BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the application of United Telephone Long Distance Company of the Midwest for a certificate of service authority authorizing it to offer resale telecommunications services to the public within the State of Missouri.)	CASE NO. TA-88-260

REPORT AND ORDER

Date Issued: February 21, 1989

Date Effective: March 3, 1989

APPEARANCES: Joseph P. Cowin, Senior Attorney, 5454 West 110th Street, Overland Park, Kansas 66211, for United Telephone Long Distance Company of the Midwest.

David K. Knowles, General Attorney, 5454 West 110th Street, Overland Park, Kansas 66211, for United Telephone Company of Missouri.

W. R. England, III, Attorney at Law, Hawkins, Brydon, Swearengen & England, P.C., P. O. Box 456, Jefferson City, Missouri 65102, for Contel of Missouri, Inc., Contel System of Missouri, Inc., Eastern Missouri Telephone Company, Fidelity Telephone Company, Missouri Telephone Company, and Webster County Telephone Company.

C. K. Casteel, Jr., Senior Attorney, 100 South Fourth Street, Suite 1200, St. Louis, Missouri 63102, and Carl J. Lumley, Attorney at Law, Curtis, Bamburg, Oetting, Brackman & Crossen, P.C., 130 South Bemiston, Suite 200, St. Louis, Missouri 63105, for MCI Telecommunications Corporation.

Donald C. Otto, Jr., Attorney at Law, Hendren and Andrae, P. O. Box 1069, Jefferson City, Missouri 65102, for Competitive Telecommunications Association of Missouri.

William M. Barvick, Attorney at Law, 231 Madison Street, Suite 301, Jefferson City, Missouri 65101, for Tel-Central of Jefferson City, Missouri, Inc.

Paula J. Fulks, Attorney at Law, 100 North Tucker Boulevard, Room 630, St. Louis, Missouri 63101-1976, for Southwestern Bell Telephone Company.

Mark P. Royer, Attorney at Law, 1100 Walnut Street, Room 2432, Kansas City, Missouri 64106, for AT&T Communications of the Southwest, Inc.

Joni K. Ott, First Assistant Public Counsel, and Lewis R. Mills, Jr., Assistant Public Counsel, P. O. Box 7800, Jefferson City, Missouri 65102, for Office of the Public Counsel and the public.

Linda K. Ohlemeyer, Deputy General Counsel, Missouri Public Service Commission, P. O. Box 360, Jefferson City, Missouri 65102, for Staff of the Missouri Public Service Commission.

HEARING EXAMINER: Beth O'Donnell

United Telephone Long Distance Company of the Midwest

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Procedural History

On April 29, 1988, United Telephone Long Distance Company of the Midwest (UTLD) filed an application with this Commission seeking a certificate of service authority authorizing it to offer the resale of interexchange telecommunications services in the State of Missouri. UTLD also requested a temporary certificate of service authority.

By order issued May 17, 1988, the Commission established an intervention deadline and set forth the issues this application raises by virtue of UTLD's affiliation with United Telephone Company of Missouri (UTM), a local exchange company. By order issued July 6, 1988, the Commission denied UTLD's request for a temporary certificate of service authority, established a procedural schedule and granted the applications to intervene of the following parties: Tel-Central of Jefferson City, Missouri, Inc. (Tel-Central), the Competitive Telecommunications Association of Missouri (CompTel), Southwestern Bell Telephone Company (SWB), AT&T Communications of the Southwest, Inc. (AT&T), MCI Telecommunications Corporation (MCI), Contel of Missouri, Inc., Contel System of Missouri, Inc., Webster County Telephone Company, Fidelity Telephone Company, Bourbeuse Telephone Company, Missouri Telephone Company and Eastern Missouri Telephone Company (collectively referred to hereinafter as the Independent Telephone Company Group or ITCG).

The order issued July 6 also granted Tel-Central's motion to join UTM and denied Tel-Central's motion to join United Telecommunications, Inc. (UTI). The Commission's Staff (Staff) and the Office of the Public Counsel (Public Counsel) also participated in this case.

Hearings were held November 16-18 and 28-30, 1988. Briefs were filed pursuant to a schedule established by the hearing examiner. The reading of the transcript required by Section 536.080, RSMo 1986, was not waived.

Findings of Fact

The Missouri Public Service Commission having considered all the competent and substantial evidence upon the whole record makes the following findings of fact.

I. Introduction

UTLD seeks authority to operate as a reseller of interexchange telecommunications services within the State of Missouri. On September 28, 1987, House Bill 360 went into effect repealing twenty-one sections of Chapters 386 and 392, RSMo, and enacting in lieu thereof new sections affecting the regulation of telecommunications companies. In considering this application the Commission is bound by the terms of these amended chapters. Section 392.440, RSMo Supp. 1988, requires that resellers of interexchange telecommunications service must obtain a certificate of service authority before providing such service. This section requires that the Commission approve such certificate upon a showing by the applicant and a finding by the Commission, after notice and hearing, that the grant of authority is in the public interest.

In Case No. TX-85-10 to be found at 10 Mo. Reg. 1048 (1985), the Commission made a statement of policy which sets forth standards pertaining to applicants requesting authority to provide interLATA telecommunications services. Therein the Commission stated that if an applicant for such authority is found to be financially fit it would be presumed that additional competition in the interLATA market is in the public interest and a certificate would be granted.

In Case No. TO-84-222, et al., the Commission found it reasonable to apply the standards established for the interLATA market to applicants desiring to provide intraLATA toll services. Re: Investigation into WATS resale by hotels/motels, 28 Mo. PSC (NS) 535 (July 24, 1986). The Commission believes that the policies enunciated in these cases are consistent with the standards set forth in Section 392.530, RSMo Supp. 1988, for construing the provisions of Chapter 392.

The applicant in this case is an affiliate of a local exchange company. No certificate to provide interexchange service has yet been issued by this Commission to a structurally integrated affiliate of a local exchange company. A previous application by UTLD for authority to operate as a reseller was denied by this Commission in Case. No. TA-87-91. Re: Application of United Telephone Long Distance Company of the Midwest, Advance Sheets 29 Mo. PSC (NS) 185 (July 28, 1987).

In that case the Commission denied the authority because it was not satisfied that UTLD had established adequate safeguards to prevent its subsidization by UTM and its enjoyment of an unfair competitive advantage through its affiliation with UTM. The Commission found inadequate the Nonregulated Accounting Procedures (NAP) established by UTI for identifying and segregating UTLD's revenues and expenses. The Commission determined that under NAP many costs were being treated as common costs only partially allocated to UTLD which should have been directly charged to UTLD.

The Commission further determined that because of the employees, executives, facilities and offices held in common by UTLD and its local exchange affiliates, UTLD would have an unfair competitive advantage through its access to information held by its local exchange affiliates.

In its order issued May 17, 1988, in this case, the Commission recognized that this application required an expanded scope of analysis beyond the question of financial fitness alone. The Commission acknowledged its policy of presuming that additional interexchange competition is in the public interest. The Commission noted that this policy did not address the situation where the applicant for interexchange authority is an affiliate of the local exchange company. The Commission observed that such a relationship raises questions of potential subsidization of the interexchange carrier by the local exchange company as well as questions of potential unfair advantage for the interexchange carrier over its competitors by virtue of its affiliation with the local exchange company. The Commission saw these possible abuses as potential violations of the public interest.

The Commission determines that it is inappropriate to presume that additional competition is in the public interest in this case until the Commission is satisfied that the applicant has established sufficient safeguards against cross-subsidization and unfair advantage to allow full and fair competition to function as a substitute for regulation.

II. UTLD's Proposal

In this current application for authority to operate as a reseller, UTLD states it has made significant changes in order to address the deficiencies which caused the Commission to deny its previous proposal. UTLD proposes to operate as a reseller of intrastate, interLATA telecommunications service to the public in Missouri within UTM's exchanges converted to equal access. In providing this proposed service UTLD plans to use UTM's local facilities and the long distance facilities of US Sprint (Sprint) and to mirror the rates charged by AT&T.

UTLD is a wholly-owned subsidiary of United Telephone Company of Kansas (UTK). UTK provides local exchange service in the State of Kansas. UTLD's affiliate, UTM, provides local exchange service in the State of Missouri. UTK, UTM, UTLD and six other companies comprise United Telephone System-Midwest Group (MWG). The MWG is not a corporation but is a group of seven local exchange companies, a cable company and UTLD. The parent company of the MWG is UTI which also is the parent company for other United companies throughout the United States. In addition, UTI is an eighty percent owner of Sprint, a carrier authorized to provide interexchange service in the State of Missouri.

Although UTLD is a subsidiary of UTK it is not structurally separate. UTLD has no assets or facilities of its own and its three full-time employees are paid by UTK. These employees are Bill Terry, the general manager, Jeff Hoefgen, an operations analyst and Sandra Ruis, an operations representative. The remainder of UTLD's functions are, and would be, performed by employees of UTK or UTM. UTK is the source of all capital required to operate UTLD, providing both the debt and equity to fund it.

UTM would provide access services and intrastate billing and collection services to UTLD pursuant to tariffs and would provide operator services, interstate billing and collection, and repair services pursuant to contracts. Any of these services are commonly available upon comparable terms to interexchange carriers (IXCs) subscribing to or contracting for them. Nontariffed services provided to UTLD but not to other IXCs by the MWG are charged to UTLD on the basis of fully allocated costing. These include legal, accounting and other management services.

To prevent subsidization, the MWG has established an accounting system the purpose of which is to ensure that costs incurred by UTM and UTK in providing nontariffed, noncontractual services for UTLD are charged to UTLD. This accounting system is contained in the Cost Allocation Manual (CAM) developed by UTI for its various operating companies. The CAM establishes methods for separating regulated from nonregulated accounts on the books of a local exchange company in accordance with requirements set forth by the FCC. FCC CC Docket 86-111. The CAM replaces the accounting procedures proposed by UTLD in its previous application case which were known as NAP. In its order denying UTLD's previous application the Commission found that NAP treated as common costs many costs which could and should have been directly charged to UTLD.

The primary emphasis of CAM is to directly charge UTLD where possible for costs incurred on its behalf. Where labor is involved, time sheets are kept and UTLD is directly charged for the salary or wages plus benefits such as pensions and vacations.

All the charges not specifically identifiable and directly charged to UTLD are allocated to UTLD from the MWG as directly attributable costs, indirectly attributable costs or capital carrying charges. Both directly attributable and indirectly attributable costs are those which, though related to UTLD's operations, cannot be specifically identified to UTLD, and therefore, are allocated to UTLD on the basis of the ratio of directly charged labor hours to total cost pool labor hours or the ratio of total UTLD costs to the total of UTM's costs including its allocated share of MWG's costs. (A cost pool is a collection of costs with a common cause for which a common cost allocation is appropriate.)

Directly attributable costs consist of departmental overheads allocated on the basis of direct labor costs within a department. Examples of these costs are moving expenses, office supplies, temporary services, tuition reimbursement, telephone concessions, travel and entertainment, computer software and office equipment costing less than $250. Some of these costs may also be allocated by indirect attribution.

Indirectly attributable costs have no direct relationship to any measure of cost causation. Examples of these costs are salaries, benefits and departmental overheads incurred in support of joint MWG/UTLD functions which do not lend themselves to direct charging. These costs are allocated by a general allocator found by multiplying the total cost pool dollars by the result of dividing the total company expenses into the sum of the UTLD direct labor dollars plus allocated expenses.

The third element of allocated costs is capital carrying charges which are billed to UTLD for its use of certain assets of the LEC such as office space, general purpose computers and office equipment plus an allowance for maintenance and depreciation on these items.

In addition to the CAM procedures outlined above, and the services paid for by UTLD pursuant to a negotiated contract with UTM or pursuant to a tariff of UTM, UTLD would also incur costs that are directly assigned to it. These costs do not require an allocation process because they are exclusively assigned to UTLD's operations. These directly assigned costs include the salaries and benefits of the three employees working exclusively for UTLD plus goods and services such as office supplies purchased by UTLD from unaffiliated third parties.

As precautions against anticompetitive behavior UTLD's proposal has the following features. Since UTLD's last application case, the MWG has issued to all employees a booklet on protection of proprietary information to educate its employees on their obligation to safeguard such information. The booklet expressly states that employees must treat UTLD like any other IXC by not providing UTLD information pertaining to the MWG which would not be provided to all IXCs and by not providing UTLD with information proprietary to another IXC. The booklet states that violation of this policy could result in disciplinary measures for the employee up to and including dismissal. Each employee is required to sign a nondisclosure agreement stating that they have read, understood and agreed to comply with the MWG's policy for nondisclosure of proprietary information.

To diminish daily contact with the MWG's personnel, UTLD's service center has been moved from the MWG's Gardner location. Each of UTLD's three employees now work for UTLD only. The number of UTLD's officers and directors who are also officers of UTM has been reduced to two. UTLD maintains separate books of account and owns no joint facilities with the LEC.

By these safeguards UTLD feels that it has met the concerns of unfair competitive advantage expressed by the Commission in its previous application case.

III. Cross-Subsidization

Cross-subsidization of UTLD by UTM would exist if costs incurred by UTM and the other companies of the MWG on behalf of UTLD were absorbed by UTM directly or indirectly via its share of the MWG's costs. UTM is allocated a percentage of the MWG's expenses. Costs incurred by UTK on behalf of UTLD would be allotted to UTM based on that percentage.

Staff states that the CAM system of accounting is capable of mitigating its concerns about cross-subsidy. Staff believes that this system can capture UTLD's costs provided the employees exercise diligence in recording their activities on behalf of UTLD. The Staff recommends that, should the Commission grant a certificate to UTLD, it direct that documents such as appointment logs, calendars and time sheets supporting labor charges to UTLD be retained by the MWG for at least five years to enable Staff to audit effectively.

In opposing this application MCI, CompTel, Tel-Central and Public Counsel argue that deficiencies in the CAM plus the failure of employees of the MWG in en cing it will allow subsidization of UTLD by UTM.

The first area of concern raised by these parties relates to the direct charging of labor time. Employees of UTK have been instructed by a letter from the MWG's controller to report any time over fifteen minutes spent on behalf of UTLD. The Commission is of the opinion that this stated policy of the MWG could result in subsidization of UTLD by UTM. To avoid such subsidization the MWG would need to change its policy so that the first fifteen minutes is reported.

Since salaried employees of the MWG are not paid for overtime, overtime hours are not reported. It is possible, therefore, for a salaried employee to work eight hours for UTM and two additional hours for UTLD without reporting the two hours for charging to UTLD. Without a clear policy to prevent it, this could result in subsidization of UTLD by UTM. The MWG would need to direct its salaried employees in this instance to charge UTLD for the time spent on its behalf in order to avoid such subsidization.

Employees working for UTLD are paid biweekly whereas UTK bills UTLD monthly for that expense without charging interest for the time elapsed. This discrepancy could allow a subsidization of UTLD by UTM. To avoid this, UTK would need to bill UTLD on a biweekly basis for salaries paid on a biweekly basis or, in the alternative, UTK would need to charge UTLD at the market rate for the time value of the money advanced to pay the biweekly salaries.

The opponents also charge that there are occasions of subsidization which are not caught by the revised accounting procedures. They question the terms of a line of credit extended to UTLD by UTK in the amount, at the time of hearing, of $1 million. The cost of this loan to UTLD is based on UTK's average monthly commercial paper rate plus 75 basis points for bank fees and 50 basis points for handling, adding up to a 1.25 percent additional charge per year. The loan is unsecured placing the stockholders of UTK at risk should a default occur. Since UTM shares in MWG's costs this presumably would place the shareholders of UTM at risk to some degree. In UTLD's previous application case the Commission found the terms of this loan to be more favorable than the market would provide.

There is no evidence in this record for a finding that the terms UTLD enjoys on this loan are less than the costs incurred by UTK. Therefore, the Commission finds that this loan does not represent an instance of subsidization of UTLD by UTM.

Opponents of the application argue that lapses by employees of the MWG in reporting time spent on behalf of UTLD in these proceedings and other activities at the Commission indicate a lack of diligence necessary to make the CAM effective. They refer to the failure of one employee of the MWG who attended two meetings at the Commission on behalf of UTLD but failed to charge the time to UTLD. Other employees who attended these meetings correctly reported their time. This oversight was discovered by Staff's audit and corrected time sheets will be submitted. This instance demonstrates that audits are valuable in helping to rectify such oversights.

The opponents to the application also assert that three employees of UTM present at the hearings in this case incorrectly failed to charge their time to UTLD. The evidence indicates that these individuals were acting on behalf of UTM which was joined as a party to this case on the motion of Tel-Central. The Commission does not view this occurrence as an example of subsidization.

The Commission determines that the remainder of the concerns about cross-subsidization voiced by the opponents are of insufficient weight to warrant lengthy discussion. Some of these were de minimis in their impact on subsidization, some were of doubtful relevance to the matter at issue while for the remainder the evidence was insufficient to support a finding of potential subsidization.

The foregoing analysis indicates that there are some deficiencies in the policy on direct charging of labor time and some lapses in the diligence of the employees applying that policy which could lead to some subsidization of UTLD's operations by UTM. The Commission is of the opinion that these deficiencies and lapses are not of sufficient magnitude to warrant denial of the certificate. Further, the Commission determines that the procedures set forth in CAM remedy the deficiencies which concerned the Commission in UTLD's previous application. Unlike

NAP, CAM provides for directly charging UTLD, when possible. There are written criteria for determining which costs are directly charged and which are allocated. Time sheets are kept by all employees whose time is directly charged to UTLD. However, the Commission believes that any certificate granted should be conditioned upon rectifying the deficient procedures as outlined above and instituting a program of oversight of the CAM's enforcement to preclude repetition of any lapse in its application.

To preclude lapses in the diligence with which the accounting procedures are enforced, the Commission determines that it should be a condition of any certificate granted to UTLD that UTLD furnish the Staff and the Public Counsel with all allocation methods, formulae and work papers used to calculate UTLD's costs on a semiannual basis. As a further condition to any certificate granted to UTLD, UTLD would need to permit the Staff and the Public Counsel to review on a semiannual basis all CAM accounts, all allocations of common costs, all financial statements and documents, all contracts with UTM and Sprint for services, and UTLD's general books and records.

IV. Anticompetitive Behavior

The opponents to this application argue that granting this application is not in the public interest because UTM would have both the incentive and the opportunity to discriminate in favor of UTLD to the detriment of its competitors. They assert that the incentive to discriminate arises from the desire to increase the profit of an affiliate and the opportunity to discriminate arises from UTM's control over access to the local exchange network and from its access to proprietary information about UTLD's competitors.

Discrimination becomes anticompetitive behavior when it is engaged in to further the business goals of an affiliated company. This anticompetitive behavior would be manifested by offering the affiliate better facilities, better prices and better service than its competitors. It can also be manifested by making available to the affiliate, or using on its behalf, proprietary information about its competitors.

The Commission's Staff supports the granting of the requested certificate provided the certificate is based upon the following conditions for deterring anticompetitive behavior. First, in no event should UTM or any of its various affiliates directly or indirectly provide to, or utilize for the benefit of, UTLD any customer information acquired by UTM which is not made available to the interexchange industry generally. Second, UTM should be prohibited from discriminating between the interexchange telecommunications services of UTLD and other interexchange carriers in establishing and disseminating technical information and interconnection standards and in planning for and implementing the construction or modification of facilities. Third, no more than two officers or employees of UTM or any of its various affiliates who have direct or indirect managerial or operational authority over UTM should also have any such authority with respect to UTLD.

Staff states that these recommendations are designed to prevent the flow of information and the incentive to discriminate in favor of UTLD. Staff argues that a violation of such conditions of certification could lead to the decertification of UTLD and/or the seeking of statutory penalties against UTLD by the Commission.

In addition, Staff recommends that UTLD's operations be incorporated within UTM's cost of service when establishing rates for that company. By considering UTLD's revenues, expenses and investments "above-the-line" Staff believes it is possible to deter anticompetitive conduct by UTM by removing the profit incentive to engage in such conduct. Staff admits that "above-the-line" treatment creates the potential for cross-subsidization by UTM's ratepayers of any losses or defaults experienced by UTLD. However, Staff asserts that their analysis of UTLD's pro forma income statements indicate that UTLD will not be a financial burden to the MWG beginning in 1989. Staff's witness, Kingsbury, testified that in 1989 UTLD will cover its incremental cost of providing service in Missouri and be able to make a positive contribution to UTM.

UTLD is willing to accept the recommendations of the Staff as to the conditions under which UTLD should be granted a certificate. UTLD believes that "above-the-line" treatment of its operations is inappropriate because it places UTM's ratepayers at risk for any losses suffered by UTLD. However, UTLD does not oppose "above-the-line" treatment of its revenues, expenses and investment.

Despite Staff's recommendations for curbing anticompetitive behavior by UTM on behalf of UTLD, the opposition of MCI, CompTel, Tel-Central and Public Counsel remain. These opponents believe that the interLATA long distance market would experience a regression from past competitive advances should UTLD be granted a certificate. Because Sprint and UTLD are both part of UTI's family of companies (UTI presently owns 80 percent of Sprint with an option to buy the remainder) the opponents believe that a grant of a certificate to UTLD would endow UTLD with a great deal of market power. Because of the avowed intention of UTLD to mirror the rates of AT&T the opponents of this application believe that UTLD and AT&T would form a duopoly within the interLATA long distance market in Missouri.

Public Counsel's witness testified that a duopoly exists when two large producers offer homogenous or nearly homogenous products. Although there is some small element of competition since neither producer alone controls the entire market, the two producers do not compete meaningfully as to price because they recognize their mutual interdependence in exerting their nearly total control of the market.

The Commission is not persuaded that a duopoly would develop as a result of granting the requested certificate. All parties agree that the market share UTLD would enjoy would be fairly substantial. To remain competitive, AT&T could well be forced to offer more attractive products and services. It is true that the prohibition against geographical deaveraging would prohibit AT&T from lowering its rates only to compete with UTLD in violation of the public interest. Section 392.200.4, RSMo Supp. 1988. It is equally true that AT&T could not raise its rates in those exchanges just to recoup revenues lowered by a loss of traffic to UTLD. It is also unlikely that AT&T would raise its rates state-wide to recoup revenue losses attributable to UTLD activities since it has other competitors throughout the state that could profit from such a development. It is, in fact, conceivable that AT&T might lower its rates state-wide to recoup loss of market share to UTLD and thereby place competitive pressure on its other competitors throughout the state.

There are five additional arguments offered by the opponents to the granting of this certificate. The first addresses the potential for transfer of proprietary information from the MWG to UTLD to the detriment of UTLD's competitors. The opponents argue that the MWG's safeguards against the release of proprietary information and Staff's conditions for preventing it would be ineffective for several reasons. The opponents state that present and future employees of UTLD with previous access to proprietary information as employees of the MWG cannot erase proprietary information from their minds. The opponents argue that people throughout the MWG who have knowledge of proprietary information and who perform duties affecting the IXCs including UTLD cannot forget the proprietary information they know. The opponents assert that these two groups of individuals have two interactive incentives for using this information to help UTLD. They have the incentive of increasing profits for UTI in general and the incentive of promotion within the UTI family of companies. The opponents argue that, since there is no mandatory discipline associated with the unauthorized disclosure of proprietary information thereby leaving the matter to the discretion of the employee's supervisor, there is no negative reinforcement to counterbalance the aforementioned inducements to disclose such information.

The Commission is not persuaded by the arguments of the opponents to this application that UTM's potential for using proprietary information anticompetitively cannot be curbed. The proprietary information policy of UTLD provides for sanctions up to and including termination for employees who fail to comply with the policy of nondisclosure. Further, the Staff's conditions for certification prohibit use of such information for the benefit of UTLD. Violation of Staff's conditions would subject UTLD to the threat of penalties and decertification. Competitors would have available to them the option of filing complaints against UTM for such violations pursuant to Sections 392.200 and 386.330, RSMo 1986, as amended, and against UTLD pursuant to Section 386.330 should a pattern of behavior develop denoting the anticompetitive use of information. Such immediate constraints would balance the incentive to increase the profits of UTI in the hope of eventual promotion within UTI.

The opponents point to specific instances where they argue proprietary information has already been passed to UTLD. The opponents allege that UTM notified UTLD of the equal access conversion schedule months before such information was given to the other IXCs. The evidence supports the finding that this schedule was tentative and was available to other IXCs upon request. The opponents allege that UTM released in these proceedings information on the market shares of various IXCs which those IXCs considered to be proprietary. The evidence indicates that this information was obtained at UTLD's expense in reballoting those customers lost by it when it was denied its previous application for a certificate. Therefore, this was not information released by UTM for the benefit of UTLD to the detriment of the other IXCs. The opponents allege that UTLD testified in these proceedings that it would, in the normal course of negotiating a billing and collection contract with UTM, be made aware by UTM of AT&T's contractural rate for the same service as a starting point for the negotiation process. The evidence on this point is insufficient to support such a finding.

The second category of anticompetitive behavior in which the opponents argue UTM would engage were this certificate granted, involves UTM's offering UTLD better facilities than those offered to the other IXCs. In support of this argument Tel-Central asserts that UTM has already discriminated against Tel-Central in the allocation of trunking facilities between the Missouri exchanges of Warsaw and Warrensburg and by the construction of tandems in Maryville and Harrisonville, both located in Missouri. The relevance of these allegations of discrimination to the issue of anticompetitive behavior in this case is tenuous given that there is no allegation that it was done to benefit UTLD. Therefore, the Commission finds that this evidence is insufficient to support a denial of the requested certificate.

A third category of anticompetitive behavior in which the opponents argue that UTM would engage were this certificate granted, involves the provision of services by UTM to IXCs. Tel-Central again offers examples of UTM's present activities to support the argument that UTM would in the future discriminate on behalf of UTLD were the certificate to be granted. Tel-Central complains that UTM fails to inform persons selecting Tel-Central as their long-distance carrier that the customer needs to contact Tel-Central to have his long-distance service activated resulting in undue delay in the connection of such service and customer dissatisfaction. UTM does not deny that the oversight occurred but counters that Tel-Central did not advise them of the problem.

Tel-Central complains that UTM included an erroneous telephone number for Tel-Central when reballoting UTLD's former customers in the Warsaw/Warrensburg exchanges at the time UTLD was denied a certificate in its previous application. When UTLD was informed by Tel-Central of the mistake new ballots were mailed to the customers in question. Tel-Central feels that the mistake on these ballots resulted in a loss of subscribers. The relevance of these instances of UTM's treatment of Tel-Central prior to any entry of its affiliate into the interexchange market is tenuous.

Discriminatory pricing is the fourth category of anticompetitive behavior in which the opponents argue UTM would engage were this certificate granted. In support of this contention the opponents allege that UTM charged UTLD significantly less for a list of customers in several of UTM's exchanges than it charged Tel-Central for an equivalent list. On this record the evidence is insufficient to support a finding that there was a discriminatory difference in the price. The opponents also point to the proposed contract between UTM and UTLD for interstate billing and collections as an example of discriminatory pricing. UTM plans to provide this service to UTLD in Missouri at the same rate it charges AT&T for that service. Since the price for this service is based upon the volume generated by the IxC the opponents argue that the proposed rate is below the market rate because UTLD's volume is less than AT&T's volume. Since UTLD has agreed to make its contracts with UTM available for the inspection of the Staff, the Staff would be able to police these contracts for any unfair competitive advantage to UTLD.

Generally preferential treatment of UTLD is the fifth category of anticompetitive behavior in which the opponents argue UTM would engage were this certificate granted. The opponents argue that the loan from UTK to UTLD represents a unfair advantage for UTLD over its competitors by virtue of its affiliation with UTM. This loan is discussed in the section on cross-subsidization. Its terms will not be repeated here. Since no evidence was adduced as to the terms upon which UTLD's competitors might borrow money, it is not possible to find that this loan is an instance of unfair advantage for UTLD. It is entirely possible that the other IXCs, through special arrangements of their own, could obtain loans on terms more favorable than the market could provide. So long as there is no subsidization by UTM, the Commission is not persuaded that this is an instance of unfair competitive advantage.

As another example of generally anticompetitive behavior, the opponents point to UTLD's recent advertising program to persuade prospective customers to choose UTLD during the current process of equal access balloting. These advertisements use United's 9-block logo and refer to UTLD as the "hometown" telephone company when, in fact, UTLD has no offices or employees in this state. This argument appears to be based upon the theory that UTLD benefits from identification with UTM to its competitive advantage over the other IXCs. There is no doubt that this identification exists but there is no evidence that it is anticompetitive.

UTLD's advertising campaign is somewhat exaggerated in touting UTLD as the "hometown" carrier. But given its concept of "one-stop shopping" the characterization is not without foundation. The customer would call the local LEC for inquiries about its long-distance service resulting in communications with people who live in that customer's community. The other IXCs can benefit from their own associations which might be more salient to some consumers in choosing a long-distance carrier.

All parties to this case agree that a local exchange company can discriminate on behalf of its long-distance affiliate to the detriment of the other IXC competitors. Based on the record in this case, the evidence is insufficient to support a finding that UTM has exhibited a pattern of improper behavior in regard to the IXCs leading to the conclusion that it would, in fact, discriminate against these IXCs on behalf of its long-distance affiliate if the requested certificate were granted.

The Commission is of the opinion that the arguments of the opponents to this application are not persuasive that UTM's potential for behaving anticompetitively on behalf of UTLD cannot be curbed. Since the previous application, UTLD has instituted changes which diminish the opportunity and incentive for employees of UTM to discriminate against or harm UTLD's competitors. The proprietary information policy, including the sanctions for its violation, and the physical separation of the employees are important in this regard. The conditions of certification recommended by Staff would make it possible to decertify UTLD should they be found to have engaged in anticompetitive behavior. The Staff could seek penalties short of decertification for lesser violations and UTLD's competitors would have the opportunity to file complaints should the impartiality of UTM come into question. Although UTLD is still not structurally separate, the Commission is of the opinion that the prohibition against disclosing proprietary information, the physical separation of the employees and offices, and the conditions of certification recommended by Staff, effectively remedy the deficiencies which concerned the Commission in UTLD's previous application.

The Staff has suggested that, if UTLD is granted a certificate, its operations be given "above-the-line" treatment as an additional disincentive to engage in anticompetitive behavior. The Commission believes that this approach would be effective in curbing anticompetitive behavior, as discussed more fully hereinafter.

V. Other Considerations

The opponents to this application argue that, since UTLD is reselling US Sprint's long-distance service at AT&T's prices, there is no benefit to the consumer from the proposed service in that the consumer is receiving a product already available in the interLATA long distance market at a price already available in that market. The primary concept in UTLD's product is "one-stop shopping" which offers the consumer a single contact, UTM, for billing, billing inquiry and repair service for both the local and long-distance services. The opponents do not believe that UTLD's offer to prospective customers of "one-stop shopping" is a meaningful difference in product for the consumer from that he could receive from Sprint at the somewhat lower prices offered by Sprint.

The opponents assert that a certificate should not be issued since the benefit is nearly nonexistent, and the potential for harm to the budding competitive market is great. Given these perceived drawbacks, the opponents believe that a grant of a certificate to UTLD would be a formula for violation of the mandates contained in Chapter 392, RSMo Supp. 1988. Chapter 392 requires that the provisions of the chapter be construed to, inter alia, promote diversity in the supply of telecommunications services and products throughout the State of Missouri. Section 392.530, RSMo Supp. 1988.

The Commission is not convinced that the benefits for consumers from UTLD's services would be as chimerical as the opponents argue. Although customers with AT&T as their long-distance carrier have only one bill, they now must call a separate AT&T number for service and billing problems. Even assuming that "one-stop shopping" is not that different a product, the decision as to its appeal should be made by the consumers in the competitive marketplace. Unlike the statutory condition existing during UTLD's previous application case, the new Chapter 392 requires this Commission to allow full and fair competition to function as a substitute for regulation consistent with the public interest. The Commission believes that the public interest would be protected in granting this certificate given the conditions upon which such certificate would be based and the controls that would be exercised by the application of the CAM, the prohibition against disclosing proprietary information, the physical separation of the employees and offices, and the scrutiny of the Staff and Public Counsel.

The Public Counsel opposes granting UTLD a certificate but suggests that, should such a certificate be granted, that UTLD be required to pay ten percent of its gross profits to UTM as a payment for the good will which UTM has acquired from its operations as a LEC and upon which UTLD relies for the vast majority of its share of the long-distance market. Although UTLD agrees that a large portion of its share of the long-distance market in Missouri is based upon its association with UTM, UTLD opposes the good will payment.

The Independent Telephone Company Group also oppose this proposal. These parties oppose the good will payment because the name, logo and reputation of UTM are not assets which are recognized in ratemaking as a cost of providing service or in any other way. For example, good will advertising is traditionally excluded from the cost of providing service in the ratemaking process. Further, the name and logo are owned by UTI and licensed to UTM and UTLD for their use. Since UTLD will pay for any services it receives from UTM through tariffs, contracts, direct charges and allocations, these parties see the good will payment as a second charge for the same services.

The Commission is of the opinion that there is insufficient evidence in this record to support the imposition of a good will payment. Public Counsel's witness did not perform any study or calculations to arrive at the good will percentage suggested. The figure was based upon amounts suggested in another docket and in cases occurring in other jurisdictions. There is insufficient evidence to demonstrate the applicability of those cases to this situation.

However, the Commission does find that a major factor in the substantial market share anticipated by UTLD is its association with UTM. Therefore, the Commission believes that it would be appropriate to consider the profits of UTLD in determining the telephone rates to be charged by UTM in Missouri. The record indicates that UTLD would be able to make a positive contribution beginning in 1989, and would have a healthy percentage of the long-distance markets in which it operates. Thus, there is little likelihood that UTLD would experience losses placing the ratepayers at risk.

There are two additional reasons why such an approach is appropriate in this instance. The benefit of supporting reasonable local telephone rates helps to balance any potential hazards arising from long-distance service offered by an affiliate of a local exchange company. For example, any minor subsidization of UTLD by UTM which might leak through the barrier of accounting procedures would be offset by this contribution to UTM's rates.

Second, this approach would control the incentive for anticompetitive conduct. The greater the profits generated by UTLD, the greater the contribution to the cost of providing service to UTM's customers. The incentive of unlimited profits having been removed, anticompetitive conduct would no longer serve a purpose.

To facilitate the consideration of UTLD's profits in determining UTM's rates, the Commission determines that UTLD should establish clear and accurate subaccounts setting forth separately from its affiliates its investment, revenues and expenses.

VI. The Commission's Decision

The Commission determines that UTLD has shown sufficient changes since its last application for a certificate to warrant granting this certificate upon the conditions set forth herein to control the potential for cross-subsidization of UTLD by UTM's ratepayers and the potential for anticompetitive behavior by UTM on UTLD's behalf.

The Commission finds that UTLD has filed current financial information to demonstrate its financial fitness to operate as a reseller of interexchange telecommunications service in this state. The record indicates that UTLD's revenues would meet their incremental cost of service during the year, 1989.

Having found that UTLD has provided adequate safeguards against the possible hazards to the public interest posed by the potential for cross-subsidization and anticompetitive behavior and that UTLD has demonstrated its fitness to perform the service proposed, the Commission determines that the public interest will be served by the additional competition a grant of authority to UTLD will afford.

The Commission further determines, pursuant to the decisions made in Case No. TO-84-222, et al., that, in addition to the conditions required to prevent cross-subsidization and anticompetitive behavior, UTLD should be required as a condition of any certificate granted to it, to observe the regulatory requirements imposed on all resellers as a condition of certification. Therefore, the Commission finds that the following conditions of certification should apply to UTLD:

(1) Should UTLD decide to offer intraLATA toll service, it shall comply with reasonable requests by the Staff for financial and operating data to allow the Staff to monitor the intraLATA toll market pursuant to Section 386.320.3, RSMo 1986;

(2) UTLD is required to file tariffs containing rules and regulations applicable to customers, a description of the services provided and a list of rates associated with the services pursuant to Section 392.220, RSMo Supp. 1988, and 4 CSR 240-30.010;

(3) UTLD is precluded from unjustly discriminating between and among its customers pursuant to Section 392.200, RSMo Supp. 1988, and Section 392.400, RSMo Supp. 1988;

(4) Under Section 392.510, RSMo Supp. 1988, master schedules with minimum-maximum ranges are only available for competitive or

transitionally competitive telecommunications services or for companies for which a range or band of rates existed at the time of the effective date of House Bill 360. Since UTLD is presently a noncompetitive company and UTLD did not have master schedules with minimum-maximum ranges approved by the Commission prior to the effective date of House Bill 360, UTLD cannot lawfully file master schedules with minimum-maximum ranges;

(5) UTLD is required by Sections 386.570, RSMo 1986, and 392.360, RSMo Supp. 1988 to comply with all applicable Commission rules except those which are specifically waived by the Commission pursuant to Section 392.420, RSMo Supp. 1988;

(6) UTLD is required to file a Missouri-specific annual report pursuant to Section 392.210, RSMo Supp. 1988, and Section 392.390.1, RSMo Supp. 1988;

(7) UTLD is required to submit Percentage of Interstate Use (PIU) reports, including the percentage of interstate use and the percentage of intrastate use, on a quarterly basis to the local exchange companies pursuant to Section 392.390.3, RSMo Supp. 1988;

(8) Should UTLD decide to provide intraLATA toll service, it shall submit to the Public Service Commission Staff on a confidential basis, within thirty (30) days of the inception of such service and until the Commission orders otherwise, quarterly reports showing its percentage of intrastate intraLATA use pursuant to Section 392.390.3, RSMo Supp. 1988;

(9) Pursuant to Section 392.390.3, RSMo Supp. 1988, UTLD is required to comply with the jurisdictional reporting requirements as set out in each local exchange company's access services tariff.

The Commission finds that UTLD should file appropriate tariffs within thirty (30) days of the effective date of this Report and Order. The Commission further finds that UTLD should file any request for a variance from the Commission's rules that may be necessary as a result of the grant of this authority within thirty (30) days of the effective date of this Report and Order. In addition, the Commission finds that UTLD should file its PIU reports within thirty (30) days of the effective date of this Report and Order.

Conclusions of Law

The Missouri Public Service Commission has arrived at the following conclusions of law.

UTLD proposes to provide telecommunications service to the public as a public utility and a telecommunications company pursuant to Section 386.020, RSMo Supp. 1988, and as such is subject to the jurisdiction of this Commission pursuant to Section 386.250, RSMo Supp. 1988.

UTLD seeks a certificate of service authority to operate as a reseller of interexchange telecommunications service in the State of Missouri pursuant to Section 392.440, RSMo Supp. 1988.

Section 392.470, RSMo Supp. 1988, provides in pertinent part as follows:

> The Commission may impose any condition or conditions that it deems reasonable and necessary upon any company providing telecommunications service if such conditions are in the public interest and consistent with the provisions and purposes of this chapter, including, but not limited to, determining that any such company should provide just and reasonable compensation to one or more other certificated telecommunications companies operating in areas in which the compensating company is providing intrastate telecommunications service without Commission authorization.

After notice and hearing, the Commission has found that the application of UTLD for a certificate of service authority should be granted upon the conditions set forth herein since UTLD has shown that the grant of the application as conditioned is in the public interest.

It is, therefore,

ORDERED: 1. That this application of the United Telephone Long Distance Company of the Midwest for a certificate of service authority to operate as a r' ller of interexchange telecommunications service in the State of Missouri is granted hereby. This certificate of service authority is subject to the conditions of certification set forth herein.

ORDERED: 2. That United Telephone Long Distance Company of the Midwest is directed hereby, as a condition of its certification, to retain for at least five (5) years all documents, including but not limited to appointment logs, calendars and time sheets, supporting labor costs directly charged to it by United Telephone Company of Missouri and the other companies comprising the United Telephone System-Midwest Group.

ORDERED: 3. That United Telephone Long Distance Company of the Midwest is directed hereby, as a condition of its certification, to furnish to the Commission's Staff and the Office of the Public Counsel on a semiannual basis all allocation methods, formulae and work papers used to calculate its costs.

ORDERED: 4. That United Telephone Long Distance Company of the Midwest is directed hereby, as a condition of its certification, to permit the Commission's Staff and the Office of the Public Counsel to review on a semiannual basis all CAM accounts, all allocations of common costs, all financial statements and documents, all contracts with United Telephone Company of Missouri and US Sprint for services, and its journal, books and records.

ORDERED: 5. That United Telephone Long Distance Company of the Midwest is directed hereby, as a condition of its certification, to establish clear and accurate subaccounts setting forth separately from its affiliates its investment, revenues and expenses.

ORDERED: 6. That United Telephone Long Distance Company of the Midwest is directed hereby, as a condition of its certification, to refrain from engaging in any practices with its local exchange affiliates which would constitute an advantage for it over its interexchange competitors by virtue of its relationship with such affiliates. Applicant shall notify this Commission immediately upon acquiring knowledge of any such practices being engaged in by its affiliates.

ORDERED: 7. That United Telephone Long Distance Company of the Midwest, as a condition of its certification, shall have no more than two (2) officers or employees with direct or indirect managerial or operational authority who also are officers or employees of United Telephone Company of Missouri or any other affiliates of Applicant, with direct or indirect managerial or operational authority over United Telephone Company of Missouri.

ORDERED: 8. That United Telephone Long Distance Company of the Midwest is directed hereby, as a condition of its certification, to verify that the policies governing charging of labor to it by its local exchange affiliates are consistent with the Commission's findings as set forth herein. Applicant shall notify this Commission immediately upon acquiring knowledge of any such practices of its local exchange affiliates which are in violation of these findings.

ORDERED: 9. That, as a condition of its certification, the profits of United Telephone Long Distance Company of the Midwest shall be considered in establishing just and reasonable rates for United Telephone Company of Missouri.

ORDERED: 10. That nothing contained herein shall be construed as a finding by the Commission of the value for ratemaking purposes of any properties herein involved or as an acquiescence in the values placed upon said properties by the Applicant.

ORDERED: 11. That United Telephone Long Distance Company of the Midwest shall file its tariffs within thirty (30) days of the effective date of this Report and Order.

ORDERED: 12. That United Telephone Long Distance Company of the Midwest shall file any request for variance from the Commission's rules that may be necessary or appropriate as a result of the grant of this authority within thirty (30) days of the effective date of this Report and Order.

ORDERED: 13. That United Telephone Long Distance Company of the Midwest shall file its PIU reports as set forth herein within thirty (30) days of the effective date of this Report and Order.

ORDERED: 14. That, should United Telephone Long Distance Company of the Midwest decide to provide intraLATA toll service, it shall file with the Commission's Staff a report showing its percentage of intrastate intraLATA use. Said report shall be filed on a confidential basis within thirty (30) days of the inception of such service, unless otherwise ordered by the Commission.

ORDERED: 15. That all motions and objections not ruled upon by the Commission heretofore are denied and overruled hereby.

ORDERED: 16. That this Report and Order shall become effective on the 3rd day of March, 1989.

BY THE COMMISSION

Harvey G. Hubbs
Secretary

(S E A L)

Steinmeier, Chm., Mueller,
Hendren and Fischer, CC.,
Concur and certify compliance
with the provisions of
Section 536.080, RSMo 1986.

Dated at Jefferson City, Missouri,
this 21st day of February, 1989.