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November 9, 2001

Mr. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37201

In Re: *Joint Petition of Crockett Telephone, Inc., People's Telephone Company, West Tennessee Telephone Company, Inc. and the Consumer Advocate Division of the Office of the Attorney General for the Approval and Implementation of Earnings Review Settlement*
Docket No. 99-00995

Dear Mr. Waddell:

Enclosed for filing in connection with the above-referenced docket are the original and thirteen copies of the Brief of AT&T.

Copies are being served on counsel for parties of record.

Yours very truly,

Jack W. Robinson, Jr.

JWR/ghc
Enclosures
cc: T.G. Pappas and R. Dale Grimes
Timothy C. Phillips
Gene V. Coker
Garry Sharp

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BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

IN RE:

JOINT PETITION OF CROCKETT TELEPHONE COMPANY, INC., PEOPLES TELEPHONE COMPANY, WEST TENNESSEE TELEPHONE COMPANY, INC., AND THE CONSUMER ADVOCATE DIVISION OF THE OFFICE OF THE ATTORNEY GENERAL FOR THE APPROVAL AND IMPLEMENTATION OF EARNINGS REVIEW SETTLEMENT	)	**DOCKET NO. 99-00995**

BRIEF OF AT&T COMMUNICATIONS OF THE SOUTH CENTRAL STATES, INC.

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INTRODUCTION

Crockett Telephone Company, Inc., Peoples Telephone Company and West Tennessee Telephone Company, Inc. (collectively "the TEC Companies") have been found to be earning in excess of their authorized rates of return. The primary issue presented in this case is what adjustments to rate design are appropriate to prevent the continuation of customers being charged excessive rates by the TEC Companies. The TEC Companies and the Consumer Advocate Protection Division (CAPD) of the Attorney General's office have entered into a "Settlement Agreement" proposing certain temporary rate reductions. The Settlement Agreement is fatally flawed and should not be approved by the Tennessee Regulatory Authority (TRA). First, it is unlawful because it violates the prohibition against retroactive ratemaking. Second, it is contrary to the public interest because it does nothing to prevent the TEC Companies from continuing to charge excessive rates to their customers. In addition, the rate design proposed in the Settlement Agreement results in rates that are unreasonably low (i.e., lowering rates that are already priced below cost) and ignores the services (such as access service) that are priced well above their cost and actually contributed to the overearnings situation.

AT&T Communications of the South Central States, Inc. (AT&T), on the other hand, proposes a solution that is rational, just and reasonable, i.e., a reduction in intrastate access charges. The TEC Companies and the CAPD will argue that AT&T is attempting to achieve access reform in this proceeding and that such an objective should more properly be considered in a generic case. Nothing could be further from the truth. By making this argument, the proponents of the Settlement Agreement only seek to confuse

the issues and divert attention away from the lack of merit associated with their proposal. AT&T is not seeking to address the statewide access problem in Tennessee in this proceeding. It seeks to address only the appropriate remedy for the three companies in this case that have been and are continuing to earn excessive profits. As will be shown below, AT&T's proposal to reduce access charges is based on regulatory precedent and is just and reasonable.

I. The Settlement Agreement Constitutes Unlawful Retroactive Ratemaking And Is Contrary To The Public Interest.

A. Unlawful Retroactive Ratemaking

Based on data for the period 1999 – 2001, the TEC Companies have projected that they would earn profits in excess of their authorized rates of return by approximately $6.35 million (Settlement Agreement, December 28, 1999, item no. 1). In order compensate for that actual and projected overearnings, the Settlement Agreement proposes (among other things) adjustments (1) to waive non-recurring charges for 2000 and 2001; (2) for a monthly credit of $5.00 per business access line for 2000 and 2001; and (3) for a monthly credit of $4.75 per residence access line for 2000 and 2001.[1] The amount of overearnings was calculated based on a time period that has already substantially passed. While the proposed rate adjustments, including those temporary adjustments listed above, may mathematically offset the overearnings, they are effective

[1] Because of the lapse of time since the Settlement Agreement was entered, the TEC Companies propose that the adjustments be extended to 24 months following the decision of the TRA (Prefiled testimony of Dwight S. Work on behalf of the TEC Companies, page 4).

for two years and then the rates revert to their previous levels.[2] Thus, the proposed temporary adjustments are intended to give refunds for rates extracted from customers in the past. As such, the Settlement Agreement attempts to fix rates retroactively, rather than to correct rates on a going forward basis, and is therefore unlawful.

In *South Central Bell Tel. Co. v Tennessee Pub. Serv. Comm'n*, 675 S.W.2d 718 (Tenn. App. 1984), the Court held that such retroactive rate-making was not contemplated by the Legislature and is not permitted by applicable statute. The Court stated that:

> Upon a study of the applicable statutes, especially TCA § 65-5-203, this Court concludes that the Legislature never intended to extend retroactive rate-making power (ordering refunds) beyond that expressly stated in § 65-5-203. . . .
>
> There is no question of the authority of the Commission to "reopen" a case for the purpose of changing previously approved rates. The question is the authority of the Commission to reserve the right to change rates retroactively thereby requiring a refund. This Court is satisfied that the Commission does not have the authority to exercise the latter authority . . . .

South Central Bell Tel. Co. v Tennessee Pub. Serv. Comm'n, 675 S.W.2d 718, 719, 720 (Tenn. App. 1984). Thus, the Settlement Agreement is flawed and unlawful and should not be approved by the TRA.

B. Contrary to the Public Interest

The Settlement Agreement is contrary to the public interest for several reasons. First, it does not address the excessive earnings on a going forward basis.

[2] It is unclear whether customers will be charged a reduced rate for basic local service during this period of time or whether they will be charged the same rate and given a credit as a separate line item. Either way, it is clear that the Settlement Agreement attempts to illegally refund amounts that were previously charged.

Because the rate reductions for non-recurring, business access lines and residence access lines last for only twenty-four months and then revert to their previous levels, consumers will continue to be charged excessive rates. This unending cycle of attempting to remedy overearnings with retroactive rate adjustments can best be illustrated by the testimony of CAPD witness Robert T. Buckner:

> First of all, a history of the process leading up to the Settlement Agreement is appropriate and helpful in coming to a decision on this issue...For the two and one half years ending December 31, 1993, the earnings of the TEC Companies were reduced by $1.7 million in Tennessee Public Service Commission ("TPSC") Dockets #91-08210, #91-08211, and #91-08209. In TPSC Docket #93-06830, the earnings of the TEC Companies were reduced by $504,410 for the year1994 through increased amortization expense and provision of fringe-area county wide calling. Additionally, the $3.00 per month local service credit for Crockett Telephone Company was continued from the previous Docket. On December 28, 1994, the TPSC denied the Consumer Advocate's petition for a Show Cause Proceeding in Docket #94-03949, but the $3.00 per month local service credit for Crockett Telephone Company was continued once more. In TRA Docket #96-00774, a settlement agreement reduced the earnings of the TEC Companies by $4.9 million for the years 1996-1998. (Buckner direct testimony, pp. 3-4).

AT&T's witness, Richard T. Guepe commented on this point in his rebuttal testimony:

> As demonstrated so very clearly in the history section of Mr. Buckner's direct testimony (pages 3-4), the use of credits to make up for past transgressions almost guarantees the need to address the continuation of over-earnings in ensuing years. The use of credits does not fix rates on a going forward basis to prevent that event from occurring in future years. The whole essence of ratemaking is to use a test period to adjust rates and design rates – either up or down -- so that the utility will have an opportunity to earn a fair rate of return on a going forward basis. The Settlement

> Agreement attempts to give reparations for past over-earnings, but does not identify and fix the rates that led to the companies' excessive profits in the first place. (Guepe rebuttal testimony, p. 3).

The proper process to follow is for the TRA to adjust rates permanently on a going forward basis and end this cycle of allowing the companies to overcharge their customers and then trying to determine how much they should be refunded. Indeed, with the current process, by the time the refunds are actually paid, there may be many customers that have relocated to a different service area or different state. Those customers would have incurred the detriment of being over charged, but would not be able to take advantage of the benefit of a refund. The consumers of telephone services should not be charged excessive rates at the outset. The Settlement Agreement simply condemns ratepayers to continuous excessive rates while engaging in retroactive adjustments to make up for past transgressions. It is not in the public interest and should not be approved by the TRA.

Second, the Settlement Agreement is contrary to the public interest because it proposes reductions in rates that are already priced below their costs rather than reducing rates for services (such as access service) that actually contributed to the overearnings result.[3] As Mr. Guepe stated at page 5 of his direct testimony:

> It is rational to reduce tariff rates of services that have contributed to the over-earnings. It would make no sense at all to reduce rates of services that are priced at or below cost because those services are not the source of the over-earnings. The source of the excessive profits is those services that are priced well above their costs. Such as intrastate access services.

[3] Although the TEC Companies were unable to provide data regarding the cost of providing basic local business and residence services, it is widely held in the industry that residence basic local exchange service is priced below its costs and requires subsidization from other services (Guepe direct testimony, page 13).

Any rate design approved by the TRA should be rational. Reducing basic local service rates that are already priced below their cost and which did not contribute to the excessive profits is irrational and should not be approved. The proper remedy for the TEC Companies' continuous overearnings is to identify the rates that produced the excess earnings and adjust those rates to produce the approved rate of return. The Settlement Agreement does not achieve this regulatory objective.

Third, the Settlement Agreement would result in astonishingly low rates for the TEC Companies. For example, residential basic local service effectively would go from $10.54 to ***$5.79*** per month for Crockett; from $6.66 to ***$1.91*** per month for Peoples; and from $5.66 to ***$1.11*** for West Tennessee. The result is similar for business basic local services.[4] These unreasonably low rates are irrational and will provide a strong impediment to the development of competition. Potential market entrants simply would not even consider the possibility of trying to compete at such low prices. T.C.A. § 65-4-123 establishes that it is the policy in the State of Tennessee to foster efficient and technologically advanced telecommunications through the development of competition. Because the Settlement Agreement results in rates that will discourage the development of competition, it contrary to State policy and, thus, contrary to the public interest.

Fourth, the TRA should be aware of the consequences that significant reductions in basic local rates would have on the potential need for a universal service fund. Because the size of a universal service fund is measured as the difference between costs and revenues for basic local service, a reduction in basic rates as proposed in the

[4] See Guepe direct testimony, page 13.

Settlement Agreement would exacerbate the need for a fund and inflate the size of such a fund. The TEC Companies should not be allowed to recover mandated rate reductions that are a result of overearnings from any universal service fund that may be created in the future.

II. A Reduction In Intrastate Switched Access Charges Is Just, Reasonable And Appropriate.

Inasmuch as the Settlement Agreement has been shown to be unlawful and contrary to the public interest, AT&T has offered a rational rate design adjustment that is just, reasonable and in the public interest. However, in proposing that intrastate switched access charges be reduced, AT&T is not asking the TRA to *reform* access charges throughout the state. As one of the TEC Companies' largest customers, AT&T has a stake in the remedy associated with of the $6.35 million in overearnings. Simply stated, there is $6.35 million dollars of excessive profits on the table in this proceeding and the question is what rates should be reduced to assure that customers are not over-charged in the future.

This proceeding would not be the first case where access charges were reduced when a local exchange company was found to be overearning. On August 20, 1993 in the South Central Bell earnings investigation for 1993-1995, Docket No. 92-13527, the TPSC stated, at p. 16:

> The Commission finds that it is in public interest to reduce South Central Bell's access rates by an amount that will allow long distance companies to reduce their toll rates to interstate levels, and to reduce South Central Bell's toll rates consistent with the method used to reduce toll rates in Docket 89-11065. This action continues the Commission's consistent practice of reducing toll rates to all Tennessee customers and moving

> access rates closer to parity with interstate rates. *The Commission intends to continue this practice as appropriate opportunities present themselves.* (Emphasis added).

Thus, there is nothing unusual about reducing access charges in an earnings investigation docket. AT&T's proposal directly addresses the rate design issue, it is limited to the three TEC Companies' excessive earnings and provides a logical and reasonable remedy. The TRA should not be distracted by arguments concerning "access reform" and references to generic dockets. AT&T's proposal addresses the $6.35 million at issue in this docket and nothing more.

The primary reason to reduce access charges is because the TEC Companies are in an overearnings situation (i.e., they are earning more than a reasonable rate of return on their Tennessee operations), and access charges have been a major contributor to these overearnings. Current access rates for the TEC Companies are 14.9 cents per minute for Crockett, 15.5 cents for Peoples and 14.1 cents for West Tennessee.[5] By design, access rates were set at levels significantly above costs to help ensure that basic local service rates were set at "affordable levels" – and in some cases, below the local company's actual cost of providing basic service. Consequently, revenues from these services are a major contributing factor to the resultant overearnings.

High switched access charges provide an unfair advantage to TEC. For example, VarTec, an affiliate of the TEC Companies' parent corporation, offers a 7 cents per minute rate plan with no monthly fee and no minimum calling time. This service is priced lower than even one end of access in each of the TEC Companies and less than 50% of the price of access that competitors must pay to complete calls within the TEC

[5] Guepe direct testimony, page 7.

Companies' service areas. Where the retail rate is priced below the price of access, then the "losses" must be covered (i.e., subsidized) through other services, such as the access charged to competitors.

> High access charges have never been conducive of competitive development in the long distance market and will surely become much more of an impediment when competition is embraced in the local market. Cost based switched access rates are fundamental to achieving the full benefits of a competitive market. (Guepe direct, p. 10).

Another reason access rates should be reduced by the TRA in this proceeding is because it cannot rely on the competitive market to drive access prices toward their economic cost. That is because there is no competitive market for access services. Although traditional market forces can be very powerful in moving the price of goods and services toward costs in an open and equal competitive environment, the TEC Companies now – and will for the foreseeable future – enjoy monopoly control over the provision of intrastate access services in their service areas. There simply is no alternative source to which IXCs can turn to obtain their need to reach end users on a large scale basis. Therefore, if the TRA does not reduce these rates, there is nothing else that will cause them to change from their present levels.

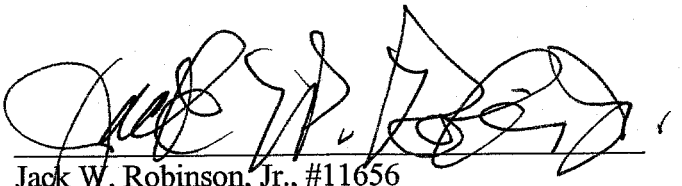
CONCLUSION

The TEC Companies intrastate access rates are too high and need to be reduced. Historically, access revenues were maintained at high levels to assure there was sufficient revenue to support the cost of basic local exchange service. In this Docket it has been found that the TEC Companies have rates that generate earnings greater than

their authorized rates of return. Thus, their existing rates are unjust, unreasonable and excessive. The rate design proposal in the Settlement Agreement is flawed because it constitutes unlawful retroactive ratemaking and because it fails the public interest test. In addition, the Settlement Agreement does not fix rates on a going forward basis, it is not directed toward correcting the rates that directly contributed to the overearings, it is contrary to State policy that favors the development of competition and finally, it could result in the TEC Companies recovering a part of the ordered rate reduction from any universal service fund created by the TRA.

The TRA should require reductions in the rates of services that have contributed to the overearnings and not reduce or refund charges for services that are priced at or below their costs. Specifically, the TRA should require the reductions of the Carrier Common Line charge, the Interconnection charge and the Directory Assistance/Information surcharge access rate elements to zero, as they have no cost basis relating to the provision of access services. If there is excessive earnings after making those changes, additional reductions should be made for the Local Switching and Local Transport rates.

Respectfully submitted this 9th day of November 2001.



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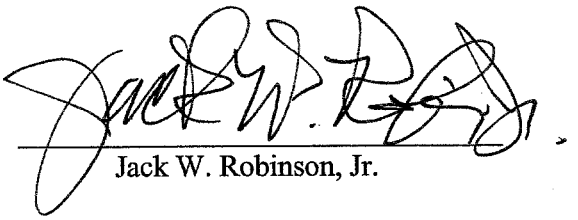
CERTIFICATE OF SERVICE

I, Jack W. Robinson, Jr., hereby certify that I have served a copy of the foregoing Brief of AT&T on T. G. Pappas and R. Dale Grimes, Esq. Bass, Berry & Sims, 315 Deaderick Street, Suite 2700, Nashville, TN 37238-2700 and to Timothy Phillips, Esq., Consumer Advocate Division, 425 5th Avenue, North, Nashville, Tennessee 37243 via facsimile and by depositing a copy of the same in the United States Mail, postage prepaid, this 9th day of November, 2001.



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