

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter, on the Commission's own motion,)	
to determine the total service long run incremental)	
costs and imputation requirements under the)	Case No. U-11103
Michigan Telecommunications Act.)	
_____)	

At the December 12, 1996 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. John G. Strand, Chairman
Hon. John C. Shea, Commissioner
Hon. David A. Svanda, Commissioner

OPINION AND ORDER

On June 5, 1996, the Commission issued an order commencing this proceeding to consider the Commission Staff's (Staff) proposal for determining total service long run incremental costs (TSLRIC), as required by MCL 484.2202(a); MSA 22.1469(202)(a). The Staff proposal is the second step in the two-step process instituted by the Commission for establishing a long run incremental cost standard.¹ The Commission's September 8 and November 10, 1994 orders in Case No. U-10620 completed the first step by approving, with modifications, the "Staff Report on Refining the Definition of and Developing a Methodology to Determine Long Run Incremental Cost for Application Under 1991 PA 179." That report established nine costing principles.²

The Staff proposal in this case interpreted and refined the nine costing principles, set forth accounting and record keeping requirements, and addressed how telecommunication providers'

¹The Commission indicated its intent to implement the two-step process in the "1994 Report to the Governor and Legislature as Required by 1991 Public Act 179," pp. 47-50.

²Although the Staff Report in Case No. U-10620 predated 1995 PA 216, which amended the Michigan Telecommunications Act, MCL 484.2101 et seq.; MSA 22.1469(101) et seq., the Staff proposal in the current docket indicates that the Staff Report is consistent with the amended act. See the June 5, 1996 order, Appendix A, pp. 10-11.

tariffed services should correspond to unbundled network components. The proposal's recommendations are summarized as follows:

Accounting Standards

1. The Uniform System of Accounts for Telecommunications Companies, as prescribed by the Federal Communications Commission (FCC) in 47 CFR pt. 32 (Part 32), should be the accounting standard used in making TSLRIC and imputation computations. Although TSLRIC is forward-looking and does not rely on embedded costs, the accounting standard provides a starting point for identifying and categorizing costs and must be used in supporting documentation for a cost study. June 5, 1996 order, Appendix A, pp. 1-4.
2. Providers that are not required to comply with Part 32 accounting standards may use other appropriate standards that apply to regulatory reporting. However, they must notify the Commission of their FCC waiver from Part 32 and the accounting standards that they will use. *Id.*, p. 3.
3. If a provider maintains accounting records that are specific to its Michigan operations, it should use those records in making TSLRIC and imputation computations. *Id.*, pp. 3-4.
4. Providers should file annual financial statements (applying Part 32 or other accounting standards) with the Commission. *Id.*, p. 4.

Services, Rates, and Rate Elements

5. Rates and services should be evaluated in TSLRIC and imputation studies by comparing revenues and costs with respect to both recurring and nonrecurring charges. Average revenue would be determined by dividing total revenues by total minutes of use. Average cost would be determined by dividing imputed or actual access expenses and TSLRIC costs by total minutes of use. *Id.*, pp. 4-5.
6. With respect to the level of specificity used in performing cost studies, the proposal presents three alternative interpretations of the word "rate": (1) The "average rate" interpretation would test broad categories of services for compliance with TSLRIC and imputation requirements. (2) The "average service rate" interpretation would perform the analysis at the level of individual services, e.g., residential message toll service, business message toll service, residential operator assisted calls, toll charges for pay telephones. (3) The "rate element" interpretation would analyze each rate component or charge of each service, e.g., both the first- and additional-minute rates of residential message toll service. *Id.*, pp. 4-7.

TSLRIC

7. Providers must document their rates in relation to TSLRIC with a cost study. Under the Michigan Telecommunications Act, a basic local exchange provider having more than 250,000 end-user customers (including end-users of affiliates) or a provider of payphone service having more than 10,000 payphones is required to prepare and file a TSLRIC study based on its own operations. [The Staff says that only Ameritech Michigan and GTE North Incorporated (GTE) currently meet these criteria.] If a provider does not meet these criteria, it may choose to prepare its own cost study or to adopt the study of a provider that is required to prepare one. *Id.*, pp. 11-13.

8. The filing requirements from Case No. U-10620 are reaffirmed; i.e., providers preparing their own TSLRIC studies must file updated studies every two years. A provider that has the option of choosing its own or another's cost study (as described in paragraph 7), but that has not yet indicated its choice, should do so within 60 days and should file its study within 180 days if it chooses to prepare one. *Id.*, pp. 13-14.

9. If a provider chooses to adopt the cost study of another provider, it may not change its designated provider for two years, although it may prepare and file its own cost study at any time. *Id.*, pp. 14-15.

10. TSLRIC studies supporting changes in rates should be presented in the format recommended by the Staff, which identifies 26 basic network components³ and provides for both group-related and service-specific costs. However, the provider preparing a study may be permitted to identify and propose additional network components if it secures Commission authorization prior to the study. *Id.*, pp. 15-17 and Exhibit A.

Imputation

11. Imputation studies are required in two contexts: (1) for toll, WATS, or other services for which toll access is a component, as required by MCL 484.2311; MSA 22.1469(311) (Section 311), and (2) for noncompetitive services provided by a local exchange carrier (LEC) to a competitor, as required by MCL 484.2362; MSA 22.1469(362) (Section 362). The Staff proposes formats for those studies. *Id.*, pp. 17-23 and Exhibits B and C.

12. Section 311 imputation studies for providers of intrastate toll access, toll, or WATS service that do not provide both basic local exchange and toll services should be filed annually and at any time that the provider files for a price reduction. *Id.*, p. 22.

13. For Section 311 studies by providers of both basic local exchange and toll services and Section 362 studies by certain local exchange service providers, two alternatives are presented: Option A would require annual studies and, in addition, would require a study whenever one of the following occurs: (1) the provider's rates for its services change, (2) the provider's access rate increases, (3) the provider's TSLRIC for one or more of its rates increases, or (4) the provider files rates for a new service. (Option A corresponds to both the "average rate" and "average service rate" interpretations in paragraph 6.) Option B would require studies to be filed within 60 days of a final order in this proceeding and whenever any one of the four circumstances identified in Option A occurs. (Option B corresponds to the "rate element" interpretation in paragraph 6.) *Id.*, p. 23.

The Commission invited comments on the Staff proposal. Ameritech Michigan, GTE, the Telephone Association of Michigan (TAM), AT&T Communications of Michigan, Inc. (AT&T), MCI Telecommunications Corporation (MCI), the Michigan Cable Telecommunications Association and Comcast Corporation (MCTA/Comcast), Continental Telecommunications of Michigan,

³A basic network component is defined as "the smallest element of the network that could be offered under tariff as a separate service." Staff Report in Case No. U-10620, *supra*, p. 6.

Inc. (Continental), and the Michigan Pay Telephone Association (MPTA) filed comments. The Staff, Ameritech Michigan, TAM, AT&T, and the MCTA/Comcast filed reply comments.

Accounting Standards

Ameritech Michigan says that it already provides the Staff with its annual report to shareholders, its quarterly and annual reports to the Securities and Exchange Commission, and its annual report to the FCC. It says that no further financial disclosure is necessary. It contends that the historical cost data required by compliance with the FCC's Uniform System of Accounts are not relevant to a forward-looking cost study.

The Staff says that booked access revenues and expenses are used in some imputation calculations. It also says that requiring copies of existing reports filed with other regulatory agencies is not burdensome.

AT&T says that the proposed accounting standards will not create additional record keeping requirements and will provide a reference for evaluating the reasonableness of the assumptions used in a TSLRIC study. The MCTA/Comcast say that record keeping and reporting requirements are necessary as a check against efforts of monopoly LECs to manipulate TSLRIC studies. The MCTA/Comcast support using the FCC's Uniform System of Accounts as an appropriate starting point for making TSLRIC calculations as long as the actual application of TSLRIC principles is forward-looking and does not rely on embedded costs.

The MCTA/Comcast and Continental also support exempting carriers with FCC waivers from complying with Part 32 because not granting the exemption would be unduly burdensome for new market entrants, particularly cable television companies. AT&T says that, in any event, small providers are likely to adopt the cost studies of Ameritech Michigan or GTE rather than creating their own cost studies.

Ameritech Michigan responds that the cable television companies' suggestion to exempt some, but not all, carriers from accounting standards would distort the competitive playing field and that all competitors should be subject to the same standards.

The Commission finds that the Staff's proposal to require accounting standards based on the FCC's Uniform System of Accounts is appropriate. As stated by the Staff, this requirement provides a framework for evaluating TSLRIC studies without obligating providers to do anything beyond making available records and reports that they already keep. Thus, the requirement adds to the ability of the Commission and other interested parties to understand a carrier's cost structure, while imposing a minimal burden. The Commission also accepts the Staff's proposal not to require compliance with the Uniform System of Accounts for those providers that are not otherwise subject to them. Requiring providers to create a new set of records would not have enough value to justify the burden.

Ameritech Michigan opposes the Staff's recommendation to require Michigan-specific accounting records and reports for providers that already maintain their books on a state-by-state basis, but not for providers that combine states for purposes of record keeping. It says that this distinction is unfair to those that keep state-specific records and may give some providers an incentive to organize on a regional or national basis. The Staff responds that its recommendation seeks to continue existing record keeping practices and to avoid new requirements.

The Commission finds that the Staff's proposed record keeping requirements are appropriate. TSLRIC and imputation cost studies require as much specificity as possible when used as a benchmark for Michigan-specific services. However, it is not apparent that the value of requiring providers to make material modifications of their record keeping practices to provide state-specific information outweighs the burden of introducing new regulatory requirements. Therefore, providers that do not maintain Michigan-specific records will not be required to create a new set of records to comply with these reporting and disclosure standards.

Definition of Rates and Services in Cost Studies

A threshold issue in the Staff proposal relates to the cost studies that providers must prepare to implement the pricing constraints of the Michigan Telecommunications Act. To perform a cost study, a provider determines the TSLRIC of its functions and network elements and then attributes those costs to each of the services that it provides to customers as a bundle of functions and

elements. TSLRIC principles act as a price floor because the revenues generated by a service are compared to its corresponding TSLRIC.⁴ The issue raised by the Staff is how to define the rates of the services or groups of services that are evaluated for compliance with TSLRIC and imputation principles.

As summarized above, the Staff proposal set forth three alternative interpretations of “rate.” First, the “average rate” interpretation focuses on broad categories of services. Second, the “average service rate” interpretation analyzes individual services. Third, the “rate element” interpretation conducts its analysis at the level of each rate component or charge included in a service. The Staff proposal did not recommend adoption of any of the three interpretations.

Ameritech Michigan says that either of the first two interpretations (the average rate and average service rate approaches), or a combination of both, are appropriate. However, it says, the rate element interpretation is not appropriate because customers purchase services, not rate elements, on a competitive basis. It claims that the rate element interpretation would impose unnecessary regulatory restraints.

Ameritech Michigan argues that, as between the first two interpretations, each provider should have the flexibility to choose for itself which it will apply. It says that competition will induce providers to offer services in packages and that a lack of flexibility could inhibit them from offering innovative rate packages that respond to customer demands. It adds that a rigid insistence on a single approach could require disruptive increases in rates and the elimination of discounted calling plans, some of which predate TSLRIC and imputation principles. It says that retaining the flexibility to use the average rate interpretation would allow continuity with the costing approaches that were used under the Michigan Telecommunications Act prior to the amendments enacted in 1995 PA 216 (Act 216).

⁴In certain instances, the act requires an imputation analysis of a bundled service that is composed of elements that are also offered as individual services in tariffs. In performing an imputation analysis, the assigned costs are the tariff prices of noncompetitive services or their functional equivalents that are actually used by the basic local exchange provider, plus the TSLRIC of all other service components. See MCL 484.2362; MSA 22.1469(362).

GTE's position is similar to Ameritech Michigan's. GTE supports the average rate interpretation because that approach provides pricing flexibility. However, it says that providers should have the option of disaggregating costs when there are significant cost differences among individual services or service classes within a service category or when a narrower approach is a more efficient means of meeting TSLRIC and imputation standards. As an example, it says that changing a single rate, or a few rates within a service category, should not require a new study for the entire category of services.

AT&T says that all providers should be required to apply the average service rate interpretation uniformly and consistently. As it understands the Staff's proposal, this interpretation would require disaggregation for each service. In other words, the costs for two residential basic local service plans, one providing a flat rate for 50 calls per month and the other a flat rate for 400 calls per month, would each be disaggregated. Costs for each toll discount plan would also be disaggregated. It contends that competition occurs at the level of individual services, which is what customers decide to purchase or not to purchase. In response to Ameritech Michigan's claim that the average service rate interpretation could eliminate toll discounts, AT&T suggests that if toll access rates declined to appropriate levels, toll rates would comply with imputation standards.

AT&T says that the average service rate interpretation strikes an appropriate balance between collecting adequate information and reducing regulatory burdens. It says that allowing providers to apply more than one definition on a flexible basis would enable them to cross-subsidize competitive services.

MCI argues that the average rate interpretation would invite cross-subsidization. Although MCI believes that the rate element interpretation has theoretical merit, it supports the average service rate interpretation as easier to apply. However, it cautions that providers should not be permitted to use that interpretation to structure all-inclusive rate classes as a means of avoiding compliance with imputation standards.

The MCTA/Comcast support the rate element interpretation, arguing that it is most likely to prevent anticompetitive conduct by incumbent LECs. In this regard, they say that the average rate

interpretation is entirely unacceptable. However, they do not oppose making the average service rate approach available to new market entrants, which they say do not have a history of anticompetitive conduct.

Continental supports the average service rate interpretation. However, it says that the rate element interpretation may sometimes be necessary to prevent providers from structuring rates in an attempt to cross-subsidize.

The MPTA supports the rate element interpretation as providing the most protection against anticompetitive pricing in the payphone market.

In its reply comments, the Staff recommends that all providers comply with the average service rate interpretation, except for providers of toll service only. It agrees with those that argued that the average rate interpretation would provide too much flexibility. It also agrees that the rate element interpretation would be burdensome to apply. It says that the average service rate interpretation, if properly applied, would be adequate to prevent cross-subsidization. However, it agrees with MCI that providers should not be permitted to define services in a manner that facilitates rate averaging over a wide range of offerings, but that cost disaggregation should be coterminous with each service that a customer can choose to purchase. In light of the changing competitive environment, the Staff also suggests that the Commission may wish to reexamine this issue two years from now.⁵

In response to the comments of those parties opposed to the average rate interpretation, Ameritech Michigan says that they exaggerate the threat of anticompetitive pricing. It says that the use of the average rate approach in the past has not erected barriers to new entrants or impeded competition. It says that recent reductions in toll access rates suggest that competing toll providers are not subject to price squeezes. Ameritech Michigan also says that allowing different types of providers to be subject to different requirements would confer an unfair advantage on some. It says that distinguishing between new entrants and existing providers is unworkable because,

⁵The MCTA/Comcast argue generally that the Commission should establish procedures for monitoring and reassessing the cost methodologies that it adopts in this order.

depending on the service, e.g., interLATA toll service, an incumbent LEC like itself could be considered a new provider.

The majority of commenting parties find the average service rate interpretation (the Staff's second interpretation) to be acceptable, although the incumbent LECs would prefer to apply a combination of that approach and the average rate interpretation. The Commission finds that the average service rate interpretation should be applied in all circumstances in which a TSLRIC or imputation study is required by the Michigan Telecommunications Act, except circumstances in which the act expressly dictates a different approach [e.g., imputation studies under Subsection 311(2)]. It appears that the detail required by the rate element interpretation would be too difficult to apply as a practical matter. On the other hand, the pricing flexibility inherent in the average rate interpretation could be subject to anticompetitive abuse. The average service rate approach should apply uniformly to all providers to prevent cross-subsidization of competitive services by less competitive services.

As argued by the Staff, cost studies should be as specific as required by the choices that providers make available to their customers. If a customer is able to make a choice regarding a service, the TSLRIC must be identified for that service. For example, cost studies must be used to compute price floors for each individual calling plan for residential or commercial basic local exchange service as well as each type of toll service. The average service rate approach is an appropriate means of promoting competition and expanding the array of services and providers that are available to customers.

The Commission agrees with the Staff's suggestion to review this issue in two years. The Staff should initiate this process by filing a report proposing any changes or adjustments that it believes are necessary.

Cost Issues

The cable television companies make several other suggestions related to TSLRIC studies. First, Continental argues that the Staff recommendation to compute costs on the basis of actual minutes of use would penalize new market entrants that have incurred costs in anticipation of

providing more service than the startup volume of their existing customer base. It says that calculations of cost per minute of use should be based on the demand capacity of the system. The MCTA/Comcast suggest that minutes of use for new market entrants be based on expected customer or design system usage.

In its reply comments, the Staff explains that its proposal does not assume historical usage. It says that estimated capacity or expected usage is the norm in TSLRIC and imputation calculations embracing a long run time frame and that these approaches are acceptable for new services as well. Ameritech Michigan says that Continental's suggestion is appropriate for a forward-looking TSLRIC study as long as the projected volumes are based on reasonable estimates.

As explained by the Staff, its proposal does not require actual or historical usage per se in making calculations required by TSLRIC and imputation studies.⁶ The Commission finds that the proposal should be clarified to reflect the Staff's explanation in its reply comments.

The MCTA/Comcast argue that incumbent LECs must be required to account for spare capacity by including capacity to serve both their current operational needs and their reasonably known increases in demand for current services in their TSLRIC computations. They also say that costs incurred for capacity to facilitate long run business plans to expand into new products and lines of business must be excluded from TSLRIC studies. They warn that procedures are needed to ensure against inappropriate adjustments for spare capacity and double-counting of capacity.

Ameritech Michigan argues that administrative spare capacity is necessary to ensure quality of service and to provide backup in case of emergencies.

In its reply comments, the Staff says that using "fill factors" to estimate spare capacity is a common and acceptable practice in TSLRIC studies. However, it says that it is not acceptable to use spare capacity to recover "stranded plant" and that spare capacity should be accounted for consistently with the nine costing principles established in Case No. U-10620.

⁶The Staff report that was approved in Case No. U-10620 clarifies this point. See, e.g., Exhibit A of the report, supra, p. 4 ("Incremental costs should reflect the entire quantity of the output provided, either at the present time or at some future date.").

The Commission finds that the Staff's clarification of the treatment of spare capacity is appropriate. The Staff proposal should be modified to reflect this clarification.

The MCTA/Comcast argue that a basis for separating basic telephone costs from costs incurred to enter new, competitive markets should be established. Their specific concern is how incumbent LECs will allocate costs associated with investment in broadband/video technology that will enable them to enter into the cable television market. The MCTA/Comcast suggest that the allocation should be made by performing two studies on a comparative basis, each of which replicates the costs of entering a fully competitive market, one for telephone service and another for video service.

In its reply comments, the Staff advises that the FCC is currently studying this issue in a rulemaking proceeding.⁷ The Staff recommends that the Commission await the outcome of the FCC rulemaking before addressing this issue. The Commission agrees with the Staff's recommendation.

Nonrecurring Charges

The Staff proposal recommends that nonrecurring charges be subject to TSLRIC and imputation requirements.

The MCTA/Comcast contend that competing providers (but not incumbent LECs) should be permitted to reduce or waive nonrecurring charges for installation or reconnection. They say that those charges represent up-front costs that will deter customers from exercising their competitive options by switching to a new provider.

Continental says that applying TSLRIC concepts to nonrecurring charges will have different competitive effects in different contexts. When applied to services provided by incumbent LECs to other providers, it says, TSLRIC will serve the salutary purpose of imposing a ceiling on the charges because the LECs' incentive is to maximize the charges. When applied to services offered

⁷Allocation of Costs Associated With Local Exchange Carrier Provision of Video Programming Services, Notice of Proposed Rulemaking, CC Docket No. 96-112, FCC No. 96-214, 61 Fed. Reg. 25184 (1996).

by new providers to customers, it continues, TSLRIC will act as a floor, thereby inhibiting competition. Continental says that providers should be permitted to reduce or waive nonrecurring charges when attempting to attract retail customers.

The Staff responds that TSLRIC is intended to act as a price floor. It says that revenues earned for a service from both recurring and nonrecurring charges, net of promotional discounts or other rate adjustments, must meet TSLRIC and imputation tests, which apply to all providers.

Ameritech Michigan supports the Staff's position on nonrecurring charges. Ameritech Michigan says that all costs, including those associated with nonrecurring charges, should be recovered in accordance with TSLRIC and imputation principles. It says that whether the costs are recovered through recurring or nonrecurring charges is a pricing decision that should be left to the discretion of the provider.

In response to those that argue that some, but not all, providers should be permitted to waive nonrecurring charges, Ameritech Michigan says that it is unfair to treat providers differently. In response to Continental's comment regarding TSLRIC acting as a price ceiling for services offered by incumbent LECs to their competitors, Ameritech Michigan observes that TSLRIC pricing for interconnection charges will expire on January 1, 1997, as provided by MCL 484.2352(1); MSA 22.1469(352)(1).

AT&T also supports the Staff's proposed treatment of nonrecurring charges as part of the cost of service.

The Commission finds that the Staff recommendation regarding nonrecurring charges should be approved. Because those charges recover part of the cost of providing a service, it is appropriate to include them in the cost studies. Moreover, no provider should receive disparate treatment with respect to nonrecurring charges.

Affiliate Transactions

The MCTA/Comcast complain that the Staff proposal fails to provide reporting requirements for transactions between providers and their affiliates. They claim that affiliate reporting is required by MCL 484.2308; MSA 22.1469(308) and that Ameritech Michigan routinely ignores

that requirement. They claim that the complaint process is procedurally too burdensome to ensure effective enforcement.

Ameritech Michigan responds that the MCTA/Comcast rely on mere allegations. Ameritech Michigan says that merely providing services to an affiliate does not trigger statutory reporting requirements, which require a transfer of employees, functions, or assets to an affiliate.

The Staff suggests that reporting and record keeping requirements for affiliate transactions should be addressed in a separate proceeding. It says that the complaint process is an adequate mechanism for pursuing specific allegations of noncompliance.

MCL 484.2308; MSA 22.1469(308) sets standards that prevent providers from subsidizing affiliates and imposes legal duties to notify the Commission of affiliate transactions. The reporting and record keeping responsibilities are straightforward and do not require the Commission to promulgate additional standards that explain or supplement them at this time. Moreover, issues relating to enforcement are beyond the scope of this proceeding. If there are specific instances of noncompliance with affiliate dealing or disclosure requirements, the allegations should be brought to the Commission's attention.

Preparation, Disclosure, Adoption, and Use of TSLRIC Studies

Ameritech Michigan and TAM challenge the statement in the Staff proposal that only Ameritech Michigan and GTE currently meet the threshold requirements for mandatory filing of a TSLRIC study. Ameritech Michigan claims that AT&T, MCI, Continental, and possibly others qualify on the basis of its interpretation of MCL 484.2304a(6); MSA 22.1469(304a)(6), which grants the option of adopting another provider's cost study to "providers who . . . provide basic local exchange service or basic local exchange and toll service to less than 250,000 end-users in this state." TAM and Ameritech Michigan contend that customers taking only toll service should be counted in determining whether a provider of basic local exchange service meets the statutory criteria.

TAM further argues that the legislative history indicates that an earlier version of the statute was amended to ensure that toll-only customers would be included in the count of a provider's

end-users. It says that if the statute is interpreted to allow both small companies (e.g., TAM members) and large toll providers (e.g., MCI) to adopt another provider's study, the toll providers will use the process to gain access to commercially sensitive data of the larger LECs.

The Staff says that the Commission should ensure compliance by requiring all providers to submit a count of their end-users, including those that purchase both local and toll service, within 30 days of this order. The Staff recommends that the totals be updated annually.

The Commission interprets MCL 484.2304a(6); MSA 22.1469(304a)(6) to count all of a basic local exchange provider's end-use customers, including those that take local service only, toll service only, and both local and toll service. The Commission further adopts the Staff's recommendation to submit counts of end-users annually and modifies the Staff proposal to reflect this recommendation.

Several comments raise concerns regarding how small providers will use the TSLRIC studies of large providers (i.e., those meeting the 250,000 end-user criteria). GTE says that its studies are confidential and are protected from disclosure by MCL 484.2210; MSA 22.1469(210). In response, the Staff, AT&T, and the MCTA/Comcast state that allowing access to large providers' cost studies would not excuse the small providers from providing confidentiality guarantees under a negotiated protective agreement. AT&T, the MCTA/Comcast, and Continental say that a small provider cannot make an informed decision regarding whether to adopt another's cost study or prepare its own unless it has access to the large providers' studies.

The Commission finds that MCL 484.2210; MSA 22.1469(210) provides an appropriate basis for allowing small providers to make meaningful decisions regarding whether to adopt one of the studies and, at the same time, protecting confidential information by requiring disclosure under the statute.

Given their present lack of access to the studies, the MCTA/Comcast and Continental say that their decisions regarding which study to designate as a cost proxy cannot be made in 60 days, as recommended in the Staff proposal. The MCTA/Comcast add that review of the studies by the Staff and others is necessary to evaluate the propriety of the often complex assumptions and

methodologies that go into the studies. They suggest that the Commission establish uniform procedures for making sensitive cost information available.

The Staff reiterates that protective agreements provide a vehicle for resolving concerns regarding disclosure of, and access to, cost studies. It also notes that the members of the Michigan Exchange Carriers Association were given 60 days to make their decision whether to adopt other providers' cost studies in Case No. U-10620.

As already stated, cost studies will be available pursuant to the disclosure provisions of MCL 484.2210; MSA 22.1469(210). Because this proceeding supplements Case No. U-10620, in which the Commission set a 60-day deadline for basic local exchange providers with less than 250,000 end-users to either adopt another's cost study or prepare their own, the Commission is not persuaded by the claims of some that they need more time to make a decision. See the September 8, 1994 order in Case No. U-10620, pp. 6-13 (60-day review period for small providers to select a cost proxy).

The Commission will allow for more experience to be gained in using statutory disclosure provisions and analyzing cost studies before deciding whether uniform disclosure and access standards should be developed.

TAM, MCI, and the MCTA/Comcast also object to the Staff's recommendation that small providers adopting a large provider's study be required to document how they applied the study to their pricing by supplying actual TSLRIC data from the adopted study. They argue that this requirement would be burdensome and that small providers should instead file only a statement designating a large provider. They also argue that the Staff's requirement is contrary to the Michigan Telecommunications Act and could intrude upon the confidentiality of large providers' cost studies. AT&T says that it is not necessary for a small provider to submit an entire study, but that it should only be required to document its pricing with data from the adopted study.

In reply, the Staff says that its proposal does not call for small providers to submit another provider's entire cost study, but only for small providers to identify the specific information in the cost study that demonstrates that their rates equal or exceed TSLRIC.

The Commission finds that the Staff's explanation of how to apply the documentation requirements for small providers is reasonable. The Staff proposal should be modified to clarify this point.

TAM, the MCTA/Comcast, and Continental object to the Staff's recommendation that a small provider adopting a large provider's cost study be prohibited from switching to a third provider's study for a two-year period following its choice. They argue that this requirement is not supported in the Michigan Telecommunications Act. TAM anticipates that a small provider could decide to offer a service that the adopted study of its cost proxy does not address, leaving the provider with no option for pricing the service other than preparing a study of its own. The MCTA/Comcast suggest that the Staff's concern regarding frequent switching from one study to another is exaggerated if the only choices are Ameritech Michigan and GTE. Continental states that the Staff proposal is ambiguous in leaving the impression that a provider, by choosing to adopt another's study, may preclude the option of preparing its own study for two years. Continental also claims that the Staff's proposal is inconsistent with the statute, which permits a small provider to use a large provider's cost study for some services and to prepare its own for other services.

In reply, the Staff and AT&T say that the Commission's September 8, 1994 order in Case No. U-10620, p. 10, makes clear that a small provider adopting a large provider's cost study retains the option of preparing its own study at any time within the two-year period. The Staff and Ameritech Michigan state that the decision to adopt another's study applies to the provider's entire network and that the provider may not apply more than one study, including its own and another's, to assign different costs for different services. The Staff further contends that restricting the choice of a study for two years makes sense when taking a long run approach to costs.

The Commission agrees with the Staff that a two-year restriction on adopting another study is a reasonable condition so long as the provider retains the option of preparing and submitting its own cost study at any time. This restriction prevents small providers from changing their cost proxies every time changes in another large provider's TSLRIC would confer a perceived pricing

advantage.⁸ The hazard of permitting unconstrained switching would also become more acute if the number of providers meeting the 250,000 end-user threshold of MCL 484.2304a(6); MSA 22.1469(304a)(6) increases. The Commission also finds that a small provider must apply its designated study to its entire network. It may not use another's study for some services and prepare its own for others. These clarifications will be reflected in the Staff proposal.

TSLRIC Format

Ameritech Michigan takes the position that the Commission does not have the authority to require a TSLRIC study covering unregulated services in advance of any dispute over the costs related to those services. AT&T responds that Ameritech Michigan's argument is inconsistent with the codification of TSLRIC principles in Act 216. AT&T further argues that a TSLRIC study covers the entire range of services (including unregulated ones) that share a basic network component. The Staff says that this issue was raised on appeal from the orders in Case No. U-10620 and that the Commission should await the Court's ruling.

The Commission finds no merit in Ameritech Michigan's argument that TSLRIC studies should not encompass unregulated services. The Commission previously rejected this argument in its November 10, 1994 order in Case No. U-10620, pp. 5-7. Since that decision, the Legislature has affirmed the validity of TSLRIC principles by embodying them in Act 216. By definition, TSLRIC require costs to be assigned to network elements that are used to provide both regulated and unregulated services. It is impossible to perform a cost study without reference to the entire cost of the network. Moreover, the Michigan Telecommunications Act prohibits using basic local exchange or access revenues, "directly or indirectly, to subsidize or offset the costs of other products or services offered by the provider or an affiliate of the provider by providing such other products or services at less than the total service long-run incremental cost." MCL 484.2308(1); MSA 22.1469(308)(1).

⁸The Commission's finding on this point is consistent with its September 8, 1994 order in Case No. U-10620, p. 10.

Ameritech Michigan takes issue with some of the Staff's assumptions regarding how unbundled network elements would be "mapped" or attributed to specific telecommunication services. Ameritech Michigan claims that a critical, but erroneous, assumption is that the cost of using an element does not vary when it is bundled with other elements to provide a service. It says that, to the contrary, costs vary on the basis of density bands, among other things. It says that the cost of a given network element, e.g., end office switching, varies with different service applications, e.g., local messages, toll service, switched access, reciprocal compensation. It argues that the Staff's proposal to allocate the cost of an element among various services on the basis of percentage of use is too simplistic. It claims that it performs its own cost calculations by using complex models, which is preferable to attempting to find a level of disaggregation that is specific enough for costs to remain unchanged, regardless of the service provided.

Ameritech Michigan further argues that costs of network elements vary with the type of purchaser, whether it be an end-user or another provider. For instance, it suggests, the cost of capital associated with an unbundled network element varies with the business risk of the service that is offered. It says that various combinations of services can affect shared costs. It also says that the usage of an unbundled element is not static and can be expected to change if the wider availability of wholesale services causes end-users to purchase more services from competing providers and fewer services from incumbent providers, thereby stranding capacity. It says that the advent of new technologies employed by new competitors could change its costs by requiring it to accelerate its investment in technology.

Ameritech Michigan argues that the process of "mapping," as proposed by the Staff, will require additional time to identify the costs of the basic network components. It requests a 180-day extension for completing a cost study that complies with the Staff's recommendation.

In reply, the Staff says that Ameritech Michigan ignores an essential purpose of assigning costs to basic network elements, which is to attribute a constant level of costs to all services that use a given network function, regardless of the type of service or the sharing of facilities by multiple services. It says that if Ameritech Michigan's cost studies are not consistent with this

principle, Ameritech Michigan should either adjust its models or document how the models take account of TSLRIC concepts. The Staff says that a 180-day extension is not necessary because Ameritech Michigan is not required to file a conforming cost study until one of the events that would otherwise trigger a study occurs.

AT&T and the MCTA/Comcast agree with the Staff that the cost of a network component does not vary with how it is sold or provisioned. They argue that Ameritech Michigan's claims of cost differences are an attempt to justify discriminatory pricing for anticompetitive ends. The MCTA/Comcast add that costs should not vary depending upon whether the purchaser is a retail customer or a competitor of Ameritech Michigan's. The MCTA/Comcast say that the cost of spare capacity should be recovered from competitive services or absorbed by Ameritech Michigan's shareholders.

AT&T opposes Ameritech Michigan's request for a 180-day extension of time to prepare a cost study. AT&T says that Ameritech Michigan has been on notice of TSLRIC principles since Case No. U-10620.

The Commission agrees with the Staff that no provision for an extended filing deadline is necessary for Ameritech Michigan to submit a cost study that conforms to the requirements of this order and the Staff report approved in Case No. U-10620.⁹ The Commission also agrees with the Staff that disaggregation should produce cost elements that do not vary with the manner in which they are combined to provide services or with the types of customers that use the services. The Staff's approach is better suited than Ameritech Michigan's as a means of eliminating discrimination within a provider's rate structure.

MCI contends that TSLRIC for network access channels should be reported separately for different density zones. MCI claims that the cost of network access channels tends to be much less in high density zones than in low density zones. The Staff responds that MCI may file an application for approval of a proposal to assign costs of network access channels on the basis of zone density.

The Commission would be willing to consider proposals for geographic deaveraging of the costs of network access channels. The provisions in the Staff proposal for securing Commission approval of further

⁹In the September 12, 1996 order in Cases Nos. U-10860, U-11155, and U-11156, the Commission rejected certain cost studies filed by Ameritech Michigan and required Ameritech Michigan to refile TSLRIC studies conforming to the order within 14 days.

proposals to unbundle cost elements are adequate to address MCI's desire to make use of the principles of geographic deaveraging in its cost studies.

AT&T suggests that the network access channel should be divided into three constituent loop elements: distribution, feeder, and loop concentration. It also suggests that the network interface device, which is the endpoint of the network access channel at the customer's premises, should be added to the listing of basic network components in Exhibit A of the Staff proposal.

The MCTA/Comcast also suggest some modifications to the Staff proposal regarding the format for TSLRIC studies. They say that the listing in Exhibit A should be supplemented with any other elements that are offered in the existing tariffs of Ameritech Michigan and GTE. They list a number of additional elements that should be available for interconnection purposes on a uniform tariffed basis. They say that the elements should be made available under a bona fide request process or by negotiations among interested parties.

Ameritech Michigan argues that AT&T's and the MCTA/Comcast's requests for a more detailed breakdown of costs into smaller elements are unnecessary because there is no indication that they are motivated by a legitimate demand for unbundled services. The Staff responds that the purpose of this proceeding is not to mandate further unbundling, although providers remain free to propose additional subelements of network elements for the studies that they submit.

The Commission finds that the network elements shown in Exhibit A of the Staff proposal are adequate for preparing TSLRIC studies at this time. However, the Commission does not preclude further unbundling if the competitive market evolves in that direction. As already stated, a provider may request Commission approval of different approaches prior to submitting a study. Moreover, nothing precludes a provider that submits a TSLRIC study in compliance with the Staff format from supplementing it with additional information showing the unbundled costs of network subelements. If situations arise in which providers or customers are frustrated in their legitimate efforts to explore the feasibility or cost of obtaining unbundled services, those disputes may be brought to the Commission.

Imputation

Ameritech Michigan states that imputation requirements should be applied in accordance with their intended purpose, which is to prevent providers controlling essential facilities from suppressing competition

by overcharging other providers for those facilities. It says that this purpose is implicated only when the facilities in question are truly essential and not freely available in the market.

Ameritech Michigan objects to the Staff's statement that Act 216 altered the expenses to be imputed under Subsection 362(2) by requiring TSLRIC to be used for components that are not offered as separate services under a tariff. Prior to Act 216, the Michigan Telecommunications Act had permitted providers to use local transport as a surrogate for interexchange plant in computing the imputed cost of providing toll service, but the Staff proposal indicated that this practice is no longer permissible.

Ameritech Michigan concludes that the imputation test of Subsection 362(2) is satisfied if a retail rate exceeds the wholesale price offered by the same provider for the same service.

The Staff responds that Subsection 362(2), which was added by Act 216, explicitly requires tariff rates or their functional equivalents for access and other noncompetitive services to be used in imputation computations. It says that the reason Subsection 362(2) requires more than a showing that retail rates exceed wholesale rates is that some providers will choose to compete with Ameritech Michigan by purchasing unbundled components instead of wholesale services. AT&T agrees that Ameritech Michigan should be required to impute access elements in its cost study of local service.

One purpose of imputation is to prevent incumbent LECs from imposing price squeezes on their competitors by overcharging them for use of essential facilities. In giving effect to this policy, Subsection 362(2) expressly states that the rate for a telecommunication service must exceed the sum of the tariffed rates for access and other noncompetitive components used to provide the service and the TSLRIC of all other components that are not offered as tariffed services. Ameritech Michigan's contention that retail services meet the test if they exceed the wholesale rate is overly simplistic and avoids the imputation analysis required by Subsection 362(2). Moreover, the FCC's recent Interconnection Order¹⁰ indicates that competing providers must have the option of purchasing either wholesale services or unbundled components (or both) as a means of entering markets traditionally dominated by incumbent LECs.

¹⁰Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket No. 95-185; First Report and Order, FCC No. 96-325, 61 Fed. Reg. 45476 (1996) (codified in 47 CFR pts. 1, 20, 51, and 90).

Ameritech Michigan says that, as the number of providers of local exchange service in a given area begins to increase, the local exchange services and unbundled elements that are subject to imputation standards will become readily available, and the standard itself will be rendered inapplicable under the terms of Subsection 362(1).¹¹ The Staff agrees with Ameritech Michigan that Subsection 362(1) establishes criteria for applying the imputation standard to local exchange service, but it observes that Ameritech Michigan apparently believes that the standard will apply only in a limited number of instances. The Staff asserts that all current local service offerings would be subject to Section 362.

Because there does not appear to be any fundamental disagreement on how Subsection 362(1) should be interpreted, the Commission need not address Ameritech Michigan's comment. However, the Commission cautions Ameritech Michigan not to assume too readily that the circumstances in a relevant market or geographic area make Section 362 inapplicable. It is unlikely that any provider other than an established facilities-based LEC could offer a basic network component for local exchange service on a fully competitive basis, as envisioned by Section 362.

Ameritech Michigan disagrees with the Staff's position that Act 216 prohibits imputation in the aggregate on a service by service basis for toll, WATS, and similar services pursuant to Subsection 311(1). It says that the Staff's position could mean the end of some discount toll plans. The Staff responds that Act 216 deleted the phrase permitting aggregation on a service by service basis in amending Subsection 311(1), while retaining that phrase in Subsection 311(2).

The legislative intent expressed in Section 311 does not permit aggregation on a service by service basis for imputation under subsection (1), which applies to toll access services offered by providers of both basic local exchange and toll services, e.g., incumbent LECs offering intraLATA toll service. Prior to Act 216, subsection (1) stated: "The imputation of services shall be in the aggregate on a service by service basis." That sentence was deleted by Act 216, but similar language was retained in Subsection 311(2), which applies

¹¹Subsection 362(1) requires a provider of local exchange service to comply with the imputation standard of Subsection 362(2) if (a) the provider offers a service that competes with the service of another provider, (b) the other provider uses a service, including an unbundled network component, that is available only from the first provider, and (c) the first provider uses the same noncompetitive service or its functional equivalent. MCL 484.2362; MSA 22.1469(362).

to providers of toll and toll access services that do not offer basic local exchange service. Unless the Commission is willing to assume that the Legislature inadvertently deleted the aggregation language from subsection (1), but not subsection (2), the effect of Ameritech Michigan's argument would be to render the amendment of Subsection 311(1) ineffective. The Commission will not presume that the Legislature intended that there be no change in meaning. A change in a statutory phrase is generally presumed to reflect a change in meaning. Gorte v Dept of Transportation, 202 Mich App 161, 167; 507 NW2d 797 (1993). The omission of a provision in one part of a statute that is included in another part should be construed as intentional. Gazette v City of Pontiac, 212 Mich App 162, 169; 536 NW2d 854 (1995).

AT&T challenges the Staff's interpretation of Subsection 311(2), which does not require the application of TSLRIC principles in performing imputation studies. AT&T contends that the reference to imputing on the basis of "cost" in Subsection 311(2) includes the TSLRIC of both access and non-access components.

The Commission is not persuaded that the Staff proposal should be modified in this respect. Subsection 311(2) does not refer to TSLRIC.

In keeping with its position in favor of the average rate and average service rate approaches to performing cost studies, Ameritech Michigan supports Option A for imputation studies. (The difference in filing requirements between Options A and B is that Option A requires annual filings, but that Option B requires one initial filing.) Consistent with their positions on the interpretation issue, AT&T supports Option A, and the MPTA supports Option B. The Staff supports Option A.

Consistent with the average service rate approach, which was adopted as discussed earlier in this order, the Commission finds that Option A should be adopted.

Ameritech Michigan objects to preparing imputation studies on an annual basis. It also says that an imputation study need not be filed to support a rate increase. It contends that disputes over an imputation study should not delay rate changes or the introduction of new services.

AT&T supports the Staff's recommendation to file imputation studies on an annual basis. It also says that an imputation study should be filed in support of any price reduction with respect to both regulated and unregulated services.

The Staff contends that annual studies are appropriate because imputation criteria must be met on an ongoing basis in a dynamic market.

The Commission finds that the Staff's imputation proposals are appropriate. Updating studies at least annually should not be burdensome and is necessary to ensure that the imputation standards and competitive policies of the Michigan Telecommunications Act are being met on an ongoing basis. Submitting imputation studies when rates change or new services are offered is also appropriate to serve those policies.

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1991 PA 179, as amended by 1995 PA 216, MCL 484.2101 et seq.; MSA 22.1469(101) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, 1992 AACS, R 460.17101 et seq.
- b. The Staff proposal, as modified in this order, should be adopted.

THEREFORE, IT IS ORDERED that the Commission Staff's proposal, as modified in this order and appended as Attachment A, is adopted.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

SSION

MICHIGAN PUBLIC SERVICE COMMI

(S E A L)

/s/ John G. Strand

Chairman

/s/ John C. Shea

By its action of December 12, 1996.

Commissioner

/s/ Dorothy Wideman
____Its Executive Secretary

/s/ David A. Svanda
____Commissioner

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1991 PA 179, as amended by 1995 PA 216, MCL 484.2101 et seq.; MSA 22.1469(101) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, 1992 AACS, R 460.17101 et seq.
- b. The Staff proposal, as modified in this order, should be adopted.

THEREFORE, IT IS ORDERED that the Commission Staff's proposal, as modified in this order and appended as Attachment A, is adopted.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

SSION

MICHIGAN PUBLIC SERVICE COMMI

Chairman

_By its action of December 12, 1996.

Commissioner

Its Executive Secretary

Commissioner

In the matter, on the Commission's own motion,)
to determine the total service long run incremental)
costs and imputation requirements under the)
Michigan Telecommunications Act.)
_____)

Case No. U-11103

Suggested Minute:

“Adopt and issue order dated December 12, 1996 adopting, with modifications, the Staff proposal implementing the total service long run incremental cost and imputation requirements of the Michigan Telecommunications Act, as set forth in this order.”

ATTACHMENT A

I. INTRODUCTION

Section 202(a) of the Michigan Telecommunications Act, 1991 PA 179, as amended by 1995 PA 216, (Act 179) requires the Commission to:

Establish by order the manner and form in which telecommunication providers of regulated services within the state keep accounts, books of accounts, and records in order to determine the total service long run incremental costs and imputation requirements of this act of providing a service.

To prescribe a manner and form in which telecommunication providers of regulated services in Michigan keep their books and records of accounts in order to determine total service long run incremental cost (TSLRIC) and imputation requirements, some sort of accounting system is necessary. According to Section 202(a):

The commission requirements under this subdivision shall be consistent with any regulations covering the same subject matter made by the federal communications commission.

It is not the Commission's intent to place any additional record keeping requirements on telecommunication providers. At a minimum, however, an accounting structure is necessary to determine TSLRIC and imputation requirement. With that in mind, the logical first choice to fill those requirements is the Federal Communications Commission's (FCC) rules in 47 CFR pt. 32 - Uniform System of Accounts for Telecommunications Companies (USOA). While the FCC's USOA is based on historical financial results, the USOA is a well established accounting system based on accounting theories and principles commonly referred to as generally accepted accounting principles. It offers a map or basis from which TSLRIC and imputation computations can be made. All telecommunication companies are required by the FCC to abide by these rules unless granted a waiver.

The accounting structure of the USOA provides a useful vehicle for identifying the different types of costs that are associated with TSLRIC for basic network components. The USOA provides a basis, for example, for categorizing types of investments. The advantage of the USOA structure and numbering system is, it exists today and is used by providers. Its utilization places no additional requirements on providers. The Commission is simply selecting an existing system of accounts that is sound and familiar to the industry.

In the determination of TSLRIC, the USOA is utilized as an identification mechanism for costs, as opposed to actual cost determination. As an example, the USOA identifies and categorizes various types of cable investment, e.g., aerial, buried, and underground, by separate accounts. As a result, specific cost factors related to the different types of cable investment can be applied in order to determine the TSLRIC.

In performing some imputation calculations, booked access expenses and revenues are used. As will be discussed later, accounting records are necessary to determine, for example, average access expenses and average rates.

In addition to providing the fundamental structure and basis for performing TSLRIC studies and imputation computations, a system of accounts allows telecommunication providers to meet various financial requirements in the course of doing business. The FCC's USOA is a useful

resource. This vast supply of data should provide assistance to the companies in their determination of TSLRIC and imputation calculations.

Those providers that do not use the USOA because they have obtained a waiver should notify the Commission of the conditions of the waiver and submit another accounting basis for their TSLRIC and imputation proofs. These providers should use records that they maintain and file with the FCC or other regulatory agencies, e. g., the Securities and Exchange Commission, National Exchange Carriers Association, Rural Utility Service, Rural Telephone Bank. Necessary documentation in support of TSLRIC and imputation filings should rely on those reports and their inherent accounting structure.

The Commission is cognizant of the fact that certain providers offering regulated services in Michigan do not keep state specific accounting records. In keeping with previous regulatory treatment, such specificity will not be required for TSLRIC and imputation filings. Those providers that do maintain state specific records should continue that procedure. All providers must provide sufficient detail to meet the TSLRIC and imputation proofs that are required by Act 179 to support any pricing proposals.

Finally, while the Commission is not requiring the reporting of historical information as a basis for computing TSLRIC and imputation determinations, such information is compiled by all providers in some form, such as FCC reporting under the USOA, 10K reports, and annual reports to stockholders. Since this information is already being prepared and supplied to other parties, providers shall be required to file copies of annual financial statements with the Commission. While the primary purpose of disclosing accounting data is to provide insight into the structure of the accounts, as indicated in these and related documents, these historical records also provide relevant information for purposes of analyzing a provider's compliance with TSLRIC and imputation standards. The specific requirements for making TSLRIC and imputation determinations follow.

II. SERVICES, RATES, AND RATE ELEMENTS

In determining the criteria to use in performing TSLRIC and imputation studies, there is a question regarding how to define the rates that are to be tested for compliance with TSLRIC and imputation principles. In other words, how is the service or group of services to be defined for the purpose of determining whether its rate or rates cover its assigned costs? TSLRIC and imputation tests could conceivably be applied in three different manners, by comparing revenues and costs for (1) broad categories of services in the aggregate, (2) each individual service, and (3) each rate element that is associated with supplying a particular service.

Of these three alternatives, the approach using individual services, also known as the "average service rate" interpretation, is most appropriate and shall be applied in TSLRIC and imputation studies. Under this approach, a cost analysis must be performed for each individual service. This would mean one rate for the residential message toll service (MTS) schedule, one rate for the business MTS schedule, one rate for residential operator assisted calls, one rate for all other operator assisted calls, one rate for interzone messages, one rate for toll message charges on public or semi-public phones, one rate for the rate discount given to hearing- or speech-impaired persons, one rate for volume usage discounts, and so on through the entire universe of services. Thus, each individual service would meet TSLRIC and imputation requirements. Consistent with previous Commission action in Case No. U-10099 and unchanged by the 1995 amendments to Act 179, nonrecurring charges are an integral part of a service and are to be included in TSLRIC and imputation determinations.

Section 311 of Act 179 identifies the services that are subject to imputation requirements as "toll, WATS and other service for which toll access service is a component."

In performing the calculation necessary to determine whether imputation requirements are satisfied, the average service rate interpretation shall be applied in all circumstances in which a TSLRIC or imputation study is required by Act 179. Any exceptions will be in circumstances where Act 179 expressly dictates a different approach, e. g., imputation studies under Subsection 311(2).

III. TOTAL SERVICE LONG RUN INCREMENTAL COST

A. Act 179 and Long Run Incremental Cost

Under Act 179, prior to amendment in 1995, there were two specific references to the term "long run incremental costs." First, Section 202(f)(viii) required the Commission to report on:

A method that will determine the **long run total incremental cost** pricing for each component of the local exchange network and access services. [Emphasis added.]

This requirement was fulfilled by the submission of the Commission's 1994 Report to the Governor and Legislature ('94 Report). Second, Section 308(1) stated (prior to amendment in 1995):

Basic local exchange or access rates or proceeds from the sale, lease, or transfer of rate acquired assets shall not be used, directly or indirectly, to subsidize or offset the costs of other products or services offered by the provider or an affiliate of the provider by providing such other products or services at less than **long-run incremental cost**. (Emphasis added.)

While Section 308(1) set the cost standard for illegal subsidization, the '94 Report set in motion the process to define long run incremental cost (LRIC), determine a proper costing methodology, and introduce basic network component concepts in the performance of cost studies.

B. Commission Action Regarding LRIC

Prior to discussing the details of LRIC, a brief history of the Commission's activities on this subject would be helpful. The '94 Report initiated the LRIC era by identifying a two-step process for determining the long run incremental cost pricing for the network components of basic local exchange and access rates. On page 45 of the report, the Commission stated:

First, a long run incremental cost definition and methodology must be determined.
Second, the pricing of provider's services must be modified to recognize the required unbundling.

The Commission identified nine costing principles to be considered in formulating a definition of LRIC. As a result of the report, the Commission Staff (Staff) was directed to conduct a staff/industry workshop to discuss refining the definition of LRIC and a methodology for determining LRIC. On April 7, 1994, the Staff circulated a rough draft of a proposal for dealing with LRIC. A technical workshop was held on April 26, 1994, where comments on that proposal and LRIC in general were received from the industry. Subsequently, the Staff prepared a position paper that reflected the Staff's initial draft report, information received at the workshop, and informal written comments received after the workshop. On June 16, 1994, the Commission issued an order in Case No. U-10620, on its own motion, inviting public comment on the Staff report. Various parties from the industry filed comments, mostly in

support of the Staff report. On September 8, 1994, the Commission issued an order in Case No. U-10620 adopting the Staff report. The Commission's order in that docket thus completed the first step of the two-step process identified in the '94 Report.

The Staff report adopted by the Commission in Case No. U-10620 addressed four specific areas:

- 1) The refinement of the LRIC definition. Total service long run incremental cost (TSLRIC) was found to be the appropriate terminology. The Commission adopted nine costing principles with expanded explanations resulting in a clear, specific, and rational definition of TSLRIC.
- 2) Formulation of TSLRIC methodology. The process of enumerating the specifics of the TSLRIC definition leads to the formulation of a methodology for performing TSLRIC studies.
- 3) Implementation of unbundling concepts. The Commission identified a list of specific basic network components and required providers to submit cost studies reflecting these network components for their entire network and to update those studies every two years.
- 4) Miscellaneous issues pertinent to LRIC studies. This included identification of various types of costs, use of annual charge factors, cost proxy allowances for small telephone companies, and study requirements that must accompany TSLRIC studies.

C. Act 179, as amended by 1995 PA 216, and TSLRIC

All of the action taken by the Commission in Case No. U-10620 is consistent with the 1995 amendments to Act 179. The TSLRIC definition identified in Section 201(ff) codifies the definition adopted by the Commission in Case No. U-10620. Section 308(1), upon which Case No. U-10620 was based, remains essentially unchanged. The statute now refers to TSLRIC as opposed to LRIC.

Throughout the current statute, it is clear that TSLRIC is the appropriate cost standard. Section 321 requires all regulated services to have rates that are not less than the TSLRIC. Section 304a permits rate restructuring upon filing with and approval by the Commission once rates have reached TSLRIC levels. Finally, it is necessary for providers to supply sufficient documentation, in sufficient detail, to demonstrate its rates meet the TSLRIC requirements adopted by the Commission.

D. Providers Required to Determine TSLRIC Through the Preparation of Cost Studies

In general, all regulated services must be offered at rates that are not less than TSLRIC. Section 321. Only Section 304a(6) and Section 319(4) specifically address who is required to determine TSLRIC through the preparation of cost studies. Section 304a(6) requires providers who, together with any affiliated providers, provide basic local exchange service or basic local exchange and toll service to more than 250,000 end-users in Michigan to prepare TSLRIC studies. Section 319(4) requires a provider with more than 10,000 payphones to determine TSLRIC for certain of its services through the preparation of a cost study.

In determining how to apply the end-user count criteria of Section 304a(6), the Commission finds that the count should include all of the basic local exchange provider's end-user customers,

including those that take local service only, toll service only, and both local and toll services. Also, all basic local exchange providers must submit an annual report enumerating its end-users. The first annual report will be due 30 days from the date of this Order.

Currently, Ameritech Michigan, GTE, and possibly others meet the end-user and payphone count criteria. Other providers that do not meet these counts are not prohibited from submitting their own cost studies. These providers are also permitted to determine TSLRIC by adopting a study performed by Ameritech Michigan or GTE.

E. Providers Who Must Submit TSLRIC Information

All providers must provide TSLRIC proofs when adjusting their rates for a regulated telecommunication service. The rate charged for the service cannot be less than the TSLRIC of providing the service, except as permitted in Section 304a. See Section 321. In the determination of TSLRIC, Section 304a(6) states:

[P]roviders who, together with any affiliated providers, provide basic local exchange service or basic local exchange and toll service to less than 250,000 end-users in this state may determine total service long run incremental cost through preparation of a cost study or may determine that their total service long run incremental cost is the same as that of a provider with more than 250,000 end-users.

While only certain providers are required to prepare TSLRIC studies, all providers must submit cost information, whether it be their own or that of another provider, in order to determine the service's rate in relation to its TSLRIC. If a provider with less than 250,000 end-users chooses to determine its TSLRIC using the cost study of a larger provider, that smaller provider must still submit TSLRIC information documenting how the specific information of the other provider is being used. It is not sufficient for a smaller provider to simply state it is adopting the cost study of another provider. Small providers electing this option shall identify the information in the cost study that demonstrates that their rates equal or exceed TSLRIC. These providers need not duplicate the entire cost study when they choose to use selected parts.

F. Basic Network Component Information

In Case No. U-10620, the Commission required cost proofs to be presented at the basic network component level. The Commission found the basic network component approach appropriate for the long term unbundling of costs in Michigan. This approach is also necessary in order to develop a regulatory framework capable of responding to a competitive environment. On Page 9 of Exhibit A of that order, the Commission briefly described the basic network components:

On Page 1, each of the four major categories of basic network components are identified: Network Access, Switching and Switching Functions, Transport-Dedicated, and Switched and Ancillary Services. These major categories present the network perspective which sets in motion the network component identification process. Within each of the four major categories are network component subcategories (Pages 2-7) which reflect specific network components. Each network component subcategory identifies individual network components. These proposed network components reflect basic level and/or types of network functionality.

Within 180 days after the Commission's September 8, 1994 order, all providers of basic local exchange and access services other than members of the Michigan Exchange Carriers Association were required to submit cost studies reflecting the basic network components identified by

the Commission for their entire networks. The Commission also ordered updated studies to be submitted every two years.

The basic network component approach is necessary for proper implementation of TSLRIC principles and for the long term unbundling of the network. The purpose of cost proofs at the basic network component level is to ensure that all services that utilize identical network functions are attributed the same level of cost. The basic network components identified in Case No. U-10620 and the requirement of updated studies every two years should continue to apply to all providers as set forth in the Commission's order.¹² If a provider has not yet submitted its own TSLRIC studies, or in the alternative has chosen to adopt the TSLRIC of another provider, a choice of action must now be made. Within 60 days of an order in this proceeding that approves the guidelines in this attachment, each provider that has not yet made its TSLRIC choice formally known shall file with the Commission an indication that it will either perform its own TSLRIC studies or adopt the TSLRIC studies of another provider. If a provider chooses to perform its own TSLRIC study, the study must be submitted, following the Commission's guidelines outlined in this proceeding and in Case No. U-10620, within 180 days of an order approving the guidelines in this proceeding.

If a provider elects to adopt the cost studies of a larger provider, the provider must continue to use the cost information of the selected provider for a minimum of two years from the date the decision is made, unless the provider proposes its own cost study. A small provider (one with fewer than 250,000 end-users) always retains the option of performing its own cost studies regardless of a previous decision to adopt the costs of a larger provider. A small provider must apply its designated study to its entire network. It may not use another's study for some services and prepare its own for others. This decision is consistent with the Commission's order in Case No. U-10620 and Act 179.

G. Format for Filing TSLRIC Information for Rate Alterations

Exhibit A presents the format to be utilized by providers for TSLRIC presentations. This format utilizes the same basic network components identified in Case No. U-10620. Exhibit A identifies 26 specific basic network components. Item #9, Channel Performance Features, and Item #14, Switching Features, are listed as individual components, but in reality are basic network component subcategories to be expanded to basic network components depending on the capability of the provider. Ancillary Services, Items #24, 25, and 26, are also listed as individual components, but are basic network component subcategories.

This format is the starting point for the mapping process. Mapping is the process of identifying the basic network cost components and other group-related and service-specific costs that comprise a service offering in order to determine the TSLRIC of providing that service. Exhibit A will be used whenever a provider proposes to introduce, restructure, or adjust a rate for a regulated service. As shown on Exhibit A, the cost for a particular service will consist of the applicable basic network components plus any group-related and service-specific costs that are appropriate. The format requires that costs be separated and identified either as volume sensitive or volume insensitive where appropriate. The order and Staff report in Case No. U-10620, identified and defined, in detail, cost types to be utilized in TSLRIC studies.

The unit costs shown on Exhibit A for each basic network component should coincide with the costs submitted in conjunction with Case No. U-10620. In determining unit costs for both

¹²The Commission notes that it has commenced two generic cost study cases, Case No. U-11280 for Ameritech Michigan and Case No. U-11281 for GTE. The studies filed in those cases will satisfy the first update required by Case No. U-10620.

TSLRIC and imputation, estimated capacity or expected usage is the norm for TSLRIC and imputation calculations embracing a long run time frame. These approaches are acceptable for new services as well. Additionally, using fill factors to estimate spare capacity is a common and acceptable practice in TSLRIC studies. Using spare capacity to recover stranded plant is not acceptable. Spare capacity needs to be accounted for in a manner consistent with the nine costing principles established in Case No. U-10620. Any request for new basic network component costs need to be reviewed and authorized by the Commission before being utilized on Exhibit A.

TSLRIC should be initially developed for the basic network components rather than for services currently defined in a provider's tariff. The development of switching costs can be used to demonstrate the difference. The identified switching components included on Exhibit A are to be developed based on the cost of utilizing a particular function rather than by call type, i. e., local, toll, or access. While a certain type of call may utilize different switching basic network components, the cost for each component, regardless of the type of call, remains the same. Only the percentage use of the various switching basic network components should affect the cost of a call.

The list of basic network components included on Exhibit A should be viewed as a minimum number of components. In Case No. U-10620, the Commission stated:

[T]he proposed list of unbundled network components should not be permanent or static. Rather, the list will be evolving and additional components may be proposed by the LECs or requested by other providers and customers through a bona fide request.

The basic network components identified in Case No. U-10620 provide adequate information for determining the TSLRIC for all regulated services. However, providers may identify and propose additional basic network components. For example, a provider may break down switching basic network components based on time of day use or density bands. Providers shall prepare and submit the appropriate cost studies for review and approval under the guidelines in Case No. U-10620 and this case as a basis for justifying the rate charged for a particular service.

IV. IMPUTATION

A. Act 179 Imputation Requirements

The purpose of the Act 179 access charge imputation test is to guard against anticompetitive pricing by access providers that also offer toll, WATS, or other services that use access as a component. This test should ensure that an access provider is not pricing its services below what a competitor would pay in access charge expense or cost for using the access facilities in the provision of toll, WATS, or other services that use access. Specifically, Section 311 stated (prior to amendment in 1995):

(1) A telecommunication provider of both basic local exchange service and toll service shall impute to itself its prices of special access and switched access for the use of essential facilities it uses in the provision of toll, WATS, or other service for which access is a component. The imputation of prices shall be in the aggregate on a service by service basis.

(2) All other providers of intrastate special access, switched access services, toll, or WATS shall impute to themselves in the aggregate on a service by service

basis their individual cost of special or switched access or its equivalent in their pricing. The commission shall resolve any dispute that may arise under this section.

In 1991, imputation tests were performed in the aggregate on a service-by-service basis. The 1995 amendments to Act 179 continue the requirement that imputation tests be done in the aggregate on a service-by-service basis under Section 311(2). However, under Section 311(1) and Section 362, it is the rate for a telecommunication service which is subject to imputation.

B. Imputation Requirements

Imputation requirements are set forth in two sections, Sections 311 and 362. Section 311 deals with the imputation for the provisioning of toll, WATS, or other services for which toll access service is a component. Section 362 deals with imputation in the provisioning of local exchange service.

1. Toll and WATS Imputation

Section 311(1) states:

A telecommunication provider of both basic local exchange service and toll service shall impute as provided under section 362 to itself its prices of special toll access service and switched access for the use of essential facilities it uses in the provision of toll, WATS, or other service for which toll access service is a component.

All providers of both basic local exchange service and toll service shall impute costs using the methodology set forth in Section 362(2), which states:

The rate of a telecommunication service shall exceed the sum of both of the following:

- (a) The tariffed rates, including access, carrier common line, residual interconnection, and similar charges, for the noncompetitive service or its functional equivalent that is actually used by the provider of local exchange service, as those rates would be charged a customer for the use of that service.
- (b) The total service long run incremental costs of all other components of the provider of local exchange service.

Providers must supply information necessary to show that the rate of a telecommunication service exceeds the imputed expenses and costs listed in Section 362(2)(a) and (b). The 1995 amendments to Act 179 present a change from the previous law, which required providers to perform imputation calculations in the aggregate on a service-by-service basis. For example, instead of providing the total toll category of service revenue of \$100 million, and imputed access expense of \$50 million, the law now requires that if the toll rate for a service is \$.15 per minute, the sum of the imputed cost elements specified in Section 362(2)(a) and (b) must be equal to or less than the \$.15 per minute.

In addition, the specific expenses that are to be imputed differ from the previous requirements. For example, previously, the cost of the interexchange plant used in providing toll service could be estimated by using local transport as a surrogate. This is no longer permitted. The cost of the interexchange plant must be based on TSLRIC. The imputation standard requires the use of tariffed access rates as those rates would be charged a customer for a particular service, and all

other components of the provider of local exchange service would be included at TSLRIC; i. e., for imputation tests, use tariffed rates where the component of the service is tariffed; otherwise use TSLRIC.

While Section 311(1) sets forth the toll imputation requirements for providers of basic local exchange service and toll service, a different requirement applies to other providers of toll and toll access type services. Section 311(2) states:

All other providers of intrastate special toll access service, switched toll access services, toll, or WATS shall impute to themselves in the aggregate on a service by service basis their individual cost of special or switched toll access service or its equivalent in their pricing.

The imputation requirement in this section consists of showing that the revenue within the category of a particular service exceeds the provider's individual cost of special or switched toll access or its equivalent in its pricing. This is consistent with Act 179 prior to the 1995 amendments. The provider has the opportunity to supply the category of service revenue to show that costs for access do not exceed that amount in the aggregate.

2. Local Imputation

Section 362 requires providers to file imputation information for local exchange service. It further requires imputation proofs to justify the rates of local exchange service. Section 362(1) states:

The rate of a provider of local exchange service is subject to subsection (2) if all of the following apply:

- (a) The provider has a service that competes with a service of another provider.
- (b) The other provider utilizes a service, including any unbundled service element or basic network component, from the provider of local exchange service that is not available within the relevant market or geographic area from any other provider of local exchange service.
- (c) The provider of local exchange service uses that same noncompetitive service or its functional equivalent.

This subsection of Section 362 identifies which providers need to meet the imputation requirements for local exchange service. Section 351 identifies providers not covered by the imputation requirements for local exchange service. Section 351 states:

Until January 1, 2000 and except for section 361, this article [Article 3A] does not apply to providers who, together with any affiliated providers, provide basic local exchange service or basic local exchange and toll service to less than 250,000 end-users in this state on January 1, 1996.

As noted previously in the discussion of toll imputation, the standard requires using tariffed access rates as those rates would be charged a customer for the use of a service and all other components included at TSLRIC. This standard also applies for local imputation. In addition, while the statute lists certain toll access rates for imputation purposes, local access rates are also applicable.

C. Timing and Format of Imputation Filings

As has been the practice, imputation filings for Section 311(2) should continue to be filed annually with the Commission's Communications Division. This annual filing permits a periodic update of the annual usage volumes utilized in determining service category revenues and access expenses. In addition, these filings must be provided any time a provider files a price reduction, permanent or promotional, to ensure the standard continues to be met. The format for the imputation study is attached as Exhibit B.

Consistent with the "average service rate" interpretation, the following schedule for imputation filings is appropriate: Imputation filings for toll, WATS, or other services for which toll access service is a component under Section 311(1) or local exchange service under Section 362 shall be filed annually. In addition to these filings, a filing is also required for all changes to a service's rates, when there is an increase in access rates, or when the TSLRIC of the service's rates increase. Filings for new services need to be accompanied by documentation that shows that the rates for the new service satisfy the imputation test. The format for the imputation study is attached as Exhibit C.

**EXHIBIT A
FORMAT TO BE UTILIZED BY TELECOMMUNICATIONS
PROVIDERS IN THE DETERMINATION OF TSLRIC
OR PROVIDING A SERVICE**

TARIFFED SERVICE:

<u>Periodic Costs</u>		<u>Non-Recurring Costs</u>
Volume Sensitive	Volume Insensitive	

Network Access Channel-

- 1) Basic Level
- 2) DS-1 Level
- 3) DS-3 Level

Network Access Channel Connection-

Switched Channel Connection

- 4) Basic Level
- 5) DS-1 Level

Dedicated Channel Connection

- 6) Basic Level
- 7) DS-1 Level
- 8) DS-3 Level

**Channel Performance and
Other Features and Functions-**

- 9) List of Features

Switching-

- 10) Intraoffice Switching
- Interoffice Switching-
- 11) Outgoing

- 12) Incoming
- 13) Tandem Switching

Switching Features-

- 14) List of Features

Transport-

Dedicated Transport

Termination

- 15) DS-0 Level
- 16) DS-1 Level
- 17) DS-3 Level

Facility

- 18) DS-0 Level
- 19) DS-1 Level
- 20) DS-3 Level

Switched Transport
21) Termination
22) Facility
23) Tandem Switching

Ancillary Services-

24) Measurement
25) Billing and Collection
26) Operator Services

GROUP-RELATED COSTS:

SERVICE-SPECIFIC COSTS:

TOTAL TSLRIC OF SERVICE

TARIFFED RATE

OVER/ (UNDER) TSLRIC

EXHIBIT B
IMPUTATION FOR PA 216

Imputation tests filed under Section 311(2) with the Commission shall contain the following information:

Service Category Revenue (i.e., toll, WATS, etc.)	_____	1
Total Access Expense	_____	2
Total Imputed Access Expense	_____	3
Service Revenue Coverage (1-(2+3))	_____	4

EXHIBIT C

IMPUTATION FOR PA 216

Imputation tests filed under Section 311(1) and/or section 362 with the Commission shall contain the following information:

Per minute rate for the service	_____	1
Per minute imputed access rate	_____	2
Per minute access expense	_____	3
Per minute TSLRIC	_____	4
Per minute total access and TSLRIC (2+3+4)	_____	5

Line 1 must exceed line 5.

Note: The example uses a per minute unit for the rates and costs, but the appropriate related unit and/or total costs and revenues should be presented.