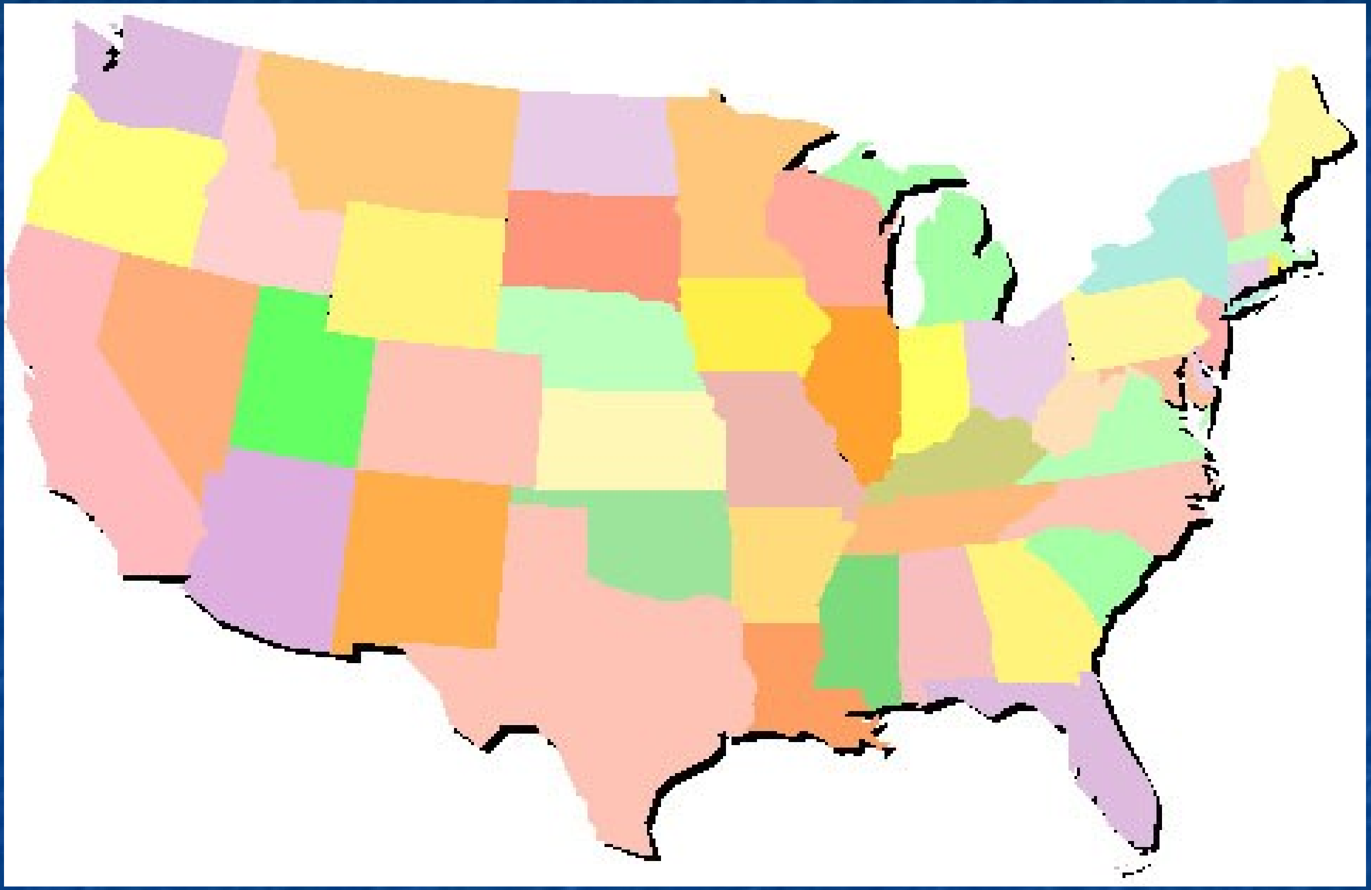
From Monopoly to Markets:

Has Competition Replaced Regulation in
Missouri Telecommunications, or
Is There Anything Left For the Regulator To Do?

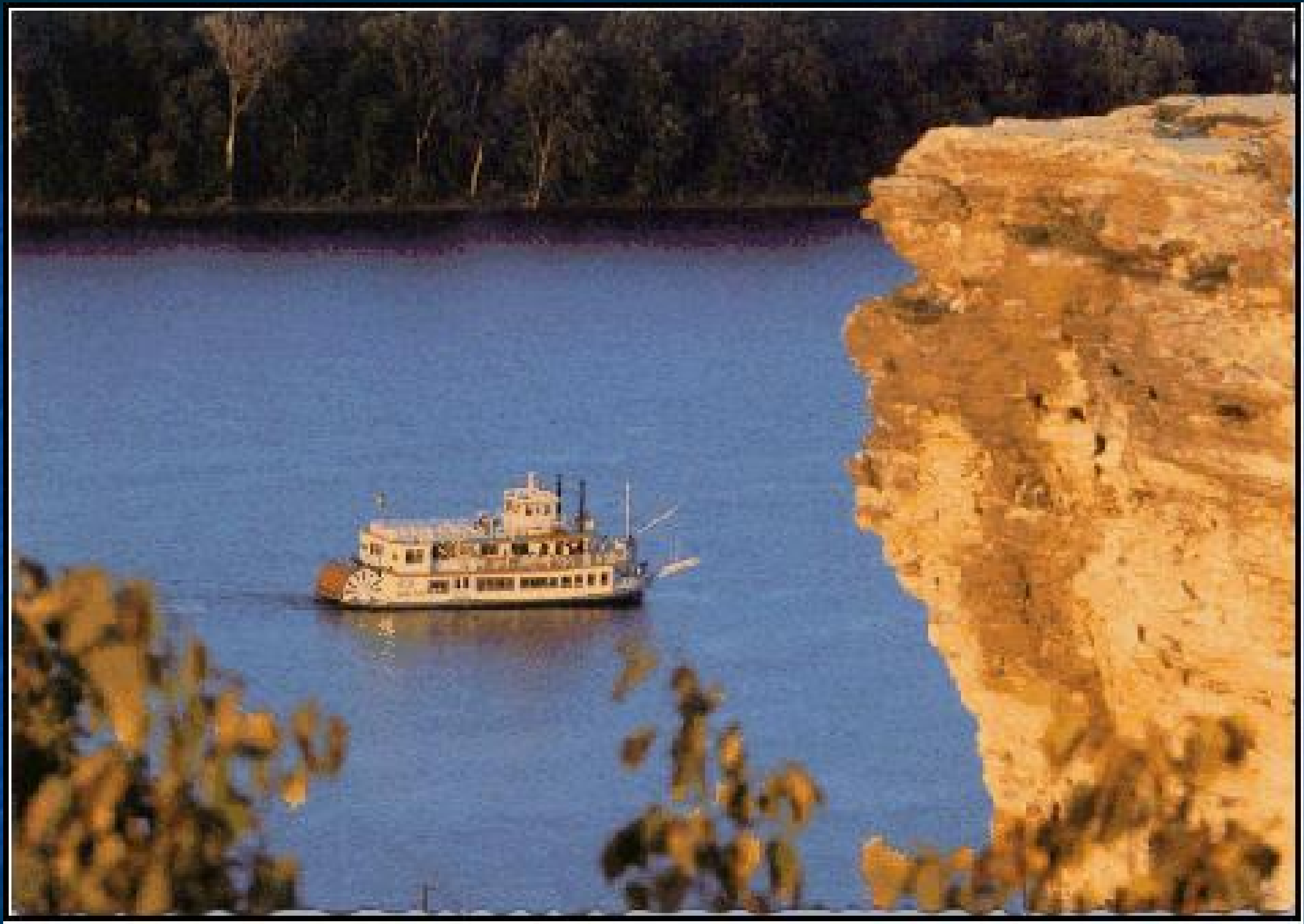
Commissioner Robert M. Clayton III
Missouri Public Service Commission

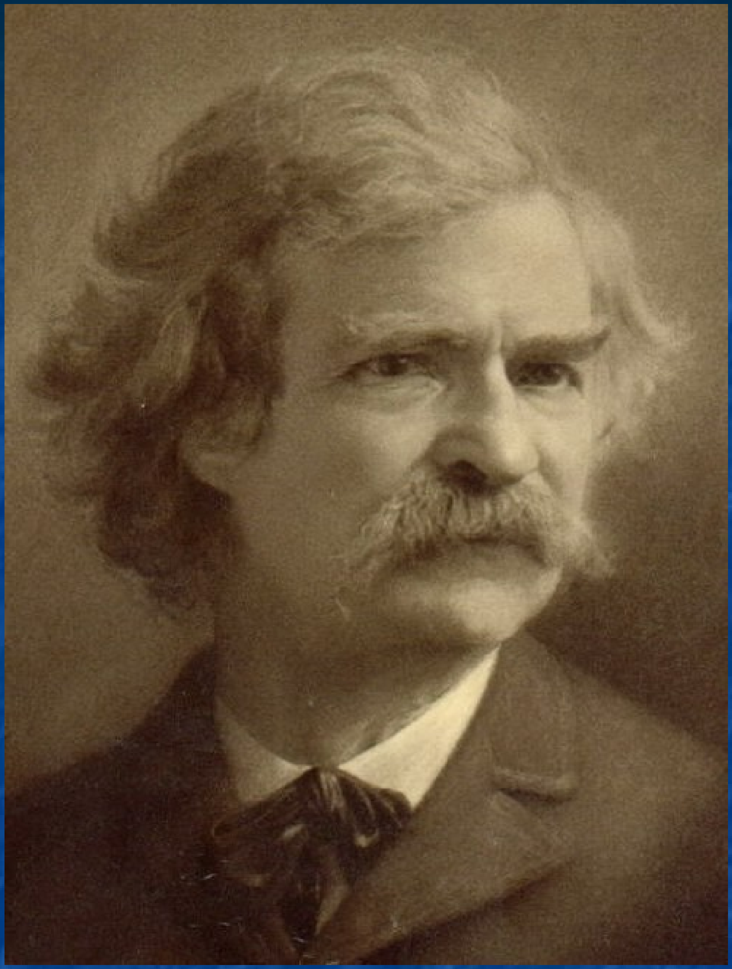
OOCUR Conference, Grenada—November 2006



Jefferson City, Missouri

The Mississippi River





Mark Twain

Missouri Public Service Commission

- Who we are:
  - Five commissioners
    - Decision makers appointed by the governor and confirmed by the Missouri Senate
    - Serve staggered 6 year terms
  - Commission Staff
    - Experts in various fields: Engineering, Law, Economics, Accounting, Finance

Our Mission

Our mission is to ensure Missouri consumers receive safe, adequate, efficient and affordable services while allowing those utility companies under our jurisdiction an opportunity to earn a reasonable return on their investment. The Commission and staff are dedicated to fulfilling these public interest goals.

What We Do

- Must assure safe, adequate, reliable utility service at just and reasonable rates…

AND

- Provide utility shareholders an opportunity to earn a reasonable return on their investments.

PSC authority – Chapter 386, RSMo

MO PSC Mission - Telecommunications

- Ensure safe and reliable service at just, reasonable and affordable rates;
- Establish standards that foster competition in services provided to Missourians;
- Create and monitor quality of service standards;

MO PSC Mission – Telecommunications (con’t.)

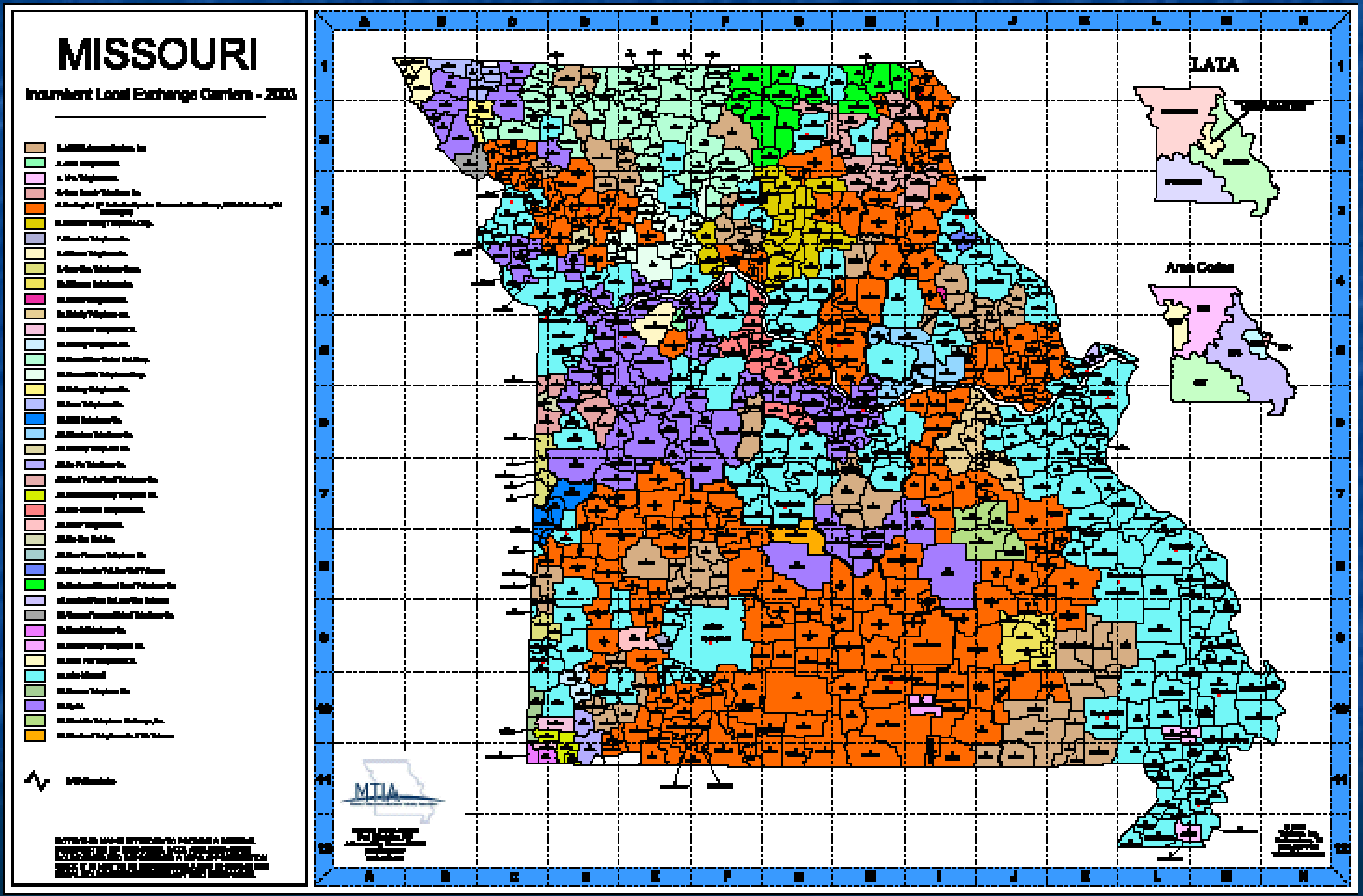
- Provide the public with information to make educated telecommunications choices;
- Resolve customer complaints against telecommunications companies; and
- Resolve / Arbitrate disputes between companies providing communication services.

Missouri Public Service Commission

The PSC Regulates

- *43 Incumbent Local Exchange Carriers (ILECs)*
- *81 Competitive Local Exchange Carriers (CLECs)*
- *438 Interexchange Carriers (IXCs)*

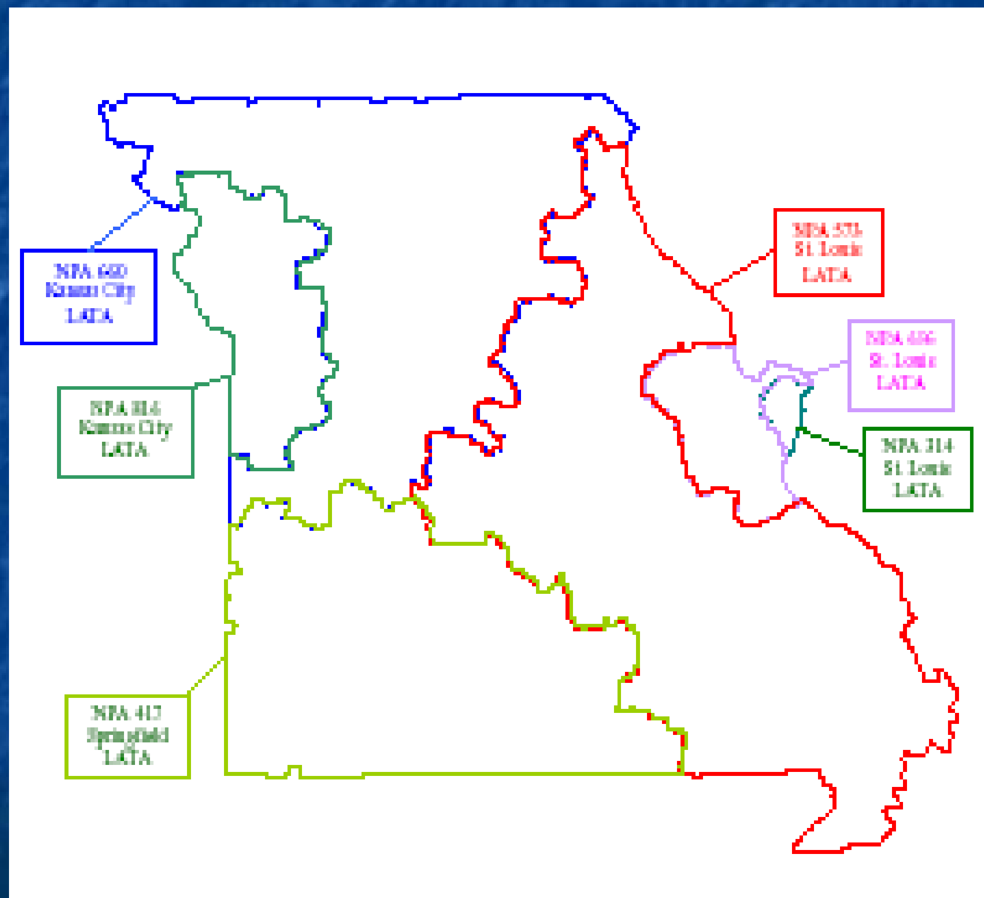
Exchanges


MISSOURI
Incumbent Local Exchange Carriers - 2003
LATA
Area Codes
MTIA

Missouri Telecommunications Industry

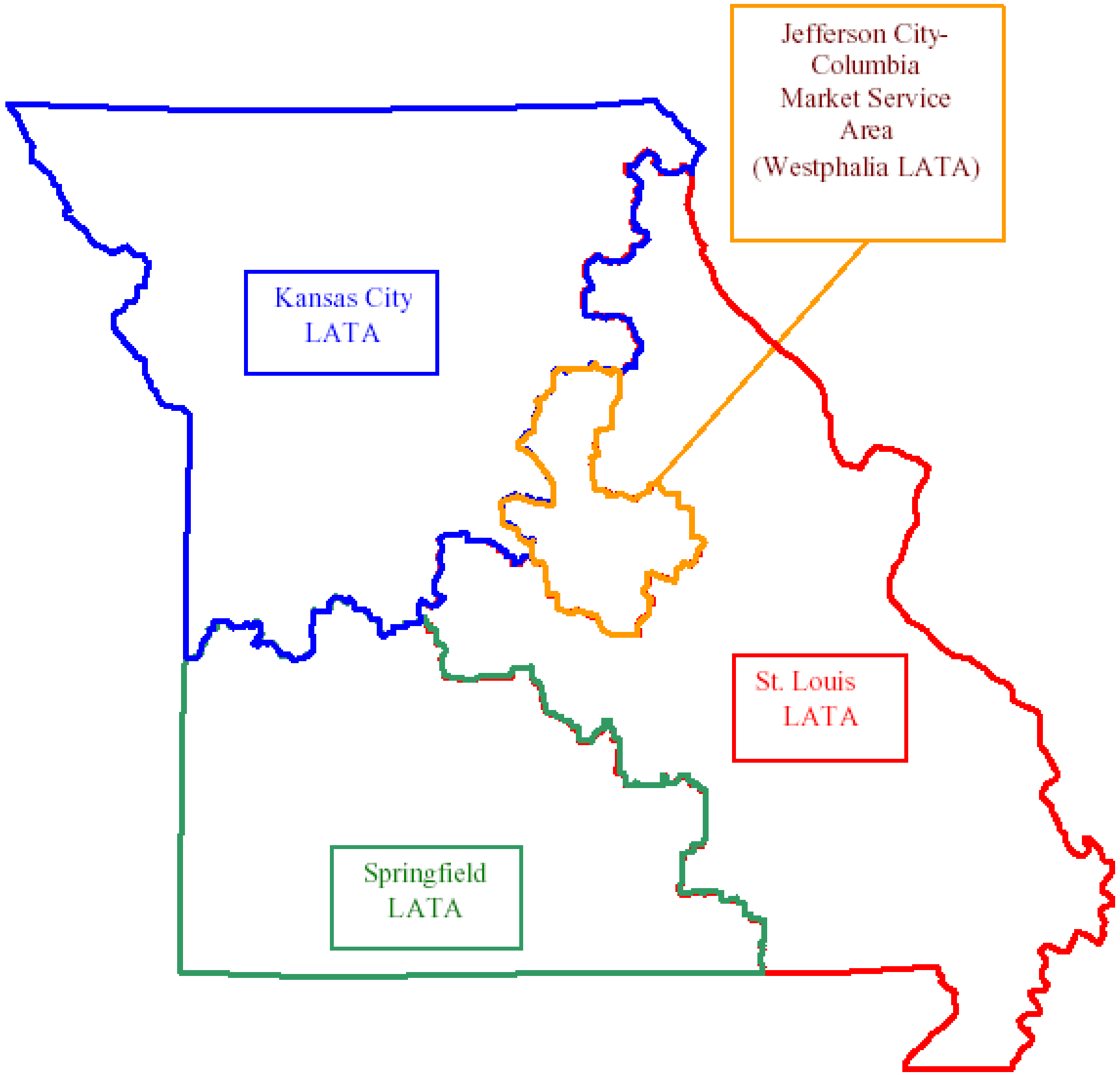
- Missouri Telecommunications Statistics
  - Approximately 3,626,041 landlines statewide
  - Six Area Codes
  - Four LATAs (Local Access Transport Area)
  - Approximately 700 Exchanges

Area Codes


NPA 660
Kansas City
LATA
NPA 816
Kansas City
LATA
NPA 573
St. Louis
LATA
NPA 636
St. Louis
LATA
NPA 314
St. Louis
LATA
NPA 417
Springfield
LATA

Local Access and Transport Area (LATA)

LATAs define geographical areas between and within which various telephone carriers may provide local and/or long-distance services according to specific rule



Missouri Public Service Commission

The PSC has NO jurisdiction to regulate:

- *Internet service providers (ISPs)*
- *Wireless / cellular telephone companies*
- *Cable television service providers*
- *Certain Internet Protocol (IP) enabled voice providers*
  - *e.g., Vonage*

(The Federal Communications Commission has jurisdiction over these providers.)

Regulatory Methodology

Telecommunications Regulation

- Why different methodologies?
  - Direction of Missouri Legislature
  - Allow full and fair competition to function as a substitute for regulation when consistent with the protection of ratepayers and otherwise consistent with the public interest (392.185(6) RSMo)

Telecommunications Regulation - Methodologies

- Telecommunications regulation methodologies:
  - Rate of return
  - “Price Cap”
  - Competitive classification

Telecommunications Regulation – Methodologies

- Rate of return (Monopoly)
  - Generally applied to small incumbent local exchange carriers.
  - Little or no competition in areas served by a rate of return company.
  - Guaranteed opportunity to earn a certain rate of return.
  - 392.240.1 RSMo

Telecommunications Regulation – Methodologies

- Rate of Return (Monopoly)
  - All prices and charges subject to PSC review and approval
    - Prices for service are based on a company's opportunity to earn a certain return on the money it has spent.
    - The only way a company can change its prices is through a rate case that examines the company's current rates and expenses.
    - Rates are established through a rate case, just like an electric utility.

Telecommunications Regulation – Methodologies

- “Price Cap” Regulation (Some competition)
  - Generally applied to medium and large incumbent local exchange carriers in areas not classified as competitive.
  - At least one competitor is providing basic local service in the price cap carrier’s service area.
  - Transition between rate of return regulation and competitive classification.
    - Under this level of regulation the PSC cannot examine expenses and revenues to set rates.

Telecommunications Regulation – Methodologies

- "Price Cap" Regulation (some competition)
  - PSC has limited control over rates
    - Rates for basic local service are adjusted annually by a nationwide inflation index for telephone services.
    - Rates for non-basic services (i.e., Caller ID) can be increased up to 5 percent per year.
    - Rates can be decreased by the company at any time.

Telecommunications Regulation – Methodologies

- Competitive classification (competitive market)
  - Complete Price Deregulation
    - Carriers have almost complete control over their rates.
    - Competition “function[s] as a substitute for regulation when consistent with the protection of ratepayers and otherwise consistent with the public interest”.

Telecommunications Regulation – Methodologies

- Competitive classification (competitive market)
  - Applies to incumbent local exchange carriers in areas deemed competitive.
  - Exchanges for incumbent local exchange carriers are subject to competitive classification:
    - When two nonaffiliated providers offer basic local service in the incumbent's exchange(s).
    - One nonaffiliated provider can be a wireless provider (392.245(5) RSMo).
    - Other factors deemed appropriate by the Commission.
  - Applies to all competitive local exchange carriers (CLECs).

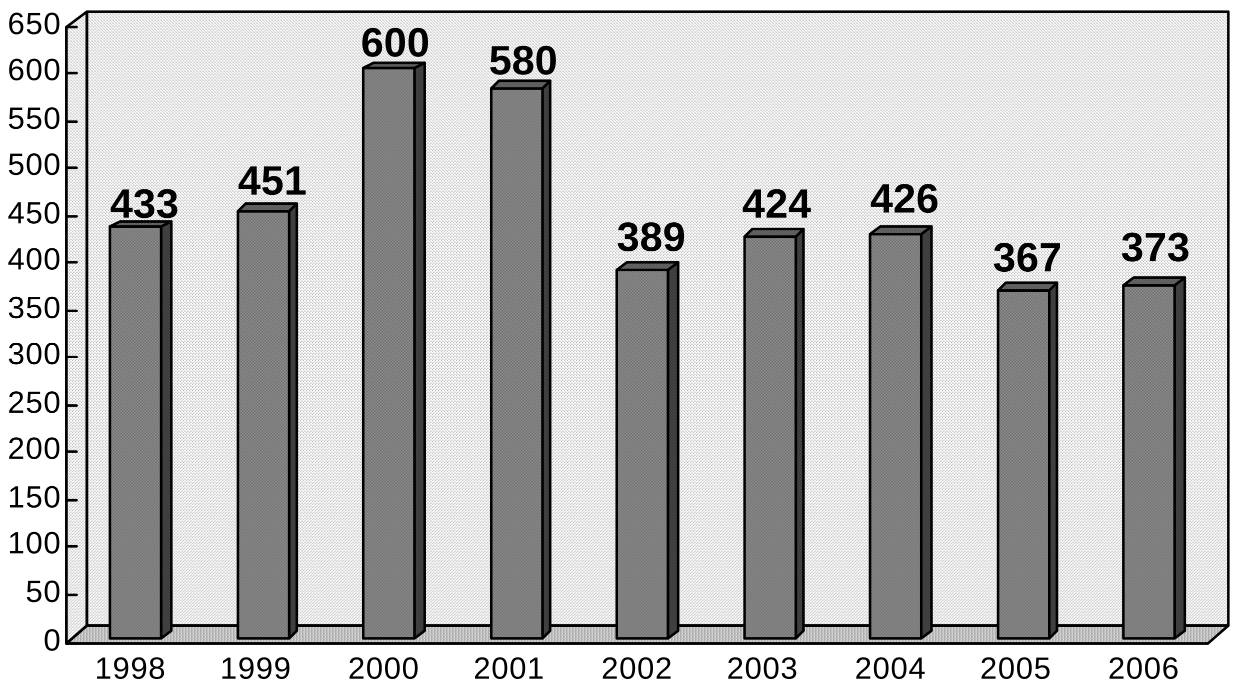
Telecommunications Regulation – Methodologies

Methodology	# of Exchanges	Percentage
Rate of Return	197	28.14%
"Price Cap"	388	55.43%
Competitive	115	16.43%
Total	700	100%

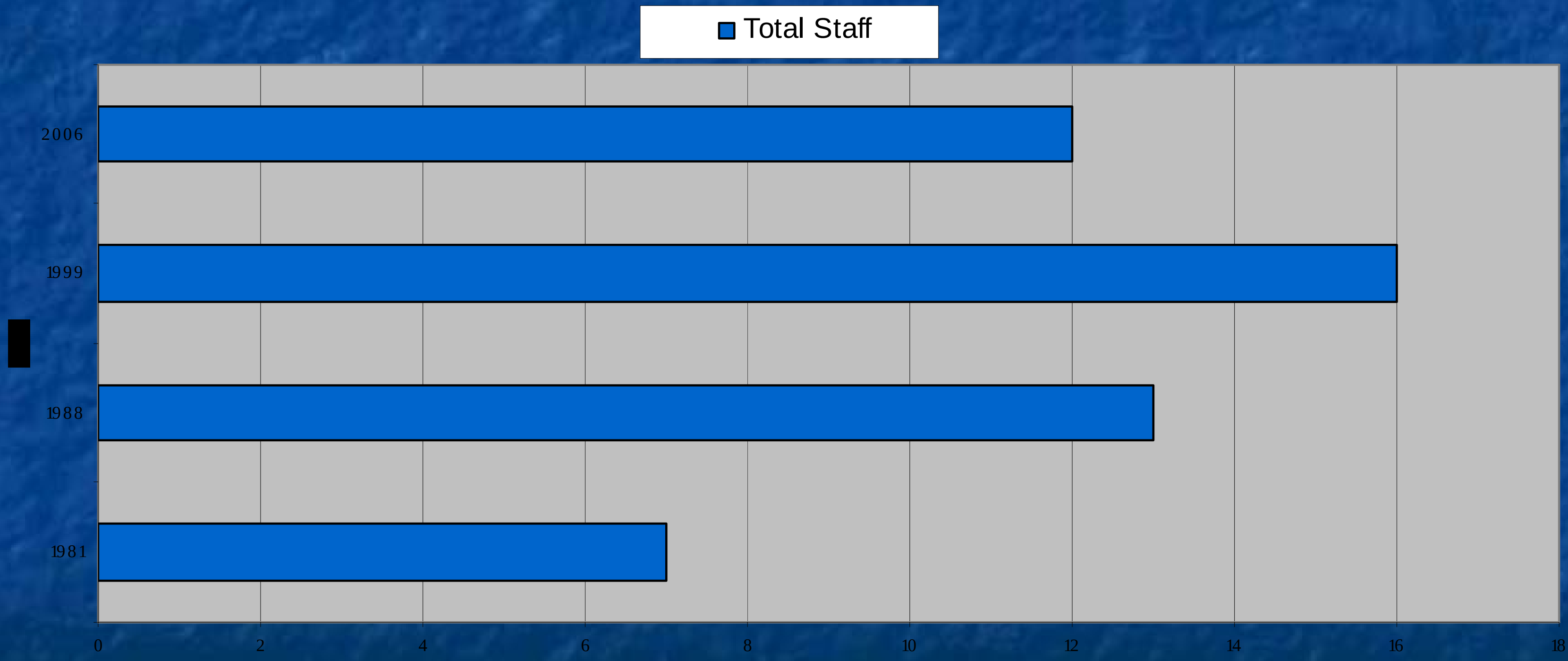
Telecommunications Regulation – Methodologies

Methodology	# of Lines	Percentage
Rate of Return	119,041	3.28%
“Price Cap”	1,121,760	30.92%
Competitive	2,386,648	65.79%
Total	3,627,449	100%

Annual Number of New Telecommunications Cases Filed



Telecommunications Regulation – Staffing Levels



Telecommunications Regulation

- What work is left to do?
  - Sort out disputes between carriers
  - Quality of Service regulation
  - Assess competitive status
  - Resolve customer complaints
  - Evaluate Interconnection Agreements
  - Foster nascent competition

Telecommunications Regulation – 1996 Act

- Removed statutory, regulatory, economic and operational barriers that protected telecommunications monopolies.
- Promoted competition in the telecommunications industry.
- Required incumbent local exchange carriers to open their local exchange and exchange access networks to competitors.
- Promoted increased competition in long distance market.
- Preserved and advanced universal service.

Interconnection Agreements vs. Tariffs

- Interconnection Agreements apply to the exchange of local traffic.
- Tariffs apply to the exchange of non-local traffic.
  - Intrastate calls: tariffs filed with the PSC list rates for both originating and terminating traffic.
  - Interstate calls: tariffs filed with NECA, a federal agency, list rates for both originating and terminating traffic.

Interconnection Agreements

- What are they?
  - Interconnection Agreements are wholesale contracts between two carriers that establish the rates, terms and conditions for exchange of local traffic.
  - Interconnection Agreements are filed with state public utility commissions and are publicly available.

Interconnection Agreements

- What is included in an Interconnection Agreement?
  - Prices for wholesale services
  - Terms and conditions for wholesale service
  - Definitions of terms
  - Dispute resolution language
  - Terms of the contract
  - Opportunities to extend contract

Interconnection Agreements

- State commission authority
  - Federal law dictates that state commissions have limited authority over interconnection agreements
    - State Commissions can only reject interconnection agreements if:
      - They are against the public interest, convenience or necessity.
      - They discriminate against telecommunications carriers not a party to the agreement.

Interconnection Agreements

- Arbitrations
  - If carriers are unable to agree to the terms of an interconnection agreement, federal law allows the state utility commission to arbitrate the dispute.
  - Once an arbitration is filed, the Commission has less than 90 days to resolve the dispute.
  - The two parties file competing proposals (baseball style arbitration) for Commission resolution.

Interconnection Agreements

- “X2A” Agreements
  - In most states, the Regional Bell Operating Company files a standard agreement establishing the terms and conditions for exchanging local traffic.
  - This agreement can be adopted by a competitor to avoid the expense of negotiation and arbitration.

Interconnection Agreements

- Adoptions of previously approved interconnection agreements
  - Any competitor can “adopt” an existing interconnection agreement.
  - The competitor must “adopt” the entire interconnection agreement and cannot “pick and choose” parts that are acceptable.

Interconnection Agreements

- Modifications to existing interconnection agreements.
  - Carriers can modify existing interconnection agreements by filing an amendment to the agreement.
    - Both parties to the agreement have to sign the amendment.
    - State regulatory commissions have the same review obligations for Amendments as for the original Agreement.

Dispute Resolution

- Dispute Resolution
  - If there is a dispute between two carriers regarding an existing interconnection agreement or tariff, carriers can file a complaint with the PSC.
  - The Commission completes an investigation or holds an evidentiary hearing to determine dispute resolution.

Intercarrier Compensation

- Divided into two parts:
  - Compensation for “local” traffic
  - Compensation for access, or non-local, traffic

Intercarrier Compensation

- Local traffic
  - Typically, local traffic is traffic that originates and terminates within the same exchange.
  - Typically both the calling party and the called party live within the same geographic area (exchange).
  - Compensation is established in an Interconnection Agreement.

Intercarrier Compensation

- Access traffic
  - Typically, the calling and called parties do not live within the same geographic area (exchange).
  - Also called “interexchange traffic” because it crosses an exchange boundary
  - Compensation paid to the terminating carrier is listed in tariffs.

Intercarrier Compensation Methodology - Historic

- Historically, the PSC first set basic local rates for carriers
- The intercarrier compensation rates were then set “residually”
  - In addition to revenue for basic local rates, this intercarrier compensation revenue would allow carriers an opportunity to earn a certain rate of return on money actually spent on the network

Intercarrier Compensation Methodology - Current

- When the PSC sets intercarrier compensation rates now, they are typically set according to a “forward looking” methodology
  - The costs are set as if the carrier’s network was built today using modern technology, with a few exceptions
  - For the most part under this methodology, actual investment is not taken into consideration
    - Hypothetical, not actual, expenses are utilized
    - Economic analysis, not accounting analysis

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