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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a Session of the Public Service Commission held in the City of Albany on December 2, 1992.

COMMISSIONERS PRESENT:

Peter Bradford, Chairman
Lisa Rosenblum
James T. McFarland
Henry G. Williams
William D. Cotter
Raymond J. O'Connor

Case 91-C-1174 - Proceeding on Motion of the Commission Regarding Comparably Efficient Interconnection Arrangements for Residential and Business Links.

ORDER ACCEPTING IN PART AND MODIFYING IN PART COMPLIANCE TARIFF FILING
(Issued and Effective December 18, 1992)

BY THE COMMISSION:

By Opinion and Order[1/] issued and effective November 25, 1991, the Commission ordered New York Telephone Company to unbundle into links and ports its Centrex[2/] and Private Branch Exchange access services in a revenue neutral manner, and to file interconnection arrangements to allow

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[1/] Case 91-C-1174 - Opinion and Order Concerning Comparably Efficient Interconnection Arrangements, and Instituting Proceeding, Opinion No. 91-24 (issued and effective November 25, 1992).

[2/] The term Centrex is used generically herein to refer to switching services allocated to a single customer's use.

provision of competitive Centrex and Private Branch Exchange links. The Commission also ordered New York Telephone Company to file comparable tariffs for all classes of service, including residence and business, or to show cause why such arrangements should not be required.

New York Telephone chose to comply fully with Opinion No. 91-24, including the filing of tariffs for Centrex, Private Branch Exchange, residence and business link and port services.[1] As a result, unbundled Centrex and Private Branch Exchange link and port services, and applicable interconnection terms, became effective July 24, 1992. However, by Order issued July 23, 1992, the Commission allowed New York Telephone to postpone, in place of suspension, its tariffs unbundling residence and business access services. The unbundling approach proposed by the company was not revenue neutral as required by Opinion No. 91-24 and resulted in the subsidization of competitive link elements. In addition, various New York Telephone Company proposals for additional pricing flexibility associated with the changes appeared insufficiently supported. Thus, the Commission granted the postponement to gather further

[1] The company simultaneously proposed to restructure rates for services overall. This request was rejected, without prejudice, in our Order (Case 88-C-004, et al., Order Accepting in Part, Suspending in Part, and Rejecting in Part Compliance Tariff Filing)(issued July 23, 1992).

comments regarding these matters. The effective date of the pending New York Telephone tariffs is December 21, 1992.

Comments were received from a variety of parties, including New York Telephone Company. They are summarized in a memorandum from our Communications Division, which is attached to this order. With the exception of New York Telephone Company's request that further unbundling be conditional upon the consideration of a rate structure proposal previously rejected by the Commission, the consensus of the parties is that unbundled link and port rate elements should reflect the subsidy in the more monopolistic port element instead of the more competitive link element.

We have carefully examined the comments and recommendations as discussed in the memorandum from the Communications Division, and conclude that link rates should, in the long run, be set closer to relevant costs, as links will now be provided in a competitive environment, and that the unbundling of business and residence loops into port and link rate elements should be accomplished in a rate-neutral manner. Further, in order to assure that this unbundling is effectuated consistently with the six principles we established in the Competition

Proceeding,[1] to guide the "systematic transition from a monopolistic to a competitive environment," the change should be accomplished in two steps.

In the first phase, residence link rates will continue to recover the bulk of subsidy inherent in existing loop or access line rates. Link rates for business services will be set at cost; residence link rates will be set to ensure that unbundling is rate neutral to customers and the current subsidies continue to flow to the benefit of ratepayers.

In the second phase, residence link rates will be moved closer to full cost. In accordance with our previously established six principles, particularly the avoidance of rate shock, staff, as discussed in its memorandum, has proposed a plan for the development of a universal service element. As proposed by staff, the universal service rate element would be calculated based upon the difference between the costs and rates for residence and business link services and applied to customers' bills so as to permit links to be priced closer to relevant costs without increasing customer rates. In other words, it would be

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[1] Case 29469 - Proceeding on Motion of the Commission to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Opinion No. 89-12 (issued May 16, 1989)(The Competition Proceeding). The six principles are: (i) universal telephone service, (ii) high quality service, (iii) adequate forums for customer concerns, (iv) avoidance of rate shock, (v) no deregulation of unregulated monopolies and (vi) the ability to reregulate when required.

designed such that the price to the end user remains at current levels; the universal service element could be either a contributory charge for exchange services that are found to be providing contribution, or a credit, where the service is currently subsidized.

This second phase, as proposed by staff, includes a unique credit plan, which raises new and important issues. This credit plan will enable customers to choose between competitive link providers based upon their relative link prices, reflective of their unique underlying costs, without the distortions created by internal cross-subsidies. This approach will also maintain rate neutrality for customers as loops are unbundled and links are provided in a competitive environment. We invite the parties to suggest other alternate approaches to achieve these objectives.

Parties will, therefore, be provided an opportunity to research the implications of the suggested approach and file comments, and reply comments, on the proposals. Parties submitting phase two comments should specifically relate them to the six principles we enunciated in the Competition Proceeding.

In addition, we will approve New York Telephone Company's associated proposals for pricing flexibility, with certain conditions, and the company will be required to implement higher speed interconnection arrangements, as discussed in the Communications Division memorandum.

The Commission Orders:

1. New York Telephone Company shall cancel, within two days, the tariff pages shown in Appendix 1 to the attached memorandum. It shall file revised pages, within ten days, in accordance with the conclusions therein, to implement phase one loop unbundling of links and ports to become effective on January 10, 1993.

2. Interested parties shall have 90 days from the issuance of this Order to file written comments on the phase two proposals contained in the Communications Division's memorandum; replies shall be due 30 days later.

3. Parties wishing to comment on these issues may do so by submitting 15 copies of the initial and reply comments no later than March 18, 1993 and April 17, 1993, respectively, to John J. Kelliher, Secretary of the Public Service Commission, Three Empire State Plaza, Albany, New York 12223.

4. Any person wishing to receive the responses, comments and replies of other parties shall so notify the Secretary to the Commission in writing no later than

January 15, 1993. The Secretary will ensure that all parties are apprised of the identity and address of all parties to the proceeding.

5. Each party appearing on the list shall provide one copy of all responses, comments and replies that it submits to the Commission to each of the other parties appearing on the list.

6. New York Telephone Company shall file tariffs, separate from the phase two comments above, introducing DS1 port interconnection arrangements as discussed in the Communications Division memorandum, within 90 days of the issuance of this Order, or show cause why it should not be required to do so.

7. This proceeding is continued.

By the Commission,

(SIGNED)

JOHN J. KELLIHER
Secretary

FILED - SESSION OF DEC 2 1992

STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

November 24, 1992

TO: THE COMMISSION

FROM: COMMUNICATIONS DIVISION

SUBJECT: CASE 91-C-1174 - Proceeding on Motion of the Commission Regarding Comparably Efficient Interconnection Arrangements for Residential and Business Links.

COMPLIANCE WITH OPINION NO. 91-24

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SUMMARY

By Opinion and Order (Opinion No. 91-24) issued November 25, 1991, the Commission ordered New York Telephone Company to unbundle into links and ports[1] its Centrex[2] and Private Branch Exchange access services in a revenue neutral manner, and to file interconnection arrangements to allow provision of competitive Centrex and Private Branch Exchange links. The Commission also ordered New York Telephone Company to file comparable tariffs for all classes of service, including residence and business, or to show cause why such arrangements should not be required.

New York Telephone did not choose to show cause and complied fully with Opinion No. 91-24, including the filing of tariffs for Centrex, Private Branch Exchange, residence and business link and port services.[3] As a result, unbundled Centrex and Private Branch Exchange link and port services, and applicable interconnection terms, became effective July 24, 1992. However, by Order issued July 23, 1992, in the above named proceeding, the Commission allowed New York Telephone to postpone, in place of suspension, its tariffs unbundling residence and business access services. In Staff's view, the unbundling approach proposed by the company resulted in the subsidization of competitive link elements and was not revenue neutral as required by Opinion No. 91-24. In addition, various New York Telephone Company proposals for additional pricing flexibility associated with the changes appeared poorly supported. Thus, the Commission granted the postponement to gather further comments regarding these matters. The effective date of the pending New York Telephone tariffs is December 21, 1992.

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1 Please see page 5 of this report for definitions of these terms.

2 The term Centrex is used generically herein to refer to switching services allocated to a single customer's use.

3 The company simultaneously proposed to restructure rates for services overall. This request was rejected, without prejudice.

Comments were received from a variety of parties, including New York Telephone Company. With the exception of New York Telephone Company's request that further unbundling be conditional upon the consideration of a rate restructure proposal previously rejected by the Commission, the consensus of the parties is that unbundled link and port rate elements should reflect the subsidy in the more monopolistic port element instead of the more competitive link.

Staff has carefully examined the comments and recommends that the Commission direct New York Telephone Company to file restructured residence and business port and link rate elements, in a rate neutral manner, in two steps. In the first phase, port rates for residence and business services would continue to reflect the bulk of the subsidy inherent in existing loop or access line rates. In the second phase -- a phase that requires an additional round of comments and replies before it is considered -- link rates would be allowed to reflect their appropriate costs, inclusive of a new form of universal service rate element. The universal service rate elements so established would reflect the appropriate subsidy or contribution level as an adjunct to the monopoly port element, such that the sum of the resultant link, port, and universal service elements equals existing customer rates. It would mean that New York Telephone Company would credit the customer of a competing local link provider with same subsidy as its own customer receives. In addition, New York Telephone Company's associated proposals for pricing flexibility should be approved, with certain conditions, and the company should be required to implement higher speed interconnection arrangements as discussed herein.

There are no significant technical distinctions between simple residence and business link services, and links provided to large businesses. The Commission has determined that unbundling of loops into links and ports is in the best interest of the overall customer body as it allows competitive link providers to expand the market for their services, thus increasing the utility of their networks, and offers all exchange access customers an alternative to their monopoly links.[4] Link competition is in its early formative stages, and the Commission found that action now will likely only modestly affect the revenues of New York Telephone. Thus, the timing is good as the company will have perhaps several years to adapt and anticipate the impact that more widespread link competition from sources possibly including wireless and cable companies may entail. Further, the two phase approach recommended here assures that the transition process from monopoly to competition continues forward in a controlled and measured manner.

The dominant local exchange telephone companies will largely continue to be monopolies or near monopolies given their ubiquitous service base, and since there are no real alternatives to the port services -- dial tone and a network address (i.e., a telephone number) for the origination and termination of public switched calls -- they provide. Thus, New York Telephone would administer the Universal Service Element at its port to ensure that the subsidy flows reflected in existing rates are undisturbed and accurately administered unless or until the Commission decides to alter them. Customers who choose alternative link providers relieve New York Telephone Company, in the long run, of providing costly, and sometimes unprofitable, link services, while simultaneously providing for continued customer use of certain other less expensive, more profitable company-provided switched services. Despite the advantages envisioned for the company in such an approach, its competitors have largely recommended the same approach in their comments. Under these circumstances, it is not necessary or desirable to couple the already ordered unbundling to any rate restructure proposal which New York Telephone may or may not decide to propose. Any such restructure can be considered on its own merit.

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4 Cases 88-C-004, 88-C-063, and 91-C-1174, Opinion No. 91-24 (issued November 25, 1991).

BACKGROUND

In its Intellipath Order (Opinion No. 91-24) issued November 25, 1992, in Case 88-C-004, et al,[5] the Commission determined that Centrex and Private Branch Exchange access services be unbundled into two separate rate elements: the link and the port. The link is the pair of wires or a virtual circuit path from the customer's premises to the local exchange carrier's central office. The port represents those facilities that actually connect the link to the telephone company's central office switch and that provide the customer with the function of dial tone and a unique customer address (e.g., a telephone number). Please see Figure One below.

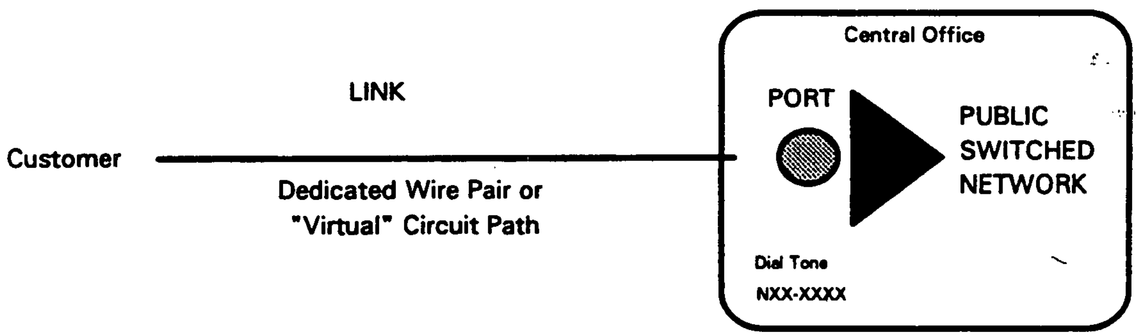

FIGURE ONE

In its order, the Commission reasoned that such an unbundling would be an essential precursor to the goal of deregulating Centrex services when statutorily permissible, and to the development of competitive alternatives for end users. As in its approach to the terminal equipment market in the past, the Commission determined that unbundling was essential to the advancement of competition and that all telephone companies providing Centrex

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[5] Opinion and Order Concerning Comparably Efficient Interconnection Arrangements, and Instituting Proceeding.

services should unbundle without delay.[6] It also directed New York Telephone Company to provide supporting interconnection arrangements.

The Commission further recognized that Centrex links were functionally indistinguishable from links provided to individual line business and residence customers, and that the issues raised by link competition generally "will resemble those associated with respect to Centrex and PBX."[7] Since the Commission saw no benefit in prohibiting the provision of competitive links under these conditions, it directed New York Telephone Company to either file appropriate tariffs, or to show cause why it should not be required to do so. To facilitate this discussion, the Commission established the instant proceeding, Case 91-C-1174:

> As a matter of principle, the potential benefits of link competition should not be limited to Centrex and PBX customers. The establishment of physical demarcation points for links at the main distributing frame (MDF) will also facilitate the eventual provision of alternate service arrangements to residence and small business customers. We have already noted this possibility:
>
> > *To insure that the expanded proceeding is carefully focused on matters ripe for consideration, it will be limited to PBX and Centrex service, for these companies such as Teleport are now prepared to offer competing link facilities. PBX and Centrex are links are functionally indistinguishable from links to smaller individual line customers; and we expect to consider in later proceedings the extension of CEI arrangements to all expansions of competitive opportunities.*
>
> The issues raised by link competition generally will resemble those associated with respect to Centrex and PBX. Once local telephone companies gain experience providing interconnection for Centrex and PBX, it will be easier to expand such interconnection arrangements. The facilities and investments

6 New York Telephone Company and 15 other independent telephone companies.

7 Cases 88-C-004, 88-C-063, and 91-C-1174, Opinion No. 91-24 (issued November 25, 1991), mimeo pp. 23-24.

> necessary to provide competitive Centrex and PBX links, for example, are entirely capable of providing service to any link user, and we see no apparent benefit in an outright prohibition of the use of such facilities in that manner. And while the potential impact on both the local telephone company and its ratepayers of widespread link competition from other sources such as cable television or wireless may appear significant in the abstract, the lack of functional competitive infrastructure makes it unlikely that alternate link providers will soon be commonplace.
>
> Accordingly, we expect to require New York Telephone to file tariffs that offer CEI arrangements for the provision of competitive links for all other classes of customers (residence and business). However, in order to afford New York Telephone a full opportunity to air its views on the matter, we shall institute a proceeding in which it will be permitted to show good cause why it should not be required to file such tariffs.[8]

After several requests for extensions by the industry, compliance tariffs were filed in June 1992, and by Order issued July 23, 1992 (July 23, 1992 Order),[9] the Commission approved the Centrex and PBX link and port rates filed by New York Telephone Company and various independent telephone companies. In addition, it approved New York Telephone's interconnection arrangements for competitive link providers, and concomitant pricing flexibility for Private Branch Exchange links offered by New York Telephone. The changes became effective July 24, 1992. The Commission also allowed New York Telephone Company to postpone, in lieu of suspension, similar proposals for residence and business ports and links as the "relevant rate levels" proposed by the company for such services appeared to comply with Opinion No. 91-24, but needed "further review and analysis." Company proposals for port and link pricing flexibility for a variety of services were also postponed. These tariffs become effective December 21, 1992.[10]

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8 Opinion No. 91-24, mimeo pp. 40-42

9 Order Accepting in Part, Suspending in Part, and Rejecting in Part Compliance Tariff Filing, Case 88-C-004, et al, (Issued July 23, 1992).

10 Further Postponement of Tariff Changes, Case 91-C-1174 (Issued November 10, 1992).

The Commission also rejected, without prejudice, a New York Telephone Company proposal to implement simultaneously a "massive and unsolicited restructuring of rates for virtually every major service category" as it "was neither contemplated nor authorized" by Opinion No. 91-24, and violated the "clear and specific" requirement of revenue neutrality to individual customers.

A further round of comments and reply comments was entertained on the matters of additional pricing flexibility and the proposed residence and business link and port rates, and the July 23, 1992 Order was served on over 350 parties. Comments were due September 8, 1992 and replies on September 23, 1992.

COMMENTS

Comments were received from the Empire State Payphone Association ("Payphone Association"), Metropolitan Fiber Systems ("Metro Fiber"), New York Telephone Company ("New York Telephone" or the "company"), and Teleport Communications Group ("Teleport").[11] The comments address three broad areas: the pricing of monopoly ports, pricing flexibility, and DS-1 port[12] interconnection. A summary of the comments on these areas, and staff's discussion follows below.

Monopoly Port Pricing

New York Telephone Company's proposed tariffs for the unbundling of access services other than Centrex and Private Branch Exchange reflect the following rate design. The port charge is roughly equivalent to the costs of the appropriate port service. Then, the

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11 CONTEL of New York, Inc. (d.b.a. "GTE New York") and the New York Clearing House Association ("Clearing House"), filed a letter dated September 8, 1992 as their comments.

12 DS-1 is a digital engineering term that describes a facility capable of handling 24 voice grade equivalent circuits.

port charge is simply subtracted from the existing access line rate[13] with the difference constituting the proposed link charge. The company has also proposed to apply a new charge -- the universal service rate element -- to all ports in keeping with the Commission's overall interconnection policy regarding the maintenance of contribution levels. Under that policy, the contribution losses associated with expanded interconnection, are uniformly recovered from the competitive service providers to ensure that the contribution flows are not affected, and to create a level playing field for all competing providers. The substance of the NYT proposed rate design approach is tabulated below:

13 As New York Telephone operates in the dual regulatory jurisdictions of the New York Public Service Commission and the Federal Communications Commission, some of the costs associated with providing these access services are assigned to the interstate jurisdiction. These charges are partially recovered in a separate, monthly interstate rate -- the Federal End User Common Line Charge. The monthly interstate rate is $3.50 for residence and $5.15 for business lines.

Table 1

NEW YORK TELEPHONE'S PROPOSED RATES AND COSTS

LINKS AND PORTS

SERVICE:		Residence[1]	Business
Existing Intrastate Rate	(a)	$ 6.60	$16.23
Federal End-User Charge	(b)	3.50	5.15[2]
Existing Total Rate (a+b)	(c)	$10.10	$21.38
Port Cost	(d)	4.98	4.96
Proposed Port rate	(e)	5.07	5.08
Effective Intrastate Link Rate (a-e)	(f)	1.53	11.15
Effective Total Link Rate (f+b)	(g)	5.03	16.30
Link Cost	(h)	18.18	18.24
Proposed Universal Service Rate Element	(i)	-0-	-0-
Proposed Total "Loop" Rate (b+e+f+i)	(j)	$10.10	$21.38

[1] Residence Message Rate Service
[2] Multi-line Business; single line business pay $3.50.

The July 23, 1992 Order invited further comment on the unbundling approach recommended by the company because, as discussed in the Communications Division memorandum accompanying that order, the proposed link rate appeared to cause more problems than it solved:

> New York Telephone argues that the offering of such a low, and in its view below cost, rate for links would actually frustrate the link competition sought by the Commission, and could constitute anticompetitive behavior. Thus, the company has proposed to increase the residence link charge now by $1.67, and by similar amounts in a series of subsequent, annual filings over the next three years. The company's concerns are overblown, and the cause may be as a result of its approach to the unbundling of these services. The problem appears to be of its own making.

> The practice of setting rates has historically focused upon the application of contribution, or subsidy, on monopoly rate elements. Since these elements are largely unavoidable by users, the application of contribution at this point is particularly effective as it virtually assures its continuation without disruption, and allows the subsidies to be targeted to those whom the Commission has authorized to receive such benefits. The company's proposed unbundling has the effect of setting monopoly port rates at cost and, thus, shifting the subsidy to competitive links; it is exactly opposite to the historical pattern and the pattern Staff expected the company to follow.[14]

1. Comments

Several parties commented upon New York Telephone's proposed link and port rates. The Payphone Association contends that since the costs filed in support on the individual line business rate demonstrate that the existing rates for business service do not cover their costs, a similar rate-to-cost relationship should be established for the Public Access Lines that its members employ to compete with New York Telephone public and semi-public coin telephone service. The Payphone Association observes that the Public Access Line rate has historically been set equivalent to the rate for business service. Thus, it argues the pricing of all ports and links requires this kind of parity. It further recommends that the Commission direct the company to unbundle its own payphone services, and that an investigation be conducted into the payphone operations of all telephone companies. In the Payphone Association's view, Opinion No. 91-24 required the company to unbundle links and ports for all classes of customers and the company's failure to unbundle its public and semi-public coin telephone services not only violates this directive, it raises serious questions of regulatory "asymmetry." Thus, it recommends that an evidentiary hearing be convened to evaluate these questions.

Regarding the issue of link and port pricing, the Payphone Association observes:

[14] Communications Division Memorandum, pp. 39-41

> (T)he link element of the access line (the potentially competitive element) is subsidized by the monopoly port element in a manner which is not consistent with the Commission's public policy goals. Shifting subsidies to competitive services is also contrary to the purpose of unbundling, that is, to encourage effective competition in the local exchange arena.[15]

Metro Fiber argues that New York Telephone should unbundle all of its services, and urges a phased-in restructuring of the company's rates based upon functional components of the network rather than service-based classifications. It also recommends that link rates be set at market-based levels so that "efficient competitors will have an economic incentive to enter the market."[16] Referring to the rate and cost disparity shown in Table One above, Metro Fiber asserts:

> For these reasons, the Commission should require NYT to set its residential and business link rates at cost-justified levels. Any required "subsidy" or universal service adjustment to cost-based rates should be applied to or associated with the port charge, not the link charge, for the reasons stated in the *July 14 Memo*, mimeo pp. 40-41. Once these steps have been taken NYT's objections to providing link services on an unbundled basis to competitive providers should be rendered moot, and NYT should therefore be required to permit the unbundled purchase and resale of all tariffed link services[17]

Metro Fiber also asserts that a major cause of the odd rate patterns offered by New York Telephone are that instead of focusing upon technical, functional unbundling, the company has employed service specific unbundling resulting in a "plethora" of widely variant link rates, especially in the Centrex service category:

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15 Payphone Association Comments, p. 6.

16 Metro Fiber Comments, p. 2.

17 Id., mimeo pp. 8-9.

> Ideally, this irrational and discriminatory rate structure should be replaced by a simpler structure that is based upon actual technology and cost causation. Such a structure would be based upon functional, rather than service specific, unbundling.[18]

New York Telephone Company's comments reassert its preference to precede any further unbundling of link and port services with an overall rate restructuring.[19] New York Telephone argues that "(f)air competition cannot flourish in a subsidized market."[20] The company calls the subsidy for residence access a significant obstacle to a competitive market. New York Telephone also renews its calls for a Universal Service Fund as a means of administering contribution flows:

> Restructuring will allow economically efficient unbundling. Some competitive losses associated with unbundling are best recovered from currently under-priced services because only as rates are bought toward cost will the production and consumption of telecommunications services reflect the cost of providing those services. Only then will efficient and fair competition be achievable.
>
> The company does not propose to bring the rate for residence access to its full cost, even at the conclusion of the four year transition plan. The rate restructure will only initiate a process through which the pricing anomalies built into the current rate structure are corrected. The Company recognizes that as increased competition erodes the Company's provision of links, not all of the lost contribution can or necessarily should be recovered by increasing port prices. As the company suggested in the June 5 filing, one way to help prevent the unintended loss of contribution is to establish a means, such as the USF, whereby all providers who benefit from access to the network share the burden of whatever rate subsidies the Commission

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18 Id., mimeo p. 5.

19 This request is supported by GTE New York. Indeed, this is the main substance of its letter filed as comments in this case. Though it admits it "did not conduct a complete review regarding the magnitude of NY Tel's proposed rate changes," GTE agrees that rate restructuring and pricing flexibility for competitive services are warranted.

20 New York Telephone Comments, p. 28.

> determines to be warranted during the transition to full local exchange competition.[21]

About the pricing of ports, New York Telephone defends its choice to set port rates at cost since, given the constraint of rate neutrality, the alternatives of pricing ports and links at the same relative proportion to their costs, or pricing ports at zero or below cost, appears less desirable:

> The flaw in the reasoning of CPB, Teleport and Staff is this: Proportionate pricing of links and ports, without cost-based pricing, in an unbundled environment will have precisely the impact on residence service rates that CPB and Staff, in particular, wish to avoid. It will increase the pressure on the company to raise the residence full service rate to compensate for contribution loss as business link and other contributory service revenues shrink.
>
> Business and usage services have historically subsidized residence services. Unless the contribution currently carried in these rates is shifted to another recovery method, such as a USF, or (more appropriately) to the residence rate itself, then the Company is forced to set some business rates above cost. If the related port rate is set at full cost, the corresponding link component will have to be set above cost to cover the needed contribution. That impedes the Company's ability to compete in the market for those services altogether.
>
> With respect to residence service, pricing the link component at as much of the full cost as the Commission-imposed rate allows, will require that a residence port be offered at a zero rate or even at a rate below $0.00. The suggestion that the Company should give a credit for the port to competitors who choose to provide residential links merely exacerbates the problem. Pricing the port at $0 would mean that an increase in residence customers who take ports only will not benefit the Company but will simply increase the subsidy (e.g., cost=$5.00; revenue=$0). When competition materializes in the residence market -- in the MetroLATA, for instance -- the Company's risk will be limited to the risk of loss on the link component and the Company will not also risk loss on each port. Pricing in any other manner merely increases the pressure to seek higher rates from all remaining customers or to increase the amount of money to be allocated through USF.[22]

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[21] New York Telephone Comments, p.30

[22] New York Telephone Comments, p. 38

Thus, the company concludes that rate unbundling should not precede moving rates toward costs.

Teleport joins with Metro Fiber in calling for New York Telephone to unbundle all services as required by Opinion No. 91-24. Teleport also has considerable concerns regarding the unbundling approach recommended by the company:

> The ratemaking approach used by NYT to set port and link charges for these additional services also demands scrutiny. As the Commission recognized in its Order, NYT priced its ports at full cost, and residually priced its links. The result is an obvious competitive imbalance. Competitors like Teleport must compete against link rates that NYT admits are below-cost, while paying NYT's full price for ports. The Commission should not permit NYT to strike such a one-sided bargain. If NYT insists on using a residual pricing approach, then it should be the port service, which all customers are required to purchase, that should be residually priced.[23]

In addition, Teleport renews its arguments that New York Telephone's proposed termination charges for Centrex customers are unfair as they impose such termination charges in cases where a customer moves from an existing company-provided full service offering to a competitor's link, but not when the opposite occurs (i.e., when Teleport customer chooses to take New York Telephone Company service). Teleport argues such approaches discriminate against customer's freedom of choice.

In reply, New York Telephone points out that the only customers who incur termination charges are those who have already entered into contracts with the company for an existing full service. Thus, the "contractual" tariff rates already reflect the benefits to the business customer for committing to a long term arrangement. Termination charges compensate the company for the customer's failure to maintain service, as agreed, during the full term:

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[23] Teleport Comments, p. 2

> This termination charge is necessary for the company to recover costs which are not avoidable and to recover the cost of capacity that is not reusable for the remainder of the service period. Termination charges may apply to a full service or to a port-only service offered in the SNAPS tariff. Termination charges do not apply under any circumstances when a customer terminates an alternative provider's link service. However, when a customer drops the Company's link for a competitor's, the customer pursuant to its contract is liable to compensate the Company for the forecasted revenue (calculated to cover the cost of providing the link over the remaining term of the contract) associated with the full service and for which the customer agreed to pay the Company.[24]

Concerning Metro Fiber's call for a simpler, function-based unbundling, New York Telephone points to the differences in costs of serving different customers as reflecting the variation in the manufacturer's switching equipment used to serve the customer:

> MFS is simply not familiar with all manufacturers' switching equipment if in fact they believe the only difference in the ports is the software features activated for each. This is not the case. While various vendors do in fact manufacture "digital switches," the underlying architecture of the switches is different and therefore, have different underlying costs associated with the provisioning of the different ports. If a future service is available from only one of these switching vehicles, then the port cost should represent the cost of that one switching type, and not an average.
>
> From a purely technological perspective, capital investment for a two-wire link is the same regardless of who is paying the bill--a residence service customer or an IMB customer. However, this similarity evaporates when additional signaling and transmission equipment that may be required for services such as PBX Trunks and Private Line to achieve appropriate transmission levels is taken into consideration. In addition, operating expenses, including testing and maintenance, will vary depending upon, for instance, whether the link is provisioned as a component of full service or as a stand-alone service to other port providers. In the latter instance, the link provisioning expense would reflect costs closer to costs for provisioning Private Line links.[25]

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[24] New York Telephone Comments, p. 18

[25] New York Telephone Reply, pp. 19-22

With regard to the contention that the company had failed to unbundle all services as required by Opinion No. 91-24, New York Telephone replies that the order limited the requirement for unbundling to switched "exchange access" services only, and was not to be so broadly interpreted as some parties have. Thus, the company excluded ports for certain switched private line services, [26] and for certain features and functions that do not constitute true services.[27]

The company also excluded Flat Rate Business Services and Party Line Service as such services are being eliminated or grandfathered respectively. The company also excluded its Public and semi-public services as it views such options as being "end-to-end" services, and because the Public Access Lines with which they compete are unbundled. Therefore, subscribers may separately avail themselves of ports for these services if they wish to utilize a competitive link. Lifeline services were also excluded. The company's choice to exempt Lifeline from unbundling reflects its concern that a heavily subsidized service such as this not be unbundled until rates overall are brought closer to costs.

The company also exempted Enhanced and basic 911 services until the needs of those who might require such interconnection are better known. Given that these services represent important emergency services, the company perceives significant issues associated with such unbundling that "need to be resolved independent of the Compliance Filing."[28] The company also points out that foreign exchange services are now effectively unbundled as customers may use a combination of dedicated and switched services to effectuate the equivalent of this service in a competitive manner. Finally, the company notes that it is

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[26] Hotline Virtual Private Line Service, Intellihub Dedicated Network Service, and V-Path II Private Network Service.

[27] Mass Announcement Service, DOV - Path Service, 800 and Outgoing WATS, and Apartment House Service.

[28] New York Telephone Reply Comments, p. 14.

currently reviewing interconnection methods related to Radio Telephone Utility services to determine how they might be best unbundled.

Regarding the issue of port pricing generally, New York Telephone replies that it shares the concerns of many commenters regarding uneconomic pricing, and reiterates that its proposal remains superior:

> In the absence of rate restructuring, the uneconomic pricing of the residence access service will persist and continue to make fair competition for the residence market impossible. The Company, like MFS and Teleport, is frustrated by the current uneconomic rate structure. But further unbundling must await rates for all services being brought toward cost. In the meantime (and until a Universal Service Fund or other mechanism for equitably distributing the subsidy burden among all providers is established), pricing ports to cover their full cost is the most economically sound means to sustain the Commission's goal of maintaining a highly subsidized residence service. Pricing flexibility will allow the Company to compete fairly as the competitive markets emerge and will alleviate some upward pressure on rates.[29]

2. Discussion

The unbundling of links and ports for residence and business service classes by New York Telephone Company should have followed the six principles the Commission established to guide the "systematic transition from a monopolistic to a competitive environment,"[30] and the "clear and specific"[31] instructions provided in Opinion No. 91-24, repeated in the July 23, 1992 Order, that the changes "be revenue neutral, without affecting the

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29 New York Telephone Reply, pp. 5-6

30 The six principles are: 1) universal telephone service, 2) high quality service, 3) adequate forums for customer concerns, 4) avoidance of rate shock, 4) no deregulation of unregulated monopolies, 6) the ability to reregulate when required (Case 29469 - Proceeding on Motion of the Commission to Review Regulatory Policies for Segments of the Telecommunications Industry Subject to Competition, Opinion No. 89-12, issued May 16, 1989).

31 July 23, Order, p. 4.

level of customer charges." Had New York Telephone heeded those principles,[32] it could have balanced its concern that competitive services, such as links, be priced at cost, with the requirement for customer-specific revenue neutrality to avoid violating the principle of rate shock to customers.[33]

Staff agrees with the parties, including New York Telephone, that a competitive link market is impossible generally unless link rates reflect their costs. A significant disadvantage of the company's proposal is that it maintains link rates below cost for an indefinite period of time. Thus, Staff recommends that link rates be moved to full costs in two discrete steps, not in a series of indeterminate stages. Failure to do so ultimately frustrates the possibility of full and fair competition.[34]

In addition, the restructuring of rates proposed by New York Telephone violates the Commission's requirement that rate changes not affect the level of customer charges. The Commission rejected, without prejudice, the company's restructuring in the July 23, 1992 Order as the filing did not meet the minimum requirements for rate changes of such a magnitude, and was beyond the scope of the instant proceeding:

> This massive rate restructuring was neither contemplated nor authorized by our order. The instructions in Opinion No. 91-24 were clear and specific, and the company's unbundling was to be revenue-neutral, without affecting the level of customer charges. The company may not, in a compliance filing, expand the scope of our order; nor may it condition its compliance on terms and conditions which were never contemplated or

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32 The company did not address these principles in either the pending tariff proposals or in its initial comments or reply.

33 Staff also entered into informal dialogue and discussions directly with the company on the specific points raised here over the last seven months. These discussions have not resulted in any official change in position by the company, but they have clarified the merits and demerits of the unbundling alternatives discussed herein.

34 Since links would then be offered at cost, this alleviates concerns regarding the resale of links or spare link capacity are alleviated. Such resale could then be authorized, as certain parties have argued.

> authorized by Opinion No. 91-24. Accordingly, we will reject these rate structure proposals.
>
> New York Telephone, however, may petition the Commission to institute a separate formal inquiry to examine various rate structure issues, if it wishes to pursue these matters further. In such a petition, however, the company should be particularly sensitive to the six principles we have articulated that guide our deliberations during this systematic transition period from a monopolistic to a competitive environment. In particular, the company should be mindful of our commitment to ensuring that universally affordable telephone service is undiminished for all New Yorkers and that rate shock to individual customer classes of groups be avoided. Furthermore, in as much as the scope of the company's proposed restructuring would have impacts on many customer groups similar to those associated with a major rate filing, the level of detail and documentation supporting a major rate filing would be necessary. Therefore, such major and far-reaching rate restructuring proposals should be accompanied by supporting testimony, affidavits and exhibits, as appropriate, should the company choose to pursue these matters.[35]

Thus, any future restructuring proposed by the company awaits only a meeting of these minimum filing requirements. Any attempt by New York Telephone to tie the requirement for link and port unbundling to its previously rejected, and less than fully supported, rate "restructure" is still inappropriate.[36]

Staff believes parties who propose that the monopoly port charge reflect the contribution or subsidies associated with that particular service class are correct.[37] This approach is in complete accord with traditional ratemaking practices, the principles previously established by the Commission for the transition to competition, generally, and for comparably

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[35] July 23, 1992 Order, mimeo pp. 4-5, (emphasis added).

[36] It should also be noted that the company's own, and as yet unsupported, estimate of the revenue effect of link unbundling and competition is a *de minimis* decrease of only $0.85 million.

[37] As New York Telephone also notes: *Ports for services that have historically carried a contribution element and offer features and functions in addition to exchange access have been priced at varying levels above their relevant cost in order to continue to provide some contribution* (New York Telephone's June 5, 1992 Compliance Filing, p. 14).

efficient interconnection, specifically.[38] The foundation of the Commission's interconnection policy has been to allow services becoming competitive to reflect their costs, and to establish separate "contribution charges" for such services payable by the competitive interconnector or the interconnector's customer.[39] The tariff refers to these contribution charges as Universal Service Elements or, in the case of switched access services, the Access Connection Element. These charges place a reasonable contribution charge on all competitors, and serve to flow that contribution through to the customers who have historically received the benefits.[40] Thus, non-link competitors already pay their fair share of the contribution when competing with NYT's services. The table below identifies the services for which competitive interconnection exists, and the applicable universal service charges payable by NYT's competitors:

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38 For example, recent decisions in the areas of switched access (Case 28425), billing & collection (Case 89-C-191), and prior rulings on competitive interconnection (Case 29469) require contribution to be associated with monopoly, not competitive, service elements.

39 The Commission's interconnection policy has also granted concomitant pricing flexibility to the telephone company for services becoming competitive due to the Commission's expanded interconnection requirements. This is discussed later in this memorandum.

40 Until such time as the Commission determines to alter or eliminate such a contribution.

Table 2

INTERCONNECTION TERMS

SERVICE	RATE ELEMENT	RATES	CONTRIBUTION MAINTAINING	PRICING FLEXIBILITY
Dedicated Lines (non-switched)	USE	\$5 to \$500/channel	YES	YES
Carrier Access (switched)	ACE	0.1 cents per MOU	YES	YES
Centrex and PBX Ports (switched)	USE	\$0 to \$500/port	YES	PENDING
Residence and Business Ports	USE	\$0	NO	NOT REQUESTED

Table 2 demonstrates that interconnectors (and their customers) currently pay contributory charges whenever they provide (or use) services that compete with New York Telephone. The intended recipient of these contribution charges is, as New York Telephone agrees, residence exchange access service. The unbundling of exchange access services, however, has the impact of effectively opening the link portion of these facilities to competitive provision. The current situation is fair to customers generally as it maintains pre-existing contribution flows, while simultaneously allowing the benefits of direct competition in the affected markets. However, under New York Telephone's instant proposal, the subsidy payments extracted as a distinct contribution charge from interconnectors directly reduce the New York Telephone residence link rates with which the interconnectors compete. To ask competitors to compete with company services whose prices reflect a subsidy derived from separate contribution payments made by the same competitors is patently unfair.[41]

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[41] Contribution is only partially derived from such charges. Other significant sources for contribution include various supplemental basic services (such as local usage or touch-tone) and non-basic optional services (e.g., carrier access, toll, mass announcement services or Call ID) associated with the monopoly port.

Although there may be merit in pricing all services at or near their cost, staff does not agree with New York Telephone that both port and link prices must cover their cost to permit fair link competition to have an opportunity to evolve. Even so, this is not an issue for business links. Thus, Staff recommends that business link rates be set at full cost levels immediately. Cost estimates provided by New York Telephone in its most recent general rate proceeding and as support for the instant unbundling indicate that full service business rates are already at, or close to, full cost levels. Business port charges should be employed to balance rates overall such that business links are at their average cost overall. Residence rates are unique in that they continue to reflect a subsidy relative to the company's embedded costs. Therefore, a more deliberate approach is recommended for residence links. Initially, Staff recommends that residence port rate continue to reflect substantial subsidy and that it be set at $1.00 per month. As shown in the table below, residence link rates established upon this basis will be more reflective of their actual underlying costs than under New York Telephone's proposal:

Table 3

STAFF'S RECOMMENDED RATES -- LINKS AND PORTS

PHASE ONE

SERVICE:		Residence[1]	Business
Existing Intrastate Rate	*(a)*	$ 6.60	$16.23
Federal End-User Charge	*(b)*	3.50	5.15[2]
Existing Total Rate (*a+b*)	*(c)*	$10.10	$21.38
Port Cost	*(d)*	4.98	4.96
Proposed Port rate	*(e)*	1.00	3.14
Proposed Intrastate Link Rate (*a-e*)	*(f)*	5.60	13.09
Effective Total Link Rate (*f+b*)	*(g)*	9.10	18.24
Link Cost	*(h)*	18.18	18.24
Proposed Universal Service Rate Element	*(i)*	-0-	-0-
Proposed Total "Loop" Rate (*b+e+f+i*)	*(j)*	$10.10	$21.38

1 Residence Message Rate Service
2 Multi-line Business; single line business pay $3.50.

After *phase one* is implemented, customer rates will be unchanged overall. Business link rates will be set at full cost, and residence link rates, on average, would cover roughly 50% of their total costs.[42] The changes are also rate neutral, as they reflect no change in the rates charged to existing customers. This is achieved by allowing residence, and to a

42 Link rates established on this basis reflect a significant advance over the pace New York Telephone originally proposed. Under the company's proposal, residence link rates would reach this level in 1994, and overall residence rates would have increased drastically. Our phase one proposal, on the other hand, brings residence link rates much closer to cost than under the company's phase one proposal and without increasing residence rates at all.

lesser extent business, port rates to carry the associated subsidy. In the long run, both port and link rates should be moved to their relevant costs. However, this second phase of unbundling requires careful scrutiny and further deliberation before it is implemented. To begin this process, a description of steps *phase two* might appropriately entail follows.

The avoidance of rate shock to individual customers guides the unbundling process in *phase one*. In *phase two*, it becomes the foundation for continued control of the transitional process to enhance competition. As no effective competitive alternative exists for ubiquitous telephone company ports, the Universal Service Element associated with the port could provide for recovery of any contribution or subsidy associated with the existing rates. As the characteristics of the port, not the competitive link, determine the functionality of the service, application of the Universal Service Element at the port would target the subsidy to the appropriate customer class – residence or business. Where a particular service is contributory at existing rate levels, the Universal Service Element should be a charge designed to reflect the expected contribution loss associated with competitive provision of the service.[43] If, on the other hand, a particular service is currently the beneficiary of a rate subsidy, as it is now for residence customers, the Universal Service Element could be a credit to be reflected in the customer's billing. Relying upon the cost and rate details shown earlier, Table 4 reflects the proposed *phase two* recommendation:

[43] Supporting documentation provided as an adjunct to New York Telephone's compliance filing indicates that under certain conditions, a comparison of deaveraged, geographically specific costs and rates for residence and business services shows some exchange access facilities are actually priced at contributory levels, others are actually priced further away from their cost than average cost/rate comparisons indicate.

Table 4

RECOMMENDED LINK AND PORT RATES

PHASE TWO

SERVICE:		Residence	Business
Existing Intrastate Rate	*(a)*	$ 6.60	$16.23
Federal End-User Charge	*(b)*	3.50	5.15
Existing Total Rate (*a*+*b*)	*(c)*	$10.10	$21.38
Port Cost	*(d)*	4.98	4.96
Proposed Port rate	*(e)*	4.98	4.96
Proposed Intrastate Link Rate	*(f)*	14.68	13.09
Effective Total Link Rate (*f*+*b*)	*(g)*	18.18	18.24
Link Cost	*(h)*	18.18	18.24
Proposed Universal Service Rate Element	*(i)*	(13.06)	(1.82)
Proposed Total "Loop" Rate (*b*+*e*+*f*+*i*)	*(j)*	$10.10	$21.38

The advantages of this approach are many. Customers will be able to choose between competitive link providers based upon the relative differences in their respective link rates, as reflected in their unique underlying link costs, without the distortion of subsidy payments. Thus, the company no longer needs to fear the possibility that competitors may target only low cost customers for competitive encroachment. This is so because the company will be able to design contribution charges to reflect the relevant cost conditions.[44] Further, tariff rates will no longer mask the inherent subsidy as the billing details would clearly reflect the actual costs of link service, and the Universal Service Element credit or charge associated with the customer's service class. Discrete identification of the "subsidy" is also a desirable rate-making goal.

This structure also requires maintenance of a distinct and separate billing relationship between the customers of alternative link providers and the telephone company. As it is likely that the Universal Service Element may vary by class of service or geographic location, it will be the company's responsibility to assure application of the appropriate Universal Service Element credits to individual port customers, and not through the intermediary of the competitive link provider.[45] Staff recommends that in those instances where a credit is applicable, the credit be applied monthly to the customer's account against the usage of all other company provided services associated with the port.[46]

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[44] Thus, if the customer group can be shown to be providing contribution for their exchange access facilities, the company will be assured of recovering a similar level of contribution. This assumes, of course, that the company can demonstrate that factors which might be expected to vary between customer groups, such as density, loop length, or geographic location, actually vary enough to support different contribution maintenance charges under different conditions.

[45] This approach is, in fact, the same as is currently applied to switched access interconnection. There, the interexchange carrier customer pays the contribution charge directly for the same reason – to assure a consistency in the contribution flow from the traditional sources.

[46] Phase two comments should address some of the practical concerns regarding this transitional approach. For example, credits might not carryover to individual customers. Thus, if, in any given month, the use of other NYT-provided services was not sufficient to exhaust the specific customer's credit, the credit would not be carried over to a future month. Unused credits could instead be tracked separately and statistically sampled. The estimated, unused credits might then form the basis for an annual adjustment to the competitive link provider's billing to reflect their estimated value. This approach encourages individual customers to use company provided switched services to gain access to the credit first-hand, reduces the costs of administering credits, and assures that only legitimate ports receive credits as the company could challenge credits for ports upon which little use is detected. Carriers

As discussed above, the switched services to which the monopoly port provides access (e.g., touch-tone, local and toll usage, carrier access, non-published services, or Call ID among others) are contributory in nature. Pricing ports on this basis thus encourages the customers (of alternative link providers) who receive credits to continue to use highly profitable, low cost, company-provided, switched services.[47] Furthermore, by allowing links to be priced at costs, and by tying the Universal Service Element to the same costs, the company's incentive to <u>reduce</u> the costs of link services through increased productivity and efficiency is enhanced, for any cost savings applicable to the link reduces its market price and the Universal Service Element credits for users of competitors' links.

It would also be desirable for *phase two* unbundling to proceed after completion of incremental cost studies for link services, that are currently being developed.[48] Incremental costs are not only a helpful pricing guide generally, their use is essential to support any deaveraging proposals the company may wish to make in *phase two*. In addition,

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commonly engage in similar practices in settling bills for carrier access services, and they could be just as effectively employed here. Alternatively, an argument can be made that link credits should not be tracked or reflected as a payment to reduce administrative costs or fraud. If these concerns are valid, credits might be limited to one or two lines for each account. Phase two comments should address these matters directly.

47 The company's concern that it might receive "zero" revenue in some cases is overstated. Average residence bills (roughly $40.00 per month) are already significantly in excess of the credits proposed here. Today, under existing rates it claims to receive revenue from subsidized customers, that are insufficient to cover its costs, and the bulk of those costs are widely recognized as associated with the link. Thus the recommended structure is more or less equivalent to the status quo. However, where customers choose to provide their own link, the company saves the cost associated with its provision and administration. Thus, depending on the costs, the company may actually be better off. Further, as discussed herein, the company still retains its relationship with the customer for the purpose of providing the low cost, high markup services normally provisioned at the monopoly switch.

48 Incremental cost manuals for subscriber loop services are scheduled for completion by December 31, 1992 in Case 89-C-198 (Subscriber Loop Proceeding).

parties should address the issue of stranded investment that could arise if link competition expands substantially. While the initial unbundling steps recommended here are unlikely to have a significant impact on the company, further unbundling in *phase two* should address the potential impact of stranded investment upon the company, and approaches already being used to mitigate this effect upon the company in other areas (e.g., the access contribution element).

Concerning the contentions of the parties that New York Telephone failed to unbundle all services, careful reading of the Opinion does not reveal such a broad requirement. Ordering Clause 4 specifies only that comparably efficient interconnection arrangements be provided "for links for all classes of customers."[49]

Thus, the company's proposals to exempt certain features and functions from the unbundling requirement are reasonable.[50] It is also reasonable not to require the company to unbundle obsolete services it is eliminating or in the process of grandfathering (i.e., flat rate Business and Party Line services). Given the existence of ports for a direct competitive option -- Public Access Lines -- it need not unbundle ports for public and semi-public coin telephone services as ports for that class of customers are available.[51] However, ports for other services -- Radio Telephone Utility services and hybrid "switched" private line services -- can be unbundled as the company has received requests to do so, unless it can be demonstrated, as

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49 New York Telephone's tariff defines "class of service" as follows: *Class of service denotes the classification of services into residence, business (including semi-public telephone service) and public telephone service* (P.S.C. No. 900 -- Telephone, Section 15, 5th Revised Page 40).

50 For example, the company has not proposed to unbundle Lifeline service.

51 The Payphone Association's concerns about the possible competitive implications of "asymmetrical" regulation of company-provided coin services vis-a-vis the Public Access Lines appear overblown. It provides no estimate of the impact its proposals might have on public coin rates, and given the important social considerations associated with the subsidized $.25 local coin rate, it is clear such an approach is best entertained in the context of a general rate proceeding. Thus, the Payphone Association's request for a new proceeding specifically to address such concerns should be denied.

with semi-public and public coin services above, that access to functionally similar ports is already available.[52]

Staff agrees with New York Telephone as to the reasonableness of applying termination charges to customers who choose, of their own volition, to dissolve their outstanding, contractual obligations to the company in order to utilize a competitive service. Termination charges are commonplace in the industry. Their existence in contracts pertaining to the company's Centrex services has done little to retard the growth of Private Branch Exchange competition generally, and it should have little impact upon the link market in the long run. New York Telephone's policy is not anticompetitive. It is simply a good business practice.

Pricing Flexibility

New York Telephone Company's compliance filing included a request for additional pricing flexibility for links and ports for various dedicated switching services (i.e., Centrex and Flexpath services),[53] and for certain analog-Private Branch Exchange and other business links. The Commission granted pricing flexibility for Private Branch Exchange links at that time, but declined to authorize wider pricing flexibility due to the lack of a strong supporting rationale and given the company's proposal to flexibly price certain business ports, and it requested further comments on the need for additional flexibility.

[52] This addresses Metro Fiber concern's regarding functional unbundling; i.e., if a feature or function, or access to a feature or function, is not available, or must be unbundled to become so, the Commission's Open Network Architecture policy presumes it should be made so, if requested by users. If access to a technically equivalent function is already available, further unbundling is unnecessary

[53] Flexpath is a digital Centrex-type service.

1. Comments

New York Telephone responds to the Commission's request for better support for its pricing flexibility request by providing a detailed rationale for its initial request. The company is requesting two forms of statewide pricing flexibility -- unconditional individual-case basis (ICB) authority and wire center-by-wire center general tariff flexibility:

> In the June 5 Filing, the Company sought statewide "unconditional" ICB authority "to determine prices on an individual case basis using relevant costs in response to competitive requests for proposal ("RFP"), or, in the absence of an RFP, based upon the Company's assessment of competitive necessity".[54]
>
> The company also sought statewide, wire center-by-wire center general tariff flexibility for various services "to selectively lower its general tariff rates for competitive services to their relevant cost or raise them annually by a percentage specified in the tariff upon ten days notice".[55]

General tariff pricing flexibility will allow the company to increase rates by either 5% or 25% depending upon the service, and decrease rates to their relevant cost, on an individual wire center basis. The company proposes to apply these forms of pricing flexibility to the following services:

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[54] New York Telephone Comments, p. 10.

[55] Id., mimeo pp. 12-13.

Table 5

NYT's PRICE FLEXIBILITY PROPOSAL

SERVICE:	FULL SERVICE PRICING FLEXIBILITY AUTHORIZED	UNBUNDLED FLEXIBILITY REQUESTED FOR:
Centrex III	NO	PORTS AND LINKS
Airport Centrex	NO	PORTS AND LINKS
Intellipath (less than 100 lines)[1]	YES	PORTS AND LINKS
Intellipath II(less than 100 lines)	NO	PORTS AND LINKS
Flexpath	YES[2]	PORTS
Switchway	YES	PORTS AND LINKS
Digital Automatic Call Distributors	YES	PORTS AND LINKS
Business Trunk	NO[3]	APPROVED FOR LINKS
Direct Inward Dial Trunk	NO	LINKS
Airport Service Lines	NO	LINKS
Airport Trunks	NO	LINKS
Public Access Lines (PAL)	NO	LINKS
Coin Compatible PAL	NO	LINKS
Individual Message Business	NO	LINKS

1 Intellipath (over 100 lines) has full service pricing flexibility.
2 Pricing flexibility authorized for Flexpath links in the New York Metro LATA
3 Pricing flexibility for links approved July 1992, in competitive wire centers onl

The company has not requested pricing flexibility for the following services: residence links, residence and business ports, or Private Branch Exchange ports. The company justifies the need for additional pricing flexibility, as summarized in Table 5 above, on several grounds. It notes that the Commission has previously established a clear logical connection between expanded interconnection and the ability of the company to respond to competition through market-based pricing. In the case of various analog Private Branch Exchange links (i.e., business trunks, Direct Inward Dial links, and Airport trunks), the company notes that these services are technically interchangeable, and often ordered by customers in a package.

Respecting other business links (i.e., Individual Message Business links, Public Access links, and Airport lines), the company argues:

> As a matter of general policy, pricing flexibility is an appropriate quid pro quo for the competitive provision of links irrespective of the type of link. It makes no difference if a link is a Centrex link, a PBX link, or some other business link.[56]

The company also includes liberal references to Teleport's marketing brochures and publications that claim Teleport is already providing "plain old telephone service (POTS) analog lines, payphone services, and Centrex ports.

Concerning Centrex and digital Flexpath services, the company notes that its request for pricing flexibility for the links and ports of both services merely recognizes what the Commission has already determined -- that Centrex services are competitive. Citing prior Commission Orders and Opinions, the company builds a case for the highly competitive aspects of such services and notes that the Commission recently declared both Centrex links and ports to be the equivalent to of Private Branch Exchange station wiring and intrasystem intercom functions, that are not only competitive, but non-basic services for "regulatory and cost allocation purposes". The rationale for pricing flexibility for Flexpath link and port services is based on the fact that there are "numerous competitive alternatives independent of CEI."[57]

New York Telephone further notes that the Commission has already authorized port pricing flexibility for similar services including Switchway Switched 56 kbps Service, Digital ACD II Service, Intellipath II Digital Centrex Service (over 100 lines) and ISDN primary service. In addition, the company demonstrates how competitors directly compete with it to provide services competitive with Flexpath:

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[56] New York Telephone Comments, p. 16.

[57] Id., p. 24

> There are a variety of services offered by other carriers which compete directly with the Flexpath links and ports. A Flexpath port interconnects to a customer's digital PBX by a DS1 link, i.e., a Flexpath DTF provided by the company or a DS1 link provided by an interconnector. The Flexpath DTF and port consist of twenty-four channels. Each channel can be configured to carry outbound traffic on a DOD basis or inbound traffic on a DID basis or two-way traffic. These same capabilities exist through interconnection to the ports (and interconnecting links) of AT&T's Megacom and Megacom 800 services, MCI's Prism service and Sprint's Ultra WATS service. This competitive impact is illustrated in Attachment A.14. A PBX customer may buy a Flexpath DTF and interconnect it with the Flexpath port in the Company's serving central office. The Company interconnects with the interexchange carrier's POP through switched carrier access arrangements and services. Second, the customer may interconnect a T1 facility directly into a Megacom or Prism or Ultra WATS port in the interexchange carrier's POP and completely bypass the company's Flexpath DTF and Flexpath port. Thus, the Flexpath port is cross-elastic with the interchange carrier's Megacom and Prism and Ultra WATS ports. [58]

Thus, the company argues that some ports may already be competitive for certain large customers, as port-like services are available from other vendors.

Concerning the flexibility requested for Centrex and Flexpath Shared Network Access Ports,[59] the company offers that its proposal to institute such flexibility on those ports assures fairness in the pricing of the ports. Thus, it proposes to charge the same rate to customers of its Shared Network Access Ports as it charges its own customer's Centrex equivalent port:

> Of course, to the extent the company seeks to exercise general tariff pricing flexibility on Centrex ports, the same rate would apply to the SNAPS port and to the equivalent port component in the existing tariff section. This will negate any

[58] New York Telephone Comments, pp. 24-25

[59] Shared Network Access Ports (SNAPS) is the name the company gives ports used by competitors for the purpose of interconnecting their links to the public switched network.

> objection that the company might price its full service ports lower than the rate for corresponding SNAPS ports. For ICBs which include flexibly priced ports, the same port rate will be made available to similarly situated customers on a non-discriminatory basis. When the Company offers a full service ICB contract which includes flexibly priced ports, the ICB contract will indicate the same port rate would apply in the event the end user would prefer to use an interconnector's links rather than the Company's.[60]

Teleport cautions that granting New York Telephone additional pricing flexibility allows the company the freedom to increase or decrease rates in advance of, or in anticipation, of real competition. Citing the company's "one-hundred year head start," Teleport argues for careful analysis of such flexibility to assure its consistency with the Commission's "larger goals."

Metro Fiber concurs with Teleport's concerns regarding limiting pricing flexibility to effectively competitive services. It would not permit the company pricing flexibility "with respect to monopoly bottleneck elements." Metro Fiber offers that New York Telephone "impute the tariffed price of the port to itself in setting the competitive price for the full service."[61] Metro Fiber also recommends a "threshold" level of customers (say, 15%) be served by a competitor before pricing flexibility is introduced.[62]

In its reply, New York Telephone notes that the central concern regarding its pricing flexibility proposals is that the company may use this flexibility to engage in anti-competitive pricing. The company reiterates that it has proposed a strict linkage between flexible pricing of ports for its full service options and the Shared Network Access Port Services used by competitors, thus negating the calls for imputation or competitive thresholds.

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60 New York Telephone's Comments, pp. 22-23.

61 Metro Fiber Comments, p. 9

62 The Clearing House argues in its letter that the Commission should not allow the company pricing flexibility for "bottleneck port facilities." Alternatively, GTE New York agrees with New York Telephone's request in its own letter.

2. Discussion

The company's proposals for pricing flexibility are generally reasonable, particularly for Centrex and Centrex-like services (e.g., Digital Automatic Call Distributors), where the company's products experience significant competition. Briefly, if customers find their New York Telephone Centrex service too costly or unsatisfactory for their needs, they can, and the majority do,[63] utilize a Private Branch Exchange system widely available in the unregulated, terminal equipment market. Thus, the Commission has had a long standing policy of granting New York Telephone and other telephone companies considerable latitude -- minimum/maximum prices, rate stability plans, and individual case basis pricing -- in the pricing of Centrex-type services. The proposals of the company to treat such services consistently are reasonable.

While link competition is in its infancy, Staff does not agree that this argues for curtailing the company's pricing flexibility. The Commission has already authorized the company pricing flexibility for certain links, that is, Flexpath and PBX (i.e., business trunk) links, and the latter is authorized only when a competitive trigger is activated.[64] If pricing flexibility were further constrained until a certain "threshold" level of link competition occurs, it would be an unreasonable constraint upon the dominant provider that not only limits its ability to react to competition as it occurs, but denies to its customers the benefits that normally attend a competitive market. Thus, any additional pricing flexibility for links should be authorized, subject only to the existence of a competitive trigger.

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63 Staff estimates New York Telephone's share of the Dedicated Switching service's market to be roughly 20% with competitively provided Private Branch Exchanges accounting for the remainder.

64 The "competitive trigger" for business trunk links is pulled in a given wire center when a competitor establishes its own interconnection node and requests port-only interconnection.

This same argument cannot be extended to ports for services other than Centrex. While Centrex ports are fully substitutable with the intercom features of competitive intrasystem Private Branch Exchange services, staff is aware of no generally available option to the use of the local telephone company's port at some point in the call path for the origination and termination of switched traffic. Thus, all other ports, including Flexpath, are purely monopolistic in character, and the concerns expressed by various parties regarding port pricing flexibility are well taken. The company has provided no persuasive rationale for the need for such flexibility and this request should be denied.

Concerning the type of pricing flexibility requested by the company -- "unconditional" individual case basis pricing and wire center specific pricing flexibility -- there remain significant concerns. It is true that existing tariffs for services such as ISDN[65] may reflect unconditional customer specific pricing, but these highly specialized services are often accorded such flexibility, and this logic is not transferable to the instant case. Link competition and associated collocation for such competition is still in its formative stages. Therefore, the company should operate under the well established constraints we have commonly employed in collocation circumstances. The application of wire center specific pricing flexibility is reasonable, but with the previously established requirement that it only be utilized in wire centers where the competitive trigger is actually activated. However, as discussed in the following section, higher speed, DS1 interconnection has the potential to significantly enhance link competition generally. Thus, Staff recommends the Commission reconsider expanded pricing flexibility options upon the occasion of the filing of appropriate tariffs to effectuate such DS1 interconnection capability.

[65] Integrated Services Digital Network

<u>DS1 Interconnection</u>

The facility connecting a customer's premises to the central office, or wire center, has been traditionally referred to as the voice grade equivalent channel, or in digital engineering parlance, a "low speed" DS0 facility. Using digital "multiplexing" technology, a "higher speed" DS1 facility can carry along the same circuit path 24 simultaneous voice grade equivalent channels (<u>i.e.</u>, a DS1 channel = 24 DS0 or voice grade channels). An issue arose as to the viability of aggregating the traffic from 24 DS0 ports for delivery to a DS1 port.

1. Comments

Metro Fiber argues that digital switches are designed to interface at the DS1 level and that New York Telephone should be required to offer this service from its digital switches, or a similar, and appropriately priced, service from analog switches. The implication of its argument is that interconnection at a DS0-level is less efficient for competitors to utilize. Teleport raises the same argument and adds that the failure to allow this form of interconnection will require the interconnectors to invest in costly multiplexing equipment to handle the lower speed DS0 circuits.

New York Telephone does not dispute the thrust of the parties' concerns and has "initiated an evaluation of such service offering."[66]

2. Discussion

New York Telephone has offered no reason why the service envisioned should not be provided and, indeed, has agreed to evaluate it. Since there appears to be no benefit to delaying introduction of the service capability requested by the parties, the Commission should direct New York Telephone to file authorizing tariffs, or to show cause why the tariffs should not be filed, within 90 days from the issuance of an Order in this proceeding. The company

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66 New York Telephone Reply Comments, p. 16.

may also use this opportunity to reevaluate its requirements for pricing flexibility for link services at that time.

CONCLUSION

Competition is increasingly the organizing force by which telecommunications services are provided. Opinion No. 91-24 directed New York Telephone Company to unbundle links and ports for all classes of service, including residence and business exchange services, and to allow customers to utilize the links of alternative providers, through comparably efficient interconnection arrangements they currently utilize in telephone company central offices. As a result, links for Centrex and Private Branch Exchange services were unbundled and can now be competitively provisioned. The company postponed the residence and business link rate proposals, as the Commission observed that the proposed link rates did not cover their costs, and reflected the subsidy traditionally related to monopoly services. Before acting, the Commission requested additional comments on the merits of this approach, and the related issue of pricing flexibility for affected services.

The link rates proposed by New York Telephone should be set at cost as links are now offered in a competitive environment. Absent other compelling factors, failure to allow link rates to reflect actual cost is generally anticompetitive and retards the pace at which the benefits of competitive telecommunications services are provided to basic ratepayers. In order to effectuate a competitive link market generally, recognition must be made of the contribution stream generated by all customers from the services associated with the monopoly port.

However, to manage this transition as called for in the <u>six principles</u>, it is recommended that residence links rates be moved towards cost in *phase one* <u>now</u>, with offsetting reductions in residence port rates, and to full cost in *phase two* with a universal service rate element (in this case a credit rather than charge) such that the price to the end user remains at current levels unless and until a fully supported rate restructuring proceeding determines that the end user rate level should change. A round of further comments and replies should be entertained on Staff's *phase two* proposal, as it has not been available to parties for consideration. *Phase one,* which can progress immediately, would set link rates at cost for business, while moving link rates substantially towards cost for residence services. Overall, for each link plus port, rates would remain unchanged in either phase. Thus, the recommendations are rate neutral to individual customers.

In *phase two*, in keeping with the Commission's prior policy, New York Telephone's proposed universal service element should not be set at zero as proposed by the company, but calculated based upon the difference between the costs and rates for residence and business link services, and applied to customers who provide their own links. The universal service element may be a contributory charge for any exchange services that are found to be providing contribution, and a credit where the service is currently subsidized, if this can be demonstrated by reference to appropriately designed incremental cost studies. The sum of the link, port and universal service element must, however, equal the customer's existing rate. Additional comments and reply comments should be invited before any changes are authorized under *phase two* of the plan detailed herein. As the second phase of the unbundling plan entails a unique credit plan which raises significant and new issues, parties should be provided an ample opportunity to research the implications of such an approach and file substantive initial and reply comments on these proposals. Accordingly, initial comments should be due in 90 days with reply comments 30 days thereafter.

New York Telephone's request for additional pricing flexibility for Centrex services, and various competitive business links, is approved, subject to the actual existence of a competitive trigger, or a request for proposal. The company should also be directed to provide DS1 interconnection within a 90 day period or show cause why not.

RECOMMENDATION

It is recommended that the Commission:

1) Direct New York Telephone Company to cancel the tariff pages shown on Appendix 1, and to file revised pages in accordance with the conclusions herein to implement *phase one* loop unbundling of links and ports, to become effective December 21, 1992, on one day's notice.

2) Advise interested parties to file written comments on the *phase two* proposals made herein with comments to be filed within 90 days of the issuance of an order in this proceeding, and reply comments filed 30 days later.

3) Direct New York Telephone Company to file tariffs introducing DS1 port interconnection arrangements within 90 days of the issuance of an Order in this proceeding, or show cause why it should not do so.

Respectfully submitted,

DENNIS F. TARATUS
Principal Communications
Rates Analyst

Reviewed by:

YOG R. VARMA
Chief, Tariff & Rates
Section

Approved by:

RICHARD STANNARD
Director, Communications Division

ADMINISTRATIVE DETAILS

New York Telephone Company

P.S.C. No. 900 - Telephone

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