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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The Ohio Bell Telephone Company for Approval of Alternative Form of Regulation.	))))	Case No. 93-487-TP-ALT
In the Matter of the Complaint of the Office of the Consumers' Counsel, Complainant vs. The Ohio Bell Telephone Company, Respondent.	))))))))))	Case No. 93-576-TP-CSS

Testimony of
Nadia L. Soliman
Telecommunications

Staff Exhibit ______

1. Q. Please state your name and business address.

A. My name is Nadia L. Soliman. My business address is 180 East Broad Street, Columbus, Ohio 43266-0573.

2. Q. By whom are you employed?

A. I am employed by the Public Utilities Commission of Ohio.

3. Q. What is your present position with the Public Utilities Commission of Ohio?

A. I am a Telecommunications Rate Analyst Coordinator in the Telecommunications Division of the Utilities Department. My main duties include the investigation and analysis of variety of telephone companies applications, including applications to offer new services, to establish individual contracts, to increase its rates, and to establish alternative regulation plan as in this proceeding. The scope of my investigation includes the analysis and evaluation of the proposed tariffs, rates, and cost of service studies provided by the telephone company in support of its application. Also, I work on special projects, and on Commission Ordered Investigation cases.

4. Q. Would you briefly state your educational background and work experience?

A. I received my Bachelor of Science degree in Electrical Engineering from Cairo University in 1982 with Major in Electronics and Communications. I worked as an Electrical Engineer in Egypt Commercial and Engineering Company from September 1982 to April 1984. I immigrated to the United States in April of 1984. I had continuing education courses in computer programming from Franklin University. I began to work at the Commission in September of 1987. I assumed my current responsibilities in April of 1994. As of June of 1992, I am a Certified Engineer in Training in the State of Ohio.

5. Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to respond to various objections to the Staff Report of Investigation (Staff Report) in this proceeding, regarding the Fully Distributed Cost of service study (FDC study) requirements, and issues concerning contractual arrangements for services in different cells.

I am specifically responding to Ohio Bell's objections 1 and 2 in Section H, and objection 1 in Section L; IXC Coalition's objections 4, 5, and 13; Ohio Library Council (OLC) objections 28, 34, 35, and 36; Ohio Newspaper Association (ONA) objections 26, 32, 33, and 34; American Association of Retired Persons (AARP) objection 26; Office of the Consumers Counsel (OCC) objections 18, and 33; Mid-East Telephone Answering Service Association (METAS) of Ohio objection 3; The United States Department of Defense (USDD) objection regarding contract proposals on page 14; Ohio Cable Television Association (OCTVA) objections 3, 30, 31, 32, 72, 73, and 74; New Par Companies objection regarding contract proposals in page 6; and the Edgemont Neighborhood Coalition objections 16 and 33.

FULLY DISTRIBUTED COST STUDIES

6. Q. What is the fully distributed cost (FDC)?

A. The FDC for a group of services or a service category provided by a firm is the total costs of that service category after allocating all the financial accounting costs of the firm to all service categories provided by that firm. The FDC for a service category includes fixed common costs and costs shared by groups of services allocated to that service category plus the costs directly caused by providing it. The sum of the FDCs of all services provided by the firm represents the total costs of the firm.

7. Q. How should the fully distributed cost results be used? (OCTVA #30 & 31, ONA #32 & 33, and OLC #34 & 35)

A. The Fully Distributed Cost results should be used to identify the existing cost and revenue relationship for different service classes or service categories as a result of previous decisions, and to identify classes or categories for which revenues and costs should be realized. However, the Fully Distributed Cost study do not provide information on how to established appropriate prices. Since the Fully Distributed Cost study uses historic costs, it does not reflect the current or future costs that are based on current or future technologies. Also, the FDC do not provide a reliable measure of what will happen to costs in the future if a particular portion of the business expanded or contracted. Additionally, the FDC study cannot reflect market reaction to price change relative to demand change.

8. Q. Did Ohio Bell (OBT) provide a fully distributed cost analysis in this proceeding? (IXC Coalition #5)

A. Yes. OBT has submitted a Fully Distributed Cost study to the Staff as response to Staff's Data Request no. 21.

9. Q. Ms. Soliman, would you please give an overview of that fully distributed cost study? (IXC Coalition #5)

A. The FDC is developed to allocate total OBT intrastate costs into 6 cost groups which are based on the combination of the three price cap baskets and the four cell classifications. These cost groups are: Cell 1 Carrier Access, Cell 1 Residence Loop, Cell 1 Residence Non-Loop, Cell 1 Non-Residence Loop, Cell 1 Non-Residence Non-Loop, and Cells 2-4. The study is based on the FCC's Part 36.

As a first step, the total company regulated investments and expenses are allocated to interstate and intrastate jurisdictional using Part 36 allocation factors, which further allocates the Company's intrastate investments and expenses into 5 operations. These operations are: InterLATA Message, IntraLATA Message, InterLATA Private Line, IntraLATA Private Line, and Other (i.e. Exchange). The second step in the study is to separate Cells 2-4 investments and expenses from Cell 1 investments and expenses. The third step is to allocate the amount of each total Cells 2-4 investments and expenses to each of the 5 Part 36 operations using Part 36 allocators for each investment and expense. The fourth step is to split the Exchange investments and expenses for Cell 1 and Cells 2-4 between Message and Private Line (PL) using Part 36 allocators. Furthermore the Exchange-Message investments and expenses is split between Loop and Non-Loop using Part 36 allocation factors. Finally, the Exchange Message-Loop operation is split between Residence and Non-Residence using loop counts, and the exchange Message Non-Loop operation is split between Residence and Non-residence using minutes of use (MOU).

The FDC study developed by Ohio Bell is based on data that represents the first four months of 1992. The Staff finds that the FDC study results based on that time frame (after Staff modifications) provide a reasonable distribution of OBT's FDC over the 6 cost groups.

10. Q. Please explain how the allocation of costs between Cell 1 and Cells 2, 3 & 4 is generally done in the study.

A. The total investments associated with most Cells 2-4 services are generally identified using Part 36 allocators where possible. In some cases, where Part 36 allocators were not available, OBT used special studies to identify Cells 2-4 investments. Once the investment associated with Cells 2-4 has been determined the Part 36 allocators can be used to determine the expenses associated with each investment.

11. Q. Ms. Soliman, did the staff, in its analysis, use the FDC study as proposed by OBT?

A. No. Staff could not use the FDC study as provided by OBT for the following reasons: first, the FDC study results do not reflect any of the Staff recommendations, and second, the study is a copy of a mainframe version that is not fully mechanized, and therefore Staff could not verify its accuracy.

Therefore, the staff developed an interactive FDC model using OBT's data for total company (interstate and intrastate) investments and expenses, and following the same steps as described earlier. The Staff has modified the model to include all Staff recommendations in the Staff Report.

12. Q. Please explain the modifications that the staff made to that FDC study.

A. There are two main adjustments that were necessary to be made in order to have a study that reflects OBT's costs based on Staff's analysis and recommendations. These adjustments are:

a. In the FDC study, the Staff utilized the recommended jurisdictional allocation factors as listed in Schedule B-7 of the Staff Report to allocate total company investments and expenses between the interstate and intrastate jurisdictions.

b. In the FDC study, the Staff utilized the recommended cell classification to separate Cells 2-4 investments and expenses from Cell 1 investments and expenses.

13. Q. Would you summarize the results of staff's FDC model?

A. The summary of the FDC model results is attached to my testimony as Attachment 1. The FDC model provides that Cell 1 services costs represent 80.9% of OBT's total intrastate costs, and Cells 2, 3 and 4 services costs together represent 19.1% of its total intrastate costs (see Attachment 3, line 1). It also provides that Cell 1/Residence services cost represent 50.8% of total intrastate costs, while Cell 1/Non-Residence services costs represent 24.1% and Cell 1 Carrier Access services costs represent 6% of total intrastate costs.

14. Q. Ms. Soliman, would you explain how the staff utilized its FDC model results? (IXC Coalition #5)

A. As stated earlier in my testimony, the Staff used the FDC study results to identify the existing cost and revenue relationship for the different service groups, and to identify categories for which costs and revenues should be realigned. Therefore, the Staff used the FDC study results to allocate the (test year) Staff recommended revenue requirements to the 6 service groups identified in the FDC model (see Attachment 3, line 3). Additionally, in order to compare cost results to actual revenues, the Staff determined the distribution of OBT's test year operating revenues over the same 6 service groups, as shown in Attachment 2.

As demonstrated in Attachment 3, line 6, OBT's test year operating revenues exceed the test year revenue requirements by approximately $135 million. The Staff found that Cell 1 services revenues and Cells 2-4 services revenues recover their respective costs. However, within Cell 1 services, the Cell 1/Residence revenues do not recover their costs and have a revenue deficiency of approximately $195 million, while Cell 1/Non-Residence and Cell 1/Carrier Access revenues recover their respective costs with an excess revenue of approximately $227 & $50 million, respectively.

15. Q. Should the development and production of the fully distributed cost study be a continuous requirement? (OBT #L.1., Edgemont #16, OLC #28, ONA #26, OCC #18, OCTVA #3, 32 & 35)

A. The Staff, in its Staff Report, recommended that at the conclusion of the 4th year of the plan Applicant be required to file an FDC study for Cell 1 services. This study, together with other information requirements listed in the Staff Report, will help the Commission to evaluate whether the plan continues to be in the public interest, and remains consistent with the telecommunications policies of the state. However, the Staff finds that developing a FDC study, in the format outlined later in my testimony, for Cell 1 services should be a continuous requirement. This FDC study for Cell 1 services should be filed every twelve months from the date the plan is approved. The FDC for all Cell 1 services will be the ceiling for total Cell 1 services revenue. Also, the FDC for Cell 1-Residence services will be the ceiling of the Cell 1-Residence revenues.

16. Q. What is the format of the fully distributed cost study that the staff recommends be filed?

A. Ohio Bell Should file an interactive FDC study for Cell 1-Residence services and for the Cell 1-Non-Residence services for the following service aggregations: Network Access Line, Central Office Termination, Usage-Flat, Usage-Message, Usage-Measured, and all other services.

17. Q. Should Ohio Bell file, at the end of the 4th year of the plan, a fully distributed cost study for each cell (Cells 1, 2, 3, and 4)? (OBT #L.1., OLC #28, ONA #26, OCC #13, OCTVA #3 & 32)

A. No. The Staff believes that OBT should file a FDC study only for Cell 1 services in the format outlined above. Using that study one can determine if Cell 1 services are subsidizing the rest of the services offered by OBT or not. This FDC study will be used as a safeguard against cross subsidization, in addition to other safeguards discussed by Staff witnesses Montgomery and Shields. In other words, as long as Cell 1 services revenues in a specific year do not exceed their respective FDC for the same period, there will be no cross subsidy between Cell 1 and other cells.

18. Q. Should the fully distributed cost be used to set rates for individual services? (OLC #34 & 35, ONA #32 &33, OCTVA #30, 31, 72 & 73)

A. No. The Alternative Regulation Rules adopted in Case No. 92-1149-TP-COI, establish the pricing rules to be followed for any Alternative Regulation plan filed by a large LEC with the Commission.

Section XII.A.4 of these rules states that "The minimum price for any new or existing service for which a cost test is required to be submitted pursuant to these rules shall be the LRSIC." Additionally, Staff witness Shields addresses the pricing parameters recommended by Staff in the context of Company's price caps plan.

The second reason that Fully Distributed Cost should not be used to set rates is that the FDC allocates non-incremental costs to services while these non-incremental costs are not affected by the decision of providing or not providing the services in question. Third, the FDC cost-based rates are not flexible to reflect changes in the market due to change in the market demand. Therefore, they do not tell whether a particular service is really profitable or not profitable. This is even more problematic in an environment that has a mixture of competitive and non-competitive services, which requires different levels of pricing flexibility.

Rates should be set based on relevant costs which are directly caused by providing the service, with additional mark-up to contribute to the common costs. That will give the Company enough pricing flexibility to respond to market changes. I would also like to point out that the Commission in its Alternative Regulation Rules has realized that "Common overhead costs are incurred for the benefit of a firm as a whole and are not avoided if individual services or categories of services are discontinued."

19. Q. Should the cell 4 floor price be set at or above the fully distributed cost? (OCTVA #30, 31 & 32)

A. No. Again, as stated previously, the Alternative Regulation Rules do not require rates for services classified in any cell to be set at the FDC. Also, Section XII.E.3 of the Alternative Regulation Rules, states that " A cost test demonstrating that the price charged is above the LRSIC shall be provided for all Cell 4 services."

Cell 4 services are competitive services, and competitive prices should be set at levels that consider the demand side of the market and what rate-payers are willing to pay for those services. To achieve that goal, prices should be set based on the relevant costs which are directly caused by the decision of providing that service plus an additional mark-up (determined by the market) that will contribute towards the recovery of the firm's common costs. The FDC for a service includes the relevant costs plus a fixed allocated portion of the common costs to that service which represents an artificially marked-up cost to be recovered. Therefore, the Fully Distributed Cost, generally, is not an appropriate tool to set rates for different services provided by a firm, and specifically competitive services rates.

20. Q Do the alternative regulation rules require a large local exchange company (LLEC) to submit a cost study (specifically FDC) at the time it classifies a service in Cell 4? (OCTVA #31)

A. The Alternative Regulation Rules require a LLEC to file certain information (see Alternative Regulation Rules, Section XII.E.) to demonstrate the competitiveness of each service it proposes to be classified in Cell 4. Also, since the rules state that all Cell 4 services shall be detariffed, the rules request that "A cost test demonstrating that the price charged is above the LRSIC shall be provided for all Cell 4 services." The "price charged" for existing services that the Staff recommended to be classified in Cell 4 have been already filed with the Commission, reviewed by the Staff, and approved by the Commission to be reasonable and above its LRSIC in other cases. Therefore, there is no need to require OBT to perform an LRSIC study for each service the Staff recommended to be classified in Cell 4.

21. Q. What is the embedded cost of a service?

A. The embedded cost of a service is the actual cost the firm incurs to provide that service.

22. Q. Should OBT provide annual embedded cost analysis? (OCC #18)

A. No. The Staff recommendation to file an FDC study every 12 months during the course of the plan will be a sufficient tool to detect any unreasonable and sudden change in costs/revenues relationship.

CONTRACTUAL ARRANGEMENTS

23. Q. Does the staff recommendation in the staff report prohibit Ohio Bell from entering into contracts that include Cell 1 services? (Department of Defense #C.3.)

A. No. The Staff recommendation gave Ohio Bell the ability to enter into contractual arrangements that include services classified in Cells 1, 2, and 4 according to the Alternative Regulation Rules in Section X. Also, the Staff recommended that OBT would be able to enter into contracts include Cell 3 services with some additional conditions regarding those contracts.

24. Q. Is it the staff's opinion that all services provided under contracts should be subject to imputation adjustments? (IXC Coalition #13)

A. No. Only services that would have been subject to imputation requirements if provided via tariffs will be subject to imputation requirements if provided via contracts. The Alternative Regulation Rules state that " LRSIC shall include an adjustment whenever the service is offered such that an alternative provider must purchase a service of the applicant to provision its competitive product, and the applicant used the service so purchased by the alternative provider, but bundles such service in the price applicant charges for its own service." The rules do not require different imputation requirements for services provided via contracts from services provided via tariffs. This means that for any Cell 1, 2, or 3 service that is provided under contract and is an essential input for the provisioning of a firm's other competitive services (i.e. are alternatives to OBT's services), Ohio Bell will be required to include the imputation adjustment in its LRSIC.

25. Q. Should rates for services provided via contracts be supported by LRSIC studies or by FDC studies? (OCTVA #73)

A. According to the Alternative Regulation Rules, section XIII.D., rates for services provided via contracts should be supported by LRSIC studies not by FDC studies. Also, there are several reasons to support the rules. The first and most obvious reason is that any firm engages in contractual arrangements for competitive reasons, and LRSIC will provide a more accurate basis on which competitive prices should be set. Second, competitive prices should be set at levels that consider the demand side of the market, or what rate-payers are willing to pay for a specific service, and LRSIC will provide that, not the FDC. Third, with the Staff recommended safeguards, such as the joint cost test and imputation adjustments requirements there should be no concerns about subsidization of contract rates or anti-competitive practice by the Applicant.

25. Q. Ms. Soliman, should the staff specify standards for what constitutes competitive challenges that OBT has to meet before it can enter into contractual arrangements that include cell 3 services? (OCTVA #74, ONA #34, OLC #36, and METAS #3)

A. No. This Staff recommendation is to accommodate any competitive challenges or unique circumstances that might face OBT or their customers in the future. The Staff realizes that it is not reasonable to set a specific standard now for an ever-changing industry, but it will be more appropriate to let the Commission evaluate it on a case by case basis. Also, the Staff recommendation is consistent with the Commission's Alternative Regulation Rules that did not specify the standards which will constitute competitive challenges or unique circumstances that a

LLEC has to meet before it can enter into contractual arrangements for Cells 1, 2, and 4.

26. Q. Should contracts between OBT and end-users be subject to a set of standards different from standards for contracts between OBT and other telecommunications service providers? (New Par b.)

A. No. The Alternative Regulation Rules regarding contractual arrangements along with the Staff recommendations in the Staff Report are intended to give the large LLEC, Ohio Bell in this case, a reasonable freedom to enter into contractual arrangements with their customers regardless of the entity of that customer (end-user or other telecommunications service provider). This freedom is accompanied with the necessary safeguards against cross subsidization to protect rate-payers, and against anti-competitive behavior to protect the competitors. The Staff and the Commission will still need to review all individual contracts to insure that OBT is operating within the approved plan framework. I would like to point out that, the Staff recommendation in this proceeding is consistent with the current Commission practices regarding contracts between utilities (LECs) and for contracts between a LEC and an end-user. Also, it is consistent with the Commission's rules adopted in Case No. 92-563-TP-COI (563) (see paragraph 10 of the Commission's Entry On Rehearing issued on December 22, 1993), that apply to Competitive Telecommunications Services (CTS) providers contract filing, which require CTS providers to file with the Commission all contractual arrangements.

27. Q. Would OBT's ability to offer cell 3 services via contracts contradict the alternative regulation rules established in Case No. 92-1149-TP-COI? (OCC #33)

A. The Staff's recommendation to allow Ohio Bell to enter into contractual arrangements for Cell 3 services is based on the satisfaction of two conditions. The first condition is to demonstrate the legitimacy of the specific competitive challenge that OBT faces for the provision of that Cell 3 service, or where it faces some other unique circumstances, which is the same criteria to let a LEC enter into contracts for Cell 1 and Cell 2 services under the Commission's Alternative Regulation rules. The second condition or requirement is to file a LRSIC study in support of the contracted Cell 3 service rate whenever the contract rate is lower than the rate it would have charged for that service if provisioned under tariff or price list. This is the same requirement for contracts that include Cell 1, Cell 2, or Cell 4 services with rates lower than the tariff rate for the respective service under the Commission's Alternative Regulation rules. Again, the Staff is trying to accommodate any competitive challenges or unique circumstances that might face OBT or their customers in the future, while protecting the competitors and ratepayers.

28. Q. Does the staff believe that the 30 day review period for contracts is an appropriate requirement? (OBT #H.1.)

A. Yes. According to the Alternative Regulation rules, for each contractual arrangement filing, Ohio Bell is required to submit, and the Staff needs to review a LRSIC study to support the contract rates. In that LRSIC study, Ohio Bell have to satisfy the imputation adjustment requirement, and the joint cost test requirement. Also, in that filing, if applicable, Ohio Bell will need to include the justification for including Cell 3 services in the contract according to the Staff recommendation. The Staff believes that it will need that time to complete its investigation and be able to provide a recommendation to the Commission. The Staff believes it is not appropriate to compare the Alternative Regulation rules and the Staff recommendation regarding that 30-day review requirement to the zero-day contract requirement in the "563" rules, mainly because the "563" contracts are solely for competitive services, but the contracts in this proceeding include a combination of competitive and non-competitive services. Also, to address Ohio Bell's concern that the 30-day requirement would deprive the Applicant of the same flexibility that CTS providers are afforded under 563 rules, the Alternative Regulation rules Section XIII.(E), provide Ohio Bell with the ability to implement a contract (for Cell 2 or a combination of Cell 1, 2, and 4) with a specific customer upon filing when necessary to respond to an imminent competitive threat to that specific customer.

29. Q. Would you explain the purpose of the Staff's recommendation to add the termination liability language, stated in the staff report page 83, to the variable term payment plan (VTPP) termination language? (OBT #H.2.)

A. The termination liability language was added by the Staff to clarify the Staff's position on termination liability terms, which is becoming important with the increasing utilization of contractual arrangements and VTPP like contracts. Also, this termination liability language has been recommended by the Staff, and endorsed by the Commission in other proceeding like the "563" rules.

30. Q. Does this conclude your testimony?

A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **Prepared Testimony** submitted on behalf of the Public Utilities Commission of Ohio was served by regular, U.S. mail, postage prepaid or hand delivered to the parties of record on this 3rd day of August, 1994.

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