COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

SOUTH CENTRAL BELL'S PROPOSED EXPERIMENTAL LOCAL MEASURED SERVICE TARIFFS) CASE NO. 9571

O R D E R

INTRODUCTION

On January 18, 1984, the Kentucky Public Service Commission in its Order in Case No. 8847[1] placed a moratorium on further expansion of South Central Bell Telephone Company's ("SCB's") optional local measured service ("LMS") tariff[2] in Kentucky. In that case, SCB alleged that optional LMS promoted economic efficiency, equitable rates, universal service and provided the consumer the opportunity to control his telephone costs. However, in reviewing SCB's optional LMS the Commission found that SCB had failed to document the incremental cost of LMS, forecast demand and construction expenditures under LMS pricing, prepare studies to demonstrate that LMS rates track costs, and develop costs/benefit studies of LMS. The Commission found that SCB's pricing strategy for optional LMS would lead to virtually all customers

1 Notice of South Central Bell Telephone Company of an Adjustment in Its Intrastate Rates and Charges.

2 Local Measured Service is a method of pricing local telephone service based on the time of day, number, distance and duration of calls.

eventually subscribing to LMS without an express Commission policy decision that the LMS rate structure was proper. Because of the lack of information and analysis of LMS the Commission indicated its intention to concentrate on the LMS pricing concept in a more general forum.

On November 15, 1984, the Commission established Administrative Case No. 285.[3] The purposes of Administrative Case No. 285 were to develop the information and analyses required for proper evaluation of LMS and to assist the Commission in the development of a statewide policy on the pricing of telephone service on a usage sensitive basis. Because of SCB's and General Telephone Company's continuing interest the Commission required these telephone utilities to prepare research proposals providing their research objectives, scope and methodologies to be used in the experiment. In addition, the Commission set forth the information and data requirements of the experiment in Appendix A of the Order initiating the inquiry. The information included such unique data as cost of traffic-sensitive plant, price elasticity estimates for on-peak usage and usage by demographic subset. Finally, to oversee the experiment and to provide consumer advice and comment the Commission established an LMS Oversight Committee[4] which was to meet periodically, receive reports on the experiment

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3 An Investigation into the Economic Feasibility of Providing Local Measured Service Telephone Rates in Kentucky.

4 See Appendix A for Membership List.

and provide feedback on the proposals. The LMS Oversight Committee has met quarterly and minutes have been maintained.

On May 1, 1986, SCB provided Notice to the PSC of its intent to change rates in the Bowling Green wire center. On May 9, 1986, SCB filed its proposed tariff changes with the PSC. SCB proposed to implement a mandatory local measured service trial in Bowling Green for the period beginning July 1, 1986, and running through December 31, 1986. In addition to its proposal for Bowling Green, SCB requested that the PSC lift its moratorium on optional LMS in exchanges with the 63 prefix in Louisville for the same period of time.

On May 21, 1986, the Commission held a public hearing for purposes of cross-examining witnesses of SCB on the proposed mandatory LMS trial in Bowling Green. The hearing was held as scheduled and all information requested at the hearing has been provided. Subsequent to the hearing, the Attorney General's Office and Harold Telephone Company requested and were granted intervenor status.

LMS Rate Experiment

Disagreement with the proposed universal LMS rate experiment has been expressed by residential and business consumers at both the rate hearing and at a public meeting held in Bowling Green on June 17, 1986.[5] The concerns centered around five fundamental issues. First, residential consumers are concerned with the

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5 Representatives of SCB and the Staff of the Commission were present to receive comments from the public.

method used to select Bowling Green as the site for the mandatory LMS trial. Second, consumers are concerned that Bowling Green residents were not given the option of selecting LMS but instead were placed involuntarily on LMS. Third, residential consumers expressed the belief that the implementation of mandatory measured service will result in a revenue windfall for SCB and adversely affect the Bowling Green area. Fourth, residential consumers were concerned that the LMS trial would be made permanent at the end of a 6-month period. Finally, Bowling Green consumers were concerned that the Bowling Green wire center would be responsible for any additional expenses associated with the LMS experiment.

The Commission wishes to emphasize that it has made every effort to minimize the impact on individual ratepayers of this 6-month experiment. According to SCB's studies of current usage patterns, 70 percent of Bowling Green ratepayers will experience a reduction in their bills for local telephone service during this period. Those ratepayers whose current usage would indicate higher bills under LMS will have the opportunity to keep these increases to an absolute minimum by limiting the number and length of their telephone calls. In any event, the rates will be capped so that no residential customer will pay more than $21.50 per month and no business customer will pay more than $56.60 per month, no matter how many calls are made.

In Administrative Case No. 285 the Commission required both General Telephone Company and SCB to state the criteria used in their selection of LMS study exchanges. SCB analyzed two wire centers, Bowling Green and Louisville Third Street, as possible candidates. In selecting the experiment or trial site SCB stated that it used three-part selection criteria. First, the technology necessary to measure local telephone usage had to be installed in the central office. Second, the site does not currently have and has not previously offered optional LMS so that the information gathered would be unbiased. Finally, the demographic characteristics of the proposed site must be comparable with statewide demographic characteristics. Since both sites met the first two requirements, SCB contracted with the Urban Studies Center at the University of Louisville to compare the demographics of the two sites with the state. The result of the study demonstrated that the Bowling Green site did provide a better demographic match with the state than the Louisville site. SCB proposed that the Bowling Green wire center serve as its study area for mandatory LMS.

A major concern of the Commission has been to obtain study results that will be useful in determining a statewide LMS policy. It is the opinion of the Commission that the Bowling Green data will because of its demographic characteristics provide information that can be applied to the state as a whole.

Since the public hearing on May 21, 1986, the Commission has spent a considerable amount of time reviewing Administrative Case No. 285 and the information requirements necessary to evaluate LMS in Kentucky. The information and analysis developed in the experiment will be Kentucky-specific and is not available from other sources. SCB contends that the LMS rate structure is more equitable, will lead to more efficient use of the telephone plant, and will contribute to universal service. The rapidly changing structure of the telephone industry makes it incumbent upon the Commission to consider all pricing options in meeting the future telephone needs of Kentucky consumers. Telephone and telecommunications services are becoming more and more essential to economic development as Kentucky and the nation move into the information age. Establishing the proper pricing for these services is vital to ensuring that Kentucky prospers in this new era. Only through gathering information from the Bowling Green study can a proper evaluation of LMS be made for Kentucky. The Commission is of the opinion that the LMS trial is necessary for its evaluation of LMS and that it should be undertaken.

Some Bowling Green residents are concerned that the trial period for universal LMS will be made permanent without further proceedings. The Commission wishes to make absolutely clear that we have no predisposition toward the LMS rate structure. If the Commission had considered that LMS was an appropriate rate structure, we would not have placed a moratorium on further expansion of optional LMS. Instead we would have encouraged it. The Commission stresses that although it endorses this experiment, after the trial period in Bowling Green the data gathered will have to be analyzed, evaluated, and additional hearings held on the costs and benefits of LMS.

Several customers voiced concern that they would not receive call detail on their LMS usage during the trial period and thus, could not verify their local telephone bill. At present, SCB cannot provide an itemized statement of local calls. The Commission shares these customers' concerns, however, and will require

SCB to adopt a written policy on how it will address disputed LMS bills during this trial.

Finally, there is concern that the Bowling Green area will be responsible for any additional expenses associated with the LMS trial. To alleviate this concern, the Commission will require SCB to separately account for those incremental expenses associated with the LMS trial. Furthermore, the Commission finds that these expenses should not be recovered from Kentucky ratepayers, but instead should be borne by SCB's stockholders.

Rate Structure

In proposing its universal LMS tariff for Bowling Green, SCB has attempted to develop a rate structure that will generate essentially the same level of revenue during the period of the experiment as would have been generated under flat rates. The usage rates included in the proposed tariff were priced at or above their incremental costs.[6] After analyzing the usage characteristic developed in the September 1985 through December 1985 traffic study, SCB determined the revenue that would be collected through the proposed usage rates. The residential and business access rates were then set residually given a revenue-neutral objective. Finally, SCB proposed capping LMS rates at $21.50 for monthly residential service and $56.60 for monthly business service during the period of the trial.

The Commission in reviewing the proposed rate structure has been concerned with two areas. First, to the maximum extent

6 Incremental Cost Study provided in Adm. Case No. 285.

possible, the usage rates should be equal to or exceed the incremental cost of the service in order to encourage efficient use of the telephone plant. Secondly, the Commission has sought to make the overall revenue impact on Bowling Green from the LMS trial revenue-neutral. To ensure that the revenue impact is neutral the Commission will, at the conclusion of the trial, require SCB to refund all revenue collected which exceeds the revenue it would have otherwise collected with flat rates. The excess revenue should be refunded to the rate class that generated it. Any refunds should be provided as credits on telephone bills in the second month following the completion of the trial period. With these safeguards the Commission is convinced that the proposed rate structure now addresses both of the above-stated criteria. We will, therefore, adopt the tariffs as proposed by SCB.

At the hearing on May 21, Paul Warnecke, Director, Division of Telecommunications, Department for Facilities Management, Commonwealth of Kentucky, requested the Commission exclude Western Kentucky University ("WKU") from the universal LMS trial. As the basis for this request, Mr. Warnecke filed a letter from Robert Wiltshire, Superintendent, Electronics, Utilities and Communication at WKU, which indicated that WKU would be unable to provide proper price signals to faculty and students without substantial changes in their billing methods. The letter also indicated if the proper price signals were to be provided it would require a substantial investment by WKU. Mr. Wiltshire stated that without this investment the LMS trial would result in a cost increase of approximately $10,000 in WKU's telephone bills for the 6 months of the trial. On June 23, 1986, WKU filed a formal request for exclusion from the LMS trial in a letter from Mr. Wiltshire. No other formal requests for exclusion from the trial were received.

In response to WKU's request SCB has indicated that WKU currently has 95 PBX trunks of which 79 trunks are for student use and the other 16 trunks are for administrative purposes. SCB contends that it has the ability to isolate and measure the usage on the 16 trunks used for administrative purposes while excluding those student trunks upon which proper price signals cannot be provided. Therefore, SCB recommends including only the 16 trunks currently used for administrative purposes in the LMS trial.

In reviewing WKU's request for exclusion from the LMS trial the Commission is concerned with the equity of excluding any user. However, the Commission is also concerned that the data gathered in this trial reflect customer responses to price signals in order that the usage response can be measured. To the extent that WKU is technologically unable to provide proper price signals to its students, the Commission concurs with WKU that student response would be unaffected by usage sensitive pricing. The Commission will therefore exclude WKU from the LMS experiment.

Optional LMS in Louisville

SCB has proposed as a part of its Phase II study that the Commission lift its moratorium on optional LMS in exchanges with the 63 prefix in Louisville. In support of the removal of the moratorium SCB contends that the pre- and post-LMS data collected from these exchanges will produce more reliable and accurate price elasticity estimates. In addition, SCB asserts that valuable demographic and calling data can be derived from removing the moratorium. Further, SCB contends it will provide important information in the evaluation of optional LMS.

The Commission will temporarily remove its moratorium on optional LMS in those Lousiville exchanges where the prefix begins with 63. The Commission will, however, limit the lifting of the moratorium to the period from July 1, 1986, through December 31, 1986. At the end of this 6-month trial all consumers will revert back to the flat rate option. The Commission will require SCB to notify consumers of this option at the time that they select optional LMS in the 63 exchange. Furthermore, the Commission will require SCB to transfer these consumers back to flat rate service without a service charge.

FINDINGS AND ORDERS

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates as proposed for Bowling Green by SCB are fair, just and reasonable.

2. The mandatory LMS trial for Bowling Green should provide important information necessary to the evaluation of LMS in Kentucky.

3. All PBX trunks providing services to WKU should be excluded from the experiment due to the cost of providing proper signals during the experiment.

4. The temporary lifting of the optional LMS moratorium in the Louisville 63 prefix wire center should provide information

necessary for estimating price elasticities and should provide other information for evaluating optional LMS in Kentucky.

5. Customers selecting optional LMS in the Louisville 63 prefix exchange should be transferred back to flat rate service at the end of the optional LMS trial.

6. To the extent that SCB's mandatory LMS tariff generates revenue in excess of the amount that is generated under the flat rate tariff, SCB should refund the excess through a credit on the customer's bill on the second month after the conclusion of the experiment.

7. SCB should track all expenses of the LMS trial for Bowling Green, maintain a full record of any incremental expenses and those expenses should be borne by SCB's stockholders.

8. SCB should adopt a written policy explaining how it will address disputed LMS bills during this trial.

IT IS THEREFORE ORDERED that:

1. SCB's mandatory LMS tariff for the Bowling Green wire center be and it hereby is approved on an experimental basis to remain in effect for the period July 1, 1986, to December 31, 1986.

2. SCB's request to lift the moratorium on optional LMS in the 63 exchange in Louisville be and it hereby is granted for purposes of this experiment and the moratorium shall be resumed on January 1, 1987.

3. SCB shall track all expenses of the LMS trial, maintain a full record of any incremental expenses associated with the LMS trial and those expenses shall not be borne by ratepayers.

4. At the conclusion of the LMS trial, SCB shall refund, by credit to customers' bills, any excess revenue generated from LMS rates that would otherwise not have been charged under flat rate local exchange service.

5. WKU's PBX trunks shall be excluded from the LMS trial.

6. SCB shall notify consumers choosing optional LMS in the 63 exchange in Louisville both orally and confirm this notification in writing at the time they order optional LMS service that on January 1, 1987, the moratorium will again apply and all consumers will revert to flat rates.

7. SCB shall revert all consumers to flat rate service at the conclusion of the LMS trial without service charge.

8. SCB shall adopt a written policy explaining how it will address disputed LMS bills during this trial and shall file this policy with the Commission within 20 days of the date of this Order.

Done at Frankfort, Kentucky, this 30th day of June, 1986.

By the Commission

ATTEST:

Forest M. Skaggs
Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION
IN CASE NO. 9571 DATED 6/30/86

LMS OVERSIGHT COMMITTEE

Mr. Jan Teensma - ALLTEL Kentucky, Inc.

Mr. John D. Hinkle - Kentucky Retail Federation, Inc.

Mr. Ben Doutt - Office of the Attorney General

Mr. R. P. Floyd - Cincinnati Bell Telephone

Mr. Ray Whitener - Utility Ratecutters of Kentucky

Mr. Stewart Wenzel - (Consultant to Utility Ratecutters)

Mr. Fred Gerwing- South Central Bell Telephone Company
Mr. David Kaetz

Mr. Robert H. Mitchell - General Telephone Company of the South
Mr. Robert Albright
Mr. Wayne Nelson

Mr. William Magruder - Duo County Telephone Cooperative

Mr. Bill Clingenpeel - Contel Service Corp.

Mr. W. H. Farmer - Kentucky Telephone Association

Mr. Jeff Zahner - Multi-Com Systems, Inc.

Mr. E. K. Bristow - Special Advisory Commission of Senior Citizens

Mr. Rand E. Kruger - Attorney for Kentucky Hospital Assoc.

Mr. C. Kent Hatfield - Representing MCI Telecommunications, Corp.
Mr. Kendrick R. Riggs

Mr. William H. Fane, III - Coin-Tel, Inc.

Ms. Mary Lynn Collins - Legislative Research Commission

Mr. J. Paul Warnecke - Director, Division of Telecommunications,
Department for Facilities Management