EX PARTE OR LATE FILED

United States Telephone Association

1401 H Street, N.W., Suite 600
Washington, D.C. 20005-2136
(202) 326-7300
(202) 326-7333 FAX

DOCKET FILE COPY ORIGINAL

September 26, 1994

RECEIVED
SEP 26 1994
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street NW - Room 222
Washington, DC 20554

Re: Ex Parte Communication
CC Docket No. 94-1

Dear Mr. Caton:

On September 26, 1994, in response to questions posed at previous meetings, the United States Telephone Association (USTA) provided the attached two documents to the following people: Kathleen Wallman and Kathleen Levitz of the Common Carrier Bureau; David Nall, Dan Grosh, Mark Uretsky, Joanne Wall, and Anthony Bush of the Tariff Division; Robert Pepper and Michael Katz of the Office of Plans and Policy; and James Olson of the Competition Division. The documents are entitled "Review of Results of Price Regulation in Selected States" and "Summary of Recently Proposed Price Regulation Plans." The viewpoints expressed are consistent with USTA's written filings in this docket.

The original and a copy of this ex parte communication are being filed in the Office of the Secretary on September 26, 1994. Please include them in the public record of this proceeding.

Respectfully submitted,

Linda Kent

Linda Kent
Associate General Counsel

Attachments

cc: David Nall
Dan Grosh
Mark Uretsky
Kathleen Levitz
Joanne Wall
Anthony Bush
James Olson
Robert Pepper
Michael Katz
Kathleen Wallman

No. of Copies rec'd 0
List ABCDE

ATTACHMENT 2

Review of Results of Price Regulation

in Selected States

and

ATTACHMENT 3

Summary of Recently Proposed Price Regulation Plans

of

Comments of Dr. Robert G. Harris on Behalf of South Central Bell

in

Tennessee Public Service Commission Rulemaking Regarding

Local Exchange Competition

Docket 94-00184

ATTACHMENT 2

Review of Results of Price Regulation in Selected States

Six States have adopted price regulation or rate freezes with no earnings sharing early enough as part of their incentive regulation plans so that positive results can be identified. The states with price regulation or rate freezes and no earnings sharing or other features of rate of return regulation are:

- Kansas: TeleKansas Plan in 1990 for Southwestern Bell in Docket #166. 856-U.
- Michigan: The 1991 Michigan Telecommunications Act replaced an earlier earnings sharing incentive regulation plan in effect since 1989.
- Nebraska: LB835 was passed in 1986 to essentially deregulate local service rates and new service introduction.
- North Dakota: SB2320, enacted in 1989, created price cap indexes for essential services. SB2440, enacted in 1993, expanded SB2320 and set the price cap into law.
- Vermont: The 1989 Vermont Telecommunications Agreement froze local rates for three years and imposed no earnings limitation. The Agreement was renewed in 1991 until 1993 when no further extensions were permitted under current statutes.
- West Virginia: A second-generation incentive regulation plan was adopted in 1991 that continued the rate freeze on basic local rates of an earlier plan and had no earnings limitations.

Each of these plans included various stipulations and compromises to ensure that the state ratepayers and the participating local telephone companies would receive benefits from the proposed incentive schemes. A summary of each regulatory plan and their impact is provided in the following section.

Kansas

The main features of TeleKansas, Southwestern Bell's incentive regulation plan, were:[1]

- The plan froze basic local residential and business rates for the period 1990-1995.
- Local rates could increase for some customers due to the elimination of some party lines and exchange reclassifications.
- Bell customers will save about $21.3 million in each of the first two years of the plan and $22.8 million in the remaining three years for a total of $110 million.
- Bell committed to an investment of $160 million over next five years to modernize telephone facilities and upgrade all customers to one-party service and eliminate all 911 basic service charges.
- The plan changed the way Bell was regulated (it removed the regulatory cap on Bell's earnings).
- Pricing flexibility on certain discretionary products was allowed by shortening the approval process to 20 days from 30 days.

The local press appeared to provide some evidence that the effects of TeleKansas have been very positive for both Southwestern Bell and telephone customers. While maintaining the price freeze on local service, the company went ahead with additional infrastructure investment and introduced new services made possible by increased regulatory flexibility:

> "As Southwestern Bell Telephone Co. enters its second year under a plan that has closed the door on traditional rate-of-return regulation...the company is reaping the rewards with increased sales and rural customers are profiting with a more modernized telephone network...The company was able to attain a 20 percent sales increase in Kansas in the fiscal year ending Dec. 31st."[2]

---

[1] Summarized from "State Modifies Bell Plan to Save Customers $110 million" by United Press International, 2/2/90.

[2] Lee Ann Groene "Southwestern Bell Sales Increase as TeleKansas Finishes First Year" in Wichita Business Journal, 2/1/91.

Conversion to digital switching was significant:

> "As the first step of the TeleKansas plan in Kansas ...the company in 1990 replaced mechanical switches with digital switches in 24 of the states 131 central offices. Another 36 central offices will be equipped with the technology this year. Those installations, while providing rural customers with services previously unavailable, have also played a key role in boosting Southwestern Bell's sales..."[3]

To be able to financially support the new infrastructure, Southwestern Bell introduced large numbers of new services and revamped its marketing strategy:

> "With the recent approval by state utility regulators of a network modernization plan for the state's rural customers, Southwestern Bell's Telephone Co. is facing another major hurdle: how to gain a full return on the company's $160 million investment. Already, the wheels are turning among those in the company's marketing and pricing departments, trying to devise unique ways to attract new customers with pricing structures that will not turn away prospective or existing customers."[4]

The new plan resulted in large numbers of new products:

> "Sales also were stimulated by the introduction of dozens of new products in 1990, ranging from voice-mail services for both business and residential customers to a personalized ring service, which offers customers the ability to distinguish their calls by a personalized ring for different individuals."[5]

In summary, TeleKansas resulted in increased infrastructure investment, more new services to justify financially those investments, and rate stability to local service

---

[3] Lee Ann Groene "Southwestern Bell Sales Increase as TeleKansas Finishes First Year" in Wichita Business Journal, 2/1/91.

[4] Lee Ann Groene, "TeleKansas Investment to Spark Telemarketing Blitz" in Wichita Business Journal, 1/22/90

[5] Lee Ann Groene, "Southwestern Bell Sales Increase as TeleKansas Finishes First Year" in Wichita Business Journal, 2/1/91.

customers. The telephone company had impressive first year revenue increases while maintaining rate stability and increasing infrastructure investment.

Michigan

Michigan's Telecommunications Act of 1991 essentially replaced rate of return regulation with service-by-service regulation. The main features of the plan were:

- Monthly service rates were frozen for all but the smallest LEC's for two years
- Residential rates were flat-rated up to 400 calls
- Basic local exchange rates may not cross-subsidize other services
- Access rates continue to be regulated and are capped at interstate rates unless approved by the Commission or upon agreement of the parties

A summary of the plan was provided in the local press:

> "Freezes for two years basic local service rates...After the two-year period, Bell can file for a rate increase with the Michigan Public Service Commission. An increase less than the inflation rate will involve little state review. An increase higher than inflation will face more stringent review...Deregulates the long-distance service Michigan Bell provides within area codes. Bell says the intent is to remove the service from cumbersome state regulation and to lower rates. Rates can only go down because the law caps Bell's long-distance charges for homes and businesses."[6]

The new law required the Commission to issue a report on the impact of the new law to the legislature and the governor on Jan. 1, 1994.[7] Despite its opposition to and dissatisfaction with the new law, the Commission recognized some results after

[6] Peter Luke, "Frequent Telephone Users to Pay More" in The Grand Rapids Press 12/5/91.

[7] Public Service Commission 1994 Report to the Legislature and Governor.

passage of the law. One of the results of the plan was that local service rates did not increase despite allowances for carriers to increase them:

> "No provider of basic local exchange service has had a general increase in rates pursuant to the notice process in Sec. 304. No provider of basic local exchange service has attempted to adjust rates for basic local exchange service under the provisions of Sec. 203."[8]

The Commission noted that Michigan Bell introduced 25 new services in basic local exchange services. This is significant in that, just prior to the Act, Michigan Bell offered only 82 local services.[9]

The Commission report also quoted local press reports and its own research on declines in toll services by Michigan Bell:

> "Prices for the PEC's (Michigan Bell and GTE-North) toll services have moved primarily downward. The decline in toll rates for Michigan Bell seems greater than for GTE-North."[10]

> "The National Utility Service determined Michigan Bell's intra-LATA toll rates "between 1991 and 1992 fell 4.6%" and "fell (between) April, 1992 (and) April, 1993 ... 8.1%. The 8.1% decrease placed the Michigan Bell rates well below the national average."[11]

Furthermore, in its overall assessment of the regulation, the Commission found that market forces were able to present workable alternatives to regulation in some competitive segments of the market.[12]

---

[8] Public Service Commission 1994 Report to the Legislature and Governor p. 38-39.

[9] Public Service Commission 1994 Report to the Legislature and Governor p. 5.

[10] Public Service Commission 1994 Report to the Legislature and Governor p. 25.

[11] Detroit Free Press report on June 15, 1993 quoted in Public Service Commission 1994 Report to the Legislature and Governor p. 25.

[12] Public Service Commission 1994 Report to the Legislature and Governor p. 69.

The Commission recognized that competition as encouraged by the Act would also encourage investment in new technology:

> "To the extent that Act 179 fosters or encourages a truly competitive telecommunications marketplace, it too will foster or encourage the deployment of state of the art technology."[13]

Finally, despite its criticisms of various segments of the plan and its perceived lack of clear evidence, the Commission found that overall, the plan provided a workable regulatory framework:

> "The Commission believes Act 179 presents a workable regulatory framework that permits the forces in competitive markets to replace regulation. The law also provides protection for captive customers of monopolistic basic services. The Commission recommends deletion of the January 1, 1996 sunset."[14]

In summary, the deregulation law was passed too recently to draw many convincing results. No basic service rate increases have occurred and Michigan Bell has substantially reduced its toll service charges and intra-LATA toll rates.

Nebraska

LB 835 deregulated all telecommunication company rates with one exception: basic local exchange service. Tariffs introducing new services or altering rates for existing services can be implemented 10 days after they are filed at the Commission. Basic local exchange service rates are not subject to traditional rate of return regulation. Basic local exchange rates are covered under various provisions of the Law: (1) The telephone companies must give their customers 120 days notice and hold a public

---

[13] Public Service Commission 1994 Report to the Legislature and Governor p. 51-52.

[14] Public Service Commission 1994 Report to the Legislature and Governor p. 70.

informational meeting in each commission district before they can change their rates; (2) Consumers can authorize the Public Service Commission to review a rate increase if enough of the subscribers affected by a rate increase sign a petition; (3) The PSC can review basic local exchange service by its own motion if rates go up by more than 10% in a year.[15]

The apparent lack of regulation over rates does not mean that the PSC does not oversee the industry:

> "The Nebraska PSC still plays an active role in monitoring industry developments and quality of service matters. It is authorized to investigate and monitor the technical quality of the state's public telecommunications facilities."[16]

LB 835 shifted the regulatory emphasis from rates and prices to quality of service and technology deployment:

> "The role of the Public Service Commission has changed as a result of the deregulation of local telephone rates. There is now more emphasis on quality of service regulation, which was enhanced by LB 835. The Commission mediated several hundred disputes last year between telephone companies and consumers. Also, an aggressive program has been implemented testing central telephone offices around the state, leading to technical upgrades in the industry and better service for the consumer."[17]

Contrary to claims that telephone rates would double in five years, US West's basic service rates did not increase between 1987 and 1991.

---

[15] This description was drawn from Mueller, Milton L. Telephone Companies in Paradise: A Case Study in Telecommunications Regulation, New Brunswick, NJ: Transaction Publishers, 1993. For more detail on the legislation, refer to this source.

[16] Mueller, Milton L. Telephone Companies in Paradise, p.33

[17] James Munnelly (member of Nebraska Public Service Commission), "Commission Regulates Telephone Quality, not Rates" in Omaha World Herald 7/27/93.

> "US West's basic service rates have not changed at all since LB 835 went into effect. An unofficial rate freeze has been maintained since January 1987. This is true for all rate groups and for both residential and business lines..."[18]

Opponents of LB835 have tried to portray constant rates as excessive and contrary to a downward trend in the national average of basic local service rates. They base this on FCC statistics showing a $3.174 billion decline in net decreases in state rate cases since 1987.[19] A comparison of Nebraska's business and residential rates with its neighbors, however, suggests that Nebraska's rates are not discernibly higher or lower than its neighbors or that they have missed any "downward trend":

> "In 1991 US West-Nebraska's B1 rate for large exchanges was $37.55 (including Touch Tone)...If B1 rates for the other four states are combined into an average weighted by the number of access lines, then Nebraska's rate is $0.41 lower than the average of the other four states. Thus there is no indication that B1 rate levels in Nebraska have been pushed to abnormal heights by deregulation..."[20]

The same pattern holds for residential rates:

> "The pattern of change since 1986 is very similar to the pattern for business rates. Minnesota and Iowa, which had significantly higher rates in large exchanges than Nebraska, have implemented 4-5% decreases. Colorado, with much lower rates, has moved steadily upward, increasing basic local service rates by 49% over 1986 levels...There is no evidence that Nebraska has missed out on a general downward trend."[21]

In fact, the regional trend has been one of convergence of local rates for various states.

> "The pattern revealed by these statistics is one of convergence toward a mean: states with rates that are higher than Nebraska (Minnesota and Iowa) made

---

[18] Mueller, Milton L. Telephone Companies in Paradise, p.56.

[19] See page 62 of Telephone Companies in Paradise for more detail.

[20] Mueller, Milton L. Telephone Companies in Paradise, p.63.

[21] Mueller, Milton L. Telephone Companies in Paradise, p.66.

> reductions that brought them closer to Nebraska. The one state with rates significantly lower than all others (Colorado) raised them substantially."[22]

In service innovation, LB 835 gave Nebraska an advantage over other states. LB 835 allowed carriers to introduce and test new services virtually at will.

> "We found that LB835 has been successful at encouraging new service introductions by US West in Nebraska. The absence of regulatory review gives the state a clear comparative advantage over other states as a site for introducing and testing new services."[23]

This had a small but measurable effect on investment:

> "As noted before, Nebraska received new and experimental services more rapidly and more frequently than other US West states, despite its small market size. Rate deregulation at the state level appears to have provided a moderate stimulus to investment and service innovation by removing regulatory constraints on capital recovery."[24]

The effect of deregulation and increased investment is gradually having an impact on Nebraska's technological lead over other neighboring states.

> "...US West's positive results in Nebraska represented a genuine response to opportunities created by detariffing. The differential between Nebraska and other states appears to be increasing rather than decreasing as time passes."[25]

Much of the increased investment and service introduction occurred despite a negative impact on US West earnings. Deregulation did not result in excessive earnings for the largest telephone carrier in Nebraska:

---

[22] Mueller, Milton L. Telephone Companies in Paradise, p.63-64.

[23] Mueller, Milton L. Telephone Companies in Paradise, p.119.

[24] Mueller, Milton L. Telephone Companies in Paradise, p.138.

[25] Mueller, Milton L. Telephone Companies in Paradise, p.147.

> "US West's rates of return have been consistently low and dropped steadily for the first three years [after deregulation]. The Lincoln Telephone Company has done better, but its profit levels have remained fairly stable, and not outside the norm for regulated companies. The state's small independent, privately owned companies, on the other hand, have seen their profits soar."[26]

This discrepancy in rates of return between the largest carriers and the smaller independents did not go unnoticed in the local press and even by opponents of the original legislation:

> "The financial figures suggest that US West, the state's largest provider of local telephone service, has not abused the rate-setting freedom that the Legislature passed in 1986 as Legislative Bill 835."[27]

In summary, LB835 did not completely deregulate local telephone service. Instead it replaced control over rates and earnings with monitoring of service quality and technology improvements. Contrary to the assertions of various opponents, local rates did not rise after LB835 was enacted; Nebraska rates have remained close to those of neighboring states; the law had a positive impact on new service introduction and network investment; and, finally, rates of return for the dominant carrier, US West, were in fact well below what they might have been under traditional regulation.

North Dakota

Some key features of SB2320 and SB2440 governing incentive regulation were:

- SB2320 classified services as essential and non-essential.
- Rates for essential services were set by the PSC's price factor formula (basically a price cap index).

---

[26] Mueller, Milton L. Telephone Companies in Paradise, p.152.

[27] State Senator David Landis of Lincoln quoted in "Landis Seeking to Re-regulate Phone Service" in Omaha World-Herald 12/29/93.

- Rates for non-essential services are not regulated.
- SB2440 increased the number of non-essential services and reduced the number of essential services; it also set the price cap in the law.
- Essential service rates have been allowed to increase slightly by the price cap index: the price cap for US West was increased by 1.665% in 1992 and by .488% for 1993; for 1994 the increase will be .6%.

SB 2440 was introduced to clarify and set into the law the list of essential services to be governed by the price cap index and to set the price cap index and its productivity adjustment into the law. Public support for the passage of the law appeared to be broad-based as evidenced by the margin of passage in both chambers of the North Dakota Legislature. SB 2440 passed with 46 votes in favor and one against (2 absent) in the Senate and with 98 votes in favor and zero against in the House.[28]

There exists some evidence that the price regulation law may have aided the relocation of industries into the state:

> "There are examples of telecommunications service industries locating a portion of their operations in North Dakota..."[29]

Some new capabilities appear to have been made available for specialized applications:

> "...There is a substantial increase in the number of long-distance educational consortiums organized by the schools."[30]

---

[28] Senate Bill No. 2440, page 12, North Dakota Legislative Assembly.

[29] David Crothers "How Deregulation Has Affected North Dakota Telecommunications - A Look at the Past Two Years" in Rural Telecommunications 11(1) Jan./Feb., 1992, p.43-45.

[30] David Crothers "How Deregulation Has Affected North Dakota Telecommunications - A Look at the Past Two Years" in Rural Telecommunications 11(1) Jan./Feb., 1992, p.43-45.

In summary, evidence of positive effects of price regulation in North Dakota is limited. However, rate increases for essential services appear to have been limited as well. Furthermore, there seems to be broad public support for continuing and expanding the price cap plan as evidenced by the broad margin of passage of SB2440.

Vermont

The Vermont Public Service Board approved the Vermont Telecommunications Agreement (VTA) on Dec. 30, 1988. It was originally to run for three years but was later extended for an additional two years. After a second agreement was withdrawn in 1992, the 1987 social contract could only be extended through 1993 due to statutory limitations. The main provisions of the VTA:

- Eliminated rate of return regulation for New England Telephone.
- Provided NET with substantial freedom to offer "new services" with rates, terms and conditions of its own choosing.
- Stabilized local service rates for three years (extended since then, but provided for rate increases when the agreement was extended).
- Committed over $280 million for network modernization (completed by the end of 1992).
- Maintained quality of service in accordance with specific criteria.

The Vermont Press viewed the plan favorably:

> "In 1987, the Vermont Public Service Board signed a landmark agreement with New England Telephone that radically altered the way the company was regulated.
> The result has been dramatic: Stable telephone rates; a proliferation of new services; and the most sophisticated telecommunications network in the country.

More than 80 percent of the state is served by digital switching and fiber optic trunk lines, and the figure is rising."[31]

"Under the Vermont Telecommunications Agreement, New England Telephone agreed not to raise the price of local telephone service and to accelerate its capital improvement program. In return, the state abolished regulation of competitive services and left the company free to earn any rate of return it could."[32]

The agreement appears to have had generally positive results as summarized by Richard Andrews of Vermont Business Magazine:[33]

- Local telephone rates in NET's territory have been stable since 1985. Ninety-five percent of all Vermont Residents have phones, the fourth-highest rate in the country.
- NET invested $280 million in five years to upgrade its system. The money would have been spent eventually even without the agreement, but more slowly. The new equipment means development officials can assure potential corporate newcomers that they won't be isolated in Vermont.
- Nineteen new services have been introduced in Vermont, more than in any other state serviced by NET.
- The state has spent less time and money regulating NET
- Regulatory rules have not changed during the agreement, allowing NET, its customers and its competitors to plan with more certainty. Less regulation means NET and its competitors can focus more on their businesses and customers and less on regulators.

NET profits did not increase during the VTA:

[31] Richard Andrews in "Telecommunications Agreement Scrutinized" in Vermont Business Magazine 3/1/91.

[32] Richard Andrews in "Telecommunications Agreement Scrutinized" in Vermont Business Magazine 3/1/91.

[33] Richard Andrews in "Telecommunications Agreement Scrutinized" in Vermont Business Magazine 3/1/91.

"The agreement hasn't been all beer and skittles from NET's point of view either. The freedom to innovate has, so far at least, created more costs than profits, and NET's rate of return has slipped several points."[34]

"NET says it lost money on VTA-1. According to company spokesman Fred Reidy, the agreement was intended to give the company an opportunity to earn a 13-percent rate of return, and it had managed only 7-percent when VTA-1 was extended. Reidy said NET calculated the annual revenue shortfall at $15 million, and the Department of Public Service acknowledged it was $10 million. Reidy pointed out that NET has had no rate increases for six years."[35]

Infrastructure modernization during the VTA was significant:

"The first VTA guaranteed NET certain rates of return in exchange for upgrading the telecommunications system of the state. At that time, according to the experts, Vermont's phone system was a backwater of antique switching stations, party lines, and rural neglect. We were not up to speed with the rest of the country, they said...Both sides agree the first VTA was a very good pact that kept phone charges predictable and allowed for the building of an advanced phone network. NET for its part was allowed to freely market many phone services and see predictable rates of return."[36]

Modernization has increased the number of services offered and made them widely available:

"With the current technology, New England Telephone offers services that can make life easier for telecommuters and for the companies who employ them...One of the newest services is ISDN (Integrated Services Digital Network) which allows two functions to occur on one telephone line. LL. Bean has already taken advantage of the ISDN technology by directing catalog sales calls to operator's homes who then talk to the customer and place the order by computer

---

[34] Richard Andrews in "Telecommunications Agreement Scrutinized" in Vermont Business Magazine 3/1/91.

[35] Richard Andrews in "Back to Square One for VTA: Proponents and Opponents of Telecommunications Agreement Face Off" in Vermont Business Magazine 10/1/92.

[36] Art Edelstein, "Changes Due on Telecommunications Pact" in Vermont Business Magazine p.27 10/1/91.

> on the same telephone line. McDougall said the state is looking into the ISDN services for Vermont-based catalog sales merchants."[37]

In summary, the VTA did not allow New England Telephone to earn excessive profits. On the contrary, the expense of modernization and launching new products resulted in lower than expected earnings for NET. Basic local rates have not increased throughout the life of the agreement and the telephone network has been modernized significantly.

West Virginia

Some key features of the incentive regulation plan for C&P:

- Effective January 1, 1992, an incentive regulation plan was approved, effective until the end of 1994.
- The plan retained the previous plan's service classification (competitive or discretionary, non-competitive, and intrastate access services) of an earlier incentive regulation plan and added one more category: services subject to "workable competition"
- Basic service rates were frozen during the plan.
- Under the incentive plan, C&P agreed to accelerate infrastructure investments toward becoming 100% digital by the end of the plan (it was on target to achieve this goal one year earlier, by the end of 1993).

The incentive regulation plan appears to have had a significant impact on the financial health of the telephone company while maintaining rate stability of basic local services. In explaining the ratings increase of C&P West Virginia debentures, Duff & Phelps discussed the following:

> "Duff & Phelps expects maintenance of strong credit quality under the incentive regulation framework adopted by the West Virginia Public Service Commission in

---

[37] Amy Jenness in "Short Commute: Telecommuting Grows as an Alternative to the Office" in Vermont Business Magazine 7/1/91 [Frank McDougall is secretary of the Agency of Community and Development Affairs for the State of Vermont].

> December 1991... Although the new regulatory plan freezes basic rates through 1994, it removes earnings constraints on competitive services... CP-WV's improved financial performance can be traced to stronger economic activity in its service territory, improved regulation, revenue growth from new services, and the company's commitment to expense control... CP WV's expense control has been driven by its modern network. At the end of 1993, the company expects to have 100 percent penetration of digital switches [one year ahead of schedule], signaling system seven capabilities, and Custom Local Area Signaling Services (CLASS) capabilities.[38]"

West Virginia's improved telecommunications infrastructure has also attracted telecommunications-intensive firms:

> "United Reader Service Inc. announced last month that it will provide telephone contact services for a variety of clients...The company was first attracted to the state through the Office of the Future Project, a joint effort of the state of West Virginia and the C&P Telephone Co... For a year [the office has] had a national advertising campaign to increase awareness of West Virginia as a business location for telecommunications-intensive work operations.
> [United Reader Service's] decision to locate in Wheeling was based on the existence of advanced telecommunications, the availability of a qualified workforce, and local training incentives.[39]"

In summary, West Virginia's incentive regulation plan appears to have effectively maintained local service rate stability and provided incentives for C&P West Virginia to rapidly upgrade its network capabilities. Through its Office for the Future program, the state, in partnership with the local telephone company seems to be successfully marketing those advanced capabilities for outside investors to relocate to the state.

---

[38] "Duff & Phelps Credit Rating Co. Upgrades the Chesapeake and Potomac Telephone Company of West Virginia" in PR NewsWire, 9/30/93.

[39] Eric Peters "Telemarketer Opens Bureau in Wheeling, The State Journal 12/1/91.

ATTACHMENT 3

Summary of Recently Proposed Price Regulation Plans

Delaware

Status:

- Legislation enacted July, 1993 allowing LECs to elect or opt in to an alternative regulation framework.
- Election must be accompanied by a Plan for Technological Investment and Deployment.
- Infrastructure commitment of $250 million must be provided by any utility electing into the plan.

Rate Adjustments/Current Rates:

- No rate adjustments specifically required by legislation.
- Separate rate proceeding determined appropriate level of rates

Price Index:

- Formula:
  Change in Inflation -3.0%
- Cap covers basic services.
- Commission can adjust rate structure for submitted price changes
- Provider or ratepayers may request exogenous change adjustments

Rate Freeze:

- Discretionary services rates may not be increased for one year.
- Rates for basic services can only be changed once a year subject to Commission approval.

Service Classification:

- Legislation divided services into three categories: basic, discretionary and competitive.
- Basic Services include, among others: residence, business, public and semi-public dial tone line and local usage services; switched access, Centrex access component, White Page listing; Touch Tone; and ISDN Basic and Primary rate interface.
- Discretionary are those services neither competitive nor basic.
- No discretionary services rates may be increased more than 15% in any year.
- Competitive services are those services generally available within a relevant geographic area from at least one unaffiliated provider which is present and viable; and there are no significant barriers to entry.
- Competitive services include directory advertising, 800 service, WATS, billing and collection services, Centrex Intercom and features, Inside Wire, Answer Call and Voice Mail, High Cap Special (1.544 Mb) and others.

Service Quality:

- No specific additional service quality requirements were included in the legislation.

Earnings Sharing with Ratepayers:

- No earnings sharing required by legislation.

Competitive Safeguards

- No cross subsidy allowed from regulated services to competitive services
- Commission required to conduct proceeding to determine if cost allocation is required to assure no cross-subsidy.
- Competitive price must be above LRIC.
- Competitive service prices must include rates for basic and discretionary components plus LRIC
- Basic and Discretionary components must be made available to other providers at same rates and terms issued by provider.
- All discretionary services and all competitive services, except Directory Advertising, must be available for resale.

Depreciation

- Depreciation was left to the company's discretion.

Indiana

Status:

- Indiana Commission issued Order on June 30, 1994, approving Settlement Agreement between all parties and Ameritech Indiana.
- Most provisions of the Alternative Regulation Plan are contained in Settlement Agreement.

Rate Adjustments/Current Rates:

- As part of the Settlement Agreement, Ameritech Indiana agreed to the several rate reductions and adjustments to its rate structure:
  - Reduction of $2.21 in the monthly local charge for access to the long distance network (phased in three steps)
  - Elimination of touchtone charges for residence and business customers.
  - Increase in call allowance for residential message rate service from 30 to 45 calls monthly
- Current Rates for local service disaggregate between three types of exchanges with class 3 exchanges being most urban and class 1 being most rural.
- About 20% of households and 11% of businesses pay additional charges because they are outside the base rate area (these charges are either $2.55/month or $5.05/month)
- Additional End-User Line charges are: $2.21 intrastate charges and $3.50 in FCC mandated interstate line charges.
- The state line charges are being phased out as part of the Settlement Agreement for the Opportunity Indiana Plan.

Price Index:

- Settlement Agreement does not use an explicit price index.
- Service prices for various baskets, are capped and cannot increase, but may be decreased, during the duration of the Agreement (which runs until December 31st., 1997).
- In general, price decreases are allowed on 24 hour notice to customers and determination that price will remain above LRSIC + 1%.
- Other Services may be increased or decreased by Ameritech Indiana at any time.

Rate Freeze:

- Rates for Basic Local Service and Basic Local Service-Related services are not allowed to increase during the duration of the Agreement with some exceptions but may be decreased.
- IntraLATA toll Basic Schedule for Residence Toll Service, Public Telephone Service and Carrier Access Services may be decreased

subject to the above requirements; also, no additional charges may be imposed that "increase the average revenue per minute of use of such service above 1993 calendar pro forma," unless 1+ presubscription is allowed in an exchange in which case rates could be increased or decreased

<u>Service Classification:</u>

- Settlement Agreement divided services into Basic Local Service , Basic-Local-Service-Related Services and Other Services.
- BLS was defined as voice-grade access to the network plus usage within the traditional local calling area.
- BLS-related services include touchtone, basic custom calling features such as call waiting, three-way calling, and call forwarding among others, and directory assistance
- Other services included every other service offered by Ameritech Indiana such as WATS, 800, Operator Services and Directory Services.

<u>Service Quality:</u>

- No change in reporting requirements for service quality by Ameritech Indiana
- No explicit linkage to rate freeze or adjustment to caps.

<u>Earnings Sharing with Ratepayers:</u>

- No sharing of earnings required in Settlement Agreement.

<u>Competitive Safeguards</u>

- Interim Imputation Agreement included in Settlement Agreement
- Separate imputation proceeding is in progress to determine:
  - Level of service aggregation for imputation test
  - Reporting requirements for non-Ameritech Indiana carriers
  - Inclusion of various type of traffic in calculating price floors

<u>Depreciation</u>

- The Commission explicitly rejected regulation of depreciation rates.

Illinois

Status:

- Hearing Examiner Proposed Order on May, 3, 1994.
- Commission approval is pending.

Rate Adjustments/Current Rates:

- No rate adjustments were required.
- Most exchanges have measured rate charges by minutes of use.
- Prices vary depending on geographical location.
- There is also a high volume usage discount which ranges from 11.50%-50% for usage rates over $52.00, and $832.00, respectively for business customers; and 3.8%-32.7% on usage rates over $2.60, and $104.00, respectively for residential customers.
- Current rates for residential and business customers are deaveraged between Chicago and rest of state.
- Local rates deaveraged according to distance called through bands A-D.

Price Index:

- Formula
  Change in GDPPI -3.8%
- All revenues are included in the calculation of the price cap index.
- Weighted change for a service basket may not exceed change in price cap index.
- However, individual elements within a basket may not experience a price increase of greater than 5% per year above the price cap index.

Rate Freeze:

- Rate freeze on basic residential services for 5 years.

Service Classification:

- Plan divides services into four baskets.
- Residence includes residence network access lines, Band A - D usage, touch-tone, Starline, Multi-ring, custom calling, advanced custom calling, and non-recurring charges.
- Business includes business network access lines, Band A-D usage, touch-tone, ISDN, custom calling, advanced custom calling, ACBS, remote call forwarding, WATS, and non-recurring charges.
- Carrier includes switched access, special access, cellular access and LIDB.
- Other services include directory services, Chicago name and address, payphone, directory assistance, private line, and operator services

Service Quality:

- Require company to file quarterly report
- No direct effect on price cap index.

Earnings Sharing with Rate Payers:

- No earnings sharing required.

Competitive Safeguards

- Imputation tests are required by statute from telecommunications carriers that provide both competitive and noncompetitive services
- Services requiring imputation include usage sensitive services, message toll services, non-payphone operator services, 800 services and others.
- Determination of whether certain other services require imputation tests are being considered separately
- Statutory requirements on competitive services revenues requires them to cover in the aggregate or as a group their LRSICs, imputed costs and allocated common overhead expenses and residual revenue requirement

Depreciation

- Hearing Examiner explicitly rejected regulation of depreciation rates.

Pennsylvania

Status:

- Commission Order adopted June 23, 1994.
- In approving Order, Commission explicitly rejected Administrative Law Judge's conclusions:
  - that Bell of Pennsylvania's rates were unjust and unreasonable
  - that earnings sharing should be included in the alternative regulation plan.

Rate Adjustments/Current Rates:

- Commission Order based its conclusion that Bell of Pennsylvania's rates were reasonable on a report by NARUC stating that Bell of PA "offers third lowest residence exchange rates and second lowest business exchange rates of the former Bell Operating Companies."
- Commission explicitly rejected Administrative Law Judge's finding that Bell of PA's rates were too high.
- Commission determined that Bell of PA's current rates did not need any adjustments before instituting the Plan.
- Current rates disaggregate exchanges from highest density central office (Class 1) to lowest density (Class 4).

Price Index:

- Formula
  Change in GDPPI - 2.93%
- Bell of PA is allowed to file tariff changes to comply with the Price Stability Mechanism.
- Commission can review price changes to determine if they comply with the PSM.
- Commission restricted revenue neutral changes to within a market basket to protect more inelastic services from significant price increases.
- However, Bell of PA can petition Commission to include several baskets to achieve revenue neutral price changes.
- Competitive services rates are unregulated.

Rate Freeze:

- Protected services rates (such as residential and business local exchange and special access) are frozen until December 31, 1999.
- Price Stability Mechanism comes into effect after freeze.