

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

In the matter of Southwestern Bell )  
Telephone Company's proposed )  
tariffs introducing DATASPEED 4540 )  
data terminals. )

In the matter of Southwestern Bell )  
Telephone Company for authority to )  
revise its rating method for future )  
customers to its DIMENSION PBX )  
Service. )

In the matter of Southwestern Bell )  
Telephone Company's proposed tariffs )  
introducing Call Priority Indicator )  
Service. )

CASE NO. TR-81-103

In the matter of Southwestern Bell )  
Telephone Company's proposed tariffs )  
introducing the HCS-200 PBX System. )

In the matter of Southwestern Bell )  
Telephone Company for authority to )  
revise its rating method for future )  
customers in its HORIZON )  
Communication System. )

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REPORT AND ORDER

The above-styled matter, Case No. TR-81-103, is a consolidation of five separate dockets involving competitive tariff offerings by Southwestern Bell Telephone Company (Bell). The original five dockets established by these filings and the particular tariff offerings associated with each of the original dockets is as follows: Case No. TR-81-103--DATASPEED 4540 data terminal equipment; Case No. TR-81-131--enhancement of existing DIMENSION PBX service offerings and introduction of DIMENSION 600 PBX; Case No. TR-81-133--Call Priority Indicator (CPI); Case No. TR-81-145--HCS-200 PBX system; and Case No. TR-81-228--HORIZON VS communication equipment.

The above-mentioned tariffs were filed by Bell with the Commission on the following dates: TR-81-103--July 31, 1980 (requested effective date September 13, 1980); TR-81-131--October 1, 1980 (requested effective date November 1, 1980); TR-81-133--September 30, 1980 (requested effective date

November 3, 1980); TR-81-145--September 18, 1980 (requested effective date November 24, 1980; and TR-81-228--January 14, 1981 (requested effective date February 15, 1981).

Each of the separate tariff filings in the above-mentioned dockets were suspended by separate orders of the Commission for initial periods of one hundred twenty (120) days beyond the requested effective dates.

By Commission order dated December 8, 1980, in the original Case No. TR-81-103 (DATASPEED 4540 tariffs), the Commission further suspended the tariffs involved therein for an additional period of six (6) months, until July 28, 1981, unless otherwise ordered, and established a schedule of proceedings in that docket, including deadlines for the filing of applications to intervene and the filing of prepared testimony and exhibits, and a prehearing conference to commence on May 5, 1981, at the Commission's offices in Jefferson City, Missouri, to be immediately followed by a hearing regarding the involved tariffs, with said hearing to continue through May 7, 1981, as necessary.

On February 20, 1981, Bell filed its "Motion to Consolidate and Hold Expedited Hearings" requesting that the five above-described dockets be consolidated into a single docket and that an expedited hearing be held regarding the five separate tariff offerings. Therein, the Company alleged, inter alia: That the five above-described tariff offerings all include a common pricing plan known as the Variable Term Payment Plan (VTPP) and that the concern expressed by the Staff of the Missouri Public Service Commission (Staff) and the only applicant for intervention in Case No. TR-81-103, Missouri Retailers Association, involves the propriety of VTPP; and that all five of said tariff offerings are for competitive services for which a demand presently exists in the State of Missouri. Thus, by its motion, Bell requested early resolution of the cases involving said service offerings in order that the Company might meet existing customer demands in as timely a manner as possible.

By orders issued on February 26, 1981, in Case Nos. TR-81-131, TR-81-133 and TR-81-145, the tariffs involved in said dockets were suspended for additional periods of six (6) months until September 2, 1981, September 3, 1981, and September 24, 1981, respectively.

On March 5, 1981, a joint motion was filed on behalf of Bell and the Staff requesting that the five above-described dockets be consolidated into a single docket in order to save duplication of effort by both the parties and the Commission. According to the consolidation plan proposed by the joint motion, Bell's five separate tariff filings would be consolidated under Docket

No. TR-81-103 and the schedule of proceedings in said docket would be revised as follows:

Deadline for applications to intervene -- March 31, 1981

Deadlines for the filing of prepared testimony and exhibits

(a) Bell -- March 27, 1981

(b) All Other Parties -- May 25, 1981

Prehearing conference -- June 1, 1981

Hearing dates -- June 2-5, 1981

The joint motion recognized that the operation of law dates in the five above-described dockets ranged from an early date of July 28, 1981, in Case No. TR-81-103 to the latest date of December 16, 1981, in Case No. TR-81-228.<sup>1</sup> In order to accomplish both a consolidation of the Commission's hearing of the five separate tariff offerings involved and a resolution of said matters at the earliest possible date, the joint motion proposed an extension of the operation of law date in the original Case No. TR-81-103 (DATASPEED 4540 tariffs) from July 28, 1981 to September 3, 1981, with the expectation that the Commission would issue a Report and Order in the consolidated case by September 3, 1981.

By Commission order dated March 16, 1981, the consolidation plan proposed by Bell and the Staff in their joint motion was adopted, wherein the Bell tariff filings in the five above-described separate dockets were consolidated for hearing under the single docket, Case No. TR-81-103. The schedule of proceedings in the consolidated Case No. TR-81-103 was established as proposed in the joint motion with a prehearing conference to commence on June 1, 1981 at the Commission's offices in Jefferson City, Missouri, and a hearing for the presentation of testimony, exhibits and witnesses for examination and cross-examination to immediately follow the prehearing conference and to continue through June 5, 1981, as necessary.

As additional matters, through its order of March 16, 1981, the Commission granted the intervention of Missouri Retailers Association in the consolidated Case No. TR-81-103 and the Commission further suspended the tariffs filed by Bell in the original Case No. TR-81-228 (HORIZON VS tariffs) for an additional period from June 16, 1981, until September 3, 1981, unless otherwise ordered.

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<sup>1</sup>The operation of law dates for the other three individual dockets are: Case No. TR-81-131 -- September 2, 1981; Case No. TR-81-133 -- September 3, 1981; and Case No. TR-81-145 -- September 24, 1981.

The prehearing conference in the consolidated Case No. TR-81-103 was duly commenced on June 1, 1981. The hearing in this matter commenced on June 2, 1981, and continued through June 4, 1981. The parties participating in the prehearing conference and hearing were Bell, the Staff, and the Office of the Public Counsel (Public Counsel). Missouri Retailers Association withdrew from the consolidated case by its filing with the Commission of June 4, 1981.

Upon the close of the hearing, the parties waived the requirement of Section 536.080, RSMo 1978, regarding the reading of the full record by the Commission, and the parties were informed that a briefing schedule would be established upon the filing of the transcript. By letter dated June 22, 1981, a briefing schedule was established in this matter which provided for the filing of simultaneous initial and reply briefs by the parties. Initial briefs were filed by all parties, and reply briefs were filed by Bell and the Staff.

#### Findings of Fact

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

Each of the service offerings involved in the instant case is included in the category of business terminal equipment which is subject to substantial competitive pressures from nonregulated suppliers. A brief description of each of said service offerings follows:

A) DATASPEED 4540

DATASPEED 4540 is a sophisticated, high speed, clustered, data communications terminal system consisting of a controller, CRT displays, keyboards and printer. The service is not presently offered by Bell in the State of Missouri. The tariffs involved herein by which Bell proposes introduction of DATASPEED 4540 in Missouri were filed with the Commission on July 31, 1980, and originally docketed in Case No. TR-81-103.

B) HCS-200

Hospitality Communications System-200 PBX (HCS-200) is an advanced electronic PBX employing digitally controlled, solid state space division switching and stored program control. It is designed for use by small and medium sized hotel and motel customers with 50 to 150 stations. The HCS-200 can serve such functions as waking guests, handling messages and providing information on room status. HCS-200 is a new service offering, not presently available in Missouri. The tariffs by which Bell proposes to offer HCS-200

in Missouri were filed with the Commission on September 18, 1980, and originally docketed under Case No. TR-81-145.

C) Call Priority Indicator (CPI)

Call Priority Indicator (CPI) is a modular, solid state system which automatically answers incoming calls, plays a prerecorded message, puts the caller on hold, and provides a visual indication to the user of the system of the order of incoming calls. The system is designed for use with standard key telephone systems and is offered to meet the needs of small business sales and service oriented customers with up to 24 incoming central office lines. CPI is also a new service offering, not presently available in Missouri. The tariffs by which Bell proposes to introduce CPI in Missouri were filed with the Commission on September 30, 1980, and originally docketed under Case No. TR-81-133.

D) HORIZON VS

HORIZON VS constitutes an expansion of Bell's existing HORIZON Communications System, which is a microprocessor-based system utilizing stored programs to control Multibutton Electronic Telephones and TOUCH-TONE non-key stations. It provides Call Coverage, Conferencing and Call Transfer. It is a new, smaller version of the existing HORIZON B system and is intended to meet the needs of smaller customers in the 15 to 28 station size range. The tariffs through which Bell proposes to introduce HORIZON VS in Missouri were filed with the Commission on January 14, 1981, and originally docketed under Case No. TR-81-228.

E) DIMENSION PBX

The DIMENSION tariffs filed in this case propose introduction of two new feature packages to Bell's presently offered DIMENSION PBX system and the introduction of a new service, DIMENSION 600. The proposed new feature packages to the existing DIMENSION PBX system are designated as Nos. 11 and 15. Proposed feature package 11 is intended for customers with 400 to 2400 lines. It combines a number of presently available features and offers new enhancements such as Emergency Access to Attendant and Data Entry via Telephone. Proposed feature package 15 is intended for general business customers with 80 to 350 stations, and offers enhanced customer control over station changes and greater system monitoring ability. DIMENSION 600 has a nominal capacity of 128 trunk lines and 600 main station lines and is being offered to replace DIMENSION PBX 400 E.

## I. Variable Term Payment Plan

Bell proposes to offer each of the above-described services in Missouri through a common lease-type payment plan referred to as the Variable Term Payment Plan (VTPP). VTPP is a contract for service for a specific term, referred to as an optional service period (OSP), which varies from 24 months to 72 months depending upon the particular service involved. During the OSP the customer is obligated to pay a single monthly rate which is designed to cover the Company's associated costs, both fixed (generally, capital costs and one-time charges) and recurring (generally, maintenance and taxes). As proposed by Bell, the VTPP rate applicable to various customers would not be subject to Company-initiated change for the duration of the OSP. Bell acknowledges that VTPP rates would remain subject to change by the Commission. The monthly VTPP rates vary inversely with the length of the various OSPs.

In conjunction with VTPP as described above, the Company proposes to offer the services involved herein through a conventional month-to-month lease. Under this month-to-month option, the applicable rate would be subject both to Company-initiated change and change initiated by the Commission or other parties.

In addition to proposing application of VTPP to the new service offerings intended by Bell for introduction into Missouri through this case, the revised tariffs would extend VTPP to the Company's current DIMENSION and HORIZON services.<sup>2</sup> Present HORIZON B and DIMENSION customers would have the option of expanding to the capacities of their present systems with their existing payment plan (referred to as the "Two-Tier" payment plan, to be described, infra) or switching to VTPP. The new services introduced through this filing would be available to customers only under VTPP. The Company intends to apply VTPP to most new major business equipment and service offerings and to certain existing offerings. The Company does not intend VTPP to be offered with all business equipment and services. VTPP has been approved in connection with one or more of the services offered by American Telephone & Telegraph Company (AT&T) Operating Telephone Companies (OTCs) in 44 states and the District of Columbia, and by the Federal Communications Commission (FCC).

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<sup>2</sup>The Company presently markets its HORIZON B and DIMENSION 100, 400, 400 E, and 2000 PBX systems in Missouri. Through the proposed tariffs the DIMENSION 400 E system would be restricted to existing systems and the 600 series and two new feature packages would be introduced.

Bell's business equipment and services are currently available to Missouri customers through month-to-month leases and the Two-Tier payment plan (Two-Tier). With Two-Tier pricing, two rate elements are involved: "Tier-A", which is designed to recover the Company's fixed costs related to the service, and "Tier-B", which is designed to recover the Company's recurring costs. The Tier-A rate can be paid at the initiation of service or over a contracted for period of time. The Tier-B rate is a monthly rate paid throughout the duration of a customer's use of the service. At the time that the contracted Tier-A period expires, the Tier-A rate "drops off" and the customer can, at its option, either terminate service or continue the service while paying the Tier-B rate, only. The Tier-A rate is not subject to Company-initiated change during the Tier-A contract period. However, the Tier-B rate is subject to Company change. Both rate elements remain continuously subject to change resulting from action initiated either by the Commission or other parties.

In accordance with Bell's original proposal in this case, the Company would perform updated cost studies for its Missouri VTPP service offerings every two years in order to make any necessary changes in price levels for such services. At the hearing, Bell revised its proposal to include annual cost updates of its VTPP services. The proposed VTPP prices have been established by including an inflation factor. No criticisms have been made by the other parties regarding the method utilized or the specific inflation projections made by the Company. If Bell's projections of the inflation rate regarding the costs of particular services are accurate, no changes will be necessary regarding VTPP prices for customers with outstanding contracts, since the price originally contracted for will have been based upon inflated costs. If Bell underestimates the inflation rate of costs associated with a particular service, the Company will have the ability to seek upward adjustment of the price for customers entering into VTPP contracts for service after the effective date of the price adjustment, but the Company would be contractually prohibited from seeking any increases in VTPP prices for contracts previously entered into.

## II. Uniform Pricing

Of the five service offerings involved in this case, three are "national offerings" in the sense that they will be marketed by AT&T through its various OTCs on a nationwide basis. The national offerings involved in

this case are DATASPEED 4540, DIMENSION PBX services and HORIZON Communications Systems. The other two services involved in this case, HCS-200 PBX and CPI, are "regional offerings" in that they will be marketed by Southwestern Bell Telephone Company within its regional territory.

With regard to the national offerings involved in this case, the initial pricing decisions as to the proposed VTPP rates were made by AT&T rather than Southwestern Bell. AT&T proposed uniform nationwide rates which were supplied to Southwestern Bell for review. Bell then conducted Missouri-based incremental unit cost (IUC) studies for each of the service offerings and compared the proposed AT&T nationwide rates with the results of said cost studies to determine the reasonableness of applying the nationwide rates in Missouri. Bell has largely adopted AT&T's nationwide rates through the VTPP prices proposed in the instant case.<sup>3</sup>

The regional offerings in this case have been priced by Bell rather than AT&T. For the regional offerings Bell has proposed uniform prices to be applicable through its multistate territory and has compared these proposed rates with Missouri-based IUC studies for reasonableness.

No witnesses from AT&T appeared in this case and no evidence has been presented as to the method utilized by AT&T in establishing its nationwide rates. Additionally, no evidence has been presented which would identify the methodology utilized by Bell in determining uniform rates for the regional offerings involved herein, other than that such prices have been set to provide contribution levels considered reasonable by the Company as compared with other IUC-priced business service offerings. It is the Company's contention that the uniform rates, both national and regional, are based upon analyses of market factors relevant to each of the various services. However, these analyses have not been presented to the Commission for review or even described by the Company in any detail.

### III. Bell's Arguments in Support of VTPP and Uniform Pricing

It is Bell's position that the Commission should permit the introduction of VTPP and Uniform Pricing with regard to the service offerings involved herein as a response to market preferences and increasing competition in the business terminal equipment and services market from unregulated vendors. While there is no conceptual necessity for linking VTPP and Uniform

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<sup>3</sup> Bell has deviated from the AT&T proposed nationwide rates only with regard to 13 individual parts or elements of the various equipment systems comprising the national offerings, and these deviations from nationwide rates are set forth in Goldammer Schedule No. 1, which is part of Exhibit 11.



Pricing, the Company contends that together VTPP and Uniform Pricing result in an appropriate response to the present and probable future market for such systems.

The record clearly indicates that Bell now finds itself in a business terminal systems market characterized generally by growing competition, largely, if not exclusively, coming from vendors not subject to regulatory restrictions in the manner in which Bell is subject to the jurisdiction of this Commission. The opening of the business terminal systems market to competition from unregulated vendors has resulted from various judicial decisions and rulings of the FCC, some of which will be discussed further, infra. The service offerings involved in this case fall into three general categories:

Data products (DATASPEED 4540); PBX systems (DIMENSION and HCS-200); and key telephone and related systems (HORIZON and CPI). The evidence indicates that Bell is the dominant vendor in Missouri in terms of PBX and key telephone systems but that the Company's market share in these areas has declined in the last several years. Bell has a minority market position in the data products field, where IBM is the acknowledged dominant vendor.

Bell's position is that VTPP, as opposed to Two-Tier, is the type of payment plan preferred by current and potential business terminal systems customers. VTPP offers the customer additional rate stability in that the entire monthly rate is protected from Company-initiated change, while with Two-Tier only the Tier-A rate (related to fixed costs) is so protected. Additionally, VTPP more closely approximates a straight lease than does Two-Tier, since VTPP involves a term of definite duration and Two-Tier does not.

While it is self-evident that Bell's customers would prefer as much rate stability as possible, the evidence offered in support of the market's preference for a straight lease-type payment plan and for VTPP as opposed to Two-Tier, in particular, rests upon the testimony of Company sales and marketing witnesses and their experience resulting from discussions with both Company field sales personnel and present and potential business services customers. No surveys as to customer preference regarding payment plans have been submitted in the record by the Company. Bell witnesses testified that, with everything else being equal, the ability (or lack thereof) of the Company to offer VTPP could be determinative as to the customer's choice of vendor. However, the Company also acknowledges that various factors are involved in customer decisions regarding choice of vendor of such business terminal systems, not the least of which is the nature of the competing equipment.

Bell's nonregulated competitors are offering alternative business systems through various payment options, including sale, straight lease and lease with option to purchase. The testimony of the Company witnesses suggests that the lack of VTPP has been a significant factor restricting Bell's ability to compete with nonregulated vendors. However, it is apparent that the mere entrance of competitors into the business terminal systems field would be responsible for some portion of Bell's loss of market share, and there is no method of determining the portion of Bell's market loss which is attributable to factors other than the availability of various payment options.

It is reasonable to conclude from the evidence that VTPP would be attractive to certain current and potential Bell customers. However, the extent to which introduction of VTPP would improve Bell's ability to compete in the market cannot be determined, especially considering the fact that the Company is proposing to withdraw the Two-Tier payment plan from application to the service offerings involved in this case while acknowledging that a certain number of customers likely would prefer Two-Tier to VTPP.

Bell also argues for the introduction of VTPP on the basis that it would provide the Company with increased revenue stability and would better facilitate the Company's planning for the introduction of new technology. In these areas, VTPP's advantage over Two-Tier is the definitive nature of the length of contracts.

Bell also supports Uniform Pricing on the basis that it would improve the Company's ability to compete in the marketplace. The Company's evidence suggests that the markets for its business products are becoming regional and national in nature. Bell's witnesses suggest that certain potential multistate customers dislike the fact that the same Bell services carry different prices in different states, and that these price differences can dissuade customers from choosing Bell services as opposed to those of competing vendors.

#### IV. Arguments in Opposition to VTPP and Uniform Pricing

Both the Staff and the Public Counsel have developed points, both through direct and cross-examination, in opposition to the VTPP and Uniform Pricing concepts and to certain specific pricing decisions made by the Company. Most of the concerns expressed by Staff and Public Counsel in some manner relate to Commission Case No. 18,309 (May 1977), which involved Bell's cost of service study and which established a framework for future cost and rate determinations

for Bell in Missouri.<sup>4</sup> Therein the Commission recognized three broad categories of service provided by the Company: Category One, covering services found to be subject to substantial competition; Category Two, covering basic telephone service (including, basic exchange service, both residential and business, and outside base rate area mileage); and Category Three, covering the balance of all other services provided by the Company. The Commission specified that Category One services would be priced so as to generate the largest practical level of contribution to joint and common costs and to basic services based on Long-Run Incremental Analysis (LRIA), and that no price for such services would be approved without providing some level of contribution. Category Three services are to be priced based upon LRIA while permitting adjustments for social or economic factors related to the provision or receipt of those services. Category Two services (basic services) are to be priced residually after taking into consideration any contribution to the revenue requirement provided by Category One and Category Three services.

While cautioning that the framework for Bell pricing and cost determinations established by Case No. 18,309 should not be inflexible, the Commission stated its opinion that the guidelines contained therein provide an appropriate response to increasing competition and the rapid advancement of technological change in the telecommunications industry, and a recognition of the social value of universal telephone service.

The Commission acknowledged that situations would arise where failure to perform a LRIA study, otherwise required by the above-described framework, would be justified if the possible benefits to be derived from the study are outweighed by the cost of conducting the study. In such circumstances the Company would be permitted to employ a directly assigned cost study methodology.

The Staff opposes the basic concept of VTPP, that is, the guarantee to the customer that the Company will not initiate a change in VTPP rate levels on outstanding contracts for the duration of a customer's contract term (OSP). Staff's concern revolves around the possibility that the Company's projections as to the effects of inflation on costs for VTPP services may prove to have been underestimated. If this were to occur, contribution will erode from levels approved as reasonable, yet the Company would be contractually prohibited from seeking an adjustment in the rate. Thus, the burden would be shifted to the Staff, Public Counsel or other parties to initiate a complaint process before

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<sup>4</sup>Administrative notice of Commission Case No. 18,309 was taken at the outset of the hearing in this case.

the Commission in order to effect a rate change. Although the Company proposes to conduct annual cost updates and to supply the results of such studies to the Commission, it would appear that the burden of proof regarding the reasonableness of the VTPP rate levels would be effectively shifted away from the Company. Assuming that a contested case develops, an allegedly inadequate VTPP rate level could continue in effect for a considerable length of time prior to final determination as to its reasonableness.

The Staff has a further objection specifically to the Company's proposed VTPP pricing in that the resulting contribution levels generally decline as the OSPs lengthen to a limit of 72 months. Since inflation projections necessarily become more precarious as the estimation period extends further into the future, the danger increases with the longer OSPs that contribution levels may become minimal or disappear completely.

Staff also argues that VTPP is designed to further an AT&T marketing strategy referred to as "migration", which Staff contends has as its purpose the causing of business customers to continuously move up from one generation of equipment technology to the most advanced available technology. The contention that VTPP promotes migration is based on the fact that the single monthly VTPP rate covers both the Company's fixed and recurring costs. In the context of OSPs ranging from two to six years and a market characterized by rapid advancements in technology, it is Staff's position that customers will be unlikely to renew VTPP contracts for existing equipment when renewal would require the customer to reincure the Company's fixed costs in the equipment. Instead, the Staff contends customers will be encouraged to select the latest generation of equipment. In contrast, Two-Tier does not hold the potential for encouraging migration since at the conclusion of the Tier-A period the customer has the option of continuing service on a month-to-month basis by paying the Tier-B rate, only, which corresponds to the Company's recurring costs.

The Company's position is that it has no intention of forcing any customers away from the retention of older generation business terminal systems, and that there is nothing objectionable about the Company pursuing an aggressive sales program for competitive service offerings and attempting to manage its product lines in an environment of rapidly advancing technology. Bell does acknowledge that there is an economic advantage to the Company if a customer chooses newer generation technology as opposed to the retention of older systems.

Staff also contends that the proposed establishment of different contribution levels for the same service at different OSPs constitutes rate discrimination prohibited by Section 392.200, RSMo 1978. The Company contends that VTPP contracts of increasing duration present decreasing levels of risk to the Company as a result of improved revenue stability and, therefore, that the differences in rates are not based upon arbitrary classifications.

Staff also criticizes the Company's utilization of economic lives longer than related OSPs for costing its HORIZON service offerings. By so doing the Company extends depreciation of the HORIZON products beyond the point at which the original contract period will expire and, therefore, the Company assumes reuse of a portion of HORIZON products. The record contains no evidence supporting this assumption of reuse, and said assumption must be questioned when at the same time Bell is stressing the increasing rate of technological advancement and the Company's emphasis on marketing the newest offerings in its various product lines.

Both Staff and Public Counsel oppose Bell's proposal to implement Uniform Pricing in Missouri. Their criticisms are addressed mainly toward the national service offerings (DATASPEED 4540, DIMENSION PBX and HORIZON) where nationwide pricing is involved, and can be divided into two general categories: First, the matter of Bell's failure to provide LRIA studies in support of the nationwide prices and, secondly, the lack of any evidence in this record from AT&T in explanation of the method by which the nationwide prices have been set.

An additional concern of the Staff involves the fact that proposed installation charges for some of the involved service offerings vary significantly, either above or below, from the corresponding inflated cost of installation. Staff's position is that installation charges should recover the inflated cost of installation but should not be priced significantly above the inflated cost because certain customers may have difficulty in making large initial payments for services. The Commission is of the opinion that no sufficient reason has been set forth in this record for the setting of installation charges at levels which vary significantly from inflated costs, and concludes that such installation charges should be set at levels approximately equal to inflated cost.

As noted previously, the Commission's Report and Order in Case No. 18,309 enunciated the position that Category One services should be priced on the basis of LRIA studies unless it can be shown that the costs of

conducting a LRIA for a particular product cannot be economically justified. The Staff has suggested that a LRIA may not be cost justified regarding the HCS-200 service offering because of the limited nature of the projected market for said product. Also, Bell suggests that the same situation exists regarding CPI. However, no party to this proceeding is contending that LRIA studies would be impractical from a cost standpoint with respect to any of the three national offerings involved herein.

The record indicates that the difference between LRIA and IUC studies is that the LRIA contains the added consideration of cross-elastic impacts, which, in the context of this proceeding, refers to marketing effects of pricing decisions between services of a particular company within a single product line. Bell has performed IUC studies in support of the proposed prices for the involved services rather than LRIAs, but asserts that cross-elastic impacts were considered by AT&T in conjunction with market forecasts made in the initial setting of the nationwide rates.

According to the IUC studies conducted by Bell in this case, the Company's proposed VTPP prices would result in average contribution levels for the various products on a typical system basis as follows:

<u>Model</u>	<u>Contribution Without Inflation</u>	<u>Contribution With Inflation</u>
DATASPEED 4540	25%	9%
HCS-200	59%	46%
CPI	49%	35%
DIMENSION PBX 100	82%	54%
DIMENSION PBX 400	73%	48%
DIMENSION PBX 600	71%	51%
DIMENSION PBX 2000	78%	54%
HORIZON VS	46%	21%
HORIZON Type B	57%	31%

It is Bell's position that these contribution levels are reasonable as compared with contribution levels produced by numerous other Category One services based upon IUC studies previously approved by the Commission. However, the Staff contends that approval of IUC-based prices for Category One services has generally occurred only with regard to adjustments to the prices of products already available to customers. The Staff's position appears to be that prices for such services should originally be established as a result of LRIA studies.

#### V. FCC's Computer II Decision

As emphasized by Bell both through the Company's briefs and through its pretrial memorandum submitted in this case, various segments of the telecommunications industry have, in recent years, been opened up to

competition as a result of court decisions and rulings by the FCC.

Particularly relevant in this regard to the instant proceeding is the FCC's Second Computer Inquiry decision, FCC Docket No. 20828, 35 PUR4th 143 (April, 1980) as modified by the FCC second Memorandum Opinion in said docket issued on December 30, 1980.<sup>5</sup> The Commission hereby takes administrative notice of the decision as modified in said docket.

Among other things, the FCC determined in its Computer II Decision that a distinction would be recognized between "basic" and "enhanced" network services, and that Customer Premises Equipment (CPE) (which includes all of the service offerings involved in this case) should be provided by the Bell System on an untariffed basis. The FCC, in its December, 1980 order, directed that implementation of this deregulation be accomplished in a bifurcated manner, whereby all CPE supplied to customers after March 1, 1982, and all federally tariffed CPE would be supplied on an untariffed basis through a separate, newly created AT&T subsidiary, and all embedded CPE as of March 1, 1982, would remain on a tariffed basis for an undefined period pending an implementation proceeding for the purpose of determining mechanisms to accomplish the detariffing of such embedded CPE. As a result of the Computer II Decision as it presently stands, units of the service offerings involved in this case which are installed in Missouri subsequent to March 1, 1982, will be provided by the new AT&T subsidiary on a detariffed basis, rather than by Southwestern Bell Telephone Company, and such units will not be available to provide contribution to joint and common costs and to basic service.

#### Conclusions

The Missouri Public Service Commission has arrived at the following conclusions:

Southwestern Bell Telephone Company is a telephone corporation as defined and is subject to the jurisdiction of the Commission pursuant to Chapters 386 and 392, RSMo 1978. The revised tariffs which are the subject matter of this proceeding were suspended under Section 392.230, RSMo 1978, and the burden of proof regarding the reasonableness of said revised tariffs is upon the Company.

Based upon the evidence and the briefs submitted, the Commission concludes that the tariffs as proposed by the Company do not establish just and reasonable rates and charges and, therefore, the Commission further concludes that said tariffs should be disallowed.

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<sup>5</sup>This FCC decision, as modified, will hereinafter be referred to as the "Computer II Decision".

The Company's case in support of the introduction of VTPP generally relies on the arguments that the competitive environment which has developed in the field of business terminal equipment necessitates use of VTPP and that decisions as to the methods by which Company business products are to be marketed involve matters which should be left to the Company's management discretion.

While there appears to be no question that the Bell System indeed is faced with increasing competition in the business terminal equipment field, the Commission finds the evidence regarding the probable impact on the Company's market situation of substituting VTPP for Two-Tier pricing with regard to these service offerings to be somewhat speculative. In this regard, the Commission specifically notes that neither customer-sponsored testimony nor evidence of customer surveys have been presented by the Company in this case. Bell's arguments in opposition to a side-by-side offering of VTPP and Two-Tier, citing increased administrative costs and possible confusion on the part of customers between multiple payment plans, are not particularly persuasive. Inasmuch as some present and potential customers of business terminal equipment will prefer Two-Tier to VTPP, it would seem reasonable to assume that the Company would be interested in providing both payment plans to its customers, unless some other Company objective is playing a determinative role.

VTPP provides increased revenue stability to the Company over Two-Tier and this increased revenue stability is perceived as beneficial both to Bell and to the fully separated AT&T subsidiary to be created pursuant to the FCC's Computer II Decision. The evidence suggests that the substitution of VTPP for Two-Tier constitutes a placement of the Company's revenue stability concerns above the consideration of providing reasonable payment alternatives to its business terminal equipment customers. The existence of the purported AT&T migration strategy must also be considered. Bell's position appears to be that what has been termed migration strategy constitutes an effort by the Bell System to manage and to aggressively market its product lines. The record presented is not sufficient to base a conclusion as to whether any AT&T migration strategy has as its purpose the leading of business customers continuously through levels of increasingly advanced telecommunications equipment and services. Regardless of the intent, however, the Commission concludes that the offering of VTPP as a replacement for Two-Tier pricing would, to a degree, discourage the retention of older generation business terminal equipment and promote its replacement with the most advanced available Bell technology.

Bell remains the dominant vendor in the PBX and key telephone markets in Missouri and is under the Missouri statutory duty of providing its services at reasonable rates and under reasonable conditions. Based upon the foregoing



reasons, the Commission concludes that the application of VTPP, ne, to the service offerings involved herein would not result in just and reasonable rates and charges. The Commission agrees that the Company is entitled to some degree of latitude in its decisions as to the marketing of its products. However, in the context of this case, the Commission concludes that the Company's management discretion can be exercised consistent with the establishment of just and reasonable rates and charges only through a side-by-side offering of VTPP and Two-Tier as payment plans available in conjunction with the services involved herein.

As noted previously, in Case No. 18,309, the Commission determined LRIA to be the proper method of pricing Category One services unless such analysis is not economically justifiable. In this proceeding, Bell takes the position that market conditions necessitate a modification of the Commission's position with regard to the performance of Missouri-based LRIA studies for pricing such services. The Company argues that competitive pressures require that it be permitted to establish uniform prices, that is, nationwide rates for national competitive business service offerings and regional prices for such offerings to be marketed in Southwestern Bell Telephone Company's multistate territory.

The Commission finds the evidence presented in support of the proposition that Uniform Pricing would significantly improve the Company's position in the business terminal systems marketplace to be speculative and not highly persuasive. Additionally, it seems doubtful that "uniform prices" could remain uniform indefinitely. The concept of Uniform Pricing assumes the accuracy of inflation projections built into VTPP rates for contracts which would extend up to six years in duration. If this Commission were to determine that a particular uniform rate had become inadequate and made a revision thereto, that rate would no longer be "uniform". Additionally, the concept of uniform rates appears to assume either that costs associated with products so priced will rise in a uniform manner in all jurisdictions in which the product is marketed, or that state regulatory commissions simply will not initiate revisions to uniform prices when changes in costs occur. The Commission does not find either of these assumptions to be realistic.

The Commission is cognizant of the fact that under the FCC's Computer II Decision all CPE (which includes all Bell's services designated by the Commission as Category One services) installed subsequent to March 1, 1982, would no longer be available to provide contribution to joint and common costs and to basic service. However, even with the present Computer II ruling, all Missouri embedded CPE as of March 1, 1982, would remain under this

Commission's jurisdiction for a transition period of undetermined duration and, thus, would remain available to provide contribution. Therefore, the Computer II Decision does not require this Commission to abandon the concept of residual pricing set forth in Case No. 18,309. Additionally, the Commission concludes that no sufficient reason has been established in this record to justify elimination of the requirement that Category One services be priced as the result of Missouri based LRIA studies. Suggestions have been made in this record that LRIAs may not be cost justified for the regional service offerings involved, CPI and HCS-200. However, the Commission is of the opinion that, at this point, insufficient evidence exists to make a firm conclusion in that regard.

Since the instant proposed tariffs do not contain LRIA based VTPP rates for any of the services involved and, additionally, do not contain any LRIA based Two-Tier rates for any of the new services involved, said tariffs must be disallowed. If Bell desires to introduce these services or other Category One services into Missouri under VTPP on a permanent basis, it may do so only if the Two-Tier payment plan is offered side by side with VTPP and all prices, both VTPP and Two-Tier, are separately supported by Missouri based LRIAs, unless it is established that a LRIA would not be cost justified for a particular offering. The Commission does not find the Company's proposal to establish prices producing different contribution levels for OSPs of varying duration to be discriminatory. However, the Commission is concerned with the possibility that the burden of proof corresponding to VTPP rates will be shifted from the Company to other parties as a result of underestimations of the effects of inflation combined with the Company's commitment not to seek a change in rate on existing VTPP contracts. The Commission is of the opinion that VTPP contracts in Missouri should be limited to a maximum OSP of four years in order to insure against the occurrence of an undue shifting of the burden of proof. Also, costs of services offered under VTPP should be based upon use of economic lives equal to the duration of the particular OSP involved unless the Company can establish the propriety of varying therefrom. The Commission concludes that Bell has not established the propriety of any such variance in this record.

The record is clear that markets presently exist in Missouri for each of the new service offerings proposed for introduction by Bell in this case and delay in approval of tariffs regarding these offerings prevents the Company from competing in these markets. Additionally, pursuant to the Computer II Decision, any units of the service offerings involved in this case which would

be placed in service after March 1, 1982, would not be subject to the Commission's jurisdiction and would not be available to provide contribution. Therefore, it would be beneficial to the Company, its business terminal equipment customers, and its basic service customers to allow provision of these services as soon as possible. However, it would be improper to allow such introduction of services under rates and terms determined to be unreasonable.

The Commission recognizes that the performance of LRIA studies can be a lengthy process and that Bell will not be able to immediately propose VTPP and Two-Tier prices supported by Missouri based LRIAs. In the context of the benefits to be derived from early introduction of these new service offerings into the Missouri market, the Commission hereby authorizes the Company to file tariffs which would effect an interim introduction of the new service offerings (DATASPEED 4540, CPI, HCS-200, DIMENSION 600 PBX and HORIZON VS) and the rerating of existing service offerings (DIMENSION 100, 400 and 2000) consistent with the following conditions.

(a) Interim introduction of services may be implemented by the Company under VTPP only in conjunction with a side-by-side interim offering of the Two-Tier payment plan for all of such services.

(b) VTPP price levels under this interim introduction shall be those proposed by the Company in this proceeding, except that such prices shall be modified by increasing contribution levels for individual USOCs for which contribution levels proposed by the Company in this case are either negative or marginal. Also, VTPP contracts on all offerings under the interim plan shall be limited to a maximum OSP of four years.

(c) Two-Tier rates shall be established for the side-by-side interim plan which provide reasonable levels of contribution. The Company and the Staff should work in full cooperation in order to develop the interim VTPP and Two-Tier rates.

(d) As proposed by the Company, present Two-Tier customers should have the option of continuing their service to capacity under said payment plan.

(e) That rates for an interim side-by-side offering of VTPP and Two-Tier for the services involved in this case shall be submitted to the Commission for approval within 30 days of the effective date of this Report and Order.

(f) The authority to effect this interim side-by-side introduction of VTPP and Two-Tier for the services involved shall be conditioned upon Bell performing Missouri based LRIA studies producing both VTPP and Two-Tier prices for each of the service offerings, with the results of said LRIA studies to be submitted to the Commission for review within six (6) months of the effective date of this Report and Order. Upon approval of such LRIA-based rates by the Commission, said rates shall be made permanent. In conjunction with the submission of LRIA-based VTPP and Two-Tier rates, the Company shall submit revenue projections for the service offerings involved.

All of the service offerings involved in this case shall be subject to the LRIA requirement unless the Company submits evidence sufficient to conclude that the performance of a LRIA study for a particular service is not economically justifiable. Additionally, in developing LRIA-based VTPP rates for these services, the Company should utilize economic lives equal to the particular OSP involved and installation charges should be set approximately equal to inflated cost. Further, all Missouri VTPP contracts shall, as agreed to by Bell at the hearing in this matter, contain language specifically notifying customers that the VTPP contract rate remains subject to change by the Commission. Such language should be similar to that contained in the Company's present Two-Tier contracts.

It is, therefore,

ORDERED: 1. That the revised tariffs filed by Southwestern Bell Telephone Company in the five separate dockets consolidated into Case No. TR-81-103 be, and the same are, hereby disapproved.

ORDERED: 2. That Southwestern Bell Telephone Company be, and the same is, hereby authorized to file revised tariffs for the purpose of effecting an interim introduction of the services involved in this proceeding under a side-by-side offering of VTPP and Two-Tier pricing in accordance with the provisions of this Report and Order.

ORDERED: 3. That the authority to file interim VTPP tariffs granted in Ordered: 2, above, is hereby conditioned upon prior commitment by Southwestern Bell Telephone Company to submit permanent LRIA-based VTPP and Two-Tier prices for the services involved in accordance with the terms of this Report and Order.

ORDERED: 4. That Southwestern Bell Telephone Company shall conduct annual cost updates of any VTPP services provided in Missouri and shall submit such annual cost updates to the Commission.

ORDERED: 5. That the Commission hereby specifically retains jurisdiction in this docket for the purposes of reviewing the implementation of any tariffs filed pursuant to the terms of this Report and Order.

ORDERED: 6. That this Report and Order shall become effective on the 22nd day of September, 1981.

BY THE COMMISSION

*Harvey G. Hubbs*  
Harvey G. Hubbs  
Secretary

(S E A L)

Fraas, Chm., McCartney, Dority,  
Bryant and Shapleigh, CC., Concur.

Dated at Jefferson City, Missouri,  
on the 9th day of September, 1981.