

Service Date: March 6, 1997

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of)	
U S WEST Communications, Inc. to)	UTILITY DIVISION
Discontinue Centrex Plus Service,)	
)	DOCKET NO. D96.2.15
and)	
)	
IN THE MATTER of the Application of)	
PTI Communications to Discontinue)	ORDER NO. 5905c
Digitrex II Service.)	

FINAL ORDER

Introduction and Procedural Background

1. On February 5, 1996 U S WEST Communications, Inc. (U S WEST) filed an application with the Montana Public Service Commission (Commission), proposing to discontinue offering its Centrex Plus service to new customers and to grandfather existing customers until April 29, 2005. U S WEST proposed to honor the term for existing contracts and to permit contract extensions until April 29, 2005. Existing Centrex Plus customers would be able to move, add and change station lines until the customer moves to another service, the contract expires, or April 29, 2005. The filing also contains certain restrictions for existing customers, some specific to customers subscribing to Centrex Plus service on a month-to-month basis and customers subscribing to other centrex-like services.

2. U S WEST's Centrex Plus filing generated protests from MCI Telecommunications Corporation (MCI), the Telemanagement Coalition (Coalition)¹ and AT&T Communications of the Mountain States, Inc. (AT&T). These objections alleged that the filing is anticompetitive, discriminatory, in violation of state and federal law, and inconsistent with the public interest.

¹ The Coalition did not subsequently petition to intervene in this proceeding.

3. Pursuant to § 69-3-810(4), MCA, ARM 38.5.2760(4) and the objections, the Commission suspended withdrawal of Centrex Plus service and issued a Notice of Opportunity to Comment and/or Intervene. The Commission established this proceeding to investigate the public interest impacts of discontinuing Centrex Plus service and to evaluate U S WEST's proposal in relation to the Telecommunications Act of 1996 (the 1996 Act).² Intervention was granted to the Montana Consumer Counsel (MCC), AT&T, Northwestern Telephone Systems, Inc. dba PTI Communications (PTI), Citizens Telecommunications Company, MCI, Montana Telephone Association, McLeod Telemangement, Inc., and Ronan Telephone Company. The Commission subsequently issued a Procedural Order, setting the hearing to commence on July 31, 1996.

4. PTI made a similar filing on April 2, 1996, proposing to discontinue offering its Digitrex II service and to grandfather it for existing customers until June 15, 2000. The Commission suspended the withdrawal of Digitrex II service and consolidated PTI's filing with the U S WEST filing on May 8, 1996. The Commission also extended intervention to include the PTI proceeding, allowed further intervention until May 14, 1996, and amended the procedural schedule to allow for adequate time for discovery relating to both filings.

5. AT&T, MCI, PTI and U S WEST submitted prefiled testimony, but none of the other parties actively participated in discovery in this matter. AT&T filed a motion to compel discovery after U S WEST objected to numerous of its data requests claiming that many of them required production of costing and pricing information far beyond the scope of this Docket. The Commission granted AT&T's motion in part on June 6, 1996. In denying portions of the motion, the Commission ruled that the purposes of this proceeding could be served expeditiously without acquiring detailed cost information from U S WEST, and that Commission consideration of such cost information is better addressed in conjunction with a comprehensive review of each company's services and the underlying network elements and functions used to provide those services. *See* Notice of Commission Action on U S WEST's Objections to Data Requests and

² Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (Feb. 8, 1996) (to be codified as amended in scattered sections of 47 U.S.C. §§ 151, *et seq.*).

AT&T's Motion to Compel Responses to AT&T's First Set of Data Requests, Docket No. D96.2.15 (June 13, 1996).

6. After the Commission acted on its first motion, AT&T moved to strike portions of U S WEST witness Karen A. Baird's testimony, claiming that without the cost data which the Commission declined to compel, her testimony could not be substantiated by U S WEST, the Commission, or the intervenors. AT&T contended that her testimony relating to arbitrage, pricing anomalies and reduced contribution to universal service should be stricken from the record. The Commission forbore ruling on AT&T's Motion to Strike as the testimony that AT&T requested stricken from the record was not yet a part of the record, not having been formally introduced at hearing, and ruling that AT&T could renew its objection to portions of the testimony when the testimony became part of the record.

7. Pursuant to requests from the parties, the initial hearing date was vacated and rescheduled for September 18, 1996. On September 12, 1996 U S WEST filed a motion for an order deeming this matter submitted to the Commission upon a stipulated record, for briefing by the parties. The stipulated record (by MCC and the active parties in this proceeding, U S WEST, AT&T, PTI and MCI) includes the testimony of the parties' witnesses without their appearance or cross-examination, subject to the pending motion of AT&T to strike portions of Ms. Baird's prefiled testimony. The Commission granted U S WEST's motion on September 17, 1996, ordering that it would decide the issues based on the prefiled testimony, written discovery and other information officially noted according to Montana law. The Commission also vacated the remainder of the Procedural Schedule, established a briefing schedule and scheduled oral argument for November 1, 1996. The oral argument was postponed and subsequently canceled upon Commission determination that it was not needed to decide the issues in this proceeding.

Summary of the Arguments

8. U S WEST and PTI assert that their existing Centrex Plus and Digitrex II³ price structures are susceptible to price arbitrage if new entrants are allowed to resell centrex in competition with basic business exchange service. They claim this arbitrage would inappropriately remove revenue contributions that support universal service. They also state that the centrex price structure is based on certain cost characteristics that may not apply to the broader basic business market and that centrex revenues may not continue to cover costs if the service is resold as single line business service.

³ Collectively referred to as "centrex" in this order.

9. In their Joint Briefs, AT&T and MCI state that withdrawing centrex service is anticompetitive because it eliminates an economically feasible way for new entrants to begin offering local service. They also claim that centrex withdrawal is inconsistent with the 1996 Act which requires incumbent LECs to allow the resale of their retail services. They suggest that requiring the LECs to resell centrex will contribute to a competitive local exchange market in Montana and will benefit end users.

AT&T's Motion to Strike U S WEST Testimony

10. In the Joint Opening Brief of AT&T and MCI, AT&T reasserted its motion to strike portions of Ms. Baird's testimony. AT&T has claimed that it issued data requests to U S WEST designed in part to determine the validity of U S WEST's claim that the public interest will be detrimentally affected due to "lost contribution" from flat-rated business services if it is not permitted to withdraw Centrex Plus service. U S WEST's rationale for this assertion is that there will be uneconomic arbitrage leading to loss of contribution towards basic universal service. AT&T argued that without cost data, it is impossible to determine whether there would be any impact on universal service if centrex services remain available to new customers. AT&T stated that the discovery requests were designed to elicit facts to support U S WEST's reasons for the proposed withdrawal. According to AT&T, Ms. Baird's statements concerning the potential for uneconomic arbitrage based upon relative contribution levels and the potential impact on the provision of universal services are "conclusory and unsupported."

11. AT&T claims that the Commission's act of sustaining some of U S WEST's objections to its data requests effectively narrowed the scope of this proceeding and rendered Ms. Baird's statements concerning arbitrage, contribution and universal services outside its scope. AT&T refers to Ms. Baird's assertion that the pricing anomalies in centrex services combined with potential effects of resale will detrimentally reduce universal service contribution. AT&T argued that if the Commission cannot determine the validity of these claims without supporting cost data--now deemed outside the scope of this proceeding--the parties cannot adequately respond to U S WEST's claims about contribution to universal service.

12. U S WEST contended that the Commission has no authority to unilaterally strike testimony because striking testimony is a severe sanction reserved for egregious behavior by a party, and that U S WEST should not be sanctioned for prevailing on its objections to AT&T's data requests. Although the Commission agrees that sanctions appropriately address some sort of wrongdoing or omission by a party, it does not interpret AT&T's motion as a request for them.

13. AT&T's motion is a request to exclude evidence from the record. AT&T cited the Procedural Order in this Docket, which states that the Commission has the authority to

"simplify issues to aid in the disposition of this proceeding, which may include striking portions of prefiled testimony at its discretion as it sees fit to expedite resolution of the proceedings, and admitting only that evidence which is material and relevant to the issues to be decided in the proceeding."

14. Striking portions of Ms. Baird's testimony will not expedite resolution of this matter. It is not necessary to strike portions of relevant testimony from the record merely because the record may not support statements made by a party. The Commission bases its decisions on an evidentiary record, and is capable of determining the weight to be given to assertions made by the parties in their testimony and capable of sifting through the record to determine whether such assertions are supported by substantial evidence. It is not necessary to strike portions of the record to remove them from Commission consideration. Unlike a jury convened to determine a verdict, the Commission is an administrative body with specialized knowledge relating to the issues in this Docket. Section 2-4-612(7), MCA, states that an agency's experience, technical competence, and specialized knowledge may be utilized in the evaluation of evidence. AT&T urges the Commission to eliminate "unsupported conjecture" from the record. This would be a waste of Commission resources if the Commission elected to excise such testimony rather than giving it the weight it deserves at the time of decision. Moreover, most parties to proceedings before the Commission are well used to presenting their cases and legal arguments to the Commission and have ample opportunity to argue that little weight should be given to conclusory and unsupported evidence.

15. AT&T's motion essentially argues that Ms. Baird's testimony, without the underlying cost data to support it, fails to convincingly explain the potential for damage to universal service and the public interest generally. This argument is appropriately addressed in briefs. Although AT&T urges the Commission to exclude this evidence, it has made no reference to the Montana Rules of Evidence in support of its contentions. AT&T's motion to strike is denied.

Summary of the Testimony

U S WEST - Prefiled Direct Testimony

16. Ms. Karen A. Baird prefiled direct testimony on behalf of U S WEST, giving two reasons for Centrex Plus withdrawal: 1) to address price arbitrage concerns, and 2) to focus its resources on developing a replacement for Centrex Plus.

17. Ms. Baird testified that existing price differences between Centrex Plus and basic business service, combined with industry changes prompted by the 1996 Act, create arbitrage opportunities that should be addressed. An exhibit attached to her testimony indicates that the

average revenue produced from a basic business access line exceeds the revenue that would be produced if that access line were converted to a resold Centrex Plus line.

18. Ms. Baird further testified that U S WEST believes that centrex resale would cause losses of intraLATA toll and switched access revenues as resellers aggregate end-user toll traffic and bypass U S WEST's system. Ms. Baird stated that lost revenues from basic business, toll and switched access services would reduce the contributions currently available to support lower residential rates and could harm universal service in Montana.

19. U S WEST contends that discontinuing centrex will not affect AT&T, MCI, McLeod or the Coalition since none of these entities currently subscribe to centrex service in Montana. Ms. Baird noted that new entrants will be able to purchase an array of LEC retail services at wholesale rates, as well as unbundled network elements, in order to compete in local markets.

20. According to U S WEST, the 1996 Act does not require it to continue offering Centrex Plus to new customers. Ms. Baird stated that Centrex Plus has a small market share as a retail service and no longer meets the needs of the intended medium and large business and government customers. Ms. Baird further stated that U S WEST considers grandfathering Centrex Plus part of an on-going evolution in centrex services, and noted that its Centron 300 and Centron Custom services were both discontinued in 1992.

PTI - Prefiled Direct Testimony

21. Mr. Theodore Otis prefiled testimony for PTI Communications. Like Centrex Plus, PTI's Digitrex II service provides central office switching functions as an alternative to customer-purchased PBX systems. He stated that PTI offers both Digitrex I and Digitrex II; Digitrex I is designed for small business customers while Digitrex II is designed for medium to large businesses.

22. PTI claims that its Digitrex II service is priced above cost and generates a contribution that would otherwise be lost to competing PBX vendors. PTI is concerned about potential effects of Digitrex II resale to small business customers, which it claims is beyond the intended market. According to Mr. Otis, this could occur if resellers are allowed to arbitrage the price difference between Digitrex II and single line business service. PTI stated that the problem is similar to that which would occur if resellers were allowed to resell residential lines to business customers. Although § 251 of the 1996 Act allows a state Commission to prohibit resale of a service to a category of customers different from the category of customers to whom the retail service is available, PTI believes it is unclear to what extent such a restriction could

apply to the resale of Digitrex II, since both Digitrex II and single line business service are business class services.

23. Mr. Otis listed two financial implications associated with Digitrex II resale. First, he contended there would be a foregone contribution from business customers, asserting that if 50 percent of PTI's small business customers were to purchase their exchange access from a reseller of Digitrex II service, the existing price would be insufficient. According to Mr. Otis' testimony, existing residential and business rates would have to increase over \$2.00 per month in order to maintain revenues that would cover network costs.

24. Second, PTI raised the possibility that Digitrex II will no longer cover costs. Mr. Otis asserted that while Digitrex II prices exceed cost when provided to its target market -- medium and large businesses in urban locations with high line concentrations -- this may not be true if Digitrex II must be provided to small, single line business customers through resellers. Mr. Otis explained that Digitrex II pricing takes advantage of certain economies involved with serving medium and large business customers which may not be available with small business customers. Thus, in a resale scenario, existing Digitrex II prices could be less than cost.

AT&T - Prefiled Direct Testimony

25. Mr. John Blake, testifying on behalf of AT&T, asserted that U S WEST and PTI's requests to discontinue centrex services are anticompetitive because their withdrawal will impede the development of competition in Montana and are inconsistent with federal and state policies. According to Mr. Blake, centrex service is nothing more than a local loop combined with certain central office switching functions that have been grouped for sale on a discounted basis. He asserted that centrex offers the transmission and facilities needed to connect end users to the local network and LECs remain monopoly providers of these basic network functions and features. AT&T believes that discontinuing centrex-type services raises barriers to entry into local and intraLATA markets and reduces customer choice.

26. AT&T asserted that the 1996 Act requires LECs to make all their retail telecommunications services available for resale and that these requirements apply equally to grandfathered services. AT&T supports the United States Department of Justice's (DOJ) comments in the FCC's Interconnection rulemaking regarding the implementation of §§ 251 and 252 of the 1996 Act, noting that DOJ stated that LECs should not be allowed to avoid the resale requirements of the 1996 Act by withdrawing a retail service. The DOJ also suggested that U S WEST's attempt to withdraw centrex throughout its 14 state region was an effort to avoid having to make the service available for resale.

27. Mr. Blake testified that it is critical that LECs be required to make their entire retail service lines available to new entrants in order to quickly bring the benefits of competition to consumers. He stated that resale provides a starting point for a competitive local exchange market, as experience in the long distance market has shown. He further claimed that centrex resale has contributed to increasing competition in the small and medium business local exchange markets in Iowa, Minnesota, Washington and Oregon.

28. According to Mr. Blake, centrex resale in Montana would benefit both residential and business customers and U S WEST and PTI should not be permitted by this Commission to create barriers to entry by grandfathering centrex service. AT&T also asserted that U S WEST and PTI have not made a reasonable case for grandfathering centrex because it is being used and it has value to consumers, and also has the potential to be used by resellers as a way to enter the local market.

29. Finally, Mr. Blake criticized U S WEST and PTI's claims of uneconomic arbitrage, asserting that if the issue is simply how the service is priced, U S WEST and PTI can resolve this concern by seeking to reprice the service. AT&T suggested that the alleged improper pricing of a service does not justify its discontinuance.

MCI - Prefiled Direct Testimony

30. Ms. Rebecca Bennett, testifying for MCI Communications, asserted that U S WEST and PTI's proposals are contrary to the 1996 Act, anticompetitive, anti-consumer and harmful to the public interest in Montana.

31. Like AT&T, MCI believes that resale of centrex services is essential to promoting local exchange competition in Montana. Ms. Bennett testified that competition in the local exchange market will develop in much the same way as it did in the long distance market-- competitive local exchange service providers will first resell local services and network elements such as centrex service. She stated that if these services are not available for resale, local exchange competition will be unnecessarily delayed.

32. MCI believes the timing of U S WEST's filing, three days before the Act became law, is evidence that U S WEST is attempting to discourage competition. Ms. Bennett stated that U S WEST and PTI's proposals violate §§ 251(b)(1) and 251(c)(4) of the 1996 Act, which require an incumbent LEC to offer for resale, at wholesale rates, any telecommunications service that it offers on a retail basis and prohibit LECs from imposing unreasonable or discriminatory conditions on the resale of its telecommunications services. MCI asserted that in Montana the ability to resell centrex is essential for new entrants because these potential competitors will have

no realistic alternatives to the features and functions provided by centrex until local exchange unbundling and interconnection arrangements are developed.

33. Additionally, MCI believes that Commission approval of the U S WEST and PTI proposals will conflict with § 253(a) of the Act which states: "No State or local statute or regulation or other State or local requirement may prohibit or have the effect of prohibiting the ability of any entity to provide interstate or intrastate telecommunications service." Ms. Bennett stated that Commission approval of centrex withdrawal will have the effect of prohibiting competitive local exchange service providers from providing local exchange service in Montana.

34. Ms. Bennett also stated that U S WEST's proposal is anti-consumer because a replacement for Centrex Plus would not be available for six to nine months. In the meantime, both retail and wholesale customers who need the features and functions provided by centrex service will be unable to satisfy those needs. She contended that U S WEST and PTI are more concerned with protecting their monopoly markets and discouraging competition than in providing the services their customers want and need.

35. Ms. Bennett also testified that the withdrawal proposals violate § 69-3-824, MCA, which concerns consumer protection against unfair business practices and anticompetitive activity. Continuing to provide centrex to certain grandfathered customers while refusing to offer the service to other customers is discriminatory and represents an unfair business practice, according to Ms. Bennett.

36. Ms. Bennett recommended that the Commission either reject U S WEST and PTI's proposals outright, or allow the services to be grandfathered on a retail basis and require U S WEST and PTI to continue to offer the service on a wholesale basis for resale. MCI believes that this will eliminate the anticompetitive aspects of the proposals and ensure the development of competition in Montana.

U S WEST - Rebuttal Testimony

37. In rebuttal testimony, Ms. Baird disagreed that the future of local exchange competition in Montana depends on the ability of new entrants to arbitrage between centrex and basic business service. She stated that new entrants will have ample opportunity to resell other retail products and services. She also testified that AT&T and MCI's assertion that centrex resale is essential for local exchange competition in Montana ignores the facilities-based interconnection requirements of the 1996 Act. In addition, Ms. Baird stated that new entrants will be able to install their own central office switches and will have access to the facilities of other companies.

38. Ms. Baird disagreed that grandfathering centrex is anticompetitive, asserting that U S WEST has the right to request to discontinue a nonessential service at any time. She stated that even in a competitive market there are a number of reasons why a firm would withdraw a product; e.g., insufficient profits, customer migration to other products, a dying market, or abuse or misuse of the product. She reiterated that resale of centrex, given the potential for arbitrage with single line business service, could negatively impact U S WEST's profitability and may negatively impact its Montana customers.

39. Ms. Baird disagreed that grandfathering Centrex Plus is anti-consumer, stating that grandfathering is a common industry practice that treats existing customers reasonably. For potential new customers, functionally equivalent alternatives to centrex exist in the form of PBX systems and key telephone systems. Further, for small business customers, U S WEST still offers Centron I service.

40. Ms. Baird criticized AT&T's reference to the DOJ's comments, stating that the reference is misleading and meaningless. It is misleading because the DOJ recognizes product obsolescence as a valid reason for withdrawing a service. According to Ms. Baird, U S WEST believes that Centrex Plus service is obsolete in Montana because it does not meet the needs of current customers and because the potential for arbitrage exists under the current price structure. She stated the DOJ reference is also meaningless because it focuses on the opinion of one of the hundreds of parties that submitted comments in the FCC's Interconnection rulemaking.

PTI - Rebuttal Testimony

41. Mr. Otis responded to AT&T's assertion that PTI failed to demonstrate that Digitrex II resale represents uneconomic arbitrage, stating that nowhere in his direct testimony did he state that the arbitrage would be uneconomic--he simply stated that it is arbitrage. However, he stated that it could be uneconomic to the extent that the cost of providing Digitrex II service outside the urban area is greater than the current price. In any case, PTI believes arbitrage is undesirable because of the distributional effects discussed in Mr. Otis' direct testimony.

42. PTI also addressed AT&T's testimony that if the issue is simply how the service is priced, PTI and U S WEST can seek to reprice the service. PTI responded that the issue is how the service is priced, and that is the point of its filing. PTI emphasized that Digitrex II prices currently reflect the cost of providing multi-line service to limited locations near the switching node. Digitrex II prices do not reflect the costs of providing single line service at diverse locations throughout the Flathead valley.

43. Mr. Otis addressed AT&T's testimony that alleged improper pricing of the service does not justify discontinuing the service or warrant the continued offering of uneconomic prices

to existing customers. He stated that the point of PTI's filing is that PTI does not presently sell Digitrex II to small, diverse, relatively high cost single line customers. Thus, PTI's proposal does not discontinue offering Digitrex II to single line business customers because that activity never occurred. PTI does not oppose resale of its Digitrex I service to single line business customers, nor does it oppose resale of Digitrex II service to Digitrex II customers. PTI contends that this is not a matter of price discrimination, as AT&T suggests, because the price differences reflect differences in the service and costs. According to Mr. Otis, the per line loop cost of serving dispersed, single line customers is five times greater than the cost of serving the average Digitrex II customer.

44. With respect to an alternative Digitrex II price structure, Mr. Otis stated that it may be appropriate to price the service based on volume, location and usage. PTI will evaluate the resale provisions of the FCC's interconnection order and incorporate them into a revised pricing structure.

Findings of Fact and Commission Decision

45. AT&T and MCI refer the Commission to decisions from other states in U S WEST's region which have denied Centrex Plus withdrawal as not being in the public interest or on other grounds. The Commission is not persuaded by these decisions, most of which were rendered prior to the FCC's First Report and Order on August 8, 1996.

46. Centrex is a service that provides business customers with central office-based alternatives to customer owned PBX switching equipment and other on-premise equipment such as key systems. Centrex service allows businesses to create a sub-network of access lines with common access to a variety of system features such as direct inward dialing from and outward dialing to the public switched network, call forwarding, three-way calling, call transfer, call conferencing and call hold. It also provides internal communications within a business entity. Centrex is a competitive central office based substitute for on-premise equipment and is marketed to medium to large business customers as an alternative to premises equipment.

47. Although it appears that Centrex Plus and Digitrex II were not intended for single line business customers, both U S WEST and PTI have expressed their concerns that the scope of potential resale by competitive LECs would include these customers because the station lines can effectively function as a substitute for single line business service. Their concerns relate to the pricing of centrex service, which is considerably less per station line than single line business service. U S WEST and PTI both provided testimony indicating that the cost of centrex is lower than business exchange service due to cost savings realized by extending multiple lines to one or a few locations close to the central office. Exchange service provided to single line customers,

on the other hand, is widely dispersed throughout an exchange. Mr. Otis' testimony on behalf of PTI included his calculations indicating that the per line loop cost of serving the dispersed single line customer is five times greater than the average Digitrex II customer. Mr. Otis compared the results of allowing resellers to resell centrex to the results of permitting them to resell residential access lines to business customers.

48. Mr. Otis testified that PTI intends to reprice Digitrex II service in a manner that will be consistent with the 1996 Act and at the same time will not invite adverse impacts on the general body of ratepayers. U S WEST also indicated that it would file tariffs for a Centrex Plus substitute within six to nine months of its initial filing for withdrawal.

49. The issues raised in this proceeding are whether the withdrawal of Centrex Plus and Digitrex II violates the 1996 Act and whether it is inconsistent with the policy mandates of Montana law or is otherwise adverse to the public interest.

Issue 1: Is withdrawal of Centrex Plus and Digitrex II consistent with the 1996 Act?

50. Both U S WEST and PTI concede that their respective filings were prompted by the 1996 Act. Section 251(b)(1) of the 1996 Act imposes a duty on all LECs "not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of its telecommunications services." Incumbent LECs have the additional duties relating to resale of their services that are set forth in 47 U.S.C. § 251(c)(4), which provides:

(4) RESALE.--The duty--

(A) to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers; and

(B) not to prohibit, and not to impose unreasonable or discriminatory conditions or limitations on, the resale of such telecommunications service, except that a State commission may, consistent with regulations prescribed by the [Federal Communications] Commission under this section, prohibit a reseller that obtains at wholesale rates a telecommunications service that is available at retail only to a category of subscribers from offering such service to a different category of subscribers.

Certain rural telephone companies are exempt from the requirements of § 251(c)(4) until they receive a bona fide request for interconnection, services, or network elements and the Commission determines that it is appropriate to terminate the exemption. PTI may qualify as an exempt rural telephone company, although the Commission has not made that determination and the issue has not been raised in this proceeding except to the extent that AT&T and MCI exclude PTI from certain arguments in their Joint Briefs, adding the caveat that the arguments would apply to PTI as well, should the Commission determine that PTI is not an exempt rural company.

51. When the filings were made in this proceeding, the regulations had not been issued by the Federal Communications Commission (FCC) to implement § 251 of the 1996 Act, and thus the reference to consistency with FCC regulations in § 251(c)(4)(B) set forth above had no effect. The FCC issued its First Report and Order (FCC Order) on August 8, 1996, adopting regulations as mandated by Congress in 47 U.S.C. § 251(d). Although portions of the FCC Order have been stayed pending appeals, the stay affects the pricing and "pick and choose" rules based on jurisdictional grounds. It is certainly not relevant to sections where Congress expressly directed the FCC to adopt rules.⁴

52. The FCC Order addressed withdrawal of services by an incumbent LEC, noting that it had sought comment in its interconnection NPRM on whether an incumbent LEC can avoid making a service available at wholesale rates by ceasing to offer the service on a retail basis, or whether it should first be required to demonstrate that withdrawing the offering is in the public interest or that competitors will continue to have an alternative means to provide the service. First Report and Order, ¶ 965. MCI and AT&T apparently rely on comments filed in that docket by the DOJ, one of numerous commenters.

53. The DOJ had argued that unilateral withdrawal should only be allowed if the service is shown to be obsolete. First Report and Order, ¶ 967, fn. 2282. The FCC did not adopt this suggestion and declined to issue general rules on withdrawal of services, concluding that this is better left to the states. For example, the FCC Order concluded that states can better assess the universal service implications of an incumbent LEC's proposal to withdraw a retail service. First Report and Order, ¶ 968.

⁴ See Order Granting Stay, slip op. (Th Cir.) (Oct. 15, 1996), *affecting the FCC's pricing and "pick and choose" rules and not the entire Order in Iowa Utilities Board, et al. v. FCC*, No. 96-3321 (and consolidated cases), appealing Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, FCC 96-325 (released Aug. 8, 1996), and see Order Lifting Stay In Part, (8th Cir.) (Nov. 1, 1996), *modifying the stay entered on Oct. 15, 1996, and affecting CMRS and LEC interconnection*.

54. U S WEST's multistate filing of Centrex Plus withdrawal was referred to in the FCC Order. First Report and Order, ¶ 967. The FCC concluded that its general presumption that incumbent LEC restrictions on resale are unreasonable does not apply to incumbent LEC withdrawal of service. First Report and Order, ¶ 968. The FCC further discussed grandfathering of withdrawn services, stating:

We find it important . . . to ensure that grandfathered customers -- subscribers to the service being withdrawn who are allowed by an incumbent LEC to continue purchasing services -- not be denied the benefits of competition. We conclude that, when an incumbent LEC grandfathers its own customers of a withdrawn service, such grandfathering should also extend to reseller end users. For the duration of any grandfathering period, all grandfathered customers should have the right to purchase such grandfathered services either directly from the incumbent LEC or indirectly through a reseller. The incumbent LEC shall offer wholesale rates for such grandfathered services to resellers for the purpose of serving grandfathered customers.

55. The Commission finds nothing in the 1996 Act or in the FCC Order that prohibits withdrawal and grandfathering of centrex services. However, a new entrant must be allowed to resell grandfathered services in order that grandfathered customers may not be denied the benefits of competition. Any possible discriminatory effect of centrex withdrawal on new entrants is alleviated by this decision.

Issue 2: Is withdrawal of Centrex Plus and Digitrex II consistent with Montana law and the public interest?

56. Applicable state law also does not prevent the withdrawal of centrex. It is the declared policy of the Montana Legislature to maintain universal availability of basic telecommunications service at affordable rates. It is also the state's policy to encourage competition in the telecommunications industry in Montana, to the extent it is consistent with maintaining universal service. *See* § 69-3-802, MCA. Montana's policies are consistent with the 1996 Federal Act, which also recognizes the importance of continued universal availability of affordable basic services in connection with its policy of encouraging competition in the local exchange market. *See generally*, 47 U.S.C. §§ 251 - 261.

57. Protecting the competitor is not a primary goal for encouraging competition in the telecommunications industry. Protecting universal service is, however. New entrants may resell centrex services to existing customers who may benefit from competitive carriers' offerings. New entrants may also purchase unbundled elements to meet the needs of the market for these business services. However, telecommunications competition is not well served by permitting

resale of a service-- for unintended uses--by new competitors seeking to gain market share at the expense of universal service.

58. The Legislature established a regulatory framework (the Montana Telecommunications Act) to allow an orderly transition to a competitive environment. An orderly transition to competitive markets emphasizes protecting competition, not the individual competitor, so long as universal service goals are met. Increased prices for basic services as a result of centrex resale is not consistent with an orderly transition to a competitive market environment and is not consistent with the policy of this state or the public interest as explained more fully below.

59. "Arbitrage" is defined as the simultaneous purchase of a product or security in one market and sale in another market in hope of making a profit on price differences in the different markets. Black's Law Dictionary 95 (5th ed. 1989). The arbitrage opportunity with centrex resale involves purchasing centrex station lines for resale to single line business customers. The prices U S WEST and PTI charge for centrex station lines are substantially less than the prices they charge for single line business service.

60. There are two issues related to the U S WEST and PTI's assertions of arbitrage. One is the potential effect on universal service and overall LEC revenues. The other relates to service costs and competition. Neither AT&T nor MCI provided substantial rebuttal of the LECs' arbitrage concerns. MCI's testimony lacks any arbitrage discussion and AT&T merely stated that it does not know what U S WEST and PTI mean by uneconomic or inappropriate arbitrage and that U S WEST and PTI have not claimed that centrex does not cover costs. Despite the apparent lack of interest by AT&T and MCI, the Commission finds that arbitrage issues are important.

61. It is clear from U S WEST and PTI's testimony that they view arbitrage as the potential for centrex resellers to take advantage of the existing rate difference between single line business and centrex services. Both AT&T and MCI suggest that centrex resale would allow them to offer local service to small business customers in competition with the incumbent LECs. These are primarily small business customers who presently subscribe to single line business service. By purchasing centrex service for resale, new entrants could offer these customers the service they are presently subscribing to at lower rates and still profit from reselling the service. Customer migration to a new entrant providing the service at substantially lower rates than the incumbent LEC charges is all but guaranteed.

62. According to U S WEST and PTI, the rates these single line business customers currently pay provide a contribution to universal service by keeping residential rates low. U S

WEST and PTI claim that the loss of single line business service revenue that would result from arbitrage could eliminate contributions that help achieve universal service goals.

63. U S WEST and PTI also assert that centrex service was designed to compete with customer premise based equipment such as PBXs and the present pricing structure relies on certain cost characteristics associated with that market. Thus, the cost issue is not whether centrex prices cover existing service costs, as AT&T suggests, but whether it will continue to cover costs in a resale environment where the service is being provided to a market for which it was not designed. The Commission finds these concerns are legitimate and were not adequately discredited by AT&T and MCI.

64. U S WEST and PTI's concerns about lost contributions that support universal service are related to broader questions about overall LEC revenues and rate unbundling and rebalancing that are beyond the scope of this case, but will be considered in other cases. For this reason the Commission sustained certain U S WEST objections to AT&T's discovery which asked for detailed cost and revenue information showing centrex contributions and business service support for lower residential rates. Nevertheless, universal service at affordable rates is a policy goal in Montana and possible adverse effects of centrex resale on universal service goals should be considered.

65. The cost concerns are also relevant. The transition to competitive local telecommunications markets should lead to sustainable and efficient competition. AT&T and MCI did not show how reselling centrex service in competition with single line business service will contribute to sustainable and efficient local exchange competition. Instead, it appears that resale of centrex service as single line business service at existing centrex prices could cause uneconomic bypass.

66. PTI's testimony in this case noted that centrex service is multiline service at limited locations near the switching node. In contrast, single line business service involves few lines at many diverse locations that may be close to or far from the switching node. PTI estimated that the per line loop cost of single line customers is five times greater than for the average Digitrex II customer. Neither MCI nor AT&T challenged this estimate. Allowing centrex to be resold as single line business service could expose LECs to higher costs which might not be recovered by existing centrex prices, and could possibly cause uneconomic bypass by end users. Competition based on these circumstances would be neither sustainable nor efficient. Neither AT&T nor MCI challenged the basic economic soundness of these arguments. Moreover, it does not appear that any of the data requests that U S WEST was not required to answer would have provided any relevant information about the cost effectiveness of centrex in

an environment where it could be resold as basic business service under the current price structure.

67. The record establishes that competitive alternatives are available to consumers who wish to obtain centrex-type services for their business needs. Thus, the withdrawal of centrex services will not adversely affect these customers. Centrex services were designed to compete with customer owned PBX systems. Cost based centrex service allows LECs to retain customers that may otherwise be lost to PBXs, make more efficient use of plant in service and possibly avoid uneconomic bypass. When approving discounted station line prices for U S WEST's Centrex Plus service the Commission previously stated that the discounts were reasonable and not discriminatory because they reflect distinctions of volume, character and length that "mirror distinctions in the character of service." In the Matter of the Application of US West Communications for Approval of Centrex Plus and Related Tariffs, Docket No. 92.9.58, Order No. 5661b, ¶ 24. (January 10, 1994).

68. Neither U S WEST nor PTI asserted that centrex service should not be available for resale to grandfathered customers. Neither AT&T nor MCI has resold centrex in Montana in the past, and both AT&T and MCI declined to indicate when they could offer local service if centrex could be resold more broadly, citing the need for rules on interconnection, unbundling and wholesale rates. Thus, withdrawing centrex on a going-forward basis does not necessarily create a barrier to AT&T's or MCI's entry into local markets and does not foreclose the opportunity to resell centrex to current customers of the service.

69. Price arbitrage opportunities would be created if centrex service were available for resale to single line business customers, given existing prices. Although not empirically verifiable with the data in this case, the record suggests the potential for centrex resale to produce competition based on uneconomic bypass which would not be sustainable. Competition based on these circumstances would be inconsistent with the Montana Telecommunications Act, § 69-3-801, MCA, *et seq.*, which requires an orderly transition to competition.

70. This case raises questions concerning incumbent LECs' present revenues, rate rebalancing and maintaining universal service in more competitive local telecommunications markets. These issues can be better evaluated in more comprehensive cost and revenue proceedings. Absent a thorough evaluation of these issues, permitting broad resale of centrex may unreasonably force LEC's to shed market share and revenues and may not be consistent with the competitive neutrality provisions of the 1996 Act. *See, e.g.,* 47 U.S.C. § 253. For these reasons it is appropriate to allow U S WEST and PTI to withdraw their existing centrex services.

71. AT&T and MCI contend that centrex resale is critical to quickly bring the benefits of competition to consumers. However, centrex resale, or even resale in general, is not the only means by which new entrants will compete with incumbent LECs. Processes are under way to unbundle LEC network elements and functions for resale, other LEC services will be available for resale at wholesale prices, and interconnection arrangements will allow facilities based competition. Even if centrex resale would quickly benefit some consumers by offering lower prices, it is unclear that such benefits would be sustainable or economic.

72. Given the lack of any end-user opposition to the LECs' proposals to withdraw centrex and the availability of facilities based alternatives to centrex service, AT&T's and MCI's assertion that withdrawing centrex is anti-consumer is questionable. The record in this case does not support AT&T and MCI's claims that allowing U S WEST and PTI to withdraw their centrex services will adversely effect the transition to sustainable and economic competition in Montana, or that withdrawal would be anti-consumer.

73. Both PTI and U S WEST have suggested that a restructured centrex service which would be suitable for resale could replace their current services. PTI indicated that restructured centrex may involve price distinctions based on volume, usage and location. Based on the record in this case it is not clear that centrex service is so essential to the public that regulation must ensure its continued availability. Customer premise alternatives to centrex already exist. Soon alternative local service competitors will have access to unbundled network functions which can be used to create services similar to centrex, but which have the potential to better meet customer specific needs. Allowing markets, driven by customer demand, to spur development of appropriate replacements for centrex seems appropriate in light of recent changes to telecommunications regulation. Therefore, while U S WEST and PTI may file replacements for their discontinued centrex services, this is not required by this order.

74 U S WEST and PTI's requests to withdraw centrex service on a going-forward basis, and grandfather the service for existing customers should be approved. The intervenors did not demonstrate that withdrawing centrex service will adversely effect an orderly transition to competitive local telecommunications markets nor did they discount LEC concerns that centrex price arbitrage may negatively effect universal service and could increase costs of service. Further, they did not adequately disprove the potential for price arbitrage or show that price arbitrage would be in the public interest. Centrex withdrawal, with grandfathering for existing customers, is consistent with the 1996 Act, the FCC Order and the Montana Telecommunications Act.

Conclusions of Law

1 The Commission has authority to supervise, regulate and control public utilities. Section 69-3-102, MCA. U S WEST and PTI are public utilities offering regulated telecommunications services in the State of Montana. Section 69-3-101, MCA.

2 Centrex Plus and Digitrex II are regulated telecommunications services, according to the definition set forth in § 69-3-803(3), MCA.

3 The Commission has authority to do all things necessary and convenient in the exercise of the powers granted to it by the Montana Legislature and to regulate the mode and manner of all investigations and hearings of public utilities and other parties before it. Section 69-3-103, MCA.

4 Although public utilities may withdraw regulated telecommunications services upon 30 days' notice to the Commission and to the users of the service, the Commission has authority to suspend the withdrawal of a service, either on its own motion or at the request of an interested person. Section 69-3-810(4), MCA.

5 The United States Congress enacted the 1996 Act to encourage competition in the telecommunications industry. Congress gave responsibility for much of the implementation of the Act to the states, to be handled by the state agency with regulatory control over telecommunications carriers. *See generally*, the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (amending scattered sections of the Communications Act of 1934, 47 U.S.C. §§ 151, *et seq.*). The Montana Public Service Commission is the state agency in Montana charged with regulating telecommunications carriers in Montana and properly exercises jurisdiction in this Docket pursuant to Title 69, Chapter 3, MCA.

6 Adequate public notice and an opportunity to be heard has been provided to all interested parties in this Docket, as required by the Montana Administrative Procedure Act, Title 2, Chapter 4, MCA.

7 The Commission's approval of PTI and U S WEST's applications to withdraw Digitrex II and Centrex Plus, respectively, is not inconsistent with the 1996 Act and FCC regulations adopted on August 8, 1996, to implement the Act, nor does it create a barrier to entry in the Montana telecommunications market. First Report and Order, ¶¶ 965-968.

8 Withdrawal of Digitrex II and Centrex Plus is not contrary to Montana law and is consistent with the public interest and Montana public policy as set forth in § 69-3-802, MCA.

Order

THEREFORE, based upon the foregoing, it is ORDERED that the issues raised in this Docket are resolved as set forth above and as follows:

1 AT&T's Motion to Strike testimony of U S WEST witness Karen A. Baird is
denied;

2 U S WEST's application to withdraw Centrex Plus is approved; and

3 PTI's application to withdraw Digitrex II is approved.

DONE AND DATED at Helena, Montana, this 25th day of February, 1997, by a vote of
3-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DAVE FISHER, Chairman

NANCY MCCAFFREE, Vice Chair

DANNY OBERG, Commissioner

BOB ROWE, Commissioner
(Voting to Dissent - Attached)

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.

DISSENT OF COMMISSIONER ROWE

I concur in much of the analysis in the Commission's order. I dissent to the extent that I would condition withdrawal of Centrex and Digitrex upon approval by the Commission of appropriately-priced substitutes.

I have long had concerns about various pricing schemes for Centrex-type service, which prior to the possibility of Centrex resale had some arguably anti-competitive elements (e.g. tying).¹ With the advent of the possibility of resale, some local exchange carriers developed different concerns and have sought to withdraw these services. Other local companies such as Citizens Tel have decided not to seek withdrawal of these services. Indeed, Citizens introduced its Centrex product to Montana after the U S WEST and PTI requests to withdraw the service were filed.²

Because Centrex-type service is a combination of specific service elements, robust local competition should theoretically allow customers to purchase discrete elements at appropriate prices and combine them to meet their particular needs. However, until vigorous competition develops, Centrex-type services will continue to fill an important need for customers (especially mid-sized businesses) which do not wish to purchase, maintain, upgrade or operate PBX equipment.

PTI witness Otis developed serious pricing concerns about PTI's Digitrex service. According to Otis, pricing is correct today (prices cover costs for the service as currently used), but might not do so if the service were provided more broadly as an alternative to 1FB primary business service. PTI and U S WEST's concern is grounded in the possibility of incorrect pricing and the possible ability of rivals to take inappropriate advantage of that pricing. Both PTI

¹ In Docket 92.9.58 the Commission addressed a number of pricing concerns related to U S WEST's Centrex Plus. Most were resolved by the final order.

² Docket D96.10.174, order dated November 25, 1996.

and U S WEST have committed to filing with the Commission substitute services. PTI's filing is now somewhat later than PTI had hoped. U S WEST's substitute filing is now significantly later than had been committed.³

Conditioning withdrawal on approval of a substitute service would provide new customers access to what for many customers continues to be a desirable service. It would also incent both companies to promptly file appropriate substitutes.

RESPECTFULLY SUBMITTED this 25th day of February, 1997.

BOB ROWE
Commissioner

³ In February, 1996, U S WEST stated it would file a substitute within six to nine months. PTI hoped to have its substitute filed by the end of 1996.