

DE 95-054

RESALE OF RETAIL TOLL SERVICES BY SWITCHLESS AGGREGATORS

Investigation

Order Approving Concept of Resale of Retail Toll Services

O R D E R N O. 22,435

December 9, 1996

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I. PROCEDURAL HISTORY

By Order of Notice dated March 6, 1995, the New Hampshire Public Utilities Commission (Commission) initiated an investigation into whether resale of retail toll services should be permitted. After the duly noticed Prehearing Conference on March 20, 1995, the Commission granted full intervenor status to New England Telephone and Telegraph Company (NYNEX), Granite State Telephone, Inc., Merrimack County Telephone Company, Contoocook Valley Telephone, Inc., Dunbarton Telephone Company, Inc., Wilton Telephone Company, Inc., Hollis Telephone Company Inc., Bretton Woods Telephone Company, Inc. and Dixville Telephone Company (independent telephone companies participating jointly, hereinafter the Independents), AT&T Communications of New England, Inc. (AT&T), MCI Telecommunications Corporation (MCI), Union Telephone Company (Union), and Frontier Communications of New England, Inc. (Frontier). The Office of the Consumer Advocate (OCA) is a statutory party. The Commission granted limited intervenor status to Capitol Region Health Care Corporation (Capital Corporation) and directed that the Telephone Resellers Association, which had filed written comments but did not request intervenor status, be placed on the service list.

At the Prehearing Conference, the parties and Commission Staff (Staff) agreed, and the Commission subsequently ordered, that the scope of the proceeding would be limited to the following questions: (a) Can switchless aggregators of customers

(aggregators) purchase toll services for resale, whether or not they are public utilities? and (b) If such purchases for resale are permissible, what tariff is appropriate to govern them?

NYNEX, the Independents, Union, AT&T, OCA, and Staff conducted discovery, filed testimony, and participated in settlement discussions. MCI and Frontier did not participate in the docket after the Pre-hearing Conference. MedNet participated in discovery and attended all hearings but did not present oral comments.

On August 8, 1995, AT&T notified the Commission of its inability to present its witness for cross examination at the scheduled hearing. AT&T requested that the Commission accept its witness' testimony as comments deserving the weight the Commission warrants.

The Commission heard evidence on August 9 and 10, 1995. NYNEX, the Independents, Union, and the OCA filed briefs, as requested by the Commission, on September 14, 1995.

During the pendency of this docket, Congress was considering legislation by which to open telecommunications markets to competition. On February 8, 1996, the Telecommunications Act of 1996 (the Act) was signed into law. Because the Act and regulations subsequently promulgated by the Federal Communications Commission (FCC) are pertinent to resolution of the issues raised in this docket, on June 4, 1996, the Commission requested supplemental memoranda from the parties addressing the impact of the Act. On June 21, 1996, memoranda were received from NYNEX, Union, the Independents, the OCA, and Staff.

II. BACKGROUND

Mednet Services (MedNet) is a subsidiary of Capital Corporation, which is also the parent company of Concord Hospital. MedNet manages telecommunications services for all of the parent company's subsidiaries, including Concord Hospital.

In DR 94-058, the Commission approved an amendment to a NYNEX special contract for Centrex services to Concord Hospital. The amended contract, between NYNEX and MedNet, allowed for expansion of Centrex service to locations served by Remote Switching Modules and described restrictions regarding the resale of certain Centrex services. The cover letter that accompanied the special contract filing at the Commission indicated that rates for toll service would remain under standard tariffs.

MedNet purchases Centrex and Customized NetSaver (CNS) for Concord Hospital and doctors affiliated with the Capital Corporation. Customized NetSaver (CNS) is a standard toll product offered by NYNEX at a significant discount to customers with high volume usage. Aggregating the toll usage of MedNet's individual customers in the Centrex group qualifies MedNet to purchase CNS and thereby obtain a significant discount off toll rates. MedNet also receives a significant discount off Centrex service in the special contract resulting from the aggregated volume of its customers. By a provision in the Centrex special contract, however, MedNet does not make a profit on Centrex. Some portion of the toll discount is passed on to MedNet's customers (the doctors and hospital), making the arrangement

satisfactory to both parties.

When Staff became aware that MedNet was acting as a switchless aggregator, purchasing and reselling CNS, it raised several issues. First, NYNEX's tariff specifically prohibits such resale of retail products and therefore it appeared to Staff that NYNEX seemed to be in violation of its own tariff. Second, MedNet's resale of toll conceivably made MedNet a public utility acting without Commission authorization. Lastly, it was arguable that groups similar to MedNet deserve a similar opportunity for discounted toll service. Staff therefore asked the Commission to commence a proceeding to address these issues; this docket ensued.

III. POSITIONS OF THE PARTIES AND STAFF

A. NYNEX

Throughout its testimony and brief, NYNEX stressed the importance of considering multiple factors with regard to the issue presented, including any effects on contribution, universal service, carrier of last resort obligations, and opportunity for rate-regulated carriers to earn a reasonable rate of return.

NYNEX argued against permitting switchless aggregators to resell toll services other than under current tariff provisions and rates, and with restrictions similar to those under which MedNet operates. In practice, that would mean reselling at low volume rates to low volume users only, reselling at high volume rates to high volume users only, and selling CNS to single locations only, as defined by the NYNEX tariff. As support for its argument, NYNEX averred that permitting switchless aggregators to resell toll services outside the current tariff conditions would harm NYNEX, interexchange carriers, current CNS customers, and competition generally.

In its contention that it would suffer harm, NYNEX argued that the CNS tariff was designed as a response to toll providers who could bypass the switched toll network by terminating special access lines directly from the customer's Centrex or PBX to an Interexchange Carrier's (IXC's) Point of Presence. NYNEX's CNS service attempts to mirror in price the toll providers' offering, providing a high volume rate to a single location, without violating the price floors agreed to in the DE 90-002 Stipulation. NYNEX argued that diverting the use of CNS to low volume users at multiple locations who have been aggregated by switchless resellers removes NYNEX's opportunity to compete with bypassers without violating the Stipulation. NYNEX claims it would also result in a loss of up to \$34,000,000 in revenues. In addition to the harm to NYNEX, the lost revenues could reduce contribution to a point where, according to NYNEX, rates would have to be increased. This likely rate increase would harm the public interest.

NYNEX also argued IXCs would be harmed because switchless resellers could price below IXC costs of access. Hence, IXCs would be forced to lower their prices to compete with the switchless resellers, or lose customers.

Current CNS customers would also be harmed by permitting unrestricted switchless resale, NYNEX claimed, because a potential CNS rate increase would occur without notice to the

CNS customers. NYNEX would be harmed further if CNS customers terminated contracts with NYNEX because of the higher rates.

NYNEX also argued that telecommunications competition in New Hampshire would be harmed because switchless resale is not true competition since it is not based upon the relative network efficiencies of the competitors. Switchless resellers depend entirely on the network provided by other carriers, whether Local Exchange Carriers (LECs) or IXCs. Promoting competition that is not based on actual efficiencies would promote mere price arbitrage, NYNEX argued, and would not bring the benefits of true competition. NYNEX pointed out that New Hampshire is already gaining the benefits of competition through switched competition, e.g., declining prices and increased Optional Calling Plan offerings.

Arguing in the alternative to its claims that resale of toll by switchless aggregators would create harm, NYNEX averred that MedNet did not resell toll. NYNEX maintained that MedNet merely operated under a restrictive contract as an end-user of Centrex service. MedNet, the end-user, exists at a single location, according to NYNEX, consistent with the NYNEX tariff; the single location, again according to NYNEX, is the Centrex switch location within the NYNEX Central Office. Inextricably part of Centrex service are capabilities for local, toll, interexchange services and call management features. The fact that those capabilities are all present and used by MedNet's "member" doctors and hospital does not make Mednet a reseller, according to NYNEX.

Lastly, NYNEX argued that the issue of resale of toll by switchless aggregators belongs in a broader docket better suited to considering policy. The appropriate docket to consider this issue, NYNEX suggested, is a docket in which the Commission evaluates the two year trial of facilities-based competition established in the DE 90-002 Stipulation.

B. The Independents

The Independents joined NYNEX in recommending that the Commission defer consideration of the issue to a generic review of the two year trial of competition established in the Stipulation. The Independents referred to the Stipulation as a comprehensive framework for resolving the many complex issues associated with long distance competition. The effects of unrestricted resale have implications for long distance competition which were covered in the Stipulation and therefore should be considered together.

As an example of the interaction between the Stipulation and unrestricted resale, the Independents discussed CNS. Unrestricted resale of CNS would go beyond the intent for which CNS was introduced, which the Independents contend was to provide a service competitive with service by IXCs utilizing Special Access (one of the forms of access central to the Stipulation's pricing rules). Including Special Access as part of the relevant form of access caused CNS to be priced a certain way, in accordance with the pricing rules set out by the Stipulation. However, according to the Independents, unrestricted resale of CNS could change the relevant form of

access from special access to switched access for switchless resellers. The Independents concur with NYNEX that the switchless resellers would have costs as low as seven cents per minute while IXCs' costs would be closer to eight cents a minute pursuant to the Stipulation.

In their brief, the Independents urged that the Commission define the terms "End User" and "Reseller" if it is going to address resale. Disagreeing with NYNEX, the Independents assert that MedNet is not an end-user in that the doctors' offices have no affiliation with MedNet other than for obtaining less expensive telecommunications service. Thus, MedNet is purchasing toll for resale and not for ultimate consumption. The key, the Independents argued, is crafting an accurate definition of end-user.

The Independents proposed to define end-user based on whether the use is for personal and administrative purposes by the customer, its employees, guests and affiliates or for sale to others. Under the Independents' definition, because MedNet's use is for sale to others, it would be a reseller. Adoption of the proposed definition, the Independents averred, would remove artificial incentives to create shell organizations to resell toll.

If the Commission were to permit resale, the Independents argued against any requirement that resale of toll be restricted to use from a single location, or any other use restriction which may create artificial incentives to bypass independent telephone company switched access services. A single location restriction thus becomes problematic because it eludes precise definition, permitting MedNet's single location to include offices located throughout Concord, Pittsfield and Pembroke.

Finally, the Independents recommended that switchless resellers of toll, if permitted, should meet Commission certification standards. The Independents claim that, by certification processes, the Commission can provide consumers with basic regulatory protections similar to the ones provided by the Commission's supervision of entry for interexchange carriers.

C. Union

Union argued against considering this issue until after evaluation of the trial period established by the Stipulation. The Stipulation, according to Union, governs all toll competition and, therefore, issues affecting toll competition must be deferred until after the Trial Period's completion. Varying the requirements of the Stipulation can occur only by consent of all the parties to the Stipulation, according to Union.

Union maintained that several impediments exist which prohibit resale of toll by switchless aggregators. First, permitting such resale, other than under tariff provisions, would constitute an unreasonable preference for switchless resellers, violating RSA 378:10 and 378:11. Second, permitting such resale would coerce NYNEX into violating the Stipulation.

D. AT&T, Telephone Resellers Association

Both AT&T and the Telephone Resellers Association (TRA) submitted written comments in support of permitting resale of

retail toll. Neither appeared at the hearing.

E. OCA

The OCA argued that the benefits of competition have arrived in the high volume toll markets where the effects of DE 90-002 can be seen in declining prices and increased choices. The Commission can bring the same benefits to low volume, i.e. residential toll markets, the OCA averred, by permitting aggregation. In the OCA's view, permitting aggregation would

correct the failure of the DE 90-002 competition experiment with regard to low volume toll customers, a failure that is evidenced by the high rates and few choices experienced by residential customers. The Commission recognized this failure, claimed the OCA, in its Order No. 21,728, wherein the Commission noted the "lack of significant reductions in standard MTS rates available to the low volume customer."

According to the OCA, the NYNEX-MedNet Centrex operation is the only non-employee and non-geographically adjacent Centrex network existing in New Hampshire. Linked with NYNEX's peculiar definition of single location, the MedNet arrangement allows NYNEX to overcome competition in the high-volume market, while retaining control and continuing to deny the advantage of the discounted toll rates to low volume customers.

The OCA asserted that the above-described situation is fundamentally unfair to residential customers, given that the technical support and structure is the same for both multi-location and NYNEX's so-called single location Centrex. Thus, other organizations should be permitted to duplicate the MedNet arrangement on a multi-location basis. The OCA concluded NYNEX unfairly extracts higher prices from smaller customers for the same service, discriminating by manipulating the definition of single location based upon who the potential customer is. In support of its argument, the OCA pointed out that although the doctors themselves did not move their offices, NYNEX treated the location of the doctors, after they joined MedNet, as being a new, single location. The definition of single location is, argued the OCA, the lever for NYNEX's ability to get high contribution from small customers while giving discounts to high volume customers in response to competition in the high volume market. This leverage could be overcome by allowing smaller customers to aggregate their usage.

The OCA proposed that NYNEX's CNS tariff should exclude reference to any single location requirement because NYNEX is not abiding by the plain meaning of the current language. Alternatively, the OCA proposed redefining the current language to include MedNet-like arrangements by organizations including neighborhood associations within a limited geographic area. Without having performed a technical or accounting assessment, the OCA argued that NYNEX could furnish a billing and collection system for multi-location systems similar to that it provides to MedNet, despite NYNEX's claim to the contrary.

The OCA also disputed NYNEX's claim that because of its social contract burdens, NYNEX should be treated differently than interstate IXCs. While shifting Non-Traffic Sensitive costs to

the state jurisdiction may have permitted aggregation of minutes on a multi-location basis at the interstate level, the OCA argues that NYNEX does not have a right to maintain its pricing disparities between high volume and low volume toll.

Lastly, the OCA argued that the New Hampshire Legislature, by mandating competition for its telecommunications market in Senate Bill 106, decided that the benefits of competition are worth the discomforts of change experienced by current monopolist telecommunications providers. Thus, the specter of increasing basic rates in order to make up for lost contribution, which the OCA argued is a false alarm, should not affect the outcome of this docket.

F. Staff

Staff argued in favor of permitting switchless aggregation of customers to purchase toll services for resale because the benefits of such an expansion would outweigh the possible loss to contribution. Staff cited lower prices, increased choices, increased efficiency, improved quality, and increased demand for toll services.

Staff argued that the New Hampshire Legislature has decided that increasing competitive pressures will bring benefits to New Hampshire. Staff claimed that no evidence was produced to prove that universal service, rate stability, economic efficiency, or carrier of last resort concerns would be adversely affected by going forward now. Staff also exhorted the Commission to allow the forces of competition to set the prices for the service, rather than attempting to regulate a price.

Staff concentrated on the lack of a firm definition of the term resale, pointing out that NYNEX considered resale to be sale to the public at large for profit while Staff considers resale to be any resale, thereby including MedNet. Staff agreed with the OCA that NYNEX has used idiosyncratic definitions to circumvent the tariff prohibition on resale of retail. Staff recommended that the prohibition be eliminated from NYNEX's tariff. Staff also recommended that, until such time as the tariff prohibition is removed, MedNet's services should be grandfathered.

Staff also agreed with the OCA's position regarding NYNEX's definition of single location. Staff cited testimony by a NYNEX witness that the only difference between multi- and single location provision of toll is a different price and packaging.

Staff averred that regulation of switchless aggregators is not directly mandated by statute but that, if the Commission chose to, the Commission could require NYNEX to limit sales of retail services for resale to those resellers who agree to abide by particular Commission regulations.

G. Post-Hearing Memoranda on the Effect of the Act

NYNEX agrees that Section 251(c)(4)(B) prohibits unreasonable restrictions on resale. NYNEX argues that its tariff condition of a single location is not a restriction but is a defining limitation of the service as it exists. NYNEX argued that the Commission should defer any further action in this docket until after the FCC issued its implementing order and

regulations. In particular, NYNEX pointed to the FCC Notice of Proposed Rulemaking of April 19, 1996, as support for its contention that the FCC intended to resolve the questions raised in this docket.

The post-hearing memorandum filed by Union and concurred in by the Independents asserted that CNS customers constitute a category or class of customers, categorized by location. Union and the Independents then cited Section 251(c)(4)(b), which allows the prohibition against reselling a service, available only to a specific category of customers, to

a

different category of customers. Union and the Independents conclude that the single location restriction, a categorizing factor, is permissible.

The OCA's memorandum put forth the argument that CNS is a retail product subject to resale at wholesale prices and that permitting its resale by aggregators will create pressure on intrastate toll rates, a positive effect of competition encouraged by the New Hampshire Legislature. The OCA also

argued

that NYNEX's tariff language restricting resale is no longer valid because it sold retail toll to MedNet for resale. In addition, the OCA raised a concern over value of service

pricing,

a method of pricing which is prohibited by the Act, according to the OCA, because it does not consist of retail price minus avoided costs.

Staff cited Section 251(c)(4) for the proposition that toll service is now available for resale. Staff then referred to portions of the FCC's Notice of Proposed Rulemaking as prohibiting all but two very narrow restrictions on resale. In Staff's opinion, enlarging those narrow restrictions to include NYNEX's peculiar definition of single location would be unreasonable and discriminatory.

IV. COMMISSION ANALYSIS

We have reviewed the testimony, exhibits, and memoranda submitted in this proceeding. We appreciate the time and efforts

of the parties and Staff in addressing an issue which was complicated by the fact that the telecommunications industry is in an era of rapid regulatory change.

We find that the Telecommunications Act of 1996 is conclusive in resolving the first part of the first issue, namely, whether switchless aggregations of customers (aggregators) can purchase toll services for resale. The plain meaning of Section 251(c)(4)(A) creates a duty for incumbent local exchange carriers to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers. Since toll service, and Centrex for that matter, is a telecommunications service provided at retail to subscribers who are not telecommunications carriers, toll service must be

offered

by NYNEX for resale. The Act provides no prohibition or

restriction that the offering shall be available only to non-aggregators. Therefore, we find that switchless aggregators must be permitted to purchase toll services for resale.

We now address the second part of the first issue, namely, whether the switchless aggregator must be a public utility. Although switchless aggregators provide telecommunications service, it is arguable that they are not squarely within the statutory definition of a public utility found at RSA 362:2 because they do not own, operate or manage any plant or equipment. Nonetheless, we believe that in keeping with the spirit of the statute, toll aggregators should be approved by the Commission as resellers consistent with our current practice.

We will therefore require Commission approval of switchless toll aggregators. MedNet, which acts as an aggregator for health professionals, should therefore file as soon as possible for approval as a reseller. In addition, Staff is currently preparing for our review a simplified and streamlined reseller approval process.

Having decided that switchless aggregators must be permitted to purchase LEC toll services for resale, we turn to a question of whether NYNEX can restrict the resale of CNS to single locations in the manner NYNEX proposes, that is, defining single location differently in different instances. This question, too, is guided by the Act. Section 251(c)(4)(B) forbids incumbent LECs from imposing unreasonable or discriminatory conditions or limitations on resale, with certain narrow exceptions. In Paragraphs 935 through 971 of its First Report and Order in Docket No. 96-325, the FCC interpreted pertinent sections of the Act. The FCC concluded that restrictions on resale of volume discounts are presumptively unreasonable as long as the reseller, in the aggregate, meets

the minimal level of demand. In Paragraph 953, the FCC stated: "We believe restrictions on resale of volume discounts will frequently produce anticompetitive results without sufficient justification." We concur in the FCC's belief and we find

that NYNEX has not overcome the presumption that its single location restriction is unreasonable. We will order the single location restriction to be removed.

The next issue, as articulated in our Order of Notice, examines what tariff is appropriate to govern resale. We will not enunciate a specific tariff here. The better approach is to require the parties to this docket to jointly file a recommendation as to the appropriate tariff for resale of retail toll, including the terms and conditions necessary for billing such service.

Based upon the foregoing, it is hereby ORDERED, that switchless aggregations of customers (aggregators) may purchase toll services for resale; and it is

FURTHER ORDERED, that switchless aggregators that purchase toll services for resale must obtain prior approval from

the Commission in order to offer resold toll services; and it is

FURTHER ORDERED, that MedNet shall file a petition for Commission approval as a reseller; and it is

FURTHER ORDERED, that MedNet is granted interim authority to serve its customers until the Commission rules on its petition for approval as a reseller; and it is

FURTHER ORDERED, that NYNEX shall remove the single location restriction from its CNS tariff by filing a tariff revision within 60 days; and it is

FURTHER ORDERED, that the parties to this docket shall jointly file a proposed tariff for resale of retail toll within 60 days of the date of this order.

By order of the Public Utilities Commission of New Hampshire this ninth day of December, 1996.

Douglas L. Patch
Chairman

Bruce B. Ellsworth
Commissioner

Susan S. Geiger
Commissioner

Attested by:

Thomas B. Getz
Executive Director and Secretary