

TOWARD AN ANALYSIS OF TELEPHONE  
LICENSE CONTRACTS AND MEASURED RATES

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## EXECUTIVE SUMMARY

This report has been compiled in response to a request by The Maryland Public Service Commission to provide technical consultant services in rate case number 7305. After an initial meeting, on May 22, 1979, with several of the Maryland Commissioners it was determined that NRRI would focus on two issues. These issues were measured use rate structures and the license contract expenses. The following report analyzes the material presented by the telephone company in the two areas.

In the area of measured service rates we found that the proposed rates were not supported by cost data. We discussed the economic implementation and theory for measured service rates and concluded that rates must be related to costs. Additionally we raise a number of questions with respect to the cost data provided and the proposed rate structure.

In the area of license contracts we have again found no cost support for the expenses. In addition the C&P Telephone Company of Maryland has not explained how the total license contract costs are allocated to specific services. We have again raised several questions; these questions address the license contract in general, specific license contract expenses and the benefits associated with license contract expenses.

It was our intention of this report to provide some insight and raise several questions in the two subject areas so that the Maryland Public Service Commission could determine the justness and reasonableness of the proposed rates.

## ACKNOWLEDGEMENTS

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## PREFACE

This report represents a partial response of the National Regulatory Research Institute (NRRI), to a request by the Public Service Commission of Maryland to provide technical consultant services in rate case number 7305 filed by the Chesapeake and Potomac Telephone Company of Maryland. The technical consultant services contract was divided into three tasks. This response is presented in fulfillment of Task One.\*

In the area of the measured use rate structure presented by the C&P Telephone Company of Maryland, NRRI was to provide the following:

1. A general description and analysis of the cost data used to support the proposed rate.
2. A general discussion of the economic implications of usage sensitive pricing, with specific reference to the proposed rate structure.
3. Questions for use by the Public Service Commission of Maryland during their investigation.

The second area consists of analysis of the license contract arrangement between AT&T and C&P Telephone Company of Maryland. The extent of the analysis was limited to a brief description of the license contract, identification of productive lines of inquiry, and the development of questions which can be raised by the Commission along those lines.

\*For a complete description of all tasks see Attachment A.

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CHAPTER 1  
TOWARD AN ANALYSIS OF MEASURED RATES

The major purpose of this chapter is to develop a sound rationale for marginal cost based usage sensitive pricing of local telephone service. In addition, in the absence of appropriate cost data, which is the case here, we will suggest the characteristics that marginal cost based rates should possess.

Traditionally, four objectives of regulation have been cited in the regulatory literature. Regulators through their decisions should; (a) provide utility stockholders a fair rate of return for their investment, (b) provide fair rates and services to consumers including those that may live in areas that are expensive to serve, (c) promote economically efficient use of society's resources, and (d) promote social equity by providing inexpensive service to economically disadvantaged individuals. Historically, regulators and the courts have been mostly concerned with the first two objectives. It is increasingly recognized that the third objective is equally, if not the most, important consideration.

Under current regulatory practice a utility company has its rates determined in three steps. First, a rate base is determined that represents the value of the property or capital investment owned by the company. This may be calculated according to original cost, fair value or, reconstruction cost. The essential difference among these is the manner of

distributing between consumers and stockholders the current value of the company's assets. Second, a rate of return is specified that is considered adequate to attract the financial capital deemed necessary for providing the service demanded. Third, these two factors are combined to find the annual revenue which the company may collect.

At this point in the ratemaking process, the general level of utility rates is known. However, the specific structure of the rates is typically suggested by the company. For the energy industries, the result has been a declining block rate structure combined with a small customer charge. The opposite pattern characterizes telephone tariffs wherein monthly customer charges are the major portion of most subscribers' local phone bill.

Most public utility commissions in the United States have the authority to regulate rates for those industries which have been designated as affecting the public interest. Accordingly, rates should be designed so as to promote the public interest. The public interest standard by itself, however, is vague and open to a variety of interpretations. The ratemaking techniques actually applied differ widely from one industry to another, and even between companies within an industry. Among the techniques commonly cited are the relation of price to value of service and cost of service. However, the methods for determining value and cost are by no means standardized.

There is a considerable body of federal and state legal precedents regarding the reasonableness of regulated rates. Most of these cases, however, are concerned with the overall revenue level rather than the rate structure. Cases involving the reasonableness of the rate structure often deal solely with the ability of the contested rate structure to

yield the correct revenue level. In the past, a proposed rate structure has been accepted as satisfactory if it was not considered in some sense unjust, unreasonable or unduly discriminatory. As an example, charging two competing industries different prices for the same service would be unduly discriminatory.

Recently, federal and state regulatory commissions have been considering a more concrete standard, such as marginal cost, for judging the ability of a rate structure to promote the public interest. Herein, we present a case for adopting marginal cost pricing as that standard. This case is made despite some known obstacles to the implementation of such rates. It is noteworthy, however, that usage sensitive pricing leads to rate structures that are directly related to the principles of marginal cost pricing. These principles serve as a lighthouse to ratemaking activities in uncharted waters which can yield maximum benefits for society.

Most decision makers attempt to reap the maximum benefits attainable, by selecting the best policy from among those which are available. As a public policy decision maker, the Public Utilities Commission does the same as it sets prices. As a criterion for judging the merits of regulated pricing policy, we suggest a measure of social benefits which is the aggregate of the benefits received by producer and consumer. The producer's benefits are simply profits--the surplus of revenue over cost. These are settled when the revenue requirement is calculated. The benefits accruing to consumers, however, are somewhat more difficult to calculate. The consumer collects a surplus, but its nature is different from profits. Instead, the consumer's surplus is the excess of what he would be willing to pay over what he actually pays for a commodity.



For example, suppose a customer is willing to pay up to five dollars for a ten minute telephone call to Florida for which the price is three dollars. He then enjoys a two dollar benefit that the telephone company could have reaped. This type of benefit exists for the consumers of all products regardless of whether the firm is competitive or monopolistic.

Before justifying a marginal cost pricing policy in detail it is important to rate some key characteristics of utilities. Most regulated industries have several characteristics in common. First, they are usually among the most capital intensive industries in the country. Several have previously experienced a more rapid growth rate than the economy as whole. These two features create some uncertainty regarding investment decisions. Uncertainty about demand conditions is cited by the energy industries as a justification for declining block rate structure since demand fluctuations occur at tail block prices for most customers, which may be close to running cost. Thus, capital or fixed costs are considered to be recovered early in the rate structure. Third, a characteristic of public utilities is that large amounts of capital investment are idle during slack demand periods. Diminishing the difference between peak and off-peak demand by appropriate pricing rules is deemed beneficial. Finally, it is generally conceded that public utilities are natural monopolies in that a significant amount of resources would be wasted if two firms entered the same service area.

For our purposes, the most important attribute of a natural monopoly is that the cost of producing a unit of output declines as output increases. If so, two firms producing half as much will result in larger unit costs.

Such industries are said to have decreasing costs. The economic meaning of decreasing costs has been confused in some recent discussion and needs restating. Decreasing costs occur if unit or average costs decrease as output increases, holding all other things equal. In particular, the prices of inputs, such as fuel, are held constant in this concept. Recent inflation has caused the cost of production to rise; however, that cost is larger regardless of the amount produced. Hence it is possible and even likely that two countervailing factors are currently influencing a utility's cost: unit costs tend to decrease as demand grows and increase because of higher costs of inputs. Although inflation has prevailed recently, that does not affect whether public utilities are decreasing cost industries.

In regulating a decreasing cost industry, the choices available to the public policy decision maker are best illustrated by two cases. He can maximize social benefits by setting prices at marginal cost or he can set price equal to average or fully allocated cost and by implication insure that the revenue requirement is fulfilled. If price equals marginal cost in a decreasing cost industry, it must necessarily be below average cost implying that the public utility is earning less than has been specified.

The fundamental dilemma one faces when trying to use marginal costs to price are that while marginal cost pricing yields the greatest social benefits, the inequitable distribution of these benefits between the producer and consumers may make marginal cost pricing undesirable. The best of both solutions could be obtained if public utilities commissions allowed this company to levy customer charges thereby creating a two-part

tariff. The customer charges could be used to transfer money to the producer thus satisfying the revenue requirement, while maintaining the price at marginal cost. The customer charges would be paid as lump sum by dividing it equally among customers over 12 months. The result could yield an improvement in social benefits. The typical criticism of such a two-part tariff is that the customer charge falls most heavily on low income users. Ignoring for the moment these inequalities in society's income distribution, the two-part tariff is quite attractive. It allows the commodity to be purchased at its marginal cost of production, while also satisfying the revenue requirement.

Without customer charges, the average cost of production must be recovered by the commodity price. The policy of using average cost to determine price for decreasing cost industries has been the response by public utility rate makers to the above dilemma. Consequently, utility rates have historically been based on total cost schemes in an attempt to measure the average cost for serving various customer classes.

The basic argument for measured service rates rests in the notion of economic efficiency. The basic tenet of economic efficiency is that there is a charge for incremental usage only if there is an incremental cost. In other words no cost--no charge. Alfred E. Kahn and Charles A. Zielenski state the economic efficiency criteria for usage sensitive rates quite clearly in their article which appeared in Public Utility Fortnightly on March 25, 1975, entitled "New Rate Structures in Communications."

"Economic efficiency does not require charges for usage as such, what it requires is rates that reflect the respective incremental costs that particular usages impose on the system. Where additional usage involves no additional costs, as in the case of additional minutes of conversation in the middle of the night, there is no reason for rates to vary with usage. Conversely, where a supplier has an obligation to serve and must incur the cost of maintaining capacity for that purpose, those who are responsible for its incurring those particular costs should be required to pay them, regardless of their actual usage. It is only where costs are in fact usage--sensitive--i.e., where added usage does impose added costs--that rates should reflect that fact."

From the above discussion it is clearly arguable that usage sensitive rates must be based on costs. Both public acceptance and economic efficiency criteria demand that rates be related to costs. In the present case C&P has not related the new measured service rate for business customers to the cost of providing that service. In a general sense they have described relationships between users and capacity but have not taken the necessary step of relating capacity costs to use.\*

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\*We would like to point out that if this tariff were filed at the federal level the tariff would be a violation of F.C.C. rules and subject to rejection. See F.C.C. Rules and Regulations, Part 61 - Tariffs §61.38.

## CHAPTER 2

### THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY OF MARYLAND'S COST STUDIES

Two general cost studies were filed by C&P in this case. These studies are entitled, "Embedded Direct Cost Study 1977" and "Exchange Class of Service Study 1977." We will first discuss the "Embedded Direct Cost Study 1977" (EDC). This study is characteristic of studies filed by Bell Companies in other jurisdictions. The main criticism of the EDC studies are that they do not allocate common and joint costs, and therefore cannot be used to determine the cost of service.

The staff of the New York\* and the Massachusetts\*\* utility commissions have separately investigated and reviewed the intrastate cost studies of New York Telephone and New England Telephone companies. Both companies used the embedded direct cost methods. In the New York study, it was found that intrastate private line revenues did not cover intrastate private line costs; it was also found that revenues from terminal equipment or vertical services were not providing subsidies but, in fact, falling short of covering their own costs. In the Massachusetts study, it was found that basic exchange ratepayers were subsidizing all other service categories, the opposite of what the Bell authorities have alledged. We should note, however, that in any study the method of allocation of common cost can determine the results of the study.

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\*New York Public Service Commission, Case No. 25290, 26426, 26732 and 26775

\*\*Massachusetts Department of Public Utilities, Docket 18210

The EDC studies supplied to the Maryland Commission in Case No. 7305 are similar to studies normally provided by AT&T affiliates. The cost studies provide accounting data on costs and investments with crucial factors necessary for decision making buried or missing. The following is an example of missing or ambiguous information:

The eight service categories are briefly defined as:

Exchange-Toll Common....These are the direct costs for the basic station equipment (rotary dial non-premium telephone set), for inside and drop wiring on non-coin main telephone service and on all coin services, for loops, and for non-traffic sensitive local central office equipment. This category represents a cost which is common to both Exchange and Toll service. Ozark separations methods are not employed to assign these costs to the Exchange or Toll category. No revenues are assigned to this category.\*

The question arises, if the Ozark Separations method is not being used, then what method is used or should be used. Information of this nature should be provided and not left to the investigators to attempt to determine.

A further example is the one presented below where no clue is provided as to the allocation method resulting from the "differential study."

Vertical business....as with the Vertical Residence category, this is the direct cost and revenue resulting from a differential study of basic Business Exchange service. Also included are the differential cost and revenue of key equipment and PBX and the direct cost and revenue of Centrex Service.\*\*

They state that the purpose of an Embedded Direct Cost Study is to determine cost-revenue relationships. However, the disclaimer is added that "It does not determine future costs, cross-elastic effects, and opportunity costs. Nor does it represent a burden test. Consequently, an EDC does not provide costs for pricing decisions."

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\*Embedded Cost Study, p.4.

\*\*IDEM p. 5.

We suggest that the Commission would find a comparative cost study useful. The study should show the reasons for cost changes between the past test year and the present test year, C&P has not provided this type study in the instant case. The Commission may additionally wish to suggest the allocation methods used by C&P Telephone. Alternatively, the Commission may wish to suggest that a number of alternative allocation methods be explored by the company and a study produced comparing the effects of these allocation methods on rates paid by all class of service. One alternative allocation method is used below shows the various results that can be produced by simply taking AT&T EDC analysis one additional step.

The Bell System's embedded direct cost studies have come under attack in both federal and state jurisdictions. Basically, the problem boils down to their usefulness. The EDC studies concern only directly attributable costs with no allocation of common or joint costs. A good analogy is trying to identify the cost of a ride in a taxi by saying that only the cost of gasoline is the direct cost. Without some reasonable division of the common costs (the driver, car, and other expenses) the price of the ride cannot be determined. AT&T's EDC studies essentially identify the cost of the gasoline without performing the task of allocating common and joint costs.

In the EDC studies presented, the common and joint costs are no small share, they represent roughly 50% of the total cost of providing telecommunications service. Common costs can be allocated by a number of methods, for example volume of service, causation, relative usage marginal cost effects, or demand elasticities to name just a few. The Federal Communication Commission currently require all costs to be

fully distributed to all services. The method of allocation used is historical cost causation, which basically means that common costs are allocated to each service based on the investment and expenses that have been assigned directly to the service.

In short the EDC studies presented by C&P Telephone Company of Maryland cannot be used to determine the cost of service. However, if we take the basic EDC data and allocate the common and joint costs to each service category (using each service's share of total direct costs as an allocation factor) we can at least see the total costs of each service and compare the relationships. Table 1, below, presents the results of a full allocation of all costs.

Table 1  
Intrastate Contribution  
(000)

<u>Service</u>	<u>Revenues</u>	<u>Direct Costs</u>	<u>Access Lines</u>	<u>Common</u>	<u>Total Cost</u>	<u>Contribution</u>
Basic	270,061	123,407	160,408	31,240	315,055	(44,994)
Toll	67,347	25,748	33,462	6,518	65,728	1,619
Private Line	16,647	20,674		5,234	25,908	(9,261)
Vertical	179,473	114,403		28,961	143,364	36,109
Miscella- neous	32,510	12,754		3,229	15,983	16,527
<b>Total</b>	<b>566,038</b>	<b>296,986</b>	<b>193,870</b>	<b>75,182</b>	<b>566,038</b>	<b>0</b>

Comparing Table 1 with C&P's results on page 2 of the 1977 Embedded Direct Cost Study one can see that there has been a change in the magnitude of the "contribution" (in this case contribution is revenue minus total cost). For example C&P's analysis stated that intrastate toll service provided \$41,599 (thousand) in contributions in 1977, under our



allocation (which only carries C&P's analysis one step further) we find that intrastate toll provides only \$1,619 (thousand) in contributions to other services. The important point of our analysis is not whether does not give the regulator sufficient evidence to base reasonable judgments. In addition the EDC analysis raises numerous questions on both the costs included in the service categories and the proper method of allocating common and joint costs. For instance, the "Access Line" category (which is called Exchange-Toll Common in C&P's narrative description) includes "the direct costs for the basic station equipment (rotary dial non-premium telephone set), for inside and drop wiring on non-coin main telephone service and on all coin services, for loops, and for non-traffic sensitive local central office equipment. This category represents a cost which is common to both Exchange and Toll Service." Clearly the category "access lines" is common to at least exchange and toll, however, AT&T allocated all these costs to exchange only. Additionally, a question needs to be raised as to whether private line services should be allocated a portion of access line costs. Private line services require both a loop and basic station equipment, however, it is not clear as to exactly what costs are included in the private line services from the description of the service category.

There is another critical problem with the allocation of private line service costs. Typically, private line service costs are allocated between interstate and intrastate based on loop counts. However, some private line services do not require a conventional loop, the results could be an overassignment to the intrastate jurisdiction. We should question the company on this specific allocation procedure.

In summary, the purpose of EDC studies, as stated by C&P, "is to determine existing cost-revenue relationships among several categories of service provided by an operating telephone company...an EDC does not provide cost for pricing decisions." We agree with the company EDC cannot be used for making price decisions. However, because EDC studies do not allocate common and joint costs these studies are of very limited value in determining cost-revenue relationships. Almost 50% of the total costs of providing service are common and joint costs and therefore supposedly unassignable. C&P suggests that we examine only 50% of the total costs, the assigned or direct costs, to determine cost-revenue relationships, we find that totally unacceptable. It appears that the so-called direct costs are just those costs which are easily identifiable or attributable to a service. In any case embedded direct cost studies in their present form and service categories were not presented by C&P to support the measured service rate change.

## CHAPTER 3

### JUSTIFICATION FOR MEASURED SERVICE RATE CHANGES

This section centers on the cost justification for the changes in measured rates as proposed by C&P Telephone. The "Exchange Class of Service Study 1977," presented by the C&P Telephone Company of Maryland is simply a summary of book costs as they were allocated to various cost categories. There is no justification provided for any of the measured service rate changes. The cost study is simply presented for your review.

The study's methodology is to assign revenues and costs to three main categories: Access Line, local usage; and station. Some argument has occurred over the proportions of these costs attributable to each of these categories and the portions assigned to common costs. For example, in the following category of station apparatus, Teletypewriter-- not only is there some confusion between interstate and intrastate allocations but also there is no clear rationale evident for the procedure:

Station Apparatus - Teletypewriter (231-01)....This category includes all station equipment provided for teletypewriter service. The total is apportioned between state and interstate based on relative number of TWX minutes of use.

The interstate P/L total is assigned to the P/L category directly. The interstate message portion is assigned to Vertical Business based on the portion of book costs used for Dataphone (obtained from D/R), and the remainder assigned to common.

The total teletypewriter investment is assigned to P/L, Vertical Business and Common in the following manner:

Vertical Business portion is obtained by subtracting the portion of book cost for Teletypewriter - Private Line found in Long Lines memo records. The ratio of Book Cost used for Dataphone to the total in the account is applied to the difference.

The Common portion, which contains investment used for official (telephone company) service, is obtained by multiplying the investment in the Vertical Business category by the ratio of official Teletypewriter - Private Line book costs (D/R obtained) to the total in 231-01.

The P/L portion is obtained by subtracting the amounts in the Vertical Business and Common portions from the total in 231-01.

The intrastate portion is obtained by subtracting the interstate message and interstate P/L values by category from the total by category.\*

Virtually none of these jointly used operating investments or costs can be identified as exchange costs directly using utility accounting records. In addition, for the most part, the directly attributable costs are derived costs based upon some allocation procedure design by the utility.

The "Exchange Class of Service Study of 1977" as we have mentioned above has many internal problems, these problems limit the use of the study. In addition the study does not, and was not submitted, to support the change in the measured use business rate. In summary, with respect to cost support, there is no cost support for the measured use rate change presented by the C&P Telephone Company of Maryland.

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\*See Exchange Class of Service Study, 1977, p. 2.

Aside from the fact that there is no cost support for the rates, there is a problem in determining the justification for the structure of the new proposed measured rates. The old structure for business local service for individual lines was a flat 8¢ charge per call, (after the initial message allowance was depleted which was 90 calls) the new structure is a two part tariff where 6¢ is charged for the first three minutes and 1.5¢ per minute for every minute after three minutes starting with the first call, in other words, there is no message allowance. The testimony presented states that the average call has been roughly three minutes under the old rate. Now a four minute call may be cheaper (under the old rates the base price included 90 calls; after 90 calls, the price was 8¢ a call--the new rate for a 4 minute call will be 7.5¢).

There is no indication, in any part of the testimony submitted, whether considerations were given to problems that may arise or costs incurred if the average call shifts to four minutes during the peak-usage period. It is entirely possible that capacity additions would be needed if usage and duration of the call increased to an average of 4 minutes. If such capacity additions were made, it is likely that the business service would not bear the entire burden of its cost, since the additions would be classed as joint costs and divided among all rate classes.

C&P Telephone Company of Maryland is proposing to change the rate structure for business customers in rate classes 8 through 11. These rate classes include exchange areas having 500,001 to 4,500,000 main stations. (See Testimony of Paul D. Kemp, Attachment 1, pages 21-24 for the exact exchanges affected by the change.) We have performed a

comparative analysis, (old rates with the new rates) in order to get a better picture of the impact of the rate and rate structure changes. Rate Class 8 was used in the analysis. The following assumptions were used in the analysis:

1. The old rate for rate class 8 for Business, Message Rate, Individual Line, was equal to \$13.12 per month and included 90 free calls (See local Exchange Service Tariff, P.S.C. - Md.- No. 202, Section 2, page 40-45).
2. The proposed new rate for rate class 8 for Business, Message Rate, Individual Line, is equal to \$8.57 per month and includes no free calls, each call is charged 6¢ for the first 3 minutes, and 1.5¢ for each additional minute. (See Local Exchange Service Tariff, P.S.C. - Md. - No. 202, section 2, page 16 and page 19.)
3. We have assumed that 90 calls will be placed under the new rate. The basis of this assumption is that under the old rate 90 free calls were included in the base charge.
4. We have assumed that of those 90 calls, 25% of them are over 3 minutes long. The basis for this assumption rests on Mr. P.D. Kemp's Testimony, page 3, where he states: "Local business calls of more than 3 minutes account for less than one-quarter of all the local business calls".

Using Mr. Paul D. Kemp's Testimony, Attachment 1, page 25, we have determined that, on the average, if 25% of the total calls are over 3 minutes, the total length of those calls is 7 minutes long.\*

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\*See Testimony of Mr. Paul D. Kemp, Attachment 1, page 25, Using 63,668,288 units as the timed business initial period units multiplying by .25 equals 15,917,072 units. Then we take timed business additional period minutes 67,754,080 minutes divided by 15,917,072 initial units equals 4.25 additional minutes, which equates to an average of 7.25 minutes for total length per call.

The charge per month would therefore equal:

new base rate	\$8.57
initial period rate 6¢ x 90 calls	5.40
additional period rate 1.5¢ x 4 minutes x 23 calls	<u>1.38</u>

Total charge per month \$15.35

The charge of \$15.35 for 90 calls represents a 17% increase over the old business rate which was \$13.12 for rate class 8.\*\* If we assume that 25% of the 90 total calls are over 3 minutes and each is only 1 minute over 3 minutes for a total length of call of 4 minutes, the charge under the new rates is \$14.32 which is a 9.1% increase over the old rates. Carrying the analysis a little further, if the customer made 90 calls each less than or equal to 3 minutes (no additional minute charge), the charge under the new rate would equal \$13.97, which still results in a 6.5% increase over the old rate.

Based on the above assumptions, business, measured rate, individual line customers are likely to experience an average increase of 14.5%\*\*\*. However, customers which in the past were placing calls less than or equal to 3 minutes will on the whole experience only a 4.5% increase if placing 90 calls. If additional calls are placed (more than the old message unit allowance) and the length of call is 4 minutes or less, the overall increase will be less than 4.5%. In other words, the percentage

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\*\*Under the same assumptions, the percent increase for rate class 9 is 14%, rate class 10 is 10.4% and rate class 11 is 7.5%. A weighted average of all affected rate classes results in an overall increase of 14.5%.

\*\*\*IDEM.

increase will decrease as more calls are placed if each call is 4 minutes or less. This is due to the fact that, under the old message unit structure after the allowance was used, each additional call was charged 8¢ a call, the new rate now is 7.5¢ for calls 4 minutes or less. For calls 5 minutes or longer customers will experience increases greater than 4.5%. By the same token, some customers will experience rate increases much greater than 14.5% if their calling habits are such that the length of call is longer than 3 minutes.

In summary, the new rate structure recognized two important elements of telephone conversations; the length of call, and the number of calls. The former structure required additional message charges only after an initial message unit allowance (after 90 calls). The major problem with the proposed rate and rate structure is that it violates one of the principles of rate making, that is, rates based on costs. There is no cost support.



## CHAPTER 4

### SOME UNANSWERED QUESTIONS ABOUT MEASURED SERVICE

- I. Questions That Should be Addressed by C&P Telephone Company of Maryland with Respect to Measured Service
  - A. Questions Related to Measured Rates
    1. What specific cost changes occurred that resulted in this change in rates from a flat 8¢ to a rate structure of 6¢ for the first 3 minutes and 1.5¢ each additional minute?
    2. It was indicated within your study that the average call is three minutes long and that under the new rates a four minute call would now be cheaper.
      - (a) Do you believe that this new rate will promote the average call length to increase to 4 minutes?
      - (b) In determining the new rates, were the concepts of load factor or peak-load ever considered?
      - (c) If during the peak period of the day an increase in usage by a large customer group were to arise, would you anticipate this to result in increased costs?
      - (d) Do you feel that these rates which may lead to further congestion during peak periods and lead to increased capacity costs are justified?
      - (e) Do you think that these peak consumers will bear the entire costs?

- (f) Is it possible that many of these capacity costs will be considered joint costs and allocated to exchange services, eventually raising residential rates?
3. If nearly two-thirds of the minutes of use for local business calls are the result of calls lasting more than three minutes, then from a usage sensitive aspect these are costly calls. Why are the rates structured in a declining block rather than an increasing block to reflect the costs of capacity usage?
  4. Were any studies done of the possible impact of a shift in the average length of a call?
  5. How are the costs of the measuring equipment allocated? Are they considered joint costs or are they directly attributable to the business class of service?
- B. Questions on Cost Methodology
1. What allocation factors were used in allocating common and joint costs among rate classes?
  2. What rationale was used in picking these factors over any others?
  3. What criteria were used in judging the resultant cost distribution to be most reflective of service costs?
  4. Were there any cost studies done by C&P Telephone Company of Maryland which were used to develop the new measured service rates? If yes, what kind of cost studies were completed and why were the studies not present in this case?

## CHAPTER 5

### CLOSING REMARKS ON MEASURED SERVICE

During the 1970's the majority of the regulatory community has become increasingly concerned with price regulation as well as profit regulation. The central question posed is how prices for the various services offered by the regulated company should be set to generate the revenues allowed to the company. The criterion that has received the most support is the cost-of-service principle. Under this principle, the price for each service offered to the customer should reflect as closely as possible the cost of providing him with that service. The result has been a general call for rate reform.

While the energy crisis has given great impetus to rate reform for energy utilities, at least two factors are creating a movement for telephone rate reform also. One is that the current principles of telephone ratemaking appear to be very much out of step with the cost-of-service principle that is receiving so much support from many public utility analysts. The support for this principle is based on a variety of concerns including economic efficiency in ratemaking, fairness, and a desire to structure rates so as to slow down the growth in system capacity which, in this period of inflation, is a major cause of rising utility bills. These concerns apply equally as much to telephone ratemaking as to ratemaking for electricity and natural gas.

In general, flat telephone rates are often considered to be based on the value-of-service principle and measured service to be based on a cost-of-service principle. It should be pointed out, however, that measured service rates must be based on costs for this to be true. A flat rate that equals the average monthly cost of serving the average customer may meet the cost-of-service criterion better than measured service which charges a price for a call that has little relation to the cost of the call.

A second factor that encourages telephone rate reform is a series of decisions by the FCC which have promoted competition between regulated and nonregulated companies in two areas of the communication industry. These areas are the terminal equipment market and intercity communications.

The FCC has ruled that telephone companies must allow customers to use terminal equipment purchased from any supplier. Terminal equipment includes key systems, radio phones, automatic answering equipment, computer interface equipment, private branch exchange and any other hardware that can be placed at the end of a telephone line. Suppliers of terminal equipment are not regulated. The situation is entirely analogous to allowing customers to purchase lamps, televisions and other electric devices from any company, not just the electric company. The FCC contends that customers are best served by having a choice; competition promotes quality, technological advances, and lower prices for terminal equipment.

Independent suppliers of terminal equipment argue that telephone company practices prevent fair competition. The cost of a telephone is normally included in the monthly flat rate which the customer must pay

even if he purchases his own equipment in most states. Even when the cost of terminal equipment is unbundled\* by the regulated company, unregulated suppliers claim that the cost quoted is too low. Three reasons explain the low cost. First, the cost quoted is an average cost of all terminal equipment in use, old and new, instead of the cost of the newest equipment. While regulated companies must determine costs on the basis of historic averages, unregulated companies have to set prices based on current costs. Second, the cost quoted by the regulated company contains only that portion of the total cost paid directly by the local exchange. The other portion, recovered by separations settlements on toll calls, is not included. Unregulated suppliers of terminal equipment claim that their products are less competitive because the customer must pay the full cost of the product upon purchase and then must pay an equipment charge on toll calls which flows into the coffers of the regulated company. A third reason, which we discuss further below, is research and development costs. Competitive producers of equipment must include the costs of all R&D in their products. Whereas AT&T products may be priced lower because some R&D expenses are paid by the ratepayer through license contract expenses. This situation has created pressure for telephone companies to unbundle properly the costs of their various services: terminal equipment provision, home and office wiring, terminal equipment repair, local exchange service, toll service, directory assistance, and so on.

Telephone rate reform is encouraged also by competition in a second area of the communications industry, intercity communications. Over the

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\*The term, unbundled, is usually used to mean that the cost of terminal equipment is separated from other telephone costs.

Last twenty years the FCC has refused to bar unregulated companies from providing private microwave communications channels. With the advent of satellite communications, the FCC adopted an "open skies" policy that encouraged competition between AT&T's price regulated private line service and a similar service offered by the unregulated. Additionally, an important Supreme Court action on May 22, 1978 may clear the way for competition in the MTS market. The high court refused to stay a lower court order allowing a private line company to connect local exchanges. Essentially, a customer in one city can use the local exchange to call the private line company (in his own city) which switches the call by "private line" to the company's office in a second city where the local exchange is used to complete the call. The FCC had ruled that such a service would not be allowed because it is a public telephone service, not a private line service; nevertheless, the court has allowed the competition.

The importance of this ruling lies in that the "private line" service is offered at rates much lower than those provided by AT&T. If AT&T is forced to compete for business in the MTS market, local exchange rates may rise significantly.

Measured service is viewed by some telephone industry representatives and by some members of the regulatory community as an appropriate pricing policy in this situation. Some believe that measured service will give consumers more control over their monthly bills and that telephone service can be provided at a minimal price to people who use the phone infrequently but require it for an emergency.

Therefore, several factors are creating incentives for telephone companies to change their billings for local service from a flat rate to a measured service basis. If such a change should occur, it is important that the regulators be in a position to oversee the cost analyses of the companies which are used to justify measured service rates.

A strong case has been made above for usage sensitive pricing and for using marginal costs as a basis for rate-making. Of course, the two sets of principles are related inasmuch as marginal costs pricing leads directly to usage sensitive pricing. This is due to the fact that the cost of each additional telephone message unit varies by time-of-day, duration (or number of units), and distance. However, we should again emphasize the fact that measured service rates must be closely related to costs. C&P Telephone Company of Maryland in the instant proceeding has not developed the relationship of costs to rates, and indeed has not even presented cost data.

CHAPTER 6  
LICENSE CONTRACTS

Before considering the subject of license contracts, let us briefly discuss the structural conditions in which the telephone industry operates. The telephone industry is dominated by holding company giants. There are 14 holding companies in the telephone industry, accounting for about 97% of the total operating revenues in the industry. The four largest holding companies, AT&T, GT&E, United TeleCommunications, and Continental Telephone account for about 95% of the industry operating revenues. The largest holding company is AT&T; based on operating revenues AT&T's share of the industry is about 87%. It is important to note the role of license contracts and how the contracts are effected by the structure of the Bell System.

We should ask ourselves the following questions:

1. Do local operating companies have any say in the license contract arrangement?
2. Do license contracts perpetuate the dominance of AT&T by tying the operating company to AT&T for services?
3. Do license contract insulate AT&T from:
  - A. attempts by regulators to isolate costs and benefits at the operating company level?



B. competing companies because AT&T has, through the use of the license contract, tied the operating company to the parent, and also assured itself of a steady flow of funds to other operating concerns, for example, Bell Labs?

We do not suggest answers to these questions we raise them only to generate interest in the structure of the industry, and the license contracts effects on that structure.

The license contracts are agreements between American Telephone and Telegraph Company (AT&T) and each of the Bell System Operating Companies. Prior to 1902 AT&T leased telephone instruments to the Bell System Operating Companies. In 1902 AT&T modified the leasing system and instituted the first license contract. The license contract required the operating companies to pay a percentage of their gross revenues to AT&T. In return AT&T provided services which can be broadly classified under the following categories: basic research and development; advice and assistance in engineering, finance, traffic, commercial, accounting, legal and plant; and the use of equipment that is covered under an AT&T patent. From 1902 until 1925 the license contract arrangement cost each operating company 4.5% of its gross revenue. In 1925 the cost of providing services under the license contract were \$26.5 million while the revenue from the operating companies were \$30.2 million resulting in a profit of \$3.7 million. This so-called "profit" of \$3.7 million on the license contract raised considerable criticism from both the regulators and the public. Because of this public outcry AT&T in 1926 reduced the fee to 4% which made costs equal to revenues. In 1927 AT&T went even further

by reducing the fee to 2%, however, they also changed the license contract arrangement. Formerly, the license contract included the rental costs for telephone instruments, the license contract fee was reduced to 2% in 1927 by selling telephone instruments to the Bell System Operating Companies. In 1928 the license contract fee was reduced to 1.5%. The fee was again reduced in 1948 from 1.5% to 1%, it would remain at 1% until 1974.

On October 1, 1974, the license contract arrangement changed radically from the direction of changes in the past. Now the amounts billed to the operating companies would no longer be limited to 1% but would be based on each companies share of the actual cost of providing the service. The maximum share of the allocated cost could be as high as 2.5% of total revenues. The practical effect of this change in methods in 1974 was to increase the costs to the operating companies (therefore the ratepayers) with no demonstration of increased benefit to either the operating company or ratepayers. In 1977 approximately 1.7% of total Bell System operating companies' operating revenues were paid to AT&T for service under the license contracts.

In the 1974-1975 period when the license contract arrangement changed, some regulatory commissions found that neither the operating company nor AT&T could justify the costs in terms of increased benefits. Therefore, they decided at the time to keep the level at 1%. (See Kentucky Public Service Commission Case No. 6232 which can be found in 12 PUR 4th at page 428; also see Massachusetts Department of Public Utilities Case DPU 18210 which can be found in 11 PUR 4th at page 307.) We mention these cases not to suggest that Commissions unilaterally disallow anything over 1%.

We suggest that the responsibility and burden of proof rests with AT&T to show specifically (item by item) the benefits received and cost incurred in each state. The Commissions in each state can determine whether each specific cost and benefit is justified.

In order to get an historical perspective on the trends in the license contract fees, Table 2 presents the amounts in the General Services and Licenses Account for the C&P Telephone Company of Maryland.

Table 2\*  
License Contract Expenses in Maryland

Year	(A) General Services and Licenses**	(B) Total Operating Revenue	(C) License Expenses ÷ Revenues (A/B)
1968	2,707,005	289,211,882	.9%
1969	2,952,170	314,973,862	.9%
1970	3,397,245	363,909,588	.9%
1971	3,686,022	391,936,528	.9%
1972	4,246,826	454,710,257	.9%
1973	4,697,313	502,691,217	.9%
1974	5,785,946	544,846,742	1.1%
1975	8,851,875	555,025,688	1.5%
1976	11,150,462	664,077,520	1.7%
1977	12,818,188	728,367,069	1.8%

\*Source: FCC Statistics of Communication Common Carriers 1968-1977

\*\*The Federal Communication Commission defines the General Services and Licenses account to include "amounts payable for services received under a license agreement; a general service contract or other arrangement providing for furnishing of general accounting, engineering, financial, legal, patent, and other general services."

Using Table 2 we can see that the license contract was just about 1% of operating revenues for the year 1968 through 1974. One can also see that once the 1% ceiling was removed in 1974 the costs of the license contract

edged upward. In 1977 the costs are more than twice the costs in 1974 (in fact, the account has increased by over 120%). In terms of percentage of operating revenues the license contract fees have gone from 1% to 1.8% in three short years. A main question is: Have benefits doubled in three short years.

From an economic and regulatory point of view it is not reasonable to incur a cost unless there is a benefit. The basic grounds for questioning the license contract are whether the Maryland ratepayers are receiving a benefit and whether the cost is reasonable. The C&P Telephone Company of Maryland in the instant proceeding has not shown, or even attempted to show whether the expenses associated with license contracts are reasonable and benefit the Maryland ratepayers commensurately.

## CHAPTER 7

### THE ALLOCATION OF LICENSE CONTRACT FEES TO SERVICE CATEGORIES

Cost data relevant to the subject of License contract fees is as difficult to measure from the data provided as were measured rate costs. In general, numbers were provided based on allocation procedures where each class of service received a portion of the contract fee expense. No rationale was provided for the allocation process nor were there any descriptions of the process. Costs were divided in a rather uneven way among service classes with public coin telephone receiving the largest allocation at .93¢ per month, centrex co was allocated the least at .25¢ per month, with business and residential paying roughly equal amounts.\*

No explanation has been given for the procedure or for the allocation factors involved in allocating license contract expenses. More data and descriptive material should be provided on these costs and their allocations. The impact on ratepayers is substantial when considering that research and development is essentially financed through charges to the ratepayer rather than through capital budgeting procedures.

We suggest that your questions be addressed to Richard G. Petzold, Division Staff Manager, Corporate Accounting and Finance, C&P Telephone Company of Maryland, during cross examination. He states (but does not

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\*"Exchange Class of Service Study 1977" p. 20, 22.

support): "C&P pays a reasonable amount for these services based upon its allocated share of the costs incurred to provide the services, as demonstrated by studies showing that the value received from License Contract services far exceed the amount paid for these services as the Commission has consistently found in the past." (See Petzold's testimony--Attachment A, page 1). The key is to determine what a truly "reasonable amount" is and whether in fact benefits exceed value, the assertions have been supported and this line of questioning should be pursued.

The Commission should first ask for a specific itemized breakdown of license contract costs. Each itemized cost should be judged on its own merits, i.e., do the Maryland ratepayers specifically benefit from the cost. If so the next question is whether the cost is reasonable, keep in mind the cost of the license contract has doubled in the last three years (since the change in 1974).

The following questions will help the Commission address specific areas in the license contract. The goal of these questions is to seek information which will match costs with benefits, so as to permit the Commission to independently determine the reasonableness of the costs associated with the license contracts.

## CHAPTER 8

### SOME UNANSWERED QUESTIONS ABOUT LICENSE CONTRACT

#### Questions That Should Be Addressed By C&P Telephone Company of Maryland

##### A. General Cost Questions

Any determination of the just and reasonableness of the license contract must hinge on the costs. The following questions address the overall license contract costs:

1. Since AT&T now allocates the costs to each operating company, the first question is: How does AT&T allocate the total costs of the license contract services to each state?
2. Assuming that other state commissions have decided that they will allow only 1% (or some other figure less than the allocated cost) for the license contract, how does that fact of life enter AT&T's allocation process. Are any other states picking up any of the "1% states" losses? In other words, does any cross-subsidizing go on?
3. Is an allocation of total costs appropriate? Should each state be charged for each specific service with only common costs being allocated?
4. What are the common costs? Why are these costs unallocable?
5. Are the costs associated with the holding company, AT&T, costs that should be the burden of the Maryland ratepayer?

Specifically can AT&T show through comparative analysis that these holding company costs are necessary and would be higher under any alternative arrangement. (Also see Section C-7 specific questions on holding company expenses.)

6. What allocation factors were used to assign License Contract expenses to each class of service?
7. On what grounds was the allocation to services method justified?
8. If License Contract expenses include costs of R&D for individual types of service improvement, can't allocation of these costs be done in some direct way?
9. Are the costs for R&D paid for by residential customers now providing an immediate benefit to residential customers? Could you explain how it directly benefits residential customers?
10. What have been the most recent major developments at Bell Labs in terms of research to help local exchange operations? How soon will new equipment or techniques be installed because of these major developments?

B. Questions Relative To The Competitive Impact of License Contracts

The next set of questions relate to the competitive aspects of the license contract, that is the funding of basic research and development which benefits Western Electric.



1. Let's assume for the moment that there is a group of common costs for basic research and development, that these costs are paid by the ratepayers, and that the basic R&D leads to the general improvement of telephony: Why are the benefits received the sole property of the Bell System? If the basis for the charge is common, shouldn't the benefits also be common, or available to all, not just AT&T? If AT&T is the sole beneficiary, shouldn't AT&T's stockholders pay the costs?
2. In 1977 the Finance Division of the California Public Utilities Commission (See CPUC Application #55492, August 26, 1977) did an evaluation and analysis on the license contracts of AT&T with respect to Bell Labs they found:

"The costs that BTL incurs for what it terms Basic Research and Fundamental Development work, are billed to AT&T and passed on the operating companies as License Contract expenses. A significant portion of this type of work is related to and is in fact vital to the development of items manufactured by Western Electric. These costs are of the type that a typical manufacturer would consider as part of the cost of production, and would recover through the prices its charges for its products. The practice of changing these costs as part of the License Contract results in the underpricing of products manufactured by Western Electric."

The California staff determined that the most appropriate action would be to temporarily allow the \$14 million in the rate base for basic research and fundamental development, however, in the future Bell Labs should charge Western Electric for these costs. The

motive in allowing the \$14 million to remain in rate base is that these charges would have been an additional cost to Western Electric products, therefore paid for by the ratepayer and included in the rate base. The idea of requiring Western Electric to pay the costs in the future recognizes that telecommunications, especially equipment manufacture, has entered a competitive environment. If these costs were charged to Western Electric, then Western Electric would no longer have that competitive edge (underpriced products) and ratepayers would be allowed to receive the benefits of competition. Answers to the following questions will help the Commission understand the costs of R&D and make a determination.

- a. What are the costs allocated to C&P Telephone Company of Maryland for basic research and fundamental development?
- b. What are the areas of basic research and fundamental development that are included in the above costs?
- c. What specific benefits do the ratepayers receive from basic research and fundamental development? Does Western Electric also benefit from these developments? In what way and to what extent?

Answers to the above questions should give the Commission an idea of how much of the ratepayers' dollar is used to support basic research and development. In addition the telephone company must be "probed" to determine whether basic research and fundamental development in any way benefits Western Electric. Additionally there is a question of which ratepayers benefit; the "present" or "future" ratepayers. Most R&D

benefits future ratepayers. However, the current method of payment requires the present ratepayer, through license contract fees, to pay for future uncertain and unseen benefits.

C. Questions Which Address Specific Expenses Included in License Contract Expenses

The following are questions which relate to expenses included in the license contract, once the answer is obtained from the telephone company the Commission can make a decision to allow or disallow the expense.

1. How much of the expense for Washington, D.C., lobbying activities are included in the license contract services? Exactly what are each of the expenses related to (give specific goal or case)? (\$43,000 has been offset already, see Richard G. Petzold's Testimony, Attachment A, p.2.)
2. Does C&P Telephone Company detail personnel to AT&T to do work related to the license contract or license contract services? If yes, give the specific cost associated with such work. These personnel costs increase the effective cost of the license contract.
3. Why does AT&T maintain the records of securities (for example stock certificates) for C&P Telephone Company of Maryland? What are the costs that are included in the license contract? The Commission may want to call in an outside securities specialist to determine whether C&P could do the job cheaper than AT&T. In other words, there are probably no economies of scale associated with this task.

4. When AT&T increases its holdings in another company (for example, Cincinnati Bell) does AT&T include the cost of the commission's paid for stock in the license contract expenses? (Expect "yes" answer). How much?
5. What are the costs to the company of litigation brought against AT&T on a case by case basis? These costs are included in license contracts. They benefit AT&T stockholders, they may or may not benefit C&P or its ratepayers.
6. These questions relate to charitable contributions.
  - a. Who decides which charities receive donations?
  - b. What is the cost of investigating organizations which may be considered for donations? Are these costs included in License Contract? (Expect "yes" answer).
  - c. What benefits do the Maryland ratepayers receive for these contributions?
  - d. How much are these contributions? (Note: some adjustments to offset charitable contributions (\$19,000) have already been made, see Testimony of Richard G. Petzold Attachment A page 2a.)
7. The following items specifically benefit the holding company and the costs probably should be the burden of the holding company. The question is whether any of these items and the associated cost are included in the license contract fee. (Expect "yes," if "no," probe.) Are any of the following expenses included in the license contract fee?

- a. Expenses directly related to the stockholders of holding company
  1. Annual meetings
  2. Annual reports
  3. Communciation between holding company and stockholder (eg. proxies)
  4. Cost of payment of dividends, bond interest and maintenance of securities.
  
- b. Expenses directly related to the operation of holding company.
  1. Directors fees
  2. Auditors fees
  3. Corporate advertising
  4. Antitrust defense expense (Current Dept. of Justice antitrust action against AT&T)

## CHAPTER 9

### CLOSING REMARKS ON LICENSE CONTRACTS

In concluding our remarks and questions we feel that it is very important to address the major underlying question--Are the license contracts in their present form serving the Maryland ratepayers? There are two areas which have to be addressed before the Commission can determine whether Maryland ratepayers benefit from license contracts. These areas are cost responsibility and competition.

Clearly there has been a trend in most regulatory bodies to move their respective regulated companies toward cost-of-service prices. If this trend is to continue in telecommunications all costs must be identified and justified. The lumping of costs into a pool and then allocating these costs to each company (the procedure used in License Contract fees) contradicts the principle of cost responsibility. Cost responsibility would guarantee to the Commission, ratepayer and the operating company that these costs are necessary and minimal. Since these costs are simply allocated to each operating company, the regulators, the ratepayers and the company must trust the holding company with respect to the magnitude and necessity of such costs. The current business environment for all telephone companies has already shifted from regulated monopoly towards "competition," which brings us to the next area.

As we have previously mentioned, competition is no longer an unknown idea in the telephone business. Competitive services are being offered in most areas of the telecommunications business. Telephone companies are now subject to competition in terminal equipment, private line service and message toll service. Only local distribution has not yet traveled the competitive road. However, in time all areas may be subject to competitive pressures including local distribution, as new technology develops.

How does competition impact the license contracts? We have already discussed the competitive edge that AT&T has in equipment because of Bell Labs basic research and fundamental development capability, which is paid for by the general ratepayer through the license contract.\* We have not discussed the role of the state commissions. As competition increases one of the last areas to feel the effects will be local distribution. If Federal authorities are given control over all toll service, the state's role in the industry will become even more demanding. The "access charge" concept, that concept where outside services are charged a fee for access to that exchange--will require state regulators to become increasingly involved in cost-of-service issues. The determination of benefits received versus cost of the license contract will become increasingly difficult, if not impossible. One alternative is to have the holding company bill the operating company for exactly the cost-of-service. The costs would be itemized and quantified for every rate case and in the company's financial annual report. The regulators could then better determine whether the cost was reasonable. The information necessary to determine the justness and reasonableness of the License Contract fees has not yet been presented by the telephone company in this case.

\*As a side note, the Federal Communication Commission in their Docket #19129 (1977) addressed the issue of license contracts to a limited extent. Currently the F.C.C. is in the process of developing a "Notice of Inquiry" which will address the issue in depth. We would like to suggest that NRRI prepare a group response to that notice, and that the Maryland Public Service Commission be a part of that group.

## ATTACHMENT A

### Maryland Contract

In the matter of case number 7305, The National Regulatory Research Institute (NRRI) will provide technical consultant services in the following areas to the extent stated below and for the specific time period stated below.

### Task One

- A. In the area of the measured use rate structure presented by the C&P Telephone Co. of Maryland, NRRI will provide the following:
1. A general description and analysis on the cost data used to support the proposed rate.
  2. A general discussion of the economic implications of usage sensitive pricing, with specific reference to the proposed rate structure.
  3. Questions for use by the Public Service Commission of Maryland during their investigation.
- B. The second area of analysis will be the license contract arrangement between AT&T and C&P Telephone Company of Maryland. The extent of the analysis will be limited to a brief description of the license contract, identification of productive lines of inquiry, and the development of questions which can be raised by the Commission along those lines. These questions will seek information regarding the following:
1. The need for license contracts
  2. The specific use of the license contracts
  3. The specific cost incurred, the reason for the costs, and the party who benefits from such costs.

Task One will be completed by June 25, 1979 and five copies of the document will be mailed on June 25, 1979.



### Task Two

Task Two will consist of technical consulting services of an unspecified nature that may develop over the course of the investigation by the Public Service Commission of Maryland. NRRI support under Task Two will be limited to one man month of services. The provision of this service by NRRI will be either in the form of telephone communications or short written analyses of the subject area or question. NRRI will bill only for actual time spent on Task Two. Task Two will start on June 25, and continue until the allocated labor hours are exhausted.

### Task Three

Task Three will commit NRRI to support our written response in Task One through testimony if the need should arise. The testimony will be strictly limited to the material presented. Since the testimony could be from any or all staff members working on the contract, the costs associated with Task Three will assume that all staff members testify. Included in the costs of Task Three will be the use of an NRRI attorney for the preparation of testimony and for NRRI staff counsel during the testimony. Task Three will not commence until NRRI is notified by the Commission. At that time the Commission will specify the areas in Task One that require testimony.