

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

IN RE: REVIEW OF BELL ATLANTIC -
RHODE ISLAND TELRIC STUDIES:
INVESTIGATION OF ACCESS RATES

DOCKET NO. 2681

REPORT AND ORDER

I. INTRODUCTION.

The Public Utilities Commission ("Commission") opened this proceeding to address the forward-looking, long run incremental costs of unbundled network elements ("UNEs") which Bell Atlantic-Rhode Island ("BA-RI") must provide to competing local exchange carriers ("CLECs") under the Telecommunications Act of 1996 ("Act"). During this investigation, the Commission determined that it needed to resolve the issue of whether to reduce intrastate switched access rates that BA-RI charges interexchange carriers ("IXCs") to reflect forward-looking costs of providing such access services, including a reasonable rate of return, and to establish updated access rates. It has been more than seven years since the Commission last adjusted intrastate switched access rates in Rhode Island.

During this period, the telecommunications market has experienced revolutionary change. Under the Act, Federal Communications Commission ("FCC") regulations for UNE rates, and related developments in state public utility commissions throughout the country, the regulatory trend in the telecommunications industry is for wholesale rates to be set based on forward-looking economic cost, in order to foster robust competition and thereby benefit end-user consumers. The Commission finds that BA-RI should be ordered to reduce its intrastate access rates immediately to 3.0 cents per minute (on an end-to-end basis), and that these rates

should be further modified in accord with the final UNE rates to be established in this docket at a later time.

There are several factors that support the immediate reduction of intrastate access rate to 3.0 cents per minute in Rhode Island. First, the Commission finds that Rhode Island's economy will benefit if access rates are competitive with rates in the region. The Commission took notice of its neighboring states' aggressive efforts to reduce their access charges to reflect cost-based rates.

Most recently, the Governor of New Hampshire signed legislation directing the New Hampshire Public Utilities Commission to reduce the state's intrastate access charges as soon as possible; the Vermont Public Service Board issued a Final Order that reduced access rates from 11 cents to 4 cents per minute immediately; Maine also has reduced its access rate from 14 cents to 5 cents per minute. Neighboring states, specifically Connecticut and Massachusetts, already had access rates well below Rhode Island's access rate. Second, an access rate reduction will directly benefit Rhode Island's consumers in two ways. As access rates are reduced, toll rates will be reduced as well. As the record indicates, BA-RI presented a scenario that showed if the Commission were to set lower access rates, competing carriers such as AT&T and Sprint will lower their toll rates because they will no longer seek to recover the inflated access charges they are paying BA-RI. This fact, in turn, will force BA-RI to lower its toll rates to be competitive with other carriers. In addition, the provisions of BA-RI's Price Regulation Plan, Docket No. 2370, require that business toll rates fall, commensurate with access charge reductions.

II. POSITIONS OF THE PARTIES.

During the November 22, 1999 evidentiary hearing regarding access rates, BA-RI and the Division of Public Utilities and Carriers ("Division") announced a bilateral agreement in principle ("Settlement Agreement") to support an intrastate access rate of 4.8 cents per minute on

an end-to-end basis.¹ BA-RI and the Division urged the Commission to take a "gradual policy approach" and to reduce access charges to cost slowly, over time.² As part of their proposal, the Division and BA-RI recommended that the Commission should retain the Carrier Common Line ("CCL") component of access charges, which accounted for 1.5 cents of the proposed total access charge of 4.8 cents per minute.

AT&T and Sprint urged the Commission to instead order BA-RI to set access rates at levels based on the Total Element Long-Run Incremental Cost ("TELRIC") of providing access. AT&T and Sprint urged the Commission to order access rates to be reduced in two phases: first, to a level corresponding to the current interim rates for unbundled network elements ("UNEs"); and subsequently to a lower level based on the permanent UNE rates that will be subsequently established by the Commission. AT&T urged the Commission to eliminate the CCL portion of the access rates on the ground that there is no cost basis for this charge, and asked the Commission to reduce the remaining access charge elements to achieve a total, end-to-end access rate of 2.9 cents per minute.

III. DISCUSSION.

One of the many benefits to consumers of effective competition in any marketplace is that competition drives prices toward cost. However, regardless of the status of competition in Rhode Island's intraLATA toll market, the Commission finds that toll rates have been forced to remain at a higher level by excessive access rates. This is true because toll rates are comprised in large part of wholesale access charges, which BA-RI admits are priced well above cost. It is undisputed that access is a bottleneck service, which IXCs must purchase from BA-RI in order to originate or terminate intrastate toll calls. As such, the price of access serves as a price floor

¹ T. at p. 68.

below which IXCs can not lower their toll prices without losing money on every minute of toll service they sell. The Commission finds that high cost of access in Rhode Island, which is currently well in excess of the cost to BA-RI of providing switched access services, inhibits competitive forces from placing downward pressure on the price of toll services. Only if access rates are set at cost-based levels can competitive forces drive toll rates toward cost.

The Division acknowledges that BA-RI's access revenues have risen dramatically over the three-year period from 1996 through 1998, and claims that this is an indication that the intraLATA toll market is competitive. However, the level of competition in the retail toll market cannot disguise the lack of competition in the wholesale market for switched access services. The fact that BA-RI has not reduced its wholesale access rates at all during this period – or, indeed, at any time prior to the last Price Regulation Plan filing³ – is persuasive evidence that, irrespective of the fact that toll calling is on the rise in Rhode Island, BA-RI has had no incentive to lower access rates. This flows from the fact that competition in the retail toll market cannot cause the price of a bottleneck wholesale service such as access to decline.

The Commission finds that unduly high access rates force consumers to pay unduly high toll charges. Only if access rates are reduced to forward-looking economic cost (including a reasonable rate of return) will toll prices decline, lowering the cost for ratepayers to make toll calls in Rhode Island. As Rhode Islanders' toll usage has increased, BA-RI has watched its access revenues grow dramatically, because IXCs (and Rhode Island consumers indirectly) have been forced to pay unnecessarily high access rates.

² T. at p. 193.

³ The end-to-end price of access was reduced to 5.0 cents in Docket No. 2370, effective January 15, 2000. This was the level which had been previously proposed by the settling parties to Docket No. 2912 in September, 1999; it was rejected, on other grounds, in Order No. 16015 (issued October 14, 1999).

The 4.8 cent per minute figure proposed by BA-RI and the Division is substantially in excess of the cost to BA-RI of providing access services, in large part because it is based on two incorrect assumptions: (1) that the appropriate ratio of direct routed calls to tandem routed calls is 20/80; and (2) that the intrastate access charge in Rhode Island should include 1.5 cents of contribution toward the loop in addition to the already high levels of contribution contained in the interim UNE rates.

First, the Settlement Agreement assumed that 80 percent of intrastate toll calls handled by BA-RI are carried via tandem switches, and that only 20 percent of BA-RI's intrastate calls are routed directly from the IXCs' networks to the BA-RI local switch which serves the customer being called. This tandem/direct ratio is significant because it is more expensive for BA-RI to carry an access call using tandem routing, which requires the use of a tandem switch and interoffice transport facilities to route the call to the BA-RI local switch from which the customer being called is served. In contrast, when an IXC delivers a toll call directly to the appropriate BA-RI local switch, then BA-RI's own interoffice transport and tandem switching facilities are not required to complete the call.

As explained during the evidentiary hearing, AT&T's experience has been the reverse of the split embodied in the settlement (*i.e.*, only 20 percent of AT&T's toll calls require tandem switching, while 80 percent are direct routed).⁴ Moreover, Sprint supported AT&T's position by explaining that Sprint's tandem/direct ratio is similar to AT&T's percent direct routed.⁵ MCI's proprietary response to the Commission's data request substantiated the evidence presented by AT&T and Sprint. Based on this evidence, the Commission finds that intrastate switched access

⁴ T. at p. 100.

⁵ T. at p. 148.

rates should be set using a tandem/direct ratio of 20/80. The contrary assumption reflected in the proposed bilateral settlement between BA-RI and the Division is not supported by the evidence.

The cost difference between the IXCs' direct/tandem ratio and the direct/tandem ratio contained in the Settlement Agreement amounts to approximately seven tenths of a cent. In short, by using an incorrect tandem/direct ratio, the proposed access rate overstated cost by 0.7 cents due to this factor alone.

Second, BA-RI and the Division defended their proposal by urging the Commission to include 1.5 cents per minute of "contribution." Contribution is the difference between the price of a service and its incremental cost. In other words, by asking the Commission to permit BA-RI to continue to charge access rates that it acknowledges are in excess of the cost of providing these services, BA-RI is seeking to force IXCs to pay wholesale access rates which either subsidize other services or which provide a windfall to BA-RI's parent company and its shareholders.

As BA-RI witness Dr. William Taylor explained in Docket 2912, the incremental cost of access is "a number on the order of a cent or less a minute."⁶ Dr. Taylor's testimony regarding the true cost to BA-RI of providing intrastate switched access is directly relevant to the access rate issues decided by the Commission in this phase of this docket. At no time has BA-RI offered credible evidence to refute this cost estimate by its own witness.

Based on this fact, the Commission finds that the 4.8 cents proposed access rate exceeds incremental cost. Indeed, any access charge over 1.0 cent per minute already includes substantial contribution. The Commission finds that the elimination of the CCL charge, consistent with Vermont's decision, and the adoption of a 3.0 cent access rate for the remaining

⁶ Testimony of William Taylor, Docket No. 2912, T. 9/13/99, p. 121.

rate elements, will result in an interim access rate that will more than cover the incremental cost of access.

With respect to the CCL portion of the current access charges, the Commission finds that the CCL charge should be eliminated because the provision of access services does not cause any incremental loop costs. The Division's witness confirmed this point, testifying that the CCL element "is not incremental to the provision of access."⁷ Although the Division joined with BA-RI in advocating a CCL of 1.5 cents per minute, it provided no factual support for that figure; its witness testified that this number was "subjectively determined."⁸ The Commission finds that there is no cost basis for continuing to assess the CCL element of the intrastate switched access rate, and that because it has no cost basis the CCL charge should be eliminated.

With respect to the appropriate overall rate for intrastate switched access in Rhode Island, BA-RI's own economic expert has testified that the cost of access is less than one cent per minute. Therefore, adopting even AT&T's 2.9 cent proposal as an interim access rate would represent several times the actual cost of providing access.

In spite of the fact that BA-RI's own witness has identified the cost of access services as one cent or less, highlighting the fact that any and all amounts above that penny represent pure contribution, BA-RI has presented no evidence that any of its services require subsidy, by access rates or otherwise. In fact, BA-RI has experienced steady growth in both intrastate access revenues and rate of return over the last four years. Billed intrastate switched access revenues grew from \$1.8 million in 1996 to \$7.5 million in 1998. During the same period, BA-RI's rate of return has increased from 9.05% in 1996 to 13.31% in 1998. This clearly demonstrates that it is

⁷ Direct Testimony of Thomas Weiss, at p. 7.

⁸ T. at p. 159.

unnecessary to include excessive contribution in access rates, as proposed by the Settlement Agreement. A 13.31% return appears to be well in excess of BA-RI's weighted average cost of capital. The Commission has not yet made a final decision regarding the appropriate forward-looking cost of capital for BA-RI; it will do so when it sets final UNE rates in this docket. However, the Commission is aware that (a) regulators in other states have found that Bell Atlantic's forward-looking cost of capital is near or below 10 percent; (b) these findings are consistent with the testimony of the Division's witness Mr. Hill and AT&T's witness Dr. Hubbard in the UNE rate phase of this proceeding; and (c) Bell Atlantic faces the same cost of capital for its wholesale services throughout its region (*i.e.*, it does not face a special, higher cost of capital for providing services in Rhode Island). The undisputed evidence regarding BA-RI's actual rate of return for its intrastate operations establishes that there is no good reason for the Commission to inflate BA-RI's switched access rates in order to provide for additional "contribution".

For these reasons, the Commission finds that BA-RI should eliminate the CCL element of its intrastate switched access rates, and that the remaining elements should be reduced on an interim basis to an average of 3.0 cents per minute. The Commission intends to review these interim access rates once it has adopted final UNE rates, to determine whether the access rates should be reduced further in order to be set in accord with BA-RI's forward-looking economic cost of providing wholesale switched access services.

From an economic development and business retention perspective, this access rate reduction will bring Rhode Island's access rate in line with those of the other New England states and, more importantly, with the access rates of states considered major business centers in the Northeast, namely New York, Connecticut, and Massachusetts.

To ensure that retail consumers derive a benefit from the reduced access charges, the Commission will require the companies serving the Rhode Island IntraLATA market to begin flowing the access charge reductions through to their retail customers within 90 days of the effective date of BA-RI's revised access tariff filing. Carriers retain discretion to select the rates that they will reduce. In addition, carriers will be required to submit reports to the Commission, demonstrating their compliance with the flow-through requirement.

Accordingly, it is

(16240) ORDERED:

1. BA-RI shall eliminate the carrier common line charge element of its intrastate switched access rates, and shall reduce the charges for the remaining access rate elements to yield an average end-to-end access rate of 3.0 cents per minute, to be estimated using an 80/20 direct/tandem ratio.
2. The Commission will revisit the issue of access rates upon the establishment of permanent UNE rates in a later phase of this docket. Basing access rates on final UNE rates will better align the price of access with its true underlying cost.
3. Within 15 days of this Order, BA-RI is ordered to file a tariff with rate reductions consistent with this Order.
4. To ensure that retail consumers derive a benefit from the reduced access charges, the Commission will require the companies serving the Rhode Island IntraLATA market to flow through the access charge reductions to their retail rates beginning within 90 days after BA-RI's tariff filing takes effect. Such companies shall submit a report to the Commission, concerning their compliance with this requirement, within six months after the BA-RI tariff filing takes effect.

EFFECTIVE AT PROVIDENCE, RHODE ISLAND PURSUANT TO AN OPEN
MEETING DECISION ON APRIL 13, 2000. WRITTEN ORDER ISSUED MAY 4, 2000.

PUBLIC UTILITIES COMMISSION

Kate F. Racine, Commissioner

Brenda K. Gaynor, Commissioner