenues and obtained replacement access charge revenues, the total industry average ROE and TIER, excluding SWB and GTE, would likely have been approximately 20.3 percent and 5.6, respectively, for the years 1986 and 1987.

95. The rural Telephone Bank will not loan money to a borrower with a TIER lower than 1.5.

96. In recent electric cooperative rate cases, the commission has established authorized TIERS in the range of 2.0. The record does not reflect any basis for belief that appropriate TIER levels for electric cooperatives should not also be appropriate for telephone cooperatives, especially in light of the fact that they both borrow through REA.

97. If one assumed that the LECs lost all WATS and 800 Service revenues in 1987, that those revenues had to be replaced in order for the LECs to have recovered their revenue requirements, and that the revenue could only be recovered through increases to local exchange rates, the magnitude of the change in local exchange rates would have ranged from a decrease of $2.78 per

month to an increase of $6.87 per month. The impacts on SWB and GTE would have equated to monthly increases of $0.31 and $0.70, respectively. The average impact on the industry, excluding SWB and GTE, would have equated to an increase of $0.66 per month per one-party residential access line.

98. The fact that some LECs would experience revenue losses as a consequence of the elimination of the current (status quo) with respect to WATS and 800 Service does not mean that LEC rate increases would be warranted to recoup those lost revenues.

99. The overwhelming majority of Texas LECs have never had their revenue requirements established by this commission.

100. Toll rate increases granted to SWB in prior rate cases have been implemented by the independent LECs as well though concurrence tariffs, and those increases have generated additional toll pool revenues for the independent LECs without the revenue requirements of those LECs ever having been scrutinized.

101. Under the most extreme assumption that the LECs would lose all WATS and 800 Service traffic to the IXCs if the anticompetitive and discriminatory effects of the current status quo were eliminated, most of the Texas LECs would be only nominally affected in terms of their existing financial condition.

102. The calculations made by Mr. Klaus do not have the precision of those necessary for calculating financial ratios on which rates would be established in a rate case. However, the calculations are straight forward and unbiased, and for purposes of this proceeding, they provide a usefull gauge of the changes in financial condition which the individual LECs would likely have experienced in the years studied had all WATS and 800 service toll pool settlement ratios been lost during those years and offset with applicable access charges.

103. The analyses performed by Mr. Lerma and Mr. Klaus are credible.

104. There is no way of determining what percentage of the LECs' current WATS and 800 Service revenues would in fact be lost were the relief requested by the IXCs to be granted in this docket.

105. AT&T will continue to offer and promote the WATS and 800 Services it is currently providing jointly with the LECs and those service offerings comprise a very large share of total WATS and 800 Service traffic within the state.

106. It is resonable to assume that if the relief requested by the IXCs were granted, AT&T would market its non-joint WATS and 800 Service offerings more heavily that its joint offerings and that customers would over time migrate from the joint offerings to the non-joint offerings.

107. AT&T has not implemented an aggressive plan to migrate customers form its joint 800 Service offering to its non-joint 800 Readyline and Megacom 800 service offerings.

108. Migration from AT&T's joint 800 Service offering to 800 Readyline has and will continue in the future given that termination of Readyline 800 Service over common lines avoids the expense of purchasing a separate WAL over which to terminate traffic.

109. There is no evidence that migration has to date occurred from the joint AT&T/SWB 800 Service offering to the non-joint Megacom 800 Service offering.

110. Migration from the joint AT&T/SWB 800 Service offering to 800 Readyline service will not result in revenue losses for SWB because: 1) 800 Readyline generates substantially more access charge revenues on the interLATA portion of the traffic than does the joint offering; and 2) SWB would return all of the replacement access charge revenues rather than sharing them with the other LECs through the intraLATA MTS/WATS toll pool.

111. The LECs will gain intraLATA 800 Service traffic and revenues at such time as the BOC 800 Database is implemented, since smaller IXCs which do not possess an 800 database will want to provide 800 Service jointly with the LECS.

112. The entry of additional IXCs into the 800 Service business will stimulate new demand for 800 Services.

113. AT&T offers a WATS-type service provided over UWALs known as the Texas Business Plan (TBP), and if the scope of that service is expanded to include intraLATA traffic in the event IXCs are permitted to carry 1+ intraLATA WATS traffic, some migration form the LECs' intraLATA WATS offerings to TBP can be expected to occur.

114. Migration of LEC WATS, and 800 Service customers to non-joint IXCs offerings will occur in the future if the relief requested by the IXCs is granted, but some portion of the current jointly provided WATS and 800 service customer base would remain.

115. The analyses performed by AT&T witness Lerma and MCI witness Klaus do not take into consideration the revenue loss that would occur if LEC MTS traffic migrated to WATS and 800 service, but the record does not support a finding that a significant amount of migration from MTS to WATS and 800 service would in fact occur.

116. Because WATS is aimed at customers will calling volumes higher than that of residential and small business users, there is no migration potential for that very large segment of MTS customers.

117. For large volume MTS users who could potentially migrate to WATS offerings, it cannot be found with any certainty that the economic cross-over point between MTS and WATS would be substantially lowered were the IXCs permitted to carry 1+ intraLATA WATs traffic. Absent a substantial reduction

in that economic cross-over point, there would be no basis for assuming any traffic migration from MTS to WATS.

118. If the economic cross-over point between MTS and WATS were substantially reduced, the LECS would lose some intraLATA MTS traffic. However, increased demand for WATS as a consequence of that development would stimulate overall toll call volume within the state, thereby generating substantial additional access changes for the LECs.

119. Increased 800 Service traffic does not represent to any significant degree lost MTS.

120. Potential traffic migration form MTS to 800 Service is not a significant problem.

121. 800 Service has tremendous potential for generation of new toll traffic.

122. Growth in overall toll traffic volume within the state as a consequence of growth in 800 Service offerings will generate substantial new revenues for the LECs.

123. The worst case scenarios projected by AT&T witness Lerma and MCI witness Klaus are not overly conservative by virtue of their lack of consideration of the potential for traffic to migrate from the LECs' MTS offerings to IXC WATS and 800 service offerings.

124. The failure of the Lerma and Klaus analyses to consider the potential for lost MTS is more than compensated for by their failure to consider the stimulation of overall toll traffic volumes that would occur were the economic cross-over point between MTS and WATS substantially lowered, and the stimulation that will inevitably result from growth in 800 Service offerings.

125. The worst case scenarios projected by Mr. Lerma and Mr. Klaus likely would not be realized if the relief requested by the IXCs were granted in this docket, althought the loss of all LEC WATS and 800 Service revenues would be a more realistic assumption than the loss of only 10 or 20 percent.

126. If the worst case scenario were realized, the resulting financial effect upon the LECs would not be sufficient to warrant denial of the relief requested by the IXCs on that basis.

127. If the LECs lost all WATS and 800 Service traffic, the number of discretionary revenue sources available in the rate design phase of a case would be reduced, but even were the current status quo maintained indefinitely, the LECs' WATS and 800 Service offerings likely could not be relied upon to generate substantial additional revenues due to the competitive alternatives to the services.

128. Increase in WATS rates would enhance the competiveness of WATS-like services for lower volume customers and increase the attractiveness of the 10-XXX dialing pattern, resulting in the loss of LEC WATS customers.

129. Increases in LEC 800 Service rates would drive LEC customers to the non-joint 800 services provided by the IXCs.

130. The loss of the intraLATA 800 Service revenue replacement rate could not reasonably be viewed as the loss of a discretionary service category over which future rate increases could be spread, given that the rate is conceptually the same as access service.

131. The fact that rate design may be made more difficult for the Commission does not mean that local exchange rates will over time rise to unacceptable levels.

132. Technical innovation in the telecommunications industry can reasonably be expected to provide the LECs with additional revenue sources in the form of new and innovative service offerings. That may well serve to increase the commission's rate design flexibility over the long term.

133. Rural LECs tend to have very high subscriber loop costs.

134. As a result of newly adopted separations procedures, small LECs with high NTS costs will allocate far more NTS loss costs to the interstate jurisdiction than was the case under the frozen SPF allocation methodology.

135. For LECs with 200,00 access lines or less, 100 percent of the NTS cost in excess of 150 percent of the national average will be allocated to the interstate jurisdiction once the new separations procedures and high cost assistance programs are fully phased in in 1993.

136. Texas NTS costs are declining dramatically for all but a couple of LECs doing business in Texas.

137. Subscriber loop costs which must be recovered from Texas intrastate rates will decline from a range of $10.55 to $67.98 under the frozen SFP allocation methodology to $11.98 to $19.16 per month (Based on 1985 costs) when the 25 percent gross allocation methodology and the high cost assistance plan are fully phased in in 1993.

138. Over the long term, changes in the separations process will substantially Mitigate any cost disadvantages associated with high subscriber loop costs.

139. To the extent that the interstate subsidy provided high cost rural LECs is considered insufficient, PURA provides for the establishment of a universal service fund to assist LECs in providing basis local exchange rates at reasonable rates in high cost rural areas.

140. Link-Up America and the Telecommunications Service Assistance Program are both available to assist in keeping local exchange service affordable for needy subscribers.

141. Loss of WATS and 800 service settlement proceeds by the independent LECs will not endanger the long term affordability of local exchange rates in rural areas because of the increasing allocation of NTS costs to the interstate jurisdiction for high cost rural LECs.

142. There is no degradation in transmission signal by virtue of the fact that a call is routed through an IXC POP.

143. The call delay resulting from back-hauling of IXC toll traffic is very slight, as a consequence of the fact that transmission over fiber and copper cable as well as microwave occurs at a speed of 186,000 miles per second.

144. The record does not reflect that routing an intraLATA call through a IXC POP would necessitate the installation of additional trunking or switching facilities.

145. The cost of any additional switching required in routing a call through an IXC POP is recovered by the LECs through access charges.

146. Any network inefficiency resulting from IXC processing of intraLATA traffic is transparent to the customers.

147. Efficient use of the IXC network does not mean that the shortest route from point A to point B is utilized in completing a call, but rather that the call is processed in the most cost effective way.

148. Back-hauling is the most economically efficient way for IXCs to handle traffic.

149. Invocation of the statutory policy favoring adequate and efficient telecommunications service cannot serve as a legitimate justification for the reservation of it intraLATA WATS traffic to the LECs.

150. GTE and SWB are legally precluded from providing services outside of LATA boundaries.

151. No IXCs participating in this proceeding offer intraLATA-only toll services.

152. LATA boundaries were deliberately drawn in such a manner that, to the extent possible, none would contain more than one SMSA.

153. An intraLATA-only offering would not permit businesses to access any of the other major business centers within the state.

154. GTE and SWB are the only LECs with customers subscribing to intraLATA-only WATS services.

155. There are presently no stand-alone intraLATA 800 service customers within Texas.

156. While there may be some small demand for an intraLATA-only offering, the vast majority of WATS and 800 Service customers desire a broader calling scope.

157. The Texas LECs other than GTE and SWB are not legally restricted from providing interLATA toll services.

158. The fact that most LECs are not subject to any legally imposed geographical restrictions on their WATS offerings is of little practical significance because virtually all of the WALs in Texas are located within the

service territories of SWB and GTE and none of the other LECs provide interLATA services, nor have any evidenced an intent to do so.

159. Regulated rates can place LECs at a competitive disadvantage.

160. PURA Section 18(e) provides an adequate mechanism for minimizing or entirely eliminating the disadvantage created by price regulation of LEC toll services.

161. LECs can petition the Commission to declare WATS and 800 Services a market subject to significant competition on or after August 17, 1989.

162. The delay in the LECs' ability to petition the commission to declare WATS and 800 Services to be subject to substantial competition would not pose a problem for the LECs because it would in any event take the LECs four to six months to reprogram switches to route 1+ intraLATA WATS traffic to the LECs.

163. The intraLATA 800 Service revenue replacement rate has not induced any IXCs to enter into new joint service arrangements with the LECs, nor has it served to stimulate intraLATA traffic volumes under the joint AT&T/SWB 800 Service offering.

164. The intraLATA 800 service revenue replacement rate neither affords the LECs equal opportunity in a competitive market place nor enhances the LECs' competitive standing.

165. The intraLATA 800 Service revenue replacement rate gives the LECs the net revenues they would have made had they garnered 100 percent of the traffic within the areas in which they are authorized to compete.

166. Reservation of all 1+ intraLATA WATS traffic to the LECs does not afford the LECs an equal opportunity to compete for the provisioning of WATS

services. It provides a substantial advantage to the LECs in the areas in which they provide WATS service.

167. The Commission's mandate under Section 18(a) is not to balance the advantages and disadvantages borne by various utilities in order to insure that eveyone has an equal opportunity to join in the competition. That should be done by removing artificial barriers to competition where possible, not by creating barriers to free competition.

168. The Commission cannot remove the geographical restriction on the toll services offered by SWB and GTE.

169. The disadvantage associated with the inability to provide interLATA toll services can be substantially mitigated without affirmatively handicapping the IXCs by affording the LECs and equal opportunity to compete for WATS traffic within the geographical areas in which they serve via a limited presubscription mechanism.

170. For WATS customers that have need for interLATA calling scope, purchasing a second WAL over which intraLATA WATS traffic could be carried by a LEC does not constitute a viable competitive opportunity.

171. The inconvenience of using a second WAL for intraLATA-only calling, combined with customer lack of familiarity with LATA boundaries, would present an insurmountable obstacle to the viability of a stand-alone intraLATA-only WATS offering.

172. A presubscription mechanism is necessary if SWB and GTE are to have an equal opportunity to compete for intraLATA WATS traffic.

173. An adequate mechanism for limited presubscription can be made available without incurring the costs associated with modifying the generic software of central office switches.

174. Each individual UWAL could be modified to route 1+ intraLATA traffic to IXCs, or not, depending upon the customer's preference. The fact that under that procedure the customer could not designate anyone other than the LEC or the interLATA carrier to handle 1+ intraLATA traffic is not offensive since it is the LECs rather than other IXCs that suffer from the disadvantageous geographical restrictions.

175. The policy objective of insuring an equal opportunity within a competitive marketplace demands that the Commission afford all customers subscribing to WATS offerings provided over UWALs an opportunity to select either the LEC or the interLATA carrier to carry their 1+ intaLATA WATS traffic.

176. It is incumbent upon the Commission to insure a competitive rate design for LEC intraLATA WATS offerings.

177. Beyond implementing a limited presubscription procedure and affording the LECs competitive WATS rates the Commission should not go under the quise of providing equal competitive opportunity to the LECs.

178. As UWALs are access facilities purchased by IXCs in order to provide services which the IXCs have marketed and sold to end user customers, affording LECs the opportunity to carry the 1+ intraLATA traffic over those access facilities if the customers so desire constitutes exceedingly fair regulatory treatment.

179. Reservation of all 1+ intraLATA WATS traffic to the LECs cannot be justified on the basis that it promotes the policy objective of insuring the provision of equal opportunity to all telecommunications utilities in a competitive market place.

180. There currently exist no LEC software limitations that would hamper the ability of LEC switches to route intraLATA 800 Service traffic to IXCs.

181. Each LEC end office which allowed 1+ intraLATA WATS traffic to be routed to an IXC would require some switch reprogramming.

182. SWB's No. 1/1A ESS, No. 2/2 BESS and No.5 ESS end offices can be reprogrammed to permit 1+ intraLATA traffic originating over UWALs to be routed to IXCs, without the necessity of generic software modifications.

183. The SWB DMS-10, DMS-100 and DMS-200 switches cannot route 1+ intraLATA traffic originating over UWALs to IXCs without generic software modifications, but those switches are not used in connection with UWALs due to their inability to properly handle international calls.

184. GTE's GTD-5 EAX switches could route 1+ intraLATA traffic to IXCs without the necessity of modifying the generic software of the switches.

185. GTE's GTD-2 EAX switches cannot route 1+ intraLATA traffic originating over UWALs to IXCs withouy generic software modifications, but in most instances GTE's WATS traffic is processed by the GTD-5 EAX switches.

186. GTE uses certain step-by-step electromechanical switches for WATS screening purposes which cannot route 1+ intraLATA traffic to an IXC, but since those end offices have not been converted to equal access, it would not in most instances be economical for IXCs to provide WATS service in those areas due to the cost of purchasing a WALE.

187. GTE's Stromberg Carlson DCO central offices switches cannot route 1+ intraLATA WATS traffic to IXCs but those switches are not used to provide WATS services due to their inability to record the traffic in a manner which allows proper billing.

188. There is no basis for concluding that the cost of reprograming those switches that would not require generic software changes would be unreasonable.

189. The cost of modifying the generic software of LEC switches would range from $50,000 to several huondred thousand dollars per switch. Additionally, a monthly fee would be changed per switch by the manufacturer.

190. There exists no substantial technical barrier to the IXC cariage of 1+ intraLATA traffic over UWALs except in connection with the GTD-z EAX switches and the GTE elecromechanical switches that serve as WSOs. As to the remaining LEC switches used to provide WATS Service over UWALs, switch software limitations cannot serve as a legitmate basis for treating IXCs and LECs in an unequal manner by allowing LECs to be the carriers of intraLATA WATS traffic originated over UWALs though use of the 1+ dialing pattern.

191. It would take four to six months to reprogram LEC switches and make the hardware additions and memory reallocations necessary to permit 1+ intraLATA WATS traffic to be routed to IXCs.

192. The cost of providing full 1+ intraLATA presubscription capability would be prohibitive.

193. The preponderance of the evidence demonstrates that the current (status quo) with respect to 1+ intraLATA WATS and 800 service is contary to the PURA Section 47 prohibition against anticompetitive practices, since the artificial cost handicap imposed by the intraLATA 800 service revenue replacement rate and the inability of the IXCs to carry 1+ intraLATA WATS traffic together tend to impair free competition within the intraLATA arena.

194. The LEC practice of stripping, carrying and billing all 1+ intraLATA WATS traffic originating over UWALs is unreasonably discriminatory, as there exists

no reasonable basis for the unequal treatment afforded LECs and IXCs with respect to 1+ intraLATA into WATS traffic.

195. No statutory policy considerations mandated by PURA warrant the continuation of the current status quo with respect to WATS and 800 service in the face of its anticompetitive and discriminatory effect upon the IXCs.

196. The protection of universal service and the prevention of anticompetitive and discriminatory conduct are not mutually exclusive concepts.

197. Elimination of the intraLATA 800 Service revenue replacement rate and the implementation of a limited presubscription procedure with respect to 1+ intraLATA WATS traffic in areas served by end offices with switches that can route 1+ intraLATA WATS traffic to IXCs without generic software modifications effectuates the public interst inherent in preventing auticompetitive and discriminatory conduct without adversely affecting any other policy which PURA charges the Commission with effectuating in its administration of PURA.

198. Having demonstrated that the (status quo) is discriminatory and anticompetitive in nature and that elimination of the discriminatory and anticompetitive effects of the (status quo) can be had without adversely affecting any other policy objective, the IXCs are not required to prove anything further as a precondition to obtaining relief.

199. Maximizing the availability of toll free numbers by avoiding suppression of 800 Service demand is beneficial to the public because consumers are given more choices of toll free shopping and greater access to toll free information sources.

200. Encouraging stimulation of 800 Service demand by eliminating artificial costs which put upward pressure on 800 Service rates can tangibly benefit rural areas.

201. Elimination of the intraLATA 800 Service revenue replacement rate will permit the current growth in 800 Services to continue, thus producing overall growth in toll traffic volumes and generating increased LEC access charge revenues.

202. Elimination of the current practice of reserving all 1+ intraLATA WATS traffic to the LECs benefits WATS customers by permitting them greater choice as to their 1+ intraLATA WATS carrier.

203. Elimination of the discriminatory and anticompetitive aspects of the current (status quo) can be expected to induce the LECs to aggressively seek to enhance the attractiveness of the LEC WATS and 800 Service oferings, which will redound to the benefit of LEC WATS and 800 Service customers, and to aggressively promote enhanced access services, which will redound to the benefit of the general body of rate payers.

204. The tangible benefits produced by removing artificial constraints upon competition for WATS and 800 Service within the intraLATA arena are the same as those generally perceived to flow from competition, to wit: lower prices, better service, more customer choice, increased demand and incentives for efficient operation and product innovation.

205. The intraLATA 800 Service revenue replacement rate should be eliminated and replaced with access charges at the same level as those applied to interLATA 800 Service traffic.

206. Those central offices switches that can route 1+ intraLATA WATS traffic to IXCs with the necessity of modifying generic switch software should be reprogrammed to route 1+ intraLATA WATS traffic to IXCs upon request by the customers.

207. The LECs should be allowed a grace period of six months following the entry of the final order in this docket, in order to permit LEC central office switches to be reprogrammed in an orderly and cost effcient manner.

208. During the six month grace period, existing WATS customers should be given the choice of selecting their LEC or their 1+ interLATA WATS carrier as their carrier of choice for 1+ intraLATA WATS traffic.

209. The LECs and the IXCs should be afforded sixty days from the date of the final order herein to file a joint proposal for establishing the procedural mechanism whereby WATS customers will designate their preferred 1+ intraLATA WATS carrier.

210. After the expiration of the grace period, new WATS customers should be required to designate their preferred 1+ intraLATA WATS carrier prior to initiation of the customer's WATS Service, and existing WATS customers should be afforded the opportunity to switch their designated 1+ intraLATA WATS carrier on an ongoing basis.

211. The LECs should be afforded twenty calendar days from the date of the final order in this docket to file revised tariff sheets incorporating the recommendations made herein.

B. Conclusions of Law

1. The Commission has jurisdiction over this case pursuant to Sections 16(a), 18, 37, 42 and 83 of the Public Utility Regulatory Act (PURA), Tex. Rev. Civ. Stat. Ann. art. 1446c (Vernon Supp. 1989).

2. Proper notice was provided to the public and to the parties in compliance with the requirements of Section 13 of the Administrative Procedure and Texas Register Act (APTRA), Tex. Rev. Civ. Stat. Ann. art. 6252-13a (Vernon Supp. 1987) and P.U.C. PROC. R. 21.25.

3. The parties were provided an opportunity to respond and present evidence on all issues involved in this case as required by APTRA Section 13(d).

4. The reservation of 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs would not constitute the grant of a state-created monopoly in contravention of Article I, Section 25 of the Texas Constitution.

5. If the Commission's reasoned balancing of the competing policy objectives set forth in PURA Section 18(a) necessitated the implementation of LEC tariffs that had the practical effect of restricting the geographical area in which a non-dominant IXC could provide service, such action would not exceed the Commission's statutory authority under PURA.

6. The Commission lacks the statutory authority to order a non-dominant IXC not to provide services within specific geographical areas, provided a certificate of convenience and necessity is not required as a precondition to providing the service.

7. Reliance upon lack of prior Commission attempts to act in a fashion which would restrict the geographical area in which IXCs can provide a service, and the anticipation of IXC customers that IXCs will carry all their toll traffic, do not together serve to create a vested property right to the provision of unrestricted statewide toll services.

8. Commission actions which have the effect of restricting the geographical area in which a non-dominant IXC can provide a toll service is not violative of Article I, Section 19 of the Texas Constitution.

9. In deciding whether the current *status quo* with respect to 1+ WATS and 800 Service should be continued, *Amtel* requires that the Commission balance against the antitrust and antidiscrimination policies inherent in PURA Sections 38, 45 and 47 other competing policy objectives mandated by PURA.

10. The Commission's mandate under PURA Section 18(a) is not to balance the advantages and disadvantages borne by various utilities in order to insure that everyone succeeds equally, but rather to insure that everyone has an equal opportunity to join in the competition. That must be done by removing artificial barriers to competition where possible, not by creating barriers to free competition.

11. The Commission lacks authority to remove the geographical restrictions to which the SWB and GTE service offerings are subject.

12. The current *status quo* with respect to 1+ intraLATA WATS and 800 Service is contrary to the PURA Section 47 prohibition against anticompetitive practices.

13. The intraLATA 800 Service revenue replacement rate is not just and reasonable but rather unreasonably preferential to the LECs and unreasonably prejudicial and discriminatory to the IXCs.

14. The LEC practice of stripping, carrying and billing all 1+ intraLATA WATS traffic originating over UWALs is unreasonably discriminatory.

15. No statutory policy considerations mandated by PURA warrant the continuation of the current *status quo* with respect to 1+ intraLATA WATS and 800 Service in the face of its anticompetitive and discriminatory effect upon IXCs.

16. Where it has been demonstrated that elimination of discriminatory or anticompetitive conduct can be achieved without jeopardizing the affordability of present or future local exchange rates or any other statutory policy objective, there exists no policy conflict which necessitates the discounting of the policies underlying PURA Sections 38, 45 and 47.

17. Having demonstrated that the *status quo* is discriminatory and anticompetitive in nature, and that elimination of the discriminatory and anticompetitive effects of the *status quo* can be had without substantial adverse impact on any other policy objective, the IXCs are not required to prove anything further as a precondition to obtaining relief.

18. MCI and the aligned IXCs have sustained their burden of proof in this proceeding as to the appropriateness of eliminating the intraLATA 800 Service revenue replacement rate and the appropriateness of ceasing the reservation to the LECs of all 1+ intraLATA WATS traffic originated over UWALs in areas served by central office switches that can route 1+ intraLATA WATS traffic to IXCs without the need for generic software modifications or switch replacement, subject to the requirement that a limited presubscription mechanism be implemented.

19. Based upon the examiner's analysis of the facts as set out in this report, sanctioning the reservation of 1+ intraLATA WATS traffic to the LECs would be violative of PURA Section 35(b), 37 and 38 and sanctioning the continued

application of the intraLATA 800 Service revenue replacement rate would be violative of PURA Section 38.

Respectfully submitted,

MARK W. SMITH
ADMINISTRATIVE LAW JUDGE

APPROVED on this the 25th day of May 1989.

PHILLIP A. HOLDER
DIRECTOR OF HEARINGS

6/6/88

MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Alenco *	Alltel (REA)	Big Bend (REA)	Blossom *	Brazoria (REA)	Brazos Tel. Co-op (REA)	Byers-Petrolia * (REA)	Cameron (REA)
	1987 - ACTUALS								
1	Federal Income Taxes	0	175,597	677,901	31,233	138,000	0	14,701	123,207
2	Fixed Charges - Gross	10,041	195,435	946,851	33	449,215	135,730	34,783	54,850
3	Net Income From Utility Operations	5,629	321,196	1,302,652	84,889	715,766	393,823	85,944	181,353
4	Total Equity Capital	34,403	1,377,899	5,791,649	581,597	3,226,429	2,275,315	585,517	1,009,032
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	17.8%	26.4%	25.3%	15.7%	25.0%	18.9%	15.8%	19.7%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	1.6	3.5	3.1	3519.8	2.9	3.9	3.9	6.6
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	$1,045	($7,372)	($65,825)	$3,177	($130,760)	($14,174)	($2,683)	($9,234)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$6,674	$317,215	$1,267,107	$87,589	$645,156	$379,649	$83,663	$176,367
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	20.8%	26.1%	24.7%	16.2%	22.8%	18.3%	15.5%	19.3%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	1.7	3.5	3.1	3601.7	2.7	3.8	3.8	6.5
11	Access Lines - Dec. '86	225	3,008	2,378	1,076	4,388	1,102	763	948
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	$0.39	($0.20)	($2.31)	$0.25	($2.48)	($1.07)	($0.29)	($0.81)
13	One-Party Residential Rates (or range of rates)	$7.50	$5.60	$7.00 / $117.00	$7.00	$10.00 / $17.00	$6.15	$8.50	$5.00

* Denotes Average Schedule Companies

ulas N/A

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6/6/88

MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Cap Rock (REA)	Centel (REA)	Central Tex. Tel. Co-op (REA)	Coleman Cty. Tel Co-op (REA)	Colorado Val. Tel. Co-op (REA)	Comanche (REA)	Community * (REA)	Continental (REA)
	1987 - ACTUALS								
1	Federal Income Taxes	513,290	12,729,840	0	0	0	303,189	82,406	11,263,898
2	Fixed Charges - Gross	196,004	1,084,088	298,503	47,891	178,992	123,552	66,676	8,823,487
3	Net Income From Utility Operations	822,944	21,865,571	1,417,145	128,340	1,578,314	378,776	188,643	23,193,939
4	Total Equity Capital	4,687,302	98,119,195	8,635,594	2,330,007	9,202,465	3,360,874	845,466	120,397,391
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	19.2%	25.1%	17.9%	5.7%	18.8%	11.9%	25.1%	21.3%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	7.8	32.9	5.7	3.7	9.8	6.5	5.1	4.9
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($11,937)	($503,810)	($38,786)	($7,931)	$5,002	($26,169)	($20,297)	($1,748,773)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$816,498	$21,593,514	$1,378,359	$120,409	$1,583,316	$364,645	$177,683	$22,249,602
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	19.1%	24.8%	17.4%	5.3%	18.8%	11.5%	23.8%	20.5%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	7.8	32.7	5.6	3.5	9.8	6.4	4.9	4.8
11	Access Lines - Dec. '86	2,199	113,515	3,312	1,772	4,734	4,551	1,394	158,440
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($0.45)	($0.37)	($0.98)	($0.37)	$0.09	($0.48)	($1.21)	($0.92)
13	One-Party Residential Rates (or range of rates)	$9.40 / $12.15	$7.90 / $18.20	$7.90	$6.65	$8.40	$8.00	$7.40 / $8.65	$8.35 / $9.55

* Denotes Average Schedule Companies

EXAMINER'S ATTACHMENT NO. 1
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MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Cumby Tel. Tel. Co-op * (REA)	Dell Tel. Co-op (REA)	Eastex Tel. Co-op (REA)	Electra *	ENMR Tel. Co-op (REA)	ETEX Tel. Co-op (REA)	Five Area Tel. Co-op (REA)	Fort Bend (REA)
	1987 - ACTUALS								
1	Federal Income Taxes	0	109,500	9,600		0	1,286	2,350	1,462,101
2	Fixed Charges - Gross	40,141	424,938	1,667,149		1,120,903	575,085	96,630	1,300,967
3	Net Income From Utility Operations	190,154	602,066	3,605,200		1,099,698	976,855	719,358	2,352,824
4	Total Equity Capital	699,002	2,957,553	21,773,809		8,937,269	4,782,214	4,842,204	15,063,933
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	31.5%	22.7%	18.1%	N/A	13.1%	22.8%	16.0%	16.9%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	5.7	2.7	3.2	N/A	2.0	2.7	8.5	3.9
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($3,497)	($5,701)	($228,953)	($11,821)	($981)	($37,176)	($19,707)	($185,054)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$186,657	$596,365	$3,410,590	($11,821)	$1,098,717	$945,255	$702,607	$2,252,895
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	31.0%	22.5%	17.2%	N/A	13.1%	22.1%	15.7%	16.3%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	5.7	2.7	3.1	N/A	2.0	2.6	8.3	3.9
11	Access Lines - Dec. '86	541	593	19,869	2,082	625	8,789	1,439	16,041
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($0.54)	($0.80)	($0.96)	($0.47)	($0.13)	($0.35)	($1.14)	($0.96)
13	One-Party Residential Rates (or range of rates)	$6.70	$15.40	$6.40 / $7.15	$5.90	$12.00 / $13.00	$8.10	$16.60 / $17.10	$8.25 / $11.00

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* Denotes Average Schedule Companies

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MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Ganado (REA)	General	Guadalupe V. Tel. Co-op (REA)	Hill Country Tel. Co-op (REA)	Industry (REA)	Kerrville	Knippa *	Lake Livingston
	1987 - ACTUALS								
1	Federal Income Taxes	26,480	56,326,000	(30,276)	6,177	302,678	1,096,012		0
2	Fixed Charges - Gross	53,496	52,221,297	735,667	1,478,001	67,860	509,034		0
3	Net Income From Utility Operations	39,207	107,311,703	4,216,226	2,155,486	571,165	1,977,463		53,036
4	Total Equity Capital	1,278,880	709,988,352	23,712,711	9,938,634	2,461,489	11,527,573		752,353
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	3.1%	16.4%	19.5%	24.3%	26.2%	18.8%	N/A	7.3%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	2.2	4.1	6.7	2.5	13.9	7.0	N/A	N/A
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($5,313)	($8,035,664)	($125,768)	($86,001)	($91,734)	($153,731)	($3,381)	$30,674
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$36,338	$102,972,445	$4,148,311	$2,082,385	$521,629	$1,894,448	N/A	$83,710
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	2.9%	15.7%	19.2%	23.6%	24.2%	18.0%	N/A	11.3%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	2.2	4.1	6.6	2.4	13.1	6.9	N/A	N/A
11	Access Lines - Dec. '86	1,291	950,449	13,816	8,378	1,442	13,912	236	921
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($0.34)	($0.70)	($0.76)	($0.86)	($5.30)	($0.92)	($1.19)	$2.78
13	One-Party Residential Rates (or range of rates)	$7.40	$8.55 / $18.00	$7.25 / $7.75	$6.25 / $9.50	$9.00 / $9.75	$7.25 / $7.40	$7.20	$7.25

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* Denotes Average Schedule Companies

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MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Lake Dallas (REA)	La Ward (REA)	Lipan * (REA)	Livingston *	Lufkin	Mid Plains Tel. Co-op (REA)	Muenster (REA)	Mustang *
	1987 - ACTUALS								
1	Federal Income Taxes	419,351	145,873	6,008		5,086,163	0	0	291,087
2	Fixed Charges - Gross	535,890	38,224	13,177		1,917,099	90,363	155,900	338,672
3	Net Income From Utility Operations	698,464	203,049	39,999		8,454,996	1,413,394	314,680	444,317
4	Total Equity Capital	2,915,151	625,786	324,210		56,923,755	6,382,655	1,924,111	2,146,314
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	27.2%	38.7%	13.1%	N/A	16.0%	24.9%	17.8%	23.1%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	3.1	10.1	4.5	N/A	8.1	16.6	3.0	3.2
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($39,598)	($8,234)	($8,088)	$44,687	($572,565)	($13,880)	($12,503)	($53,157)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$677,081	$194,815	$31,911	$24,131	$8,145,811	$1,399,514	$307,928	$415,612
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	26.5%	37.5%	10.6%	200.0%	15.5%	24.7%	17.5%	21.8%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	3.0	9.9	3.9	ERR	7.9	16.5	3.0	3.1
11	Access Lines - Dec. '86	3,983	825	786	4,239	56,660	2,008	1,604	2,063
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($0.83)	($0.83)	($0.86)	$0.88	($0.84)	($0.58)	($0.65)	($2.15)
13	One-Party Residential Rates (or range of rates)	$6.90	$7.80	$7.70 / $8.70	$5.40	$6.05 / $8.75	$13.25 / $13.75	$7.00 / $8.00	$5.90

* Denotes Average Schedule Companies

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MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Peeples (REA)	Peoples Tel. Co-op (REA)	Poka-Lambro Tel. Co-op (REA)	Riviera (REA)	Romain (REA)	San Marcos *	Santa Rosa Tel. Co-op (REA)	South Plains Tel. Co-op (REA)
	1987 - ACTUALS								
1	Federal Income Taxes	123,714	2,773	828	31,432	279,772	2,791,716	930	1,990
2	Fixed Charges - Gross	59,264	544,871	236,001	40,275	8,962	863,766	93,883	108,166
3	Net Income From Utility Operations	244,416	1,430,730	594,656	219,465	406,261	4,670,170	758,879	638,650
4	Total Equity Capital	1,729,214	6,242,841	8,403,289	1,199,074	2,101,339	15,648,556	2,911,399	4,229,272
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	15.2%	25.9%	7.3%	20.1%	21.4%	35.1%	30.0%	16.3%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	7.2	3.6	3.5	7.2	77.5	9.6	9.1	6.9
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($13,150)	($22,684)	($32,656)	($20,657)	($6,658)	$113,379	($3,226)	($24,057)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$237,315	$1,408,046	$566,898	$208,310	$402,666	$4,731,395	$757,137	$614,593
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	14.8%	25.5%	7.0%	19.2%	21.2%	35.5%	29.9%	15.8%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	7.1	3.6	3.4	7.0	77.1	9.7	9.1	6.7
11	Access Lines - Dec. '86	920	6,312	3,030	755	946	18,260	1,546	3,462
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($1.19)	($0.30)	($0.90)	($2.28)	($0.59)	$0.52	($0.17)	($0.58)
13	One-Party Residential Rates (or range of rates)	$4.75 / $7.10	$7.95 / $8.20	$5.45 / $9.35	$8.90	$8.15	$5.95	$7.50	$7.90 / $10.65

* Denotes Average Schedule Companies

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MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Southwest Ark. Tel. Co-op (REA)	Southwest Texas (REA)	Sugar Land (REA)	Sweeny-Old Ocean (REA)	Tatum *	Taylor Tel. Co-op (REA)	Texas Midland (REA)	Tri-County (REA)
	1987 - ACTUALS								
1	Federal Income Taxes	0	462,860	466,727	343,548	56,004	0	1,542,774	316
2	Fixed Charges - Gross	292,848	121,893	3,922,263	389,892	1,820	251,002	92,918	52,227
3	Net Income From Utility Operations	428,897	911,999	1,695,460	673,603	91,347	1,109,660	2,301,614	4,840
4	Total Equity Capital	3,105,676	4,054,846	8,915,381	2,676,569	168,043	6,039,568	18,013,487	407,541
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	14.8%	25.3%	21.0%	28.8%	74.6%	20.2%	13.6%	1.2%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	2.5	12.3	1.6	3.6	82.0	5.4	42.4	1.1
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($1,356)	($93,504)	$5,696	($41,908)	($61,144)	($32,927)	($111,436)	($10,531)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$427,541	$861,507	$1,698,536	$650,973	$39,375	$1,076,733	$2,241,439	($4,111)
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	14.8%	24.1%	21.0%	28.0%	40.9%	19.7%	13.3%	-1.0%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	2.5	11.9	1.6	3.6	53.4	5.3	41.7	0.9
11	Access Lines - Dec. '86	366	2,278	21,504	2,365	742	5,040	9,309	762
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($0.31)	($3.42)	$0.02	($1.48)	($6.87)	($0.54)	($1.00)	($1.15)
13	One-Party Residential Rates (or range of rates)	$10.75	$11.35 / $103.40	$16.15	$9.05	$6.00	$7.40 / $8.40	$6.40 / $8.40	$6.25

* Denotes Average Schedule Companies

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MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

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Line No.	DESCRIPTION	Trinity Valley (REA)	United	Valley Tel. Co-op (REA)	Valley View (REA)	Waterwood	Wes-Tex Tel. Co-op (REA)	West Texas Tel. Co-op (REA)	XIT Tel. Co-op (REA)
	1987 - ACTUALS								
1	Federal Income Taxes	925,254	7,396,088	158	0		385	0	0
2	Fixed Charges - Gross	501,846	3,953,121	293,323	49,428		128,056	182,526	85,841
3	Net Income From Utility Operations	1,392,834	14,669,534	2,703,150	273,039		658,789	490,590	708,518
4	Total Equity Capital	9,457,283	68,261,482	14,102,096	1,070,201		5,845,680	4,533,766	3,962,394
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	15.9%	24.1%	21.2%	29.2%	N/A	11.9%	11.4%	19.6%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	5.6	6.6	10.2	6.5	N/A	6.1	3.7	9.3
	PRO FORMA								
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($9,277)	($624,125)	($75,550)	($6,131)	($6,833)	$6,132	$7,940	($3,788)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$1,387,824	$14,332,507	$2,627,600	$269,728	($6,833)	$664,001	$498,530	$704,730
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	15.8%	23.6%	20.7%	28.9%	N/A	12.0%	11.6%	19.5%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	5.6	6.5	10.0	6.5	N/A	6.2	3.7	9.2
11	Access Lines - Dec. '86	4,985	100,667	4,011	828	337	3,017	1,628	933
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($0.16)	($0.52)	($1.57)	($0.62)	($1.69)	$0.17	$0.41	($0.34)
13	One-Party Residential Rates (or range of rates)	$6.65	$7.10 / $9.30	$10.65 / $12.65	$8.00	$9.30	$5.90 / $10.65	$12.50	$13.40

* Denotes Average Schedule Companies

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MCI TELECOMMUNICATIONS CORPORATION, INC.
ANALYSIS PERTAINING TO THE FINANCIAL CONDITION
OF LOCAL EXCHANGE COMPANIES IN TEXAS

Line No.	DESCRIPTION	Southwestern Bell **	Total Industry	Total Industry (without SWB)	Total Industry (w/o SWB or GTSW)
	1987 - ACTUALS				
1	Federal Income Taxes	192,062,558	297,803,479	105,740,921	49,414,921
2	Fixed Charges - Gross	231,466,343	319,767,159	88,300,816	36,079,519
3	Net Income From Utility Operations	419,778,135	646,959,500	227,181,365	119,869,662
4	Total Equity Capital	3,449,860,411	4,795,357,501	1,345,497,090	635,508,738
5	EARNED RETURN ON AVERAGE EQUITY (ROE) L3/(((L4*2)-L3)/2)	12.2%	13.8%	18.4%	20.8%
6	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L3)/L2	3.6	4.0	4.8	5.7
	PRO FORMA				
7	Net Revenue Effect Assuming 100% Loss of WATS & 800 Traffic	($22,367,580)	($35,641,704)	($13,274,124)	($5,238,460)
8	Adjusted Net Income From Utility Operations L3+(L7*(1-FIT RATE))	$407,699,641	$627,460,859	$219,761,218	$116,788,773
9	RETURN ON AVERAGE EQUITY (ROE) L8/((((L4-L3)*2)+L8)/2)	11.8%	13.4%	17.9%	20.3%
10	TIMES INTEREST EARNED RATIO (TIER) (L1+L2+L8)/L2	3.6	3.9	4.7	5.6
11	Access Lines - Dec. '86	5,983,265	7,593,665	1,610,400	659,951
12	Net Revenue Loss Per Access Line Per Month (L7/L11)/12	($0.31)	($0.39)	($0.69)	($0.66)
13	One-Party Residential Rates (or range of rates)	$8.15 / $11.05			

* Denotes Average Schedule Companies ** ROE Formulas N/A

SOURCES: (1) 1987 Annual Reports filed with the Public Utility Commission;
(2) Responses to MCI's Requests for Information 1.16, 1.17, 1.18, & 1.3;
(3) GTE-Southwest's RFP in Docket 5610

MCI Telecommunications Corporation
SUMMARY OF FINANCIAL RATIOS
PERTAINING TO LOCAL EXCHANGE COMPANIES

Schedule B

Description	1986 ROE	1986 TIER	1987 ROE	1987 TIER
INDUSTRY				
Actual				
HIGH	152.5%	3,345.4	74.6%	3,519.8
LOW	-0.6%	0.9	1.2%	1.1
AVERAGE	13.4%	4.1	13.8%	4.0
AVERAGE w/o SWB	17.7%	4.6	18.4%	4.8
AVERAGE w/o SWB & GTE-SW	20.8%	5.7	20.8%	5.7
Pro Forma				
HIGH	133.4%	3,418.3	40.9%	3,601.7
LOW	-0.6%	0.9	-1.0%	0.9
AVERAGE	13.0%	4.1	13.4%	3.9
AVERAGE w/o SWB	17.1%	4.5	17.9%	4.7
AVERAGE w/o SWB & GTE-SW	20.3%	5.6	20.3%	5.6
REA COMPANIES				
Actual				
HIGH	31.4%	59.3	38.7%	77.5
LOW	-0.6%	0.9	1.2%	1.1
MEAN	18.2%	7.4	19.6%	8.3
MEDIAN	18.5%	5.1	19.6%	5.3
Pro Forma				
HIGH	30.6%	58.7	37.5%	77.1
LOW	-0.6%	0.9	-1.0%	0.9
MEAN	17.5%	7.2	19.1%	8.2
MEDIAN	17.9%	5.0	19.2%	5.1
NON-REA COMPANIES				
Actual				
HIGH	152.5%	3,345.4	74.6%	3,519.8
LOW	1.3%	1.1	7.3%	1.6
MEAN	25.8%	23.5	23.7%	14.0
MEDIAN	21.5%	6.1	17.8%	6.8
Pro Forma				
HIGH	133.4%	3,418.3	40.9%	3,601.7
LOW	5.7%	1.0	11.3%	1.7
MEAN	26.1%	21.5	21.0%	10.8
MEDIAN	21.6%	6.0	18.0%	6.7

EXAMINER'S ATTACHMENT NO. 3
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SCHEDULE A
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ANALYSIS OF NTS COST ALLOCATION BETWEEN
THE STATE AND FEDERAL JURISDICTIONS
(Prepared by MCI)

NAME	LOOPS	URRPL	HCAPL (Post-1987)	SPF	CIRRPL	NIRRPL	NIRRPL less CIRRPL	Net Change In Intrastate NTS Rev Req	Residual Intrastate NTS Rev Req Per Loop Per Month	
									Pre G.A.&HCA	Post G.A.&HCA
TEXAS	(A)	(B)	(C)	(D)	(E)=(B)*(D)	(F)=((B)*.25)+(C)	(G)=(F)-(E)	(H)=(G)*(A)*-1	(I)=((B)-(E))/12	(J)=((B)-(F))/12
Cameron Telephone Company	957	$402.08	$106.77	0.2304	$92.64	$207.29	$114.65	($109,720)	$25.79	$16.23
Alto Telephone Company	1,309	279.20	19.24	0.1221	34.09	89.04	54.95	(71,930)	20.43	15.85
Big Bend Telephone Company	2,176	957.93	523.65	0.4114	394.09	763.13	369.04	(803,031)	46.99	16.23
Brazoria Telephone Company	4,389	334.72	56.25	0.1436	48.07	139.93	91.86	(403,174)	23.89	16.23
Brazos Telephone Cooperative Inc.	1,133	632.18	279.34	0.1639	103.61	437.39	333.78	(378,173)	44.05	16.23
Cap Rock Telephone Company Inc.	2,309	560.80	225.81	0.1679	94.16	366.01	271.85	(627,702)	38.89	16.23
Central Texas Telephone Co-op, Inc.	3,196	886.31	469.94	0.1437	127.36	691.52	564.16	(1,803,055)	63.25	16.23
Coleman County Telephone Co-op, Inc.	1,752	307.43	37.59	0.2014	61.92	114.45	52.53	(92,033)	20.46	16.08
Colmesneil Telephone Company	1,324	500.53	180.60	0.1547	77.43	305.73	228.30	(302,269)	35.26	16.23
Colorado Valley Co-op., Inc.	4,651	391.44	98.79	0.1401	54.84	196.65	141.81	(659,558)	28.05	16.23
Comanche County Tel Company Inc.	4,474	275.66	16.94	0.1182	32.58	85.86	53.28	(238,375)	20.26	15.82
Conroe Telephone Company	28,385	275.59	16.90	0.3390	93.43	85.80	(7.63)	216,578	15.18	15.82
Dell Telephone Co-op. Inc.	318	2,486.27	1,669.91	0.6719	1,670.52	2,291.48	620.96	(197,465)	67.98	16.23
Eastex Telephone Cooperative, Inc.	19,373	365.92	79.65	0.2025	74.10	171.13	97.03	(1,879,762)	24.32	16.23
ETEX Telephone Cooperative Inc.	8,529	267.53	11.66	0.1676	44.84	78.54	33.70	(287,427)	18.56	15.75
Five Area Telephone Co-op. Inc.	1,456	832.16	429.33	0.2654	220.86	637.37	416.51	(606,439)	50.94	16.23
Fort Bend Telephone Company	15,474	332.56	54.63	0.2801	93.15	137.77	44.62	(690,450)	19.95	16.23
Ganado Telephone Company Inc.	1,268	350.61	68.16	0.0938	32.89	155.81	122.92	(155,863)	26.48	16.23
GTC of the SW - Texas	945,910	315.41	6.58	0.2504	78.98	85.43	6.45	(6,101,120)	19.70	19.16
Guadalupe Valley Tel Co-op. Inc.	12,722	343.86	63.10	0.2288	78.68	149.07	70.39	(895,502)	22.10	16.23
United Telephone Co. of Texas Inc.	90,159	342.40	62.01	0.1800	61.63	147.61	85.98	(7,751,871)	23.40	16.23
Hill Country Telephone Co-op, Inc.	8,273	489.53	172.35	0.2503	122.53	294.73	172.20	(1,424,611)	30.58	16.23
Industry Telephone Company	1,518	737.85	358.59	0.1396	103.00	543.05	440.05	(667,996)	52.90	16.23
Kerrville Telephone Company	13,310	191.72	0.00	0.3400	65.18	47.93	(17.25)	229,598	10.55	11.98
Lake Dallas Telephone Company, Inc.	3,613	389.03	96.98	0.3330	129.55	194.24	64.69	(233,725)	21.62	16.23
La Ward Telephone Exchange Inc.	850	499.09	179.52	0.1663	83.00	304.29	221.29	(188,097)	34.67	16.23
Lake Telephone Company [Lake Livingsto	908	416.36	117.48	0.3321	138.27	221.57	83.30	(75,636)	23.17	16.23
Lufkin Telephone Exchange Inc.	27,098	205.79	0.00	0.1756	36.14	51.45	15.31	(414,870)	14.14	12.86
Mid-Plains Rural Tel. Co-op. Inc.	2,119	526.58	200.14	0.1961	103.26	331.79	228.53	(484,255)	35.28	16.23
Central Telephone Company of Texas	106,525	272.39	14.82	0.4390	119.58	82.92	(36.66)	3,905,207	12.73	15.79
Muenster Telephone Corp. of Texas	1,673	263.97	9.34	0.1818	47.99	75.33	27.34	(45,740)	18.00	15.72
Mustang Telephone Company	2,024	311.98	40.55	0.3212	100.21	118.55	18.34	(37,120)	17.65	16.12
ALLTEL Texas	2,664	274.02	15.88	0.2560	70.15	84.39	14.24	(37,935)	16	15.80

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SCHEDULE A
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ANALYSIS OF NTS COST ALLOCATION BETWEEN
THE STATE AND FEDERAL JURISDICTIONS
(Prepared by MCI)

NAME	LOOPS	URRPL	HCAPL (Post-1987)	SPF	CIRRPL	NIRRPL	NIRRPL less CIRRPL	Net Change In Intrastate NTS Rev Req	Residual Intrastate NTS Rev Req Per Loop Per Month	
									Pre G.A.&HCA	Post G.A.&HCA
TEXAS	(A)	(B)	(C)	(D)	(E)=(B)*(D)	(F)=((B)*.25)+(C)	(G)=(F)-(E)	(H)=(G)*(A)*-1	(I)=((B)-(E))/12	(J)=((B)-(F))/12
Peeples Telephone Company	884	500.46	180.55	0.1474	73.77	305.67	231.90	(205,000)	35.56	16.23
Peoples Telephone Cooperative - Tx	6,189	315.09	42.57	0.1621	51.08	121.34	70.26	(434,839)	22.00	16.15
Poka-Lambro Rural Tel. Co-op., Inc.	3,288	569.63	232.43	0.1391	79.24	374.84	295.60	(971,933)	40.87	16.23
Riviera Telephone Company Inc.	724	678.45	314.04	0.2293	155.57	483.65	328.08	(237,530)	43.57	16.23
Southwest Texas Telephone Company	1,854	569.25	232.14	0.1872	106.56	374.45	267.89	(496,668)	38.56	16.23
Romain Telephone Company	912	621.68	271.47	0.2884	179.29	426.89	247.60	(225,811)	36.87	16.23
Santa Rosa Tel. Coop., Inc.	1,547	545.81	214.56	0.1715	93.61	351.01	257.40	(398,198)	37.68	16.23
South Plains Tel. Coop., Inc.	3,387	420.26	120.40	0.1561	65.60	225.47	159.87	(541,480)	29.56	16.23
Sugar Land Tel. Co.	21,805	289.95	26.23	0.3073	89.10	98.72	9.62	(209,764)	16.74	15.94
Sweeny-Old Ocean Tel. Co.	2,667	382.17	91.83	0.2194	83.85	187.37	103.52	(276,088)	24.86	16.23
Taylor Tel. Co-op., Inc.	5,077	321.46	46.71	0.1587	51.02	127.08	76.06	(386,157)	22.54	16.20
Texas-Midland Telephone Company	9,015	419.05	119.49	0.1773	74.30	224.25	149.95	(1,351,799)	28.73	16.23
Continental Telephone Co. of Texas	133,396	422.28	121.92	0.2194	92.65	227.49	134.84	(17,987,117)	27.47	16.23
Trinity Valley Telephone Company	5,047	458.70	149.23	0.2439	111.88	263.91	152.03	(767,295)	28.90	16.23
Valley Telephone Co-op. Inc. - Tx	3,743	833.96	430.68	0.1851	154.37	639.17	484.80	(1,814,606)	56.63	16.23
Valley View Tel. Co. - Tx	824	316.44	43.45	0.2277	72.05	122.56	50.51	(41,620)	20.37	16.16
West Texas Rural Tel. Co-op. Inc.	1,787	575.92	237.15	0.3457	199.10	381.13	182.03	(325,288)	31.40	16.23
Wes-Tex Telephone Co-op.	3,058	379.31	89.69	0.1478	56.06	184.52	128.46	(392,831)	26.94	16.23
XIT Rural Telephone Co-op. Inc.	914	943.53	512.85	0.4778	450.82	748.73	297.91	(272,290)	41.06	16.23
E.N.M.R. Tel. Coop., Inc. - Tx	677	246.94	0.00	0.4700	116.06	61.74	(54.32)	36,775	10.91	15.43
Southwestern Bell - Texas	6,107,770	232.63	0.00	0.2347	54.60	58.16	3.56	(21,743,661)	14.84	14.54
TOTAL	7,636,404	$252.31	$6.68	0.2389	$60.28	$69.76	$9.48	($72,356,719)	$16.00	$15.21

NOTES: Post 1987 HCA was calculated using 1985 unseparated NTS costs & the HCA formula adopted by the FCC on April 16, 1987 in CC Dockets 80-286 & 86-297. In 1988, the local exchange companies will receive three-eights of their Post-1987 HCA.

The data in colums (A) and (B) was taken from the FCC's monitoring report in CC Docket 87-339 released in September 1987.

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SCHEDULE A-1

EXPLANATION OF COLUMN HEADINGS

LOOPS	NUMBER OF OSP CAT 1.33 WORKING LOOPS
URRPL	UNSEPARATED NTS REVENUE REQUIREMENT PER LOOP
HCAPL	HIGH COST ASSISTANCE PER LOOP
SPF	FROZEN SUBSCRIBER PLANT FACTOR
CIRRPL	CURRENT (SPF) INTERSTATE NTS REVENUE REQUIREMENT PER LOOP
NIRRPL	25% + HCF INTERSTATE NTS REVENUE REQUIREMENT PER LOOP

DOCKET NO. 7330

INQUIRY INTO WATS COMPETITION ON MULTI-JURISDICTIONAL WATS ACCESS LINES	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

ORDER

In public meeting at its offices in Austin, Texas, the Public Utility Commission of Texas finds that the above styled matter was processed in accordance with applicable statutes by an examiner who prepared and filed a report containing Findings of Fact and Conclusions of Law, which Examiner's Report is ADOPTED and made a part hereof, except to the extent inconsistent with the terms of this Order. The Commission further issues the following Order:

1. The petition of MCI Telecommunications Corporation is DENIED.

2. The Findings of Fact and Conclusions of Law attached to this Order as Attachment A are ADOPTED in lieu of those set forth in the Examiner's Report. To the extent that discussion in the Examiner's Report is inconsistent with the findings and conclusions reached herein, that discussion is expressly NOT ADOPTED.

3. All motions, applications and requests for entry of specific Findings of Fact and Conclusions of Law and any other requests for relief, general or specific, if not granted herein, are DENIED for want of merit.

SIGNED AT AUSTIN, TEXAS on this the 30th day of August 1989.

PUBLIC UTILITY COMMISSION OF TEXAS

SIGNED: Marta Greytok
MARTA GREYTOK

SIGNED: Jo Campbell
JO CAMPBELL

SIGNED: William B. Cassin
WILLIAM B. CASSIN

ATTEST:

Mary Ross McDonald
MARY ROSS MCDONALD
SECRETARY OF THE COMMISSION

lsw

A. Findings of Fact

1. This proceeding was initiated by order of the Commission on December 18, 1986, for the purpose of resolving the issue of whether interexchange carriers (IXCs) should be allowed to carry and bill 1+ intraLATA WATS traffic originating over UWALs, or whether all such tarffic should be reserved to the local exchange carriers (LECs).

2. The scope of the proceeding was subsequently expanded to include the issue of whether all intraLATA 800 Service traffic and/or revenues should be reserved to the LECs or whether IXCs should be permitted to carry and bill such traffic, subject only to the payment of access charges.

3. Prehearing conferences were held in this docket on April 29, 1987, April 4, 1988, April 19, 1988, and August 15, 1988. The hearing on the merits was convened on August 22, 1988 and adjourned on September 14, 1988. Numerous parties participated in the docket, as reflected in the procedural history set out in Section I of the Examiner's Report.

4. Notice of the pendency of this proceeding was mailed to all LECs, all IXCs registered with the Commission in accordance with P.U.C. SUBST. R. 23.61(i) and (j), all parties to Docket Nos. 7020 and 7160, and the Office of Public Utility Counsel.

5. The IXCs bear the burden of persuasion in this proceeding.

6. By examiner's order, two post-hearing exhibits were admitted into evidence without objection.

7. Wide Area Telecommunications Service (WATS) is a discounted toll service designed for business customers whose calling volumes are relatively large and whose usage is relatively predictable.

8. The primary technical distinction between WATS and regular message telecommunications service (MTS) is that a WATS customer accesses the LEC network via a WATS access line (WAL) rather than a common access line.

9. WATS is a switched access service, and thus WATS calls are screened by a LEC central office switch to determine how they are to be routed.

10. The screening function for WATS traffic must be performed by a WATS Service Office (WSO).

11. If the central office at which a WAL terminates is not capable of serving as a WSO, the WATS traffic is routed via shared interoffice trunk facilities to a central office which is capable of serving as a WSO. The shared trunk facility between the central office and the WSO is known as a WAL extension (WALE).

12. The WSO screens all WATS traffic and routes the interLATA traffic to the designated IXC's point of presence for transportation over the IXC's facilities. The WSO routes all 1+ intraLATA traffic to the LEC for transportation and termination over the LEC's facilities.

13. If an IXC chooses to make the 10-XXX dialing option available to its WATS customers and a customer dials the IXC's 10-XXX code in lieu of 1+, the WSO automatically routes the call to the IXC for transportation over the IXC's facilities, irrespective of the geographical destination of the call.

14. The only technical difference between WATS and WATS-like services is that, in lieu of a WAL, the access connection between the customer and the IXC's POP is accomplished via a customer or IXC-owned facility or a special access facility leased from the LEC.

15. Since WATS-like services bypass the LEC switched network, all 1+ intraLATA WATS-like traffic is transported solely by an IXC.

16. 800 Service is a mechanized reverse charge service which permits interested parties to dial an 800 Service customer without being billed for the call.

17. 800 Service traffic originates over common lines connecting calling parties to the switched network.

18. 800 Service traffic can be terminated at the customer's premises using a common line, a WAL, a special access line, or a dedicated private facility installed by an IXC or the 800 Service customer.

19. Unlike WATS, only one dialing plan can currently be used in conjunction with 800 Service.

20. An 800 Service number cannot be used by LEC switches to connect a calling party with the 800 Service customer, nor can call jurisdiction be determined from the 800 Service number.

21. Before a calling party can be connected with an 800 Service customer, the dialed 800 Service number must first be translated by an 800 Service database into the ten digit POTS number assigned to the 800 Service customer's called terminating location.

22. AT&T, MCI and Sprint are the only IXCs that own 800 Service databases, although the Bell Operating Companies (BOCs) plan to deploy their own 800 Service database in the near future.

23. After an 800 number is translated to a POTS number, the manner in which the call is routed depends upon the service arrangement between the LEC and the IXC.

24. If the IXC is providing 800 Service jointly with the LEC and the call is intraLATA in nature, the IXC switch routes the call back the the LEC for carriage and billing by the LEC.

25. If the IXC is not providing 800 Service jointly with the LEC, the IXC switch routes all 800 calls over the IXC network for carriage and billing by the IXC, but the IXC must pay the LEC a revenue replacement rate, in lieu of access charges for each originating intraLATA 800 Service minute of use carried by the IXC.

26. This Commission has in the past never explicitly adopted a policy of bestowing upon LECs the ownership rights to 1+ intraLATA WATS and 800 Service traffic. Nevertheless, this policy has been implicit in the Commission's approval of tariffs and rates for such services.

27. Although the geographical market for toll services should logically be statewide in scope, it is necessary to assume an intraLATA geographical market for purposes of analyzing whether the reservation of 1+ intraLATA WATS and 800 Service traffic to the LECs would contravene the constitutional prohibition against state-created monopolies, since LATA boundaries define the areas in which the LECs operate, LATAs constitute the areas in which the LECs and IXCs directly compete in the provision of toll services, and LATAs are the areas affected by the competitive constraints alleged by the IXCs.

28. The toll market cannot be divided realistically between WATS, 800 Service, MTS, or other such services because the IXCs have the ability to reconfigure their networks at will to provide different kinds of services that are essentially substitutable or interchangeable.

29. Were one to recognize the existence of discrete product submarkets, the only submarkets for which support from the record could be found would be WATS and WATS-like services on the one hand, and 800 Service on the other.

30. The fact that the 10-XXX dialing option requires a WATS customer to dial four extra digits in order to have an IXC carry an intraLATA WATS call is not sufficient to require that 1+ be viewed as a separate service market.

31. For purposes of analyzing claims of monopoly, there exists only one product market, to wit: the aggregation of all toll services.

32. Although the LECs presently bill and carry 1+ intraLATA WATS traffic to the exclusion of the IXCs, there exists substantial competition between the LECs and the IXCs in the provisioning of WATS-type services.

33. A lack of evidence prevents relative market share from being quantified with respect to any facet of the intraLATA toll services product market.

34. A Commission prohibition of IXC provisioning of intraLATA 800 Service would not create a LEC monopoly because 800 Service constitutes only a small portion of the intraLATA toll market and because the LECs could not leverage their control of that market segment into control of the overall intraLATA toll market.

35. The LECs cannot prevent the entry of competitors into the toll market, nor can they adversely manipulate prices, given the existence of price regulation.

36. Tariffs do not presently prohibit any IXC from offering 800 Service on an intraLATA basis, and none of the LECs have requested that their tariffs be modified in the future in order to require that all intraLATA 800 Service be carried and billed by LECs.

37. AT&T, Sprint and MCI can and do offer 800 Service within the intraLATA arena.

38. Under the stipulation reached by the parties in Docket No. 7160, IXCs are free to carry intraLATA 800 Service traffic but they are required to pay the LECs a revenue replacement rate which is designed to compensate the LECs for the net revenues which the LECs would have earned if they carried and billed the intraLATA portion of the 800 Service traffic themselves.

39. The intraLATA 800 Service revenue replacement rate could not provide the LECs with monopoly control of the 800 Service aspect of the intraLATA toll market because: 1) the rates are regulated and priced substantially in excess of the incremental costs of providing the service; 2) the LECs are prohibited from offering 800 Services outside of LATA boundaries and thus, the IXCs can leverage their statewide market presence by marketing an integrated 800 Service offering which permits calls to be received from any and all areas in which the customer is interested; and 3) the competitive disadvantage which the revenue replacement rate places upon IXCs is mitigated by the IXCs' ability to average their disparate interLATA and intraLATA costs incurred in providing the integrated service.

40. A commission decision to implement on a permanent basis the *status quo* with respect to 1+ intraLATA WATS and 800 Service, or even to further constrain IXCs with respect to 800 Service, would not contravene the constitutional prohibition against state-created monopolies.

41. The Commission has no authority to order an IXC not to provide non-local exchange services within specific geographical areas. That does not mean, however, that the Commission necessarily lacks the authority to take actions with respect to the operations or services of other utilities over which it has full jurisdiction which might have the consequence of preventing IXCs from providing toll services within designated geographical areas.

42. PURA Sections 18(g) and 38 together constitute a stong policy statement against unreasonably discriminatory and anticompetitive conduct by this Commission.

43. The 10-XXX dialing option requires an IXC customer to dial four more digits than would have to be dialed using the 1+ dialing pattern, in instances where the caller and the terminating location are in different area codes, and seven more digits in instances where both the caller and the terminating location are in the same area code.

44. Because the customers are generally unfamiliar with LATA boundaries and could not be expected to know whether a called number in fact terminates within the same LATA in which it originates, customers using the 10-XXX dialing option would as a practical matter have to use that dialing pattern in all instances regardless of the interLATA or intraLATA nature of the call.

45. Dialing extra digits in connection with WATS applications is inconvenient, but it is possible to eliminate or substantially mitigate the inconvenience of dialing extra digits through use of auto-dialers, adjunct equipment on digital PBXs, or front-end processors for PBXs.

46. The IXCs presented no evidence that the cost of auto-dialers or adjunct equipment was prohibitive.

47. Sprint offers the 10-XXX dialing option to its WATS customers, indicating that it is feasible for IXCs to do so.

48. The cost of PBXs and auto-dialers can increase the cross-over point at which a WATS offering becomes more economical that MTS, but there are no policy ramifications to the cross-over point for WATS and MTS pricing.

49. For large customers that can most easily afford equipment which makes the extra digits associated with the 10-XXX dialing option transparent to the calling party, a WATS-like service may prove to be more economical that WATS.

50. The 10-XXX dialing pattern cannot be used in non-equal access end offices.

51. If an IXC offered the 10-XXX dialing pattern to its WATS customers, a customer could reach any IXC over the WAL, instead of solely the IXC which purchased the WAL.

52. The cost of a WAL extension is usually such that it is not economical for a customer served by a non-equal access end office to purchase WATS service. Accordingly, the non-availability of 10-XXX in such areas is inconsequential from the OCCs' perspective.

53. It is unlikely that the lack of availability of the 10-XXX option in non-equal access areas can be a significant consideration for AT&T or MCI given that neither AT&T nor MCI has ever chosen to use the 10-XXX option in connection with any of their WATS services. Sprint, which offers its customers this option, does not challenge in this proceeding the LECs' carriage of intraLATA WATS traffic.

54. Since equal access will soon be ubiquitous within the geographical areas for which there exists customer demand for WATS services, the unavailability of the 10-XXX option in non-equal access areas is not a serious impediment to competition.

55. A WATS customer would have no incentive to use the 10-XXX code of an IXC other than the IXC providing WATS service to the customer because, if the customer did so, the call would be billed at MTS rates rather than at the discount afforded by WATS service.

56. Reservation of the 1+ dialing pattern for the exclusive use of the LECs is a preferential practice. The preponderance of the evidence, however, reflects that this practice has not impaired the ability of the IXCs to compete for the carriage of intraLATA WATS traffic has not impaired.

57. If a LEC carries 1+ intraLATA WATS traffic originated over UWALs, enhanced pricing, billing, and blocking features offered by IXCs in connection with interLATA WATS traffic will not be available to the customer in connection with the customer's intraLATA traffic.

58. The only enhanced IXC WATS features that have any real significance in the context of intraLATA WATS traffic are billing features.

59. The lack of availability of enhanced WATS feature capability can be overcome by the customer's use of the 10-XXX option.

60. The nonavailability of enhanced WATS feature capability is far more disadvantageous to the customer than it is to an IXC.

61. The lack of an IXC's ability to provide end-to-end service to its WATS customers, in instances where the 10-XXX dialing option is not offered by the IXC, does not inhibit the IXC's ability to market its services *vis a vis* other IXCs since all IXCs share the same disadvantage. An IXC's ability to market its services *vis a vis* the LECs is not inhibited since the LECs also lack end-to-end service capability.

62. WATS customers are sophisticated telecommunications users who can reasonably be expected to understand the mechanics of the LEC joint WATS provisioning arrangement.

63. The interjection of the LECs into the relationship between the IXC and the customer is not a significant competitive disadvantage for IXCs.

64. There is no evidence from which it can be concluded that the LECs obtain a cost advantage over IXCs in the provisioning of intraLATA WATS as a consequence of the fact that LECs do not contribute to the costs incurred by IXCs to purchase WALs.

65. To the extent that an IXC is unwilling to offer its customers the 10-XXX dialing option, or that customers are unwilling to use it, the IXCs still have the ability to provide 1+ calling capability via their WATS-like service offerings.

66. Aside from the loss of potential earnings from intraLATA WATS traffic, those IXCs which choose not to offer the 10-XXX dialing pattern suffer no significant competitive disadvantage by virtue of that fact.

67. The LECs presently lack the ability to provide intraLATA 800 Service without the assistance of an IXC because they have no means of determining the terminating jurisdiction of an intraLATA 800 Service call, and they will not have that ability until such time as a planned nation-wide BOC 800 Database is deployed.

68. AT&T is the only IXC which provides 800 Service jointly with the LECs. MCI and Sprint provide 800 Service only under the non-joint option.

69. Intrastate Interim 800 Service, which was not available in Texas until March 1, 1987, employs "Six-digit screening" (800 NXX) to determine the appropriate IXC to which an 800 call is to be routed, based upon pre-assigned NXX codes.

70. Access provided in connection with Intrastate Interim 800 Service differs from other forms of access in that it requires use of six digit screening. Given the fact that the Intrastate Interim 800 Service rate adopted in Docket No. 7160 was based upon a stipulation, the Commission has not analyzed the costs of providing access for that service as opposed to other forms of access which do not require six digit screeing.

71. Since this docket was not a rate change proceeding, evidence was not presented, on the relative cost of various forms of access service.

72. The 800 Service rates of the IXCs are generally lower than those charged by SWB.

73. AT&T's non-joint 800 Readyline service offering is currently losing money on intraLATA traffic but the service as a whole is profitable due to the margin AT&T makes on its interLATA traffic.

74. IXC 800 Service offerings can be competitive even if burdened with the intraLATA revenue replacement rate.

75. The evidence shows that the 800 Service market segment is competitive even though the revenue requirement rate is applied to intraLATA access.

76. The evidence does not show that continued application of the intraLATA 800 Service revenue replacement rate will suppress demand for IXC 800 Service offerings. No IXC testified that if the intraLATA 800 Service revenue replacement rate were eliminated, the IXC would reduce 800 Service rates.

77. If the intraLATA 800 Service revenue replacement rate is not eliminated, AT&T testified that it will be forced to raise its current 800 Readyline rates. The evidence presented, however, shows that AT&T makes, on average, $.0662 per minute profit on 800 Readyline service.

78. The fact that the 800 Service market segment is competitive even though the revenue replacement rate is applied in areas in which the LECs and IXCs compete reflects that the burden which application of the rate imposes upon the IXCs can in fact be borne.

79. The LECs assert a number of policy considerations which they believe together provide a reasonable basis for the competitive *status quo*: 1) The need to maintain high levels of contribution to joint and common costs provided by LEC WATS and 800 Services, which assist in keeping basic local exchange rates affordable in furtherance of universal service; 2) the need to insure the continuation of benefits to universal service which flow from statewide distribution of this contribution through the pooling process; 3) the need to promote efficient telecommunications service; and 4) the need to insure that the LECs are afforded equal opportunity within the competitive telecommunications marketplace.

[4] 80. Universal service means making basic local exchange service affordable to the largest percentage of the population that one can reasonably achieve.

[5] 81. The Commission's policy of pricing non-basic local exchange services substantially in excess of their direct long run incremental costs furthers the goal of universal service in Texas.

82. All intraLATA toll services are provided jointly by the LECs and the revenues collected by the LECs are pooled on a statewide basis.

83. Had the LECs lost 100 percent of their WATS and 800 Service traffic to the IXCs in 1986, the intraLATA MTS/WATS toll pool would have lost billed revenues totaling $61,451,064, or approximately 9.315 percent of the total revenues paid into the pool in 1986. However, that loss would have been offset by $26,219,614 in access charges paid to the LECs by the IXCs for that WATS and 800 Service traffic, resulting in a net loss to the LECs of $35,231,450.

84. The Texas intraLATA MTS/WATS toll pool rate of return on net investment in 1986 was approximately 19.90 percent. Were the replacement access charge revenues paid into the pool, the $35,231,450 net loss associated with loss of 100 percent of the WATS and 800 Service traffic would have decreased the pool's 1986 return by only 1.24 percent, to 18.66 percent.

85. In Docket No. 5113, the targeted rate of return or settlement ratio for the intraLATA MTS/WATS toll pool was 11.94 percent. The Commission has increased LEC MTS/WATS rates since Docket No. 5113.

[6] 86. The intraLATA MTS/WATS toll pool rate of return is not a valid measure of overall profitability of LECs because rates for those services have intentionally been set at a level intended to provide large contributions to joint and common costs.

87. The overall industry revenue losses which would result if the LECs lost all WATS and 800 Service traffic will be borne disproportionately by the smaller LECs that do not originate or terminate much WATS or 800 Service

traffic, since access charges are billed and kept by the LEC that provides originating or terminating access to IXCs.

88. Had the LECs lost 100 percent of their 800 Service traffic to the IXCs in 1986, SWB would have lost $26,307,846 in settlement revenues from the toll pool but would have gained $14,609,851 in replacement access charge revenues, for a net loss of only 44 percent. On the other hand, the independent LECs would have lost $14,410,070 in settlement revenues from the toll pool and gained only $1,444,930 in replacement access charges, for a net loss of almost 90 percent of the 800 Service revenues those LECs would have gotten from the toll pool.

89. 90 percent of the WALs in Texas are located in SWB's service territory.

90. If one assumed that the LECs lost all WATS and 800 Service revenues in 1987, that those revenues had to be replaced in order for the LECs to have recovered their revenue requirements, and that the revenue could only be recovered through increases to local exchange rates, the magnitude of the change in local exchange rates would have ranged from a decrease of $2.78 per month to an increase of $6.87 per month. The impacts on SWB and GTE would have equated to monthly increases of $0.31 and $0.70, respectively. The average impact on the industry, excluding SWB and GTE, would have equated to an increase of $0.66 per month per one-party residential access line.

91. The current earnings levels of the LECs should not be given substantial weight in deciding long term Commission rate design policy issues. The proper procedure for correction of revenue surpluses or deficiencies is a general rate proceeding, and not a policy docket such as this.

92. The overwhelming majority of Texas LECs have never had their revenue requirements established by this Commission.

93. Toll rate increases granted to SWB in prior rate cases have been implemented by the independent LECs as well through concurrence tariffs, and

those increases have generated additional toll pool revenues for the independent LECs without the revenue requirements of those LECs ever having been scrutinized.

94. AT&T will continue to offer the WATS and 800 Services it is currently providing jointly with the LECs, but it is reasonable to assume that if the relief requested by the IXCs were granted, AT&T would market its non-joint WATS and 800 Service offerings more heavily than its joint offerings and that customers would over time migrate from the joint offerings to the non-joint offerings.

95. It is reasonable to expect AT&T customers to migrate from its joint 800 Service offering to its non-joint 800 Readyline and Megacom 800 service offerings.

96. Migration from AT&T's joint 800 Service offering to 800 Readyline has and will continue in the future given that termination of Readyline 800 Service over common lines avoids the expense of purchasing a separate WAL over which to terminate traffic.

97. It is reasonable to expect that the LECs will gain some intraLATA 800 Service traffic and revenues at such time as the BOC 800 Database is implemented, since smaller IXCs which do not possess an 800 database will want to provide 800 Service jointly with the LECs.

98. AT&T offers a WATS-type service provided over UWALs known as the Texas Business Plan (TBP), and if the scope of that service is expanded to include intraLATA traffic in the event IXCs are permitted to carry 1+ intraLATA WATS traffic, some migration from the LECs' intraLATA WATS and MTS offerings to TBP could occur.

99. Migration of LEC WATS and 800 Service customers to non-joint IXC offerings occur in the future if the relief requested by the IXCs is granted,

and very little, if any, of the current jointly provided WATS and 800 Service customer base would remain.

100. The analyses performed by AT&T witness Lerma and MCI witness Klaus do not take into consideration the revenue loss that would occur if LEC MTS traffic migrated to WATS and 800 Service.

101. For large volume MTS users who could potentially migrate to WATS offerings, it cannot be found with any certainty that the economic cross-over point between MTS and WATS would be substantially lowered were the IXCs permitted to carry 1+ intraLATA WATS traffic, since there is no evidence that the IXCs will lower their rates if they prevail. Absent a substantial reduction in that economic cross-over point, there would be no basis for assuming any traffic migration from MTS to WATS.

102. If the economic cross-over point between MTS and WATS were substantially reduced, the LECs would lose some intraLATA MTS traffic.

103. Increased 800 Service traffic does not represent to any significant degree lost MTS, but the evidence reflects the possibility of some MTS loss if 800 traffic is stimulated.

104. Growth in overall toll traffic volume within the state as a consequence of growth in 800 Service offerings will generate new revenues for the LECs.

105. The loss of all LEC WATS and 800 Service revenues would be a more realistic assumption than the loss of only 10 or 20 percent if the relief requested by the IXCs were granted in this docket.

106. If the LECs lost all WATS and 800 Service traffic, the number of discretionary revenue sources available in the rate design phase of a case would be reduced.

107. Increases in LEC 800 Service rates could drive LEC customers to the non-joint 800 services provided by the IXCs, absent an intraLATA 800 usage rate for non-joint services designed to discourage such migration.

108. Rural LECs tend to have very high subscriber loop costs.

109. As a result of newly adopted separations procedures, small LECs with high NTS costs will allocate far more NTS loss costs to the interstate jurisdiction than was the case under the frozen SPF allocation methodology.

110. For LECs with 200,000 access lines or less, 100 percent of the NTS cost in excess of 150 percent of the national average will be allocated to the interstate jurisdiction once the new separations procedures and high cost assistance programs are fully phased in in 1993.

111. Texas NTS costs are declining dramatically for all but a couple of LECs doing business in Texas.

112. Subscriber loop costs which must be recovered from Texas intrastate rates will decline from a range of $10.55 to $67.98 under the frozen SPF allocation methodology to $11.98 to $19.16 per month (based on 1985 costs) when the 25 percent gross allocation methodology and the high cost assistance plan are fully phased in in 1993.

113. Over the long term, changes in the separations process will substantially mitigate any cost disadvantages associated with high subscriber loop costs.

114. To the extent that the interstate subsidy provided high cost rural LECs is considered insufficient, PURA provides for the establishment of a universal service fund to assist LECs in providing basic local exchange rates at reasonable rates in high cost rural areas.

115. Link-Up America and the Telecommunications Service Assistance Program are both available to assist in keeping local exchange service affordable for certain needy subscribers.

116. There is no degradation in transmission signal by virtue of the fact that a call is routed through an IXC POP.

117. The record reflects that there are no serious inefficiencies in the way IXCs handle WATS and 800 traffic. The LECs, however, may have a cost advantage for short-haul intraLATA services.

118. GTE and SWB are legally precluded from providing interexchange toll services outside of LATA boundaries.

119. No IXCs participating in this proceeding offer intraLATA-only toll services.

120. LATA boundaries were deliberately drawn in such a manner that, to the extent possible, none would contain more than one SMSA.

121. An intraLATA-only offering would not permit businesses to access any of the other major business centers within the state.

122. GTE and SWB are the only LECs with customers subscribing to intraLATA-only WATS services.

123. There are presently no stand-alone intraLATA 800 Service customers within Texas.

124. While there may be some small demand for an intraLATA-only offering, the vast majority of WATS and 800 Service customers desire a broader calling scope.

125. The Texas LECs other than GTE and SWB are not legally restricted from providing interLATA toll services. Since the networks of these LECs are interconnected with those of SWB and GTE, the LECs are restricted as a practical matter from providing interLATA services.

126. Regulated rates can place LECs at a competitive disadvantage.

127. PURA Section 18(e) provides a mechanism for some rate flexibility for LECs. This section does not eliminate the disadvantages created by price regulation of LEC toll services.

128. LECs can petition the Commission to declare WATS and 800 Services a market subject to significant competition on or after August 17, 1989.

129. The intraLATA 800 Service revenue replacement rate has not induced any IXCs to enter into new joint service arrangements with the LECs, but it can reasonably be expected to discourage mass migration from the joint AT&T/SWB 800 Service offering, while allowing IXCs to carry and bill for intraLATA 800 traffic.

130. The intraLATA 800 Service revenue replacement rate gives the LECs approximately the same level of contribution to LEC joint and common costs as would have been achieved had the LECs carried the traffic.

131. The Commission cannot remove the geographical restriction on the toll services offered by SWB and GTE.

132. The disadvantage associated with the inability to provide interLATA toll services can be substantially mitigated by allowing the LECs to carry 1+ intraLATA WATS traffic, and by maintaining the contribution level for intraLATA 800 Service.

133. For WATS customers that have need for interLATA calling scope, purchasing a second WAL over which intraLATA WATS traffic could be carried by a LEC does not constitute a viable competitive opportunity.

134 The inconvenience of using a second WAL for intraLATA-only calling, combined with customer lack of familiarity with LATA boundaries, would present an insurmountable obstacle to the viability of a stand-alone intraLATA-only WATS offering.

135. It is incumbent upon the Commission to insure a competitive rate design for LEC intraLATA WATS offerings.

136. The cost of providing full 1+ intraLATA presubscription capability would be prohibitive.

[7] 137. The LEC practice of stripping, carrying and billing all 1+ intraLATA WATS traffic originating over UWALs is preferential, but the policy and fairness reasons advanced by the LECs form a reasonable basis for the unequal treatment afforded LECs and IXCs with respect to 1+ intraLATA WATS traffic.

138. The protection of universal service and the prevention of anticompetitive and discriminatory conduct are not mutually exclusive concepts.

139. The record reflects that access charge compensation as proposed by the IXCs would not replace existing contribution levels.

140. Looked at in a vacuum, the loss of high contribution levels from any particular LEC service probably would not negatively impact universal service. However, erosion of contribution from services such as WATS and 800, over time can impact universal service.

141. The IXCs have not identified and quantified any significant public interest benefits associated with their proposal. Even though the LECs had no

burden of proof, they have demonstrated public interest benefits associated with the *status quo*.

142. Based upon the preponderance of the evidence, the public interest will be served by maintaining the *status quo* at this time.

143. Given the inability to establish a "level playing field" for intraLATA services, the Commission is concerned that the modifications to the *status quo* suggested by the IXCs would diminish rather than enhance competition, due to the possibility that the IXCs may simply displace the LECs altogether in the provisioning of intraLATA WATS and 800 Service.

144. It would be appropriate to re-examine the policy established by the Commission in this proceeding when the MFJ's interLATA restrictions are removed by the Federal Court.

145. During the early proceedings in this docket, TSTCI was denied discovery of information from MCI concerning the amount of intraLATA traffic and services provided by MCI. Denial of that discovery request was improper since it was reasonably calculated to lead to the discovery of material evidence relevant to the issues in dispute in this proceeding.

B. Conclusions of Law

1. The Commission has jurisdiction over this case pursuant to Sections 16(a), 18, 37, 42 and 83 of the Public Utility Regulatory Act (PURA), Tex. Rev. Civ. Stat. Ann. art. 1446c (Vernon Supp. 1989).

2. Proper notice was provided to the public and to the parties in compliance with the requirements of Section 13 of the Administrative Procedure and Texas Register Act (APTRA), Tex. Rev. Civ. Stat. Ann. art. 6252-13a (Vernon Supp. 1987) and P.U.C. PROC. R. 21.25.

3. With the exception of discovery sought by TSTCI from MCI concerning the amount of intraLATA traffic and services provided by MCI, the denial of which is harmless error in light of the Commission's decision herein, the parties were provided an opportunity to respond and present evidence on all issues involved in this case as required by APTRA Section 13(d).

4. The reservation of 1+ intraLATA WATS and 800 Service traffic and/or revenues to the LECs would not constitute the grant of a state-created monopoly in contravention of Article I, Section 26 of the Texas Constituiton.

5. If the Commission's reasoned balancing of the competing policy objectives set forth in PURA Section 18(a) necessitated the implementation of LEC tariffs that had the practical effect of restricting the geographical area in which a non-dominant IXC could provide service, such action would not exceed the Commission's statutory authority under PURA.

6. The Commission lacks the statutory authority to order a non-dominant IXC not to provide services within specific geographical areas, provided a certificate of convenience and necessity is not required as a precondition to providing the service.

7. Reliance upon lack of prior Commission attempts to act in a fashion which would restrict the geographical area in which IXCs can provide a service, and the anticipation of IXC customers that IXCs will carry all their toll traffic, do not together serve to create a vested property right to the provision of unrestricted statewide toll services.

8. Commission actions that have the effect of restricting the geographical area in which a non-dominant IXC can provide a toll service are not violative of Article I, Section 19 of the Texas Constitution.

9. In deciding whether the current *status quo* with respect to 1+ WATS and 800 Service should be continued, *Amtel* requires that the Commission balance the competing policies inherent in PURA.

10. The Commission's mandate under PURA Section 18(a) is to insure that all telecommunications utilities have an equal opportunity to compete. In cases where regulated telecommunications utilities face insuperable competitive disadvantages, reasonable preferential treatment may be justified.

11. The Commission lacks authority to remove the geographical restrictions to which the SWB and GTE service offerings are subject.

12. The LEC practice of stripping, carrying and billing all 1+ intraLATA WATS traffic originating over UWALs is not unreasonably discriminatory.

13. The intraLATA 800 Service revenue replacement rate is just and reasonable and not unreasonably preferential to the LECs and is not unreasonably prejudicial and discriminatory to the IXCs.

[8] 14. Statutory policy considerations mandated by PURA warrant the continuation of the current *status quo* with respect to 1+ intraLATA WATS and 800 Service, especially in light of the fact that such practice does not have any significant anticompetitive or discriminatory effect upon IXCs.

15. MCI and the aligned IXCs have not sustained their burden of proof in this proceeding as to the appropriateness of eliminating the intraLATA 800 Service revenue replacement rate and the appropriateness of ceasing the reservation to the LECs of all 1+ intraLATA WATS traffic originated over UWALs.

16. Based upon the Commission's analysis of the facts as set out herein, sanctioning the reservation of 1+ intraLATA WATS traffic to the LECs and sanctioning the continued application of the intraLATA 800 Service revenue replacement rate would not be violative of PURA.

PETITION OF CENTRAL POWER AND LIGHT COMPANY FOR DECLARATORY ORDER	§ § §	DOCKET NO. 8650

January 10, 1990

Examiner's Order No. 31

Examiner denied HLP's and Texas Utilities' motions to dismiss. The order was not appealed to the Commission.

[1] COGENERATION--WHEELING SERVICE

Neither the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. Section 824a-3 nor the Federal Energy Regulatory Commission's (FERC's) implementing regulations found at 18 C.F.R. Section 292.101 et. seq. require that the production and consumption of a qualified facility's (QF's) cogenerated energy be an integrated process. (p. 1750)

[2] COGENERATION--WHEELING SERVICE
CERTIFICATION--SERVICES/FACILITIES WHICH REQUIRE CERTIFICATION

The Commission has the legislative authority to implement P.U.C. SUBST. R. 23.31(c)(1)(F), which requires QFs to obtain a certificate of convenience and necessity prior to making retail sales of electricity. (p. 1752)

[3] JURISDICTION--DECLARATORY ORDERS AND ADVISORY OPINIONS

The Commission has the authority to issue declaratory orders. To issue a declaratory order there must be (1) a real controversy existing between the parties that (2) will actually be settled by the declaration sought. (p. 1753)

DOCKET NO. 8650

PETITION OF CENTRAL POWER AND LIGHT COMPANY FOR DECLARATORY ORDER	§ § §	PUBLIC UTILITY COMMISSION OF TEXAS

EXAMINER'S ORDER NO. 31
CONCERNING HLP'S AND T. U. ELECTRIC'S
MOTIONS TO DISMISS

On November 6, 1989, a prehearing conference was convened by the undersigned examiner for the purpose of considering Houston Lighting and Power Company's ("HLP's") and Texas Utilities Electric Company's ("T. U. Electric's") motions to dismiss. Appearances were entered by:

1. Mr. Milton E. Lorenz, Jr., and Mr. Jim Anthony for Central Power and Light Company ("CPL");
2. Mr. Louis S. Zimmerman, Mr. Sam Richardson, and Mr. Leslie Adams for The Coastal Corporation ("Coastal");
3. Mr. Taylor S. Davis for Occidental Chemical Corporation ("Occidental");
4. Mr. Greg Copeland, Mr. Randy McManus, and Mr. Michael L. Jines for Houston Lighting and Power Company ("HLP");
5. Mr. M. D. Sampels and Ms. Angela Hatton for Texas Utilities Electric Company ("T. U. Electric");
6. Mr. Ruben Barrera for Public Utility Board of Brownsville ("PUBB");
7. Mr. Campbell McGinnis for Texas Electric Cooperatives ("TEC");
8. Ms. C. Kingsbery Ottmers for Office of Public Utility Counsel ("OPC"); and
9. Assistant General Counsel Paula Mueller for the Commission staff and the public interest.

I. Introduction

Coastal operates a cogeneration plant which is a "qualified facility" ("QF") in CPL's service area. Coastal requested the use of CPL's transmission facilities to allow Coastal to wheel energy to thirty remote installations owned by a "subsidiary" of Coastal. Currently these installations are being

served with retail service by CPL. CPL denied Coastal's request for wheeling service based on its interpretation of P.U.C. SUBST. R. 23.31(c)(1)(F). Consequently, CPL petitioned the Commission for a declaratory order concerning the applicability of the certificate of convenience and necessity ("CCN") requirement of P.U.C. SUBST. R. 23.31(c)(1)(F) as it related to the transaction proposed by Coastal.

P.U.C. SUBST. R. 23.31(c)(1)(F) reads as follows:

> (1) A certificate, or certificate amendment, is required for the following:
>
> (F) a qualifying facility which is making or plans to make retail sales of electricity to an end user, unless the end user is also the sole purchaser of the thermal output of the qualifying facility, or unless the qualifying facility generates less than ten (10) megawatts of electric power by renewable resources, biomass, or solid waste. As a requisite to certification, the commission shall find that the ratepayers of the utility in whose service area the purchasing end user is located will not be substantially adversely impacted as a result of such retail sales.
>
> (emphasis added)

Coastal has argued that P.U.C. SUBST. R. 23.31(c)(1)(F) does not apply, since it will not be making a "retail sale" of electricity.

The examiner divided the docket into two phases. As set out in Examiner's Order No. 7 the first phase will consider: Whether Coastal is required to file for a certificate of convenience and necessity pursuant to P.U.C. SUBST. R. 23.31(c)(1)(F). The second phase, if it becomes necessary, will consider: Whether Coastal's request for wheeling service from CPL should be permitted if Coastal is not required to file for a certificate of convenience and necessity. Discovery was limited to the first phase of the docket.

Immediately before the hearing in the first phase T. U. Electric and HLP raised three jurisdictional issues which are outlined below:

1. Whether Coastal would lose its qualified facility status if the relief requested were granted.

2. The jurisdictional validity of Commission Substantive Rule 23.31(c)(1)(F).

3. Whether CPL's request for a declaratory order is actually a request for an advisory opinion because all the details of how the service between Coastal and CPL will be handled have not been made clear.

Briefs were prepared by the parties and at the prehearing conference the examiner questioned the parties about the above issues. For the reasons detailed below the examiner hereby **DENIES** T. U. Electric's and HLP's motions to dismiss.

II. Discussion

A. Coastal's QF Status

P.U.C. SUBST. R. 23.31(c)(1)(F) requires a QF to obtain a CCN prior to making retail sales of electricity. T. U. Electric and HLP have argued that Coastal's QF status would be jeopardized if its request for wheeling service were granted. They argued that if Coastal loses its QF status then P.U.C. SUBST. R. 23.31(c)(1)(F) would no longer be applicable and the Commission would be making an advisory opinion. The examiner disagrees.

Coastal's cogeneration facility was certified as a QF by the Federal Energy Regulatory Commission ("FERC") on December 31, 1983, pursuant to the Public Utility Regulatory Policies Act of 1978 ("PURPA"), 16 U.S.C. Section 824a-3 and FERC implementing regulations found at 18 C.F.R. Section 292.101 et. seq. The general requirements for qualification are set out in Section 292.203(a) of the FERC rules. Specifically, a small power production facility is a qualifying facility if it: (1) Meets certain maximum size criteria relating to power production; (2) Meets certain fuel use criteria relating to type of fuel; and

(3) Meets ownership criteria relating to the prohibition of electric utility ownership. Upon complying with the above criteria a small power production facility can obtain qualifying status pursuant to Section 292.207(a) or (b). Qualifying status may be obtained by either self-certification requiring notice to FERC or by application for FERC certification.

T. U. Electric and HLP have argued that under Coastal's proposal, the producing and consuming functions of Coastal's cogeneration facility would no longer be part of an integrated process. Consequently, Coastal would no longer be entitled to the benefits of QF status under FERC's regulations. Additionally, they argued that under Coastal's proposal FERC may revoke its qualifying status because Coastal would no longer comply with a statement contained in its application for certification pursuant to Section 292.207(d)(1): Coastal's cogenerated energy would no longer be sold for resale by CPL but rather consumed by the thirty remote installations owned by a "subsidiary" of Coastal.

[1] The examiner disagrees with T. U. Electric's and HLP's analysis for the following three reasons. First, as noted above Section 203(a) lists the requirements for qualification as a QF. Section 203(a) does not include a requirement that production and consumption of the cogenerated energy be an integrated process. Second, the FERC application for obtaining qualifying status found in Section 292.207(b)(1)-(5) does not require that the QF disclose how the cogenerated energy is consumed or by whom. If FERC believed that an integrated process was necessary as T. U. Electric and HLP have argued, then why does not FERC require a QF applicant to disclose how the energy will be consumed in determining a cogenerator's QF status? Third, as the Assistant General Counsel argued in her brief, it would be inappropriate for the Commission to base any decisions on speculation as to what FERC may or may not do given a certain set of facts. Whether Coastal remains a QF is exclusively a matter for FERC to determine.

B. <u>The Validity of P.U.C. SUBST. R. 23.31(c)(1)(F)</u>

P.U.C. SUBST. R. 23.31(c)(1)(F) permits a QF to make sales of its energy for other than resale. T. U. Electric and HLP have attacked P.U.C. SUBST.

R. 23.31(c)(1)(F) arguing that the Commission overstepped its legislatively mandated jurisdiction. T. U. Electric and HLP argued that the Texas Legislature did not authorize the Commission to expand the authority of QF's to make dispositions of energy other than as authorized by PURPA. They argued that because there is no statutory basis to permit QF's to serve retail load, with or without a CCN, the Commission had no authority to implement P.U.C. SUBST. R. 23.31(c)(1)(F). Consequently, the Commission could not regulate or adjudicate the relief sought by either CPL or Coastal. The examiner disagrees with T. U. Electric's and HLP's interpretation of the Commission's authority as requiring specific grants of legislative authority to exercise its implied powers.

Section 16(a) of PURA grants the Commission broad powers. Specifically, Section 16(a) states that:

> The Commission has the general power to regulate and supervise the business of every public utility within its jurisdiction and to do all things, whether specifically designated in this Act or implied herein, necessary and convenient to the exercise of this power and jurisdiction. The Commission shall make and enforce rules reasonably required in the exercise of its powers and jurisdiction, including rules governing practice and procedure before the commission.

T. U. Electric's and HLP's arguments ignore the fact the Commission has implied powers and does not need a specific grant of authority from the legislature for every action it takes. The court in General Tel. Co. v. Public Utility Com'n, 628 S.W.2d 832, 837-840 (Tex. App.--Austin 1982, writ ref'd n.r.e.) rejected the argument that the Commission only possessed those powers specifically granted in PURA. Upon citing to Section 16(a) the court concluded that this section did not indicate that the legislature intended that the Commission could only exercise those powers expressly granted by the Act. Id. at 840.

Additionally, Section 16(g) of PURA specifically grants the Commission the power to "make and enforce rules to encourage the economical production of electric energy by qualifying cogenerators and qualifying small power producers." When Section 16(g) is considered together with the Commission's implied powers found in Section 16(a) T. U. Electric's and HLP's argument does

not carry much weight.

[2] The Intervenor's argument is further weakened by an attorney general's opinion the Commission requested upon enacting P.U.C. SUBST. R. 23.31(c)(1)(F). The Attorney General in Op. Tex. Att'y Gen. No. JM-353 (1985) ("JM-353") found that the Commission has the authority under Section 49(a) of PURA to certificate the facilities of cogenerators making retail sales of electricity. A copy of JM-353 is attached.

Finally, this docket is not the proper forum for attacking the validity of a Commission rule. The parties are aware that Section 12 of the Administrative Procedure and Texas Register Act ("APTRA"), Tex. Rev. Civ. Stat. Ann. art. 6252-13a, provides that the validity or applicability of any rule may be determined in an action for declaratory judgment in a district court of Travis County, and not elsewhere. Because of the foregoing the examiner is not persuaded by T. U. Electric's and HLP's argument.

C. CPL's Request for a Declaratory Order

T. U. Electric, HLP, and General Counsel have argued that the requested relief is in fact a request for an impermissible advisory opinion. The examiner disagrees.

This docket began when CPL denied Coastal's request for wheeling service based on its interpretation of P.U.C. SUBST. R. 23.31(c)(1)(F). Consequently, CPL petitioned the Commission for a declaratory order concerning the applicability of the CCN requirement of P.U.C. SUBST. R. 23.31(c)(1)(F) as it related to the wheeling transaction proposed by Coastal. The denial of the wheeling service to Coastal is the underlying basis of this request for declaratory order. The Commission has been asked to determine whether CPL's denial of service was appropriate based upon CPL's interpretation of a Commission rule. The Commission has the authority to interpret its rules and determine whether CPL's denial of service was appropriate. The requested relief is not an advisory opinion, but a permissible request for a declaratory order.

[3] The Legislature authorized the Commission to issue declaratory orders. Section 3(p) of PURA defines "order" as:

> the whole or part of the final disposition, whether affirmative, negative, injunctive, or declaratory in form, of the regulatory authority in a matter other than rulemaking, but including issuance of certificates of convenience and necessity and ratesetting. (emphasis added)

In Petition of Houston Lighting and Power Company for a Declaratory Order, Docket No. 8058, 14 P.U.C. Bull. 311 (June 30, 1988) the Commission found that it has the authority to issue declaratory orders pursuant to Sections 16(a) and 3(p) of the PURA. To issue a declaratory order there must be (1) a real controversy existing between the parties that (2) will actually be settled by the declaration sought. Board of Water Engineers v. City of San Antonio, 283 S.W.2d 722 (Tex. 1955) and Wilson v. Grievance Committee for State Bar District No. 3-A, 565 S.W.2d 361 (Tex. Civ. App. - Austin 1978, writ ref'd n.r.e.).

The basis for T. U. Electric's, HLP's, and General Counsel's argument is that Coastal in prehearing briefs has argued that the proposed transaction would not constitute a "retail sale" as described by P.U.C. SUBST. R. 23.31(c)(1)(F) and that therefore Coastal would not be required to obtain a CCN. The Assistant General Counsel argued that to determine the applicability of P.U.C. SUBST. R. 23.31(c)(1)(F) there must first be a finding that Coastal's proposed activity constitutes a "retail sale". Furthermore, she argued that because all the details of the proposed transaction have not been made clear the Commission would be in the position of making an advisory opinion.

CPL denied service to Coastal because of its interpretation of a Commission rule. The burden is upon CPL to demonstrate that its interpretation of P.U.C. SUBST. R. 23.31(c)(1)(F) and subsequent denial of service was appropriate. The intervenors and General Counsel would require CPL and Coastal to continue to negotiate and more clearly delineate the terms of a contract. CPL believed that it was not required to provide the requested service and to require it to expend time and money after it has made this determination would be wasteful.

A hearing is the appropriate forum to determine factual and legal disputes relating to denial of service as well as interpretation of Commission rules.

A controversy does exist between Coastal and CPL, and the Commission does have the authority to settle their dispute. The examiner cannot agree that this docket would require the Commission to issue an advisory opinion.

For the foregoing reasons the examiner **DENIES** T. U. Electric's and HLP's motions to dismiss.

SIGNED AT AUSTIN, TEXAS on this the 10th day of January 1990.

PUBLIC UTILITY COMMISSION OF TEXAS

JEFFREY A. FRIEDMAN
HEARINGS EXAMINER

Attachment

TELEPHONE

Guadalupe Valley Telephone Cooperative, Inc., Docket No. 8881. Examiner's Report adopted March 8, 1990. Applicant's request to establish a ten percent depreciation rate for new microwave equipment granted.

Complaint of Hershel J. Williams Against AT&T, Docket No. 8893. Examiner's Report adopted February 23, 1990. Applicant's complaint dismissed with prejudice to refiling for lack of jurisdiction.

Hill Country Telephone Company, Docket No. 8966. Examiner's Report adopted February 23, 1990. Applicant's request to revise its private pay telephone tariff granted.

Colorado Valley Telephone Cooperative, Inc., Docket No. 8968. Examiner's Report adopted March 8, 1990. Applicant's request to implement private pay telephone service granted.

Coleman County Telephone Company, Docket No. 8969. Examiner's Report adopted February 23, 1990. Applicant's request to revise its private pay telephone tariff granted.

Muenster Telephone Corporation of Texas, Docket No. 8981. Examiner's Report adopted February 23, 1990. Applicant's request to implement private pay telephone service granted.

Central Texas Telephone Cooperative, Inc., Docket No. 8982. Examiner's Report adopted March 8, 1990. Applicant's request to implement private pay telephone service granted.

Complaint Against AT&T, Docket No. 8984. Examiner's Report adopted March 8, 1990. Commission dismissed complaint involving interstate international communications pursuant to P.U.C. PROC. R. 21.82(a)(1) and (7).

Central Telephone Company of Texas, Docket No. 8985. Commission issued an order adopting the stipulation of the parties. Centel's application to withdraw the minimum monthly usage charge applied to usage-rated access services was granted.

Contel of Texas, Docket No. 9016. Examiner's Report adopted March 7, 1990. Application to amend service area boundaries in Harrison County approved.

Kerrville Telephone Company, Docket No. 9039. Examiner's Report adopted February 23, 1990. Applicant's request to revise its private pay phone tariff granted.

Southwestern Bell Telephone Company, Docket No. 9060. Examiner's Report adopted March 7, 1990. Application to revise base rate area boundaries within the Beeville Exchange in Bee County approved.

GTE Southwest, Inc., Docket No. 9072. Examiner's Report adopted March 7, 1990. Application to amend service area boundaries in Parker County approved.

Royal Frontier Studios, Inc., Docket No. 9091. Proposed Final Order adopted February 12, 1990. Stipulation resolving inquiry against provider of automatic dial announcing devices adopted.

ELECTRIC

Texas Utilities Electric Company, Docket No. 8404. Examiner's Report adopted March 7, 1990. Commission approved Texas Utilities' interpretation of its FC Rider.

West Texas Utilities Company, Docket No. 8815. Examiner's Report adopted March 7, 1990. Application for a transmission line in Dallas County approved.

Houston Lighting & Power Company, Docket No. 8942. Examiner's Report adopted February 21, 1990. Application for a transmission line in Harris County approved.

Swisher Electric Cooperative, Inc., Docket No. 9024. Examiner's Report adopted February 24, 1990. Applicant's request to change line extension policy granted.

Southwestern Electric Service Company, Docket No. 9040. Proposed Final Order adopted March 8, 1990. SESCO's application for authority to change rates as modified by a stipulation among the parties was granted.

Concho Valley Electric Cooperative, Inc., Docket No. 9056. Examiner's Report adopted February 23, 1990. Applicant's request to change its rates was granted.

Houston Lighting & Power Company, Docket No. 9063. Examiner's Report adopted February 21, 1990. Application for a transmission line in Harris County approved.

West Texas Utilities Company, Docket No. 9195. Examiner's Report adopted February 21, 1990. Application for a transmission line in Pecos County approved.

Southwestern Electric Power Company, Docket No. 9304. Examiner's Report adopted March 7, 1990. Application to amend certificated service area boundaries in Panola County approved.