

AN INQUIRY ON STATE RESPONSES
TO
REGULATORY CHANGES IN THE TELECOMMUNICATIONS INDUSTRY

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EXECUTIVE SUMMARY

The Telecommunications Research Division of The National Regulatory Research Institute (NRRI), as one part of a contract with the Public Utilities Commission of Ohio, undertook a telephone survey of public service commissions to ascertain their responses to the many regulatory changes occurring in the telecommunications industry. Fifty-one public service commissions (fifty states and the District of Columbia) were interviewed. Questions were asked regarding deregulation of customer premises equipment (CPE), rate design issues, depreciation changes, the expensing of inside wiring and forthcoming issues of significance.

The survey was conducted over a period ranging from May to September 1981. During this time many of the states were involved in rate cases and were in the process of determining their positions regarding many of the issues touched on in the survey. In answer to questions for which there was no official commission or staff position, many respondents chose to either say "I don't know," or to indicate how they thought their commission would be inclined. By the completion of this report, many of the states may have come quite a distance in their decisions regarding regulatory strategies for approaching some issues. If surveyed again, some of the respondents might well have different responses to some of the questions. Also the recent tentative settlement of the AT&T anti-trust case, calling for divestiture of the Bell operating companies brings a new dimension to some of the questions asked. However, the survey results should still be useful as a barometer of the current climate of state regulation of telecommunications.

In preparation for deregulation, at least 32 states have unbundled rates and some of these have developed cost allocation methods. Two respondents reported that their commissions will not go along with the FCC order to deregulate CPE, and that CPE will continue to be offered under tariff in those states. The respondents from a majority of states (28) indicated their commission would wait for FCC guidelines rather than act on their own to determine transfer prices and associated expenses of CPE. Several of these added that upon receiving the guidelines they would then act in the best interests of their own states. Relatively few commissions (12) had any estimate of the impact of detariffing on the jurisdictional rate bases, revenue requirements or settlements revenue. In most cases, the estimates were from company supplied data or were estimates of the separations effect only.

When asked their preference regarding AT&T's requested "flash-cut" approach to CPE deregulation, an equal number (11) preferred the flash-cut

as preferred the bifurcated approach. The remaining twenty-nine either had no preference, were undecided, or gave other responses. Among the other responses were two commissions that favored a bifurcated approach for the Bell companies and a flash-cut for the independents. Twenty-two states have initiated or are considering special steps to separate tariffed from detariffed activities for those companies not establishing a separate CPE subsidiary.

The rate design questions were concerned with flexible pricing and with measured rate service (MRS). Companies have requested flexible pricing in 31 states and it has been granted in 20 states. Slightly more than half of the states which have granted flexible pricing reported they had some type of limitations or monitoring procedures. Typically these referred to the existence of a floor price or floor and ceiling prices and the need for a notification period (usually 30 days and in one case 20 days) for a change in price.

Some form of measured rate service is in use in 44 states, though only 12 states reported a commission preference for measured rates over flat rates. The most commonly used form of measured rates is a charge based on frequency only. In almost all cases measured rates were optional, though four states reported mandatory MRS for business customers and optional MRS for residential customers. The objections to MRS by customers include (1) complaints from heavy users; (2) subscriber fears that optional MRS will become mandatory; and (3) concern that MRS will result in restricted usage by the elderly and low income subscribers. The most frequently mentioned objection to MRS by the commissions was that there has been no cost justification provided and/or no way to show any benefits and no evidence of efficiencies.

A question was asked regarding the use of straight-line, equal-life group depreciation (SLELG). Sixteen state commissions either have already allowed its use or expect to do so. Twelve reported either they would not allow it or were leaning against it. The reported reasons for opposing it included (1) the rates would be too high; (2) it is too complex to monitor; and (3) the belief that use of remaining life is a better way to accelerate capital recovery.

On the matter of expensing station connections, eleven state commissions had already issued an order addressing these issues and cases were pending in fifteen states. Twenty-three states had estimates of the increase in installation costs necessary to fully cover all costs of inside wiring. There was wide variation in the estimates with expected increases ranging from a low of 20 percent to an expected four-fold increase. Thirteen expressed a preference for a flash-cut expensing of all new inside wiring and eleven preferred a phase-in approach. Nine state commissions had no preference and another nine indicated they would approach the issue on a company-by-company basis. Typically this meant they would phase in the larger companies and use the flash-cut for small companies.

In response to a question about the future use of access charges, the respondents reported a variety of concerns. The three most frequently

mentioned were (1) problems with jurisdiction and/or exchange boundaries; (2) the impact on revenue and/or the need to change rates; and (3) problems of cross-subsidization.

Only five states reported that local loop competition has become an issue of concern at this time. The remaining forty-six states recognized this issue as one for the near future, but felt that other issues were currently more pressing.

The final question of the survey was, "What do you think are the real challenges to state regulation over the next five to ten years?" All fifty-one jurisdictions responded to this question, and typically there was more than one response from each. While there were many varied comments and perspectives, one primary underlying theme was concern for the ability to continue to provide quality, universal service. The two most frequently mentioned challenges concerned the relationship between the states and the federal government (34 states) and the level of local rates in the future (29 states). A second major theme related to changing technology and the regulatory changes necessary to deal with technological advances.

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FOREWORD

This report was prepared by The National Regulatory Research Institute (NRRI) under contract with the Public Utilities Commission of Ohio (PUCO). The opinions expressed herein do not necessarily reflect the opinions or the policies of either the NRRI or the PUCO.

The NRRI is making this report available to those concerned with state utility regulatory issues, since the subject matter presented here is believed to be of timely interest to regulatory agencies and to others concerned with utility regulation.

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CHAPTER 1
INTRODUCTION

As is widely known, recent actions of the Federal Communications Commission (FCC) have created substantial change in the regulatory climate of the telephone industry. This process of change, spurred by the advent of competition and rapid technological advances, will have a significant impact on both local revenue requirements and the structure of the industry. There are currently several major issues before the FCC (in varying stages of the decision-making process) which will have great impact on state regulatory activity. Among these major issues are the deregulation of customer premises equipment (CPE), changes in depreciation methods, expensing of station connections, changes in the separations and settlements procedures, and the future development of access charge arrangements for long distance services.

Much of the burden of implementing these changes will fall on the state regulatory commissions. Ideally, this implementation would take place in such a way as to minimize the economic dislocations and at the same time preserve the newly created competitive climate, create equity among the network customers and maintain universal service. The FCC will undoubtedly issue guidelines and rulings about the implementation of these changes. However, many of the details of implementation, especially those concerned with monitoring the transition and ameliorating its impact, will be left to the states. These issues are complicated and interrelated. Some state commissions have begun examining them; others have not.

As one part of a research contract with the Public Utilities Commission of Ohio (PUCO), the National Regulatory Research Institute (NRRI) undertook a telephone survey of the state commissions for the purpose of identifying state opinions on these regulatory changes and gaining insight into the magnitude of the impact on local revenue requirements.

The survey instrument was designed to address some of the issues previously mentioned (deregulation, depreciation, the expensing of station connections and the access charge concept) as well as questions related to rate design. The survey concentrated on the deregulation of CPE since this is a most complex matter with far-reaching implications. Rate design questions were also emphasized because the dollar magnitude of the impact of deregulation and the other issues is such that innovations in rate design may become more important as commissions strive to minimize the impact on local revenue requirements.

The survey contained 16 questions, mostly geared for "yes" or "no" responses, but open for elaboration. A copy of the questionnaire used is contained in the appendix. The surveys were administered by scheduled telephone appointments. In almost all cases, the questions were answered by members of the communications or telecommunications staffs. Conversations were held with representatives from all 50 state commissions and the District of Columbia Public Service Commission.¹

It is important to note that this survey was done during a period ranging from May through September, 1981. During this time, many of the states were involved in rate cases and were in the process of determining their positions regarding many of the issues touched on in the survey. In answer to questions for which there was no official commission or staff position, many respondents chose to either say "I don't know", or to suggest their perceptions as to how they thought their Commission would be inclined. Upon the completion of this report, many of the states may have come quite a distance in their decisions regarding regulatory strategies for approaching some issues. If surveyed again, several of the respondents might well have different responses to some of the questions. However, the survey results will still be useful as a barometer of the current climate.

¹There are 51 respondents including the one in the District of Columbia. For convenience, the respondents are all referred to as states. Also for convenience the words state or commission response are sometimes used in this report, but this is not necessarily to imply that any commission or state position was taken on these matters in the sense of formal deliberations and resolution.

The state regulator's task in moving through this period of transition is awesome. The burden can be eased somewhat to the extent that information and staff assistance are available to the commissions. The results of this survey serve the purpose of at least giving a clearer picture of the current status of state commission activity. It is hoped that this survey can be a vehicle to facilitate the sharing of information and ideas among states. Where appropriate, the survey results will identify those states that have already undertaken a given action. Comments and opinions are not identified by states but studies and rulings are. Thus, a commission interested in the particular subject can quickly identify those states that may have begun to work on the matter.

The survey results along with a brief background of the issues involved make up the following chapters.

CHAPTER 2
DEREGULATION OF CUSTOMER PREMISES EQUIPMENT

Background of Issues

In its Final Decision in the Second Computer Inquiry (Computer II)¹, adopted April 7, 1980, the FCC ordered the unbundling and detariffing of all CPE by March 2, 1982. Additionally, AT&T and GTE were ordered to set up fully separated subsidiaries for the provision of CPE and all enhanced services. On October 28, 1980 the FCC modified its previous order so as to require that only new CPE be detariffed by March 2, 1982. Embedded CPE would remain in the rate base, pending further study regarding implementation of deregulation of this type of equipment. Party line equipment, previously retained under regulation, would now be detariffed also. GTE would no longer be required to offer CPE through a fully separated subsidiary.

On February 20, 1981, AT&T filed before the FCC a request to "flash-cut" all CPE,² that is, a request to move both new and embedded CPE into the unregulated sector at the same time. The FCC ruled against the AT&T request on October 7, 1981,³ and also moved the date for deregulation to January 1, 1983.

¹Federal Communications Commission, Docket 20828, Second Computer Inquiry, Final Decision, adopted April 7, 1980.

²AT&T, "Petition for further Reconsideration of American Telephone and Telegraph," in the Matter Amendment of Section 64.702 of The Commission's Rules and Regulations (Second Computer Inquiry) Docket 20828, before the Federal Communications Commission.

³Action by the Commission by Memorandum Opinion and Order on Further Reconsideration (FCC 81-481) October 7, 1981.

As a result of this latest ruling all CPE, including inventory owned by the company as of January 1, 1983, would stay with the regulated sector and continue to be offered under tariff. An implementation proceeding will be initiated to deal with the question of deregulation of embedded CPE.

This latest FCC ruling on deregulation of CPE allows the Bell operating companies to provide, under contract, installation and maintenance services for the business systems of the fully separated subsidiary for 18 months after the date of deregulation. Payment for these services must include all direct and indirect costs with the costs being allocated on a fully distributed basis. Separate accounts must be set up to handle the provision and payment of these services.

A major concern of state regulators relative to the deregulation of CPE is the impact on local revenue requirements. Costs associated with terminal equipment are currently divided between local and toll operations. Theoretically, if the costs have been correctly allocated between CPE and other services and between jurisdictions, if the equipment has been properly priced; and if the revenues have been allocated between jurisdictions in proportion to the jurisdictional allocation of costs, then the deregulation of CPE would result in a removal of costs in proportion to the removal of revenues and, consequently, there would be minimal upward pressure on local revenue requirements. However, it is unlikely that all the correct cost allocations and pricing policies have been followed and thus, one would expect an impact on local revenue requirements. The magnitude of this impact will be increased by the reduction in size of toll settlements due to the removal of CPE from the separations process. The magnitude of the impact of deregulation on the local revenue requirements will be greatly influenced by the transfer price⁴ of the CPE-related investment items and the extent to which a commission can remove all CPE-

⁴Transfer pricing refers here to the value at which the CPE and its associated investment items are removed from the rate base.

associated expenses from the regulated sector. Thus, determination of transfer prices and associated expenses become a critical factor in implementing the deregulation of CPE.

The FCC has indicated, in broad outline, the dimensions of the deregulation of CPE and the implied cost allocations and will, in the future, determine guidelines for implementing the decision. (Though it may be some time before final guidelines are evolved and the last court case settled.) In the meantime, there are several advantages to the state commissions' beginning now to assess the net effects of deregulation on their jurisdictions and to identify problem areas and methods of monitoring the process. A major advantage to beginning the analysis now is that it allows more time to make the necessary adjustments and to establish and test effective monitoring systems. Secondly, beginning now will provide data that will allow the commissions to have substantive input to FCC and Joint Board processes. A third advantage to beginning now relates to the fact that there may well be rate cases filed between now and the time of the FCC final decisions and guidelines. An understanding of the dimensions and potential impact of deregulation (as well as the impact of the other issues) can enable a commission to make decisions now which might ameliorate the impact on local revenue requirements and ease the transition period.

Five questions were asked regarding the deregulation of CPE. These were designed to give insight into the status of state activity relative to the transition and to identify any states which have developed methods or procedures that might be of interest to other states. The questions frequently generated comments beyond the "yes" or "no" answers. While this generated more information, it also made it more difficult to classify the responses. Consequently, care should be taken in drawing conclusions or generalizations from the responses. The following section contains the responses to those questions related to deregulation of CPE.

Commission Responses to Deregulation Issues

1. AS YOU KNOW, THE FCC HAS ORDERED THE DETARIFFING OF TERMINAL EQUIPMENT BY MARCH 1982. HAS YOUR COMMISSION OR STAFF BEGUN TO ALLOCATE COSTS BETWEEN TERMINAL EQUIPMENT AND OTHER SERVICES?

The interpretations of this question by respondents varied. Some staff members interviewed interpreted the question as one of whether or not they had begun to unbundle their costs. Others interpreted the question as referring to full scale cost allocation studies for both ratemaking and/or accounting purposes. Because of the ambiguities in interpretation, some responses to this question were judged to be unreliable. However, the responses were useful in indicating that at least 32 states have unbundled rates or are in the process of doing so. Nine of these 32 further reported either that they have unbundled rates extensively or that they are utilizing a cost allocation method. These nine are Arizona, California, Connecticut, Ohio, Montana, New York, North Carolina, South Carolina and West Virginia. Iowa reported that it has adopted accounting rules. The staff members in two additional states reported their commissions are not planning to go along with the change at all, and that marketing of CPE will continue to be under state jurisdiction after the deregulation deadline.

Some typical comments (as drawn from the notes of the interviewer here and in the following sections) explaining the answers to these questions were:

... Utilities have come in with partially or fully unbundled costs.

... We have had a long standing practice of pricing terminal equipment at full cost (other than the handset), although we have not allocated out toll. We have unbundled telephone instruments from the access charge.

... We deregulated most terminal equipment in 1976. We have flexible pricing, and are now looking to be sure costs are properly covered.

... We have not distinguished accounting differences, but for the last six to eight years have set terminal equipment prices with separation of costs in mind.

... We have ordered our Bell company to do a cost of service study.

... We are currently promulgating rules for CPE and station equipment.

... Our companies are developing cost allocation systems.

... We will have a "show-cause" involving all companies-- a generic hearing with all telephone companies coming to discuss all of these issues.

2. DO YOU EXPECT YOUR COMMISSION TO ACT ON ITS OWN TO DETERMINE TRANSFER PRICES AND ASSOCIATED EXPENSES (OF CPE) OR WILL IT WAIT FOR FCC GUIDELINES?

The answers to this question fit into five categories. "Wait" indicates that the staff member explicitly said they would wait for FCC guidelines. "Act" indicates that they unequivocally intend to initiate action themselves. "Wait" and "Act" indicates that they will probably do a combination of both--in other words, they will begin acting in some ways on their own, or will wait to see what the FCC has to say and then judge for themselves what they want to accept. "Don't Know" (DK) means the state had either not discussed this issue or they were not inclined in any particular direction. The "Other" category was for states whose responses did not fit neatly in any of the other categories.

The number of states responding in each category is shown in table 2-1.

TABLE 2-1

NUMBER OF STATES THAT WILL WAIT FOR FCC
GUIDELINES FOR SEPARATING COSTS

	<u>Wait</u>	<u>Act</u>	<u>Wait and Act</u>	<u>Don't Know</u>	<u>Other</u>
Number of States	28	7	5	6	5

There were few comments in response to this question. The most frequent comments were by those who reported they would wait, and the most common of these comments were to the effect that (1) the commission was understaffed to deal with this problem in addition to its regular rate case load, or (2) the commission would wait for FCC guidelines, and then act on its own in the interest of its state.

3. HAVE YOU ESTIMATED THE IMPACT OF DETARIFFING ON JURISDICTIONAL RATE BASE, REVENUE REQUIREMENTS, AND SETTLEMENTS REVENUE? IF YES, WHAT IS THE MAGNITUDE?

The responses to this question are summarized in table 2-2.

TABLE 2-2

NUMBER OF STATES THAT HAVE ESTIMATED THE IMPACT OF DETARIFFING
CUSTOMER PREMISES EQUIPMENT

	<u>Yes</u>	<u>No</u>	<u>Don't Know/ No Answer</u>	<u>Other</u>
Number of States	12	32	3	4

Most of those interviewed answered this question "No" and made no additional comments. Those who responded "Yes" typically reported either

that they had company--typically Bell--supplied data or that they had data on the separations effect. Only a few states had made their own estimates. In only a very few cases were actual numbers reported.

For those who have some sort of estimate, some of the magnitudes cited were as follows:

... There will be a doubling of the basic exchange rate.

... We have some figures in the \$40-60 million range. We want to verify them in the rulemaking.

... For (Bell Company) the impact of separations treatment of terminal equipment is a revenue requirement of \$22.9 million or around 25% (not including settlements).

... We have several kinds of estimates. We did studies under different assumptions, such as depreciation changes, separations changes, and expensing of station connections. It is expected that there will be significant changes--hundreds of millions of dollars in intrastate revenue requirements, a local exchange rate increase of 25-50%.

... The five largest telephone companies have an impact magnitude of \$1 1/2 billion.

... We have broad estimates of 200%.

... We had Bell give us estimated figures--the rates could go up as much as three times. We don't know about the independent companies.

4. DOES THE COMMISSION OR STAFF HAVE A PREFERENCE BETWEEN AT&T'S REQUESTED FLASH-CUT OF CPE AND THE BIFURCATED APPROACH?
--

In many cases, the responses to this question were not answers reflecting the formal policy but were leanings of particular staff members. Staff inclinations were not necessarily in agreement with leanings of their commissions. (The question now, of course, is irrelevant in light of the FCC's latest ruling on Computer II,⁵ though it is useful for achieving increased understanding of the various state perspectives). Table 2-3 contains a summary of these responses.

TABLE 2-3

COMMISSION PREFERENCES REGARDING "FLASH-CUT"
DEREGULATION OF CPE

<u>Preference</u>	<u>Number of States</u>
Prefer Flash-cut Approach	11
Prefer Bifurcated Approach	11
No Preference	6
Undecided	12
Other	8
Don't Know	2
No Response	1

Eleven respondents favored AT&T's requested flash cut approach, with one of these reporting that the staff favored a flashcut but the Commission was undecided. Several of these eleven expressed concern about the initial impact of the flashcut on local revenue requirements.

Eleven respondents favor the phase-in or bifurcated approach. Four of these twelve indicated that the commission had not expressed a position but

⁵See pages 5 and 6.

the staff was leaning toward the phase-in approach. Few expressed any additional comments, but those who did tended to think that this approach would be less severe for the rate payer.

The eight states in the "Other" category gave responses which did not fit any of the previous categories. Two of these eight favored a phase-in approach for Bell companies and a flash-cut for the independents, while another two favored retaining embedded CPE and using a flash-cut approach for new CPE.

5. FOR COMPANIES NOT ESTABLISHING SEPARATE CPE SUBSIDIARIES, WHAT SPECIAL STEPS ARE YOUR COMMISSION OR STAFF CONSIDERING TO SEPARATE THE COMPANY'S TARIFFED ACTIVITY FROM THE DETARRIFFED ACTIVITY?

Responses to this question are contained in table 2-4 and are generally categorized in the "Yes-No" form with "Yes" indicating that monitoring activities are being considered or have already been initiated. "No" means that the Commission is not, at this time, considering any action of this type. "Will do so" means the Commission is planning to address the issue in the future. Included in the "No Response" category are the two states which have not accepted the FCC's deregulation of CPE.

TABLE 2-4

NUMBER OF STATES PLANNING TO TAKE SPECIAL STEPS TO MONITOR TARIFFED AND DETARRIFFED ACTIVITY

	<u>Yes</u>	<u>No</u>	<u>Will Do So</u>	<u>No Response</u>
Number of States	22	17	9	3

All of the twenty-two replying "yes" to this question indicated they would use some kind of accounting separation. A few reported they would also use some cost allocation methods, especially for joint and common costs. In some of these states, independents are now selling CPE (in an unregulated environment) and a few independents have set up separate subsidiaries. The following are selected responses to this question.

... Revenues and costs of detariffed items should be below the line.

... Complete accounting separation.

... Revenues and expenses below the line. Have to allocate costs between the utility and non-utility.

... Will have to develop cost allocation procedures. Recommend accounting procedures, allocation of common cost procedures.

... Separate accounting procedures. Check for cross-subsidization.

... Have issued temporary accounting guidelines.

... Over-the-counter sales are regulated, leases are not. Will revise system of accounts later.

... Accounting changes made so that activities are distinct development of subaccounts.

... Have issued USOA modifications for separate accounts. Order #2U902 (Wisconsin).

CHAPTER 3
RATE DESIGN

Flexible Pricing

Flexible pricing is a mechanism that allows a telephone company to alter prices on CPE without engaging in a full-scale rate case for each rate change. Typically, the company is granted a minimum tariff (in a rate case) and is further granted the ability to raise the rate without formal rate case proceedings. Often there is a ceiling placed on the allowable rate and a notification period required before the new rate becomes effective. Many companies have sought flexible pricing on the grounds that the ability to alter prices quickly and easily enables them to better meet competition in the CPE market.

The impending deregulation of CPE together with the existence of reserve deficiencies and the expected changes in depreciation practices all combine to create possible additional problems for the ratepayer if a company has been granted flexible pricing. Specifically, if the relative prices of substitutable products are changed sufficiently to severely alter the previous price relationships, then a customer may be induced to leave one product and adopt its substitute. One effect of this "migration strategy" is to force the early retirement of some lines of CPE. The existence of substantial amounts of early retirements means that reserve-deficiencies or other expenses may well increase significantly.

Given the impending deregulation of CPE, this means that the problems associated with determining transfer prices and funding reserve deficiencies are further complicated. In addition, depending on how the early retirements and consequent reserve deficiencies are handled, there is a very real possibility that ratepayers will pick up an unnecessarily large share of these added expenses. While this situation may ease the transition by spreading the impact over a longer period of time and over more customers, serious equity questions arise.

6. HAVE ANY COMPANIES FILED FOR FLEXIBLE PRICING? WAS IT GRANTED? IF YES, WERE ANY SPECIAL STEPS TAKEN TO MONITOR OR LIMIT ITS USE?

A summary of the responses to this question is found in table 3-1.

TABLE 3-1

NUMBER OF STATES WHERE COMPANIES HAVE FILED FOR FLEXIBLE PRICING AND RECEIVED APPROVAL

	Have companies filed for flexible pricing?			If yes, was it granted?		
	Yes	No	Don't Know	Yes	No	Case Pending
Number of states	31	19	1	20	7	4

The states which reported they have granted some form of flexible pricing are as follows:

- | | | | |
|-------------------------|-------------|--------------------|--------------------|
| 1. Arizona | 5. Idaho | 10. Nebraska | 15. North Dakota |
| 2. Connecticut | 6. Iowa | 11. Nevada | 16. Ohio |
| 3. Delaware | 7. Maine | 12. New Jersey | 17. Pennsylvania |
| 4. District of Columbia | 8. Michigan | 13. New York | 18. South Carolina |
| | 9. Missouri | 14. North Carolina | 19. South Dakota |
| | | | 20. Wisconsin |

At the time of the survey, cases were pending in California, Rhode Island, Tennessee and Vermont.

Slightly more than half of the states which have granted flexible pricing reported they had some type of limitations or monitoring procedures. Typically, these referred to the existence of a floor price or floor and ceiling prices and the need for a notification period (usually 30 days and in one case 20 days) for any change in the price. In a few cases, additional requirements were reported. They are as follows:

... The company must apply to make a change and the commission is not bound to accept it even though a price list has been established.

... The company must first prove the floor price is justifiable. Then there is periodic review of the rates in rate cases.

... Cost studies must be filed first. New studies are required for new items.

... The company must report estimated costs and estimated gains and losses. (In this state, the case was pending at the time of the survey.)

Three states reported that flexible pricing applied only to design line items; one state applied it only to the Princess phone and one state applied it to direct sale items only.

Measured Rate Service

Measured rate service (also referred to as usage sensitive pricing) is the concept of charging for local telephone service on the basis of costs created. Rather than a flat fee for unlimited calling, the customer might

be charged on the basis of the number of calls made, the time of day, the length of the call, the distance involved or some combination of these factors. The idea of measured rate service (MRS) has been around for decades but had not been widely adopted for local service.

In recent years, MRS has received significant widespread attention and renewed consideration. This is due largely to two factors. (1) A new emphasis on the use of cost of service principles rather than value of service for ratemaking purposes, caused in large part by the advent of competition and the need to avoid cross subsidization; (2) the many factors (such as inflation, deregulation of CPE, and expensing of station connections) which are creating significant upward pressure on local rates. Those commissions that have adopted MRS typically hope to gain greater equity and to reduce the growth in costs and thus slow the growth in local rates.

Several questions were asked about measured rates in order to get insight into the extent to which they are currently in use and public and commission reaction to them.

13. DOES YOUR COMMISSION HAVE A PREFERENCE FOR MEASURED RATES OR FLAT RATES? FOR BUSINESS SERVICE? FOR RESIDENTIAL SERVICE?

In responding to this question the states tended not to distinguish between business and residence service. Only 12 expressed a preference for measured service while seven preferred flat rate service. In eleven states, the staff preferred measured service and the commissions either preferred flat rates or had not yet expressed a preference. Four states did not know what their preference was, and 17 states responded with descriptions of their rate designs but did not indicate the commission's preference. Table 3-2 contains the responses to this question.

TABLE 3-2

COMMISSION PREFERENCES FOR FLAT RATES VS.
MEASURED RATES

<u>Preference</u>	<u>Number of States</u>
Prefer Measured Rates	12
Prefer Flat Rates	7
Staff prefers Measured Rates Commissioners preference unknown	8
Staff prefers Measures Rates Commissioners prefer Flat Rates	3
Don't know	4
Other	17

Some of the comments in response to this question were as follows:

... Because we envision telephone rates increasing, it (MRS) is the only option to provide low cost service to low income people.

... Prefer measured rates when there is equipment in place.

... Cannot justify measured service for business only.

... Measured rates are acceptable if they are optional.

... There is a concern that if measured rate service is optional, the high users will not use it.

... Prefer measured rates with a commitment to maintain the residential option.

- ... Want measured rates to maintain universality.
- ... Prefer flat rate because of size of exchange in state.
- ... The public is opposed to measured rates, so we are.
- ... We are more cautious than the telephone industry. The cost of usage going down (fiber optics, coaxial). We are not as interested in all measured service. We see measured service in future measured by the hour.

14. TO WHAT EXTENT ARE MEASURED RATES IN EFFECT IN YOUR STATE? IF YES, WHAT TYPE OF TARIFF IS USED? FOR BUSINESS SERVICE? FOR RESIDENTIAL SERVICE?

While only 12 states preferred measured rates, some form of MRS is in use in 44 states. In several cases the measured rates are on a trial basis and rarely do they appear to be in widespread use. The most commonly used form of measured rates is a charge based on frequency only. Not all states reported on the type of tariff used, and some states reported that more than one type was in use. Table 3-1 contains the responses given on the type of tariff.

TABLE 3-3

NUMBER OF STATES HAVING VARIOUS
TYPES OF MEASURED RATE TARIFFS

<u>Type of Tariff</u>	<u>Number of States</u>
Frequency Only	17
4 Element	7
Duration, Time of day and Distance	4
3 Element	3
2 Element	3
Time and Distance	1
Minutes of Use	1

Few states indicated the extent of usage. Of those who did three reported MRS was available to 50-60% of the customers; four reported it was available to 10% or less, and four reported it was available in four or fewer exchanges. In almost all cases, measured rates were optional, though four states reported mandatory measured service for business, and optional MRS for residential customers. A small number of states reported their measured service was for low usage customers or as a lifeline rate.

15. WHAT ARE THE MAJOR OBJECTIONS TO MEASURED RATES (IF ANY) FROM THE SUBSCRIBER? FROM THE COMMISSION?

Fourteen states either did not respond to the first part of this question, did not know the major objections of subscribers, or their response was not applicable to the question. Six states reported that subscribers had either no objection or only mild objections.

The remaining thirty-one states reported one or more objections. Those responses are categorized as follows.

1. The primary complaints are from heavy users (8 responses).
2. The subscribers are just not interested - want flat rate tariffs (6 responses).
3. The subscribers are afraid that optional measured service will become mandatory (6 responses).
4. The concern is that elderly and low income subscribers will not be able to afford it and thus will have their calling restricted (5 responses).

5. Subscribers believe it is a "plot by the telephone companies to 'rip them off' and raise prices" (5 responses).

6. It is too complicated - subscribers don't understand it (4 responses).

7. Subscribers are afraid it will cost them more than flat rate (4 responses).

8. Subscribers don't want their calling habits restricted (2 responses).

9. No itemized statement is provided detailing the calls made (1 response).

10. Subscribers don't want a record kept of their local calls (1 response).

11. Subscribers don't want to remember the number of calls made (1 response).

Few respondents identified objections to MRS by the commissions. Of those who did the most frequently mentioned objection (8 responses) was that there had been no cost justification provided and/or no way to show any benefits and no evidence of efficiencies. Four responded that political pressure and public acceptance were major problems, and three states mentioned the cost of metering and/or providing measured rate service. Only one mentioned the cost to high users as a commission objection, and one state reported that the legislature had prohibited the use of measured rates. Some states responded that they felt the companies should do a better job of explaining and selling the concept to the public.

CHAPTER 4
OTHER ISSUES

Depreciation

In Docket 20188 (adopted November 6, 1980) the FCC allowed for the use of remaining-life calculations in setting depreciation rates. Traditionally, depreciation rates have been set using whole-life calculations. However, given a climate of rapid technological change, whole-life techniques can result in increased reserve deficiencies as technological obsolescence sets in. The use of remaining life calculations provides a vehicle for adjusting rates to meet changes in equipment lives, since the use of remaining life requires that depreciation reserves be allocated among the various investment accounts. The FCC initiated proceedings to determine how to allocate these reserves for those companies (namely, Bell Operating Companies) which have not maintained reserve balances by account. The issue was primarily whether to allocate reserves based on theoretical reserve studies or to allocate reserves based on historical debits and credits. On October 1, 1981 the FCC approved the use of actual debits and credits for the allocation of depreciation reserves among telephone plant accounts.

In its decision on Docket 20188, the FCC also authorized the use of the straight-line, equal-life group (SLELG) method of depreciation for new investment. The use of SLELG is to be phased in over a three-year period wherein SLELG is applied to new additions to outside plant in the first year, to new additions to central office equipment in the second year, and to new additions to all other investment items in the third year. The straight-line, equal-life group method would replace the currently commonly used straight-line, vintage group (SLVG) methods of depreciation.

Under SLVG, telephone plant in each depreciation category is subdivided into vintage groups with a vintage group consisting of all plant in a given category which was added in a single year. Since these items may well have different estimated lives, a weighted average of lives in each vintage group is computed. Depreciation rates for a given category are then calculated using a weighted average of depreciation rates (based on vintage group estimated average lives) for each vintage group. Use of SLVG typically means that full recovery for those items with shorter than average lives will not occur until some time after those items have been removed from use.

Under the equal life group (ELG) method, assets within a category are placed into groups on the basis of their expected lives. That is, those items with the same estimated life are grouped together. Depreciation rates for each category are again calculated using a weighted average of depreciation rates for each group within the category.

Proponents of ELG favor this method because it more nearly matches the recovery of investment funds through depreciation with the "life" of the assets. Opponents of ELG generally contend that (1) its use will cause substantial increases in revenue requirements at a time when several other forces are also exerting upward pressure on rates, (2) ELG may be too complex for commissions to administer and monitor effectively, and (3) smaller companies may not have sufficient data to utilize ELG. In an effort to gain insight into the various state perspectives, a question was asked regarding the state commissions' views of ELG.

7. DO YOU THINK YOUR COMMISSION WILL ALLOW THE USE OF STRAIGHT-LINE, EQUAL-LIFE GROUP DEPRECIATION? IF YES, HAVE YOU ESTIMATED THE IMPACT OF THESE CHANGES?

Table 4-1 summarizes the responses to this question.

TABLE 4-1

NUMBER OF STATES ALLOWING THE USE OF STRAIGHT-
LINE, EQUAL-LIFE GROUP DEPRECIATION

	<u>Yes</u>	<u>No</u>	<u>Don't Know</u>	<u>Cases Pending</u>
Number of States	16	12	18	5

Those answering "yes" had responses that ranged from "have already done so" to "have no alternative." These 16 states include those who simply said "yes" as well as those who said "probably" and three who said "will eventually."

The twelve states in the "no" category include those who said definitely "no", as well as those who were "leaning" against it. While few of these states made additional comments, those who did opposed it because (1) the rates would be too high--"depreciation rates of 30 percent are uncalled for"; (2) ELG is too complex to keep track of; (3) prefer remaining life as a better way to accelerate capital recovery; or (4) one state which preferred straight-line, whole-life with amortization of undepreciated amount at the end.

Few of those in the "don't know" category had any comments on the issue. One did state a preference for remaining life, while two reported that the use of remaining life was currently under discussion. Some other comments are listed below.

... Don't know, probably not. It depends on FCC actions.

... Don't know. It was heard in a recent case. We didn't like the company's evidence that it was justified.

... We have some problems with this but are not really prepared to discuss it.

... Generally the FCC requires us to sign off--we haven't decided yet.

... The FCC has agreed to let companies use ELG. Our Commission is deciding whether to let the triennial conference control or to establish separate interstate accounts. We have formally objected to the FCC. The impacts could be great. We are really concerned.

Expensing of Station Connections

On March 11, the FCC voted to direct the expensing of new inside wiring over a four-year period, to begin by October 1. Under this requirement, 25 percent of all new inside wiring in year one would be expensed that year; 50 percent of all new wiring in year two would be expensed; 75 percent of all new inside wiring would be expensed in year three; and beginning in year four, all new inside wiring would be expensed. In addition, the FCC allowed any company to "flash-cut" all new inside wiring with regulatory approval.

Whether the phase in or flash-cut approach is preferable is largely dependent on two factors. One, the differential between current installation rates and the rate necessary to cover all expenses; and two, the rate of attrition in existing inside wiring.

The magnitude of attrition in existing inside wiring is a significant element because concurrent with the expensing of new wiring, the FCC has ordered the expensing, over a ten-year period, of existing inside wiring. Thus, the impact on revenue requirements is a function of both new and existing wiring.

8. IN THE PAST, INSIDE WIRING AND INSTALLATION COSTS HAVE BEEN CAPITALIZED IN ACCOUNT 232. THE FCC IS NOW MOVING TO EXPENSE THESE COSTS. HAVE THERE BEEN ANY RULINGS BY YOUR COMMISSION WHICH SPECIFICALLY ADDRESS THIS ISSUE?
--

A summary of the responses to this question is contained in table 4-2.

TABLE 4-2

NUMBER OF STATES THAT HAVE RULINGS ON THE
EXPENSING OF INSIDE WIRING

	<u>Yes</u>	<u>No</u>	<u>Pending</u>
Number of States	11	25	15

During the time when this survey was done, quite a few states (15) were in the process of addressing this issue. In several of these instances, states had cases scheduled during which the inside wiring issue was expected to be discussed. Others were conducting general investigations or were in the process of formulating policy or promulgating rules.

Twenty-five of those interviewed replied "no" to this question, though in many cases they indicated the issue would be addressed in the near future. Eleven states have taken action on the expensing of inside wiring. Typically, the states have followed the accounting changes of the FCC order and four of the eleven reported that customers may install their own wiring.

9. HAVE YOU ESTIMATED THE PERCENTAGE INCREASE IN INSTALLATION COSTS NECESSARY TO FULLY COVER ALL COSTS OF INSIDE WIRING? IF YES, HOW MUCH?

Table 4-3 reports the number of states which have estimates of the increases in installation charges necessary to recover all costs.

TABLE 4-3

NUMBER OF STATES THAT HAVE ESTIMATED
INCREASES IN INSTALLATION CHARGES

	<u>Yes</u>	<u>No</u>	<u>Other</u>	<u>No Response</u>
Number of States	23	25	2	1

While twenty-five replied "no", several indicated that they expected to do so shortly. Two responses were categorized as "Other", since they gave general comments which could not be interpreted as either "yes" or "no."

Twenty-three states did have estimates of the increase. Eight of the twenty-three had obtained the estimates from company supplied data (usually in the context of a rate case). Fifteen of the persons interviewed supplied the estimates available to their commissions. Because the estimates were provided in a variety of forms, they could not be organized in a tabular format. All estimates provided are listed below so as to provide the fullest information to the reader.

1. 20% - 150% depending on the Company
2. 20% - 30% for the Bell company; 100% for smaller companies, because they haven't had rate increases and their capital costs are not as great.
3. From \$38 to \$65 (71%)
4. 88%
5. 100%
6. 100% or more
7. Over 100% - in one case 200%
8. 199%

9. 200%
10. 300%
11. Triples - 2 responses
12. 4 times
13. \$100 per residential customer
14. Currently recovering from 40% - 75% of total cost

These reported estimates indicate significant variations in the effect on installation charges. The estimates vary not only among states, but also among companies within a given state. Some of the differential may be due to the fact that most of these are estimates. When definitive amounts are known, the variation may be less. On balance, however, one might expect considerable variation. Among the factors which would contribute to a non-uniform change in installation charges are (1) differences in labor costs among companies and states, (2) differences in the historic pricing policies of commissions, (3) differences in population densities and terrain among franchise areas, and (4) differences in the frequency with which rate increases have been granted in the past.

10. DOES YOUR COMMISSION OR STAFF HAVE A PREFERENCE BETWEEN A FLASH-CUT AND PHASE IN APPROACH TO EXPENSING NEW INSIDE WIRING?

TABLE 4-4
COMMISSION PREFERENCES FOR EXPENSING
NEW INSIDE WIRING

	<u>Prefer Flash- cut</u>	<u>Prefer Phase in</u>	<u>Company by Company</u>	<u>No Prefer- ence</u>	<u>Other</u>	<u>No Response/ Don't Know</u>
Number of States	13	11	9	9	4	5

The states expressing a preference were almost evenly divided between the flash-cut and phase in approach, with thirteen preferring (or leaning toward) the flash-cut. Some of those favoring the flashcut expressed concern about its higher short-term impact, but in the words of one respondent, "Why delay the inevitable?"

Nine states had no preference and another nine indicated they would approach the issue on a company-by-company basis. Typically, this meant they would phase in the larger companies and use the flash-cut for small companies. Five states either did not respond or did not know if the commission had a preference. Of the four categorized as "Other", three reported existing differences of opinion which had not yet been resolved and one replied that, given a choice, they would prefer to phase in over a 16-month period.

CHAPTER 5
FUTURE REGULATORY NEEDS

The preceding sections have dealt with some of the current challenges facing state regulators, and it will be quite a long time before these are all fully resolved. Yet new challenges will continue to arise. The ongoing changes in technology and market structure will continue to create new problems and issues for regulators.

In an attempt to begin now to identify future regulatory needs, three questions were asked relative to prospective problems. One dealt with the concept of access charges. With the onset of alternate firms in the inter-city market, new methods must be found for dealing with the separations and settlements process. Access charges reflecting the true cost of each service connecting to the local network need to be identified. The problems inherent in designing appropriate access charges are well known. In addition, the change to access charges (when and if it occurs) will undoubtedly create new pressures and problems for the regulation of local network services. One question was asked concerning the prospective impact of access charges on local jurisdictions.

A second question was asked regarding the prospect of competition in the local loop. Many believe this will be a significant factor in the future. If so, it is to the regulators' advantage to begin now to identify the regulatory changes needed to meet this challenge.

A third general question was asked regarding what regulators perceive as the most significant challenges facing them in the next 5 to 10 years. The parameters of the telecommunications industry and customer base vary greatly among the states. The state commissions charged with regulating

this industry often face dissimilar problems. A first step in meeting the needs of this diverse community is to identify the prospective problems facing them.

Access Charges

11. WHEN INTERSTATE TOLL CHARGES BECOME BASED UPON AN ACCESS CHARGE, WHAT STATE REGULATORY CHANGES MIGHT BE NEEDED?

In response to this question, three states replied it would depend on the access charge; 2 replied "none" and 15 either didn't know what changes might be needed or didn't answer the question. The other twenty-one states did not answer the question directly, but rather commented on types of problems they could foresee in developing an access charge. Their comments are summarized in Table 12. There are more than twenty-one responses since some states reported more than one concern.

TABLE 5-1

STATE CONCERNS RELATIVE TO
ACCESS CHARGES

<u>Category</u>	<u>Number of States</u>
Problems with jurisdiction and/or exchange boundaries	10
Impact on Revenue and/or need to change rates	8
Problems of cross-subsidization	5
Quality of Service Problems	2
Other	11

Following is a selection of the comments made in response to the question about access charges.

... It will be necessary to develop uniform access charges for all jurisdictions.

... We have requested computer capability--will need cost studies --state, interstate, intrastate.

... We don't foresee it coming into this state.

... We want carefully cost-based rates set by states. Want states to set access charges and vary company by company.

... We might need legislation to be able to appeal access charges directly from the public service commission level to the FCC, rather than having to go through the state Supreme Court.

... We will make changes to the extent that access charges affect revenue.

... We will need to make some policy decisions regarding how to deal with new interconnect companies coming in.

... The answer to this question depends on WHO WOULD FORMULATE the access charge. Intrastate message toll could change if the access charge applies to intrastate as well.

... There may be a problem if charges for access lines are not brought up to cost.

... We need to find out who will have jurisdiction over what.

... This depends on the Communications Act, and whether the determination of exchange boundaries is left to the states.

... We are concerned about equity of treatment between AT&T companies and the OCC's.

... If we should go only with the FCC order, someone will have to police the services of the inter-connects. This will be difficult to do.

... If the state does not buy what the joint board develops, it will have to come up with its own access charges to cover costs.

... We may have to be concerned with low density users subsidizing high density users.

... Inherent in this question is a need for usage sensitive pricing. There would need to be a major restructuring of how telephone rates are established. We would need to consider banding principles, unlimited calls, and unbundled rates.

... There could be problems from a transmission standpoint. Some carriers do not have adequate transmission capabilities.

Competition in the Local Loop

12. WITH CABLE AND COMPUTER COMPANIES BEGINNING TO PROVIDE TWO-WAY COMMUNICATIONS, COMPETITION IN THE LOCAL LOOP IS BEGINNING TO BECOME TECHNOLOGICALLY FEASIBLE. HAS LOCAL LOOP COMPETITION BECOME AN ISSUE OF CONCERN FOR YOUR COMMISSION? IF YES, WHAT REGULATORY ACTIONS ARE BEING CONTEMPLATED?

TABLE 5-2

HAS LOCAL LOOP COMPETITION BECOME AN ISSUE OF CONCERN?

	<u>Yes</u>	<u>No/Not Yet</u>
<u>Number</u> of States	5	46

There were only five states in which local loop competition has become an issue of concern at this time. Responses from the other 46 states recognized this issue as one of the near future, but felt that other issues were currently more pressing. Some comments of those responding "no" are listed below.

... No immediate problem. It has to be taken into account in pricing structure. We can't overprice business customers.

... No--the only issue is in terms of channel, private line services. We have to be sure we are pricing local loop and inter-exchange properly.

... Not yet, but it is proliferating. One TV station is going to put up an earth station.

... Not yet, though we are aware of a pending case where a cable company is trying to provide local service.

... Not yet--the first company will soon file for an intrastate, intercity toll network.

... No one has applied for local loop. We do have a cable TV company being denied access by the telephone company. Cable company is willing to stipulate they won't compete.

The comments of the five states in which local loop competition has become an issue of concern were varied. The following is a list of those comments.

1. Yes. Regulate CATV. Cable has not (yet) competed with telco. There will be problems somewhere down the road. Our big concern has been to get charges up to cost, and not be subsidized. We have been increasing local loop charges.

2. There is a problem with statutory authority--we will seek LMS and Resale of WATS.
3. Yes - if we find intrastate competition--will probably have to contact them and inquire about their business. We may have to require them to be licensed.
4. Yes, but no competition yet. It came up in a recent Bell case, relative to private line.
5. Yes. We have a cable company providing data and voice. We have to regulate it but don't want to. We are trying to deregulate part of it, and have proposed legislation.

Future Challenges in Telecommunications

Regulation

16. WHAT DO YOU THINK ARE THE REAL CHALLENGES TO STATE REGULATION IN THE AREA OF TELECOMMUNICATIONS OVER THE NEXT 5 TO 10 YEARS?

All fifty-one states responded to this question, and typically there was more than one response from each. While there were many varied comments and perspectives, one primary underlying theme was concern for the ability to continue to provide quality, universal service. The two most frequently mentioned challenges concerned the relationship between the states and the federal government and the future of local rates. A second major theme related to changing technology and the regulatory changes necessary to deal with technological advances. The many responses are summarized in the following sections.

TABLE 5-3

SUMMARY OF PERCEIVED FUTURE CHALLENGES

<u>Concern</u>	<u>Number of States</u>	<u>Number of Responses</u>
Jurisdictional Concerns	34	46
Local Rate Levels	29	48
Deregulation of CPE	23	28
Cost Based Pricing	10	10
Quality of Service	8	8
"Survival"	7	7
Intercity Competition	7	7
Technology	6	6
CATV and Computer Access	5	5
Other Concerns (3 or fewer responses each)	-	20

Jurisdictional Concerns

Thirty-four states identified the state-federal relationship as a major challenge of the future. While there were various perspectives on this problem, much of the concern expressed in the comments was directed towards the question of how the state commissions would retain the ability to meet the diverse needs of each jurisdiction. Their comments are categorized below. More than thirty-four comments are recorded since some states voiced more than one type of concern relative to state-federal relationships.

1. Retaining State Jurisdiction--24 responses. This includes such comments as how to retain the regulatory authority of the state commission with its greater knowledge of local problems; how to assure state participation in the major changes of the future; how to resolve conflicts between state legislators and FCC decisions.
2. Keeping up with and adjusting to all of the new FCC regulation changes--11 Responses. Determining what the FCC is doing and understanding what direction the federal mandate will take.
3. Having to defend the federal positions to the local ratepayers while having no real control over federal actions--5 responses.
4. "Eastern Seaboard Mentality" of the FCC. The lack of awareness of, or understanding of, regional differences and needs by the FCC--5 responses.
5. To influence Congress and the FCC to have a workable regulatory plan so that there can be reasonable service and reasonable rates--1 response.

Local Rate Levels

There were forty-eight responses from twenty-nine different states which expressed significant concern for local rates as a result of the many changes now occurring in telecommunications regulation. The specific concerns are listed below.

1. Keeping local rates affordable--being able to maintain service--23 responses. The sources of upward pressure on local rates included impact of CPE deregulation, expensing station connections, changes in depreciation, the potential for heavy

users "fleeing the network", and changes in REA rates and REA budget cuts.

2. The settlements impact on local rates and designing proper separations procedures--8 responses.

3. Assuring that the industry stays "humanistic"--concern about low cost service to low income and elderly-- 5 responses.

4. Impact of current changes on rates and the move to cost based rates in sparsely populated areas--ability to continue to provide rural service--4 responses.

5. How to keep small companies viable given possible revenue impacts on small companies--4 responses.

6. The impact of going to SLU on the revenues of independent companies--3 responses.

7. Forcing measured rates on subscribers because of upward pressure on flat rates--1 response.

Deregulation of CPE

Twenty-eight responses from twenty-three states identified the transition to deregulation of CPE as a major challenge.

1. Adjusting to competition and deregulation; defining regulated vs. unregulated; redesigning rates to function in a competitive environment--17 responses.

2. How to integrate structural reform into the existing network; how to change state regulatory structures to meet the changes--9 responses.

3. Setting up separate subsidiaries and the oversight function throughout the transition--2 responses. One of these respondents viewed the oversight function as the single biggest challenge facing regulators.

Cost Based Pricing

The determination of costs of service, cost allocation, the determination of reasonable rates and the avoidance of cross-subsidies were considered to be a major challenge by 10 states.

Quality of Service

The possible decline in quality of service was identified as a major challenge by eight states. The problems were primarily seen as one of how to monitor and assure quality with the advent of competition. A second problem mentioned was the impact on quality from the revenue loss resulting from resale.

Survival

Seven respondents said that "getting through it all--surviving it," i.e., this whole period of massive regulatory change was one of the greatest challenges facing them.

Intercity Competition

Seven of those interviewed listed intercity competition as a major challenge.

1. Competition on the intercity network including resale (6 responses). The perceived challenges from this included revenue problems for small companies from competition in the toll network; difficult accounting problems for companies opening resale

subsidiaries; quality of service problems from resale; designing local access charges; legislative conflicts; and problems for small users when large users depart the regulated companies.

2. How to get ENFIA to include all companies and all services (1 response).

Technology

Six respondents reported that keeping up with technological change would be a major challenge in the next several years.

CATV and Computer Access

Five persons identified regulation of access to the local network as a major problem in the future. Specifically the problems involve how to regulate computer access and CATV, including the need for revision in regulatory structures governing cable, computer access and telephone services.

Other Comments

1. Staff size--3 responses
2. Impacts of obsolescence--2 responses
3. Maintaining flexibility to respond to changes in exchange boundaries and retaining state responsibility for local exchange boundaries--2 responses.
4. Extended area service - advantages primarily to big users--2 responses.
5. Embedded CPE - Is it "grandfathered"? On which side of the ledger do the associated costs belong?--2 responses.

6. Long run impact of the cellular concept--1 response.
7. Properly balancing the need for cost-based rates vs. subsidization--1 response.
8. Increased numbers of people moving from urban areas to rural areas creating need for more toll and private line--1 response.
9. Growing consumer awareness and activity in the ratemaking process--1 response.
10. PBX market - what to do with idle equipment with the advent of competition--1 response.
11. Getting rid of regulation as soon as possible--1 response.
12. Being receptive to new ideas--1 response.
13. Breaking up the Bell system. AT&T conglomerate can cause service problems and problems for the state--1 response.
14. What to do with all the land-line with growing use of satellites--1 response.

Summary

The responses to this survey indicate that the state commissions and their staffs are actively involved in meeting the regulatory needs of the telephone industry and its customers. The responses indicate thoughtful concern for both ratepayers and the industry with the evolution of a new competitive era.

In addition to their normal workload of ratecases (involving all regulated industries) the majority of states have been engaged in

investigating and acting on many of the new issues initiated by the FCC.
As summary figures:

- 44 states have initiated some form of measured rate service.
- 31 have heard requests for flexible pricing (20 have granted it).
- 32 have initiated cost allocation studies or, at a minimum, have unbundled rates.
- 22 have begun to determine steps to monitor the transition to competition.
- 11 have acted on issues relative to the expensing of inside wiring (with 15 more states having cases pending at the time of the survey).

The state responses regarding future regulatory needs show that the commissions are very sensitive to the needs of their jurisdiction; that there is diversity among the states in the parameters of the regulatory environment; and that the commissions are beginning now to appraise the structural and procedural changes needed to meet the customer, company, and market needs of the future.

APPENDIX

SURVEY QUESTIONNAIRE

This appendix contains a copy of the questionnaire used in the telephone survey of public service commissions. The survey instrument was read verbatim by the interviewer. A call was made to each commission to establish the identity of the appropriate interviewee, and to schedule a date and time for the interview. The survey was then performed at the scheduled times. These interviews took place over a period of time from May to September 1981.

INTERVIEWEE _____

DATE _____

STATE _____

START TIME _____

ADDRESS _____

QUESTIONNAIRE

for Surveying

Public Utility Commissions.

Concerning

Regulatory Strategies in Response

to

Changes in the Telephone Industry

May 1981

QUESTIONNAIRE

HELLO MY NAME IS _____, I AM CALLING ON BEHALF OF THE NATIONAL REGULATORY RESEARCH INSTITUTE (THE RESEARCH ARM OF NARUC) IN CONNECTION WITH A STUDY BEING DONE FOR THE PUBLIC UTILITIES COMMISSION OF OHIO. THE OHIO COMMISSION IS INTERESTED IN DETERMINING SOME OF THE REGULATORY STRATEGIES BEING USED OR CONSIDERED TO RESPOND TO THE CHANGES IN THE TELECOMMUNICATIONS INDUSTRY, GIVEN RECENT AND LIKELY FCC DECISION. IF YOU DON'T MIND I WOULD LIKE TO HAVE YOU ANSWER A FEW STANDARD QUESTIONS. LET ME EMPHASIZE THAT YOUR ANSWERS WILL NOT BE IDENTIFIED BY YOUR NAME.

1. AS YOU KNOW, THE FCC HAS ORDERED THE DETARIFFING OF TERMINAL EQUIPMENT BY MARCH 1982. HAS YOUR COMMISSION BEGUN TO ALLOCATE COSTS BETWEEN TERMINAL EQUIPMENT AND OTHER SERVICES? Y N DK

2. DO YOU EXPECT YOUR COMMISSION TO ACT ON ITS OWN TO DETERMINE TRANSFER PRICES AND ASSOCIATED EXPENSES (OF CPE) OR WILL IT WAIT FOR FCC GUIDELINES? ACT WAIT OTHER

3. HAVE YOU ESTIMATED THE IMPACT OF DETARIFFING ON JURISDICTIONAL RATE BASE, AND REVENUE REQUIREMENTS, AND SETTLEMENTS REVENUE? Y N DK

IF YES, WHAT IS THE MAGNITUDE?

RATE BASE _____%

REVENUE REQUIREMENT _____%

SETTLEMENTS REVENUE _____%

4. DOES THE COMMISSION STAFF HAVE A PREFERENCE BETWEEN AT & T'S REQUESTED
FLASH-CUT OF CPE AND THE BIFURCATED APPROACH? Y N DK

5. FOR THOSE COMPANIES NOT ESTABLISHING SEPARATE CPE SUBSIDIARIES, WHAT
SPECIAL STEPS ARE YOUR COMMISSION OR STAFF CONSIDERING TO SEPARATE THE
COMPANY'S TARIFFED ACTIVITY FROM THE DETARIFFED ACTIVITY?

NONE _____

HAVEN'T DECIDED _____

6. HAVE ANY COMPANIES FILED FOR FLEXIBLE PRICING? Y N DK

WAS IT GRANTED? Y N DK

IF YES, WERE ANY SPECIAL STEPS TAKEN TO MONITOR OR LIMIT ITS USE?

7. DO YOU THINK YOUR COMMISSION WILL ALLOW THE USE OF STRAIGHT-LINE,
EQUAL-LIFE GROUP DEPRECIATION? Y N DK

IF YES, HAVE YOU ESTIMATED THE IMPACT OF THESE CHANGES?

8. IN THE PAST, INSIDE WIRING AND INSTALLATION COSTS HAVE BEEN
CAPITALIZED IN ACCOUNT 232. THE FCC IS NOW MOVING TO EXPENSE THESE
COSTS. HAVE THERE BEEN ANY RULINGS BY YOUR COMMISSION WHICH
SPECIFICALLY ADDRESS THIS ISSUE? (E.G., CAN THE RATEPAYER INSTALL HIS
OWN WIRING OR PURCHASE IT FROM THE COMPANY? ETC.) Y N DK

IF YES, WOULD YOU BRIEFLY DESCRIBE THEM OR CAN YOU GIVE ME THE
DOCKET NUMBER OR OTHER REFERENCE FOR FINDING THE DECISION?

- HAVE YOU ESTIMATED THE PERCENTAGE INCREASE IN INSTALLATION COSTS
9. NECESSARY TO FULLY COVER ALL COSTS OF INSIDE WIRING? Y N DK

IF YES, HOW MUCH?

10. DOES YOUR COMMISSION HAVE A PREFERENCE BETWEEN A FLASH-CUT AND A PHASE
IN APPROACH TO EXPENSING NEW INSIDE WIRING? Y N DK

11. WHEN INTERSTATE TOLL CHARGES BECOME BASED UPON AN ACCESS CHARGE, WHAT
STATE REGULATORY CHANGES MIGHT BE NEEDED?

12. WITH CABLE AND COMPUTER COMPANIES BEGINNING TO PROVIDE TWO-WAY
COMMUNICATIONS, COMPETITION IN THE LOCAL LOOP IS BEGINNING TO BECOME
TECHNOLOGICALLY FEASIBLE. HAS LOCAL LOOP COMPETITION BECOME AN ISSUE
OF CONCERN FOR YOUR COMMISSION? N Y DK

IF YES, WHAT IF ANY STATE REGULATORY ACTIONS ARE BEING CONTEMPLATED?

13. DOES YOUR COMMISSION HAVE A PREFERENCE FOR MEASURED RATES OR FLAT
RATES?

FOR BUSINESS SERVICE? Y N DK

FOR RESIDENTIAL SERVICE? Y N DK

14. TO WHAT EXTENT ARE MEASURED RATES IN EFFECT IN YOUR STATE?

IF YES, WHAT TYPE OF TARIFF IS USED? (E.G., 4 ELEMENT, 2 ELEMENT,
FREQUENCY ONLY?)

FOR BUSINESS SERVICE?

FOR RESIDENTIAL SERVICE?

15. WHAT ARE THE MAJOR OBJECTIONS TO MEASURED RATES (IF ANY) FROM THE
SUBSCRIBER?

FROM THE COMMISSION?

16. WHAT DO YOU THINK ARE THE REAL CHALLENGES TO STATE REGULATION IN THE
AREA OF TELECOMMUNICATIONS OVER THE NEXT 5 TO 10 YEARS?