Service Date: August 23, 1985

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * * *

IN THE MATTER Of The Application of the MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY (Mountain Bell) for Authority to Change Rates and for Approval of Tariff Changes Due to Divestiture.	)	UTILITY DIVISION DOCKET NO., 83.11.81
IN THE MATTER of the Application of the MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY (Mountain Bell) for Authority to Increase Rates and for Approval of Tariff Changes for Telecommunications Service.	)	UTILITY DIVISION DOCKET NO. 84.4.19 ORDER NO. 5046f

TABLE OF CONTENTS

Service Date:

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * * *

IN THE MATTER Of The Application of the MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY (Mountain Bell) for Authority to Change Rates and for Approval of Tariff Changes Due to Divestiture.	)	UTILITY DIVISION DOCKET NO., 83.11.81
IN THE MATTER of the Application of the MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY (Mountain Bell) for Authority to Increase Rates and for Approval of Tariff Changes for Telecommunications Service.	)	UTILITY DIVISION DOCKET NO. 84.4.19 ORDER NO. 5046f

* * * * * *

REVENUE REQUIREMENTS
AND RATE DESIGN

* * * * * *

APPEARANCES

REPRESENTING MOUNTAIN BELL:

Lawrence D. Huss and Dennis R. Lopach
Mountain Bell Legal Department
560 North Park
Helena, Montana 59601

REPRESENTING AT&T COMMUNICATIONS:

Gary B. Witt
AT&T Communications, Room 1537
1872 Lawrence
Denver, Colorado 80202

Donald A. Garrity
Garrity, Keegan & Brown
1313 - 11th Avenue
Helena, Montana 59601

REPRESENTING THE DEPARTMENT OF DEFENSE:

LeRoy L. DeNooyer
Regulatory Law Office
U.S. Army Legal Service Agency
5611 Columbia Pike
Falls Church, Virginia 22041-5013

REPRESENTING THE MONTANA CONSUMER COUNSEL:

James C. Paine and John C. Allen
Montana Consumer Counsel
34 West Sixth Avenue
Helena, Montana 59620

REPRESENTING THE RURAL MONTANA TELEPHONE SYSTEMS:

Calvin K. Simshaw
Legal and Industry Affairs
P.O. Box 2166
Great Falls, Montana 59403

REPRESENTING THE COMMISSION:

Robert A. Nelson and Calvin K. Simshaw
Montana Public Service Commission
2701 Prospect Avenue
Helena, Montana 59620

BEFORE:

CLYDE JARVIS, Chairman
JOHN B. DRISCOLL, Commissioner
HOWARD L. ELLIS, Commissioner
TOM MONAHAN, Commissioner
DANNY OBERG, Commissioner

FINDINGS OF FACT

General

1. On April 26, 1984 Mountain Bell filed an application for authority to increase rates to generate an additional $28,004,000 annually.

2. On October 18, 1984 Mountain Bell filed a Revised Motion to Amend the Procedural Order in this Docket.

3. On November 2, 1984 the Commission issued an Amended Procedural Order. The original Procedural Order would have resulted in all the testimony presented to the Commission in this docket utilizing budgeted data as opposed to actual historical data. The amended procedure bifurcated the hearings in this docket such that historical data would be used to determine revenue requirements in this case. The Amended Procedural Order set hearings on rate design and rate of return to begin on December 4, 1984. Hearings on the remaining issues in this docket began on June 25, 1985.

4. On January 31, 1985 the Commission issued Order No. 5046d is this docket. That order addressed all rate of return issues in this case and authorized Mountain Bell an overall rate of return of 11.64%.

5. On January 31, 1985 the Commission also issued Order No. 5046a which granted Mountain Bell an interim revenue increase of $10,495,000. This revenue requirement was calculated using ten months of actual 1984 operating results.

6. On March 25, 1985 Mountain Bell filed testimony on revenue requirements using a historical 1984 test year. In that testimony the Company requested a permanent revenue increase of $24,071,000.

7. On June 13, 1985 Mountain Bell filed its rebuttal testimony revising the requested revenue requirement to $25,490,000. This amount was further revised in the June 25, 1985 hearing to $25,167,000.

8. The following parties intervened in this Docket:

Montana Consumer Counsel
Department of Defense
AT&T Communications
Montana People's Action
Rural Montana Telephone Systems

REVENUE REQUIREMENTS

9. Brian Johnson testified on behalf of Mountain Bell on revenue requirement issues. Therese Saracino also testified on behalf of Mountain Bell in the areas of Bell Communications Research, Inc. (BCR) and Bell Tri-Co. matters. Nancy Bright testified on behalf of the Montana Consumer Counsel on revenue requirement issues. Allen Buckalew presented testimony on behalf of the Montana Consumer Counsel in the areas of CPE Phase-out, BCR and Tri-Co. issues and affiliated interest issues.

Uncontested Issues

10.Several of the adjustments presented in this case were uncontested by any party. These were adjustments for:

a. Advances in aid of construction,
b. Customer deposits and the associated interest expense,
c. Unrecovered capital,
d. General Telephone related true-up.

The Commission finds that all of the above adjustments are reasonable.

11. In Docket 79-105 the FCC ordered all telephone companies to begin expensing the costs of station connections (inside wire). The FCC ordered a 10 year amortization of the embedded balance of previously capitalized inside wire costs.
The FCC has now indicated that it would save the 10 year amortization period in favor of a shorter period if the State Commission regulating a telephone company agreed to the shorter period. In this case Mountain Bell requested a three year amortization of embedded inside wire costs to become effective on September 1, 1985. Montana Consumer Counsel did not object to this treatment for inside wire. The Commission grants Mountain Bell's request to amortize inside wire over a three year period.

12. Brian Johnson, in this rebuttal testimony, revised

the revenue request of Mountain Bell to reflect true-ups for the Percent Interstate Usage Factor and the Standard Network Facilities Agreement. The Montana Consumer Counsel did not object to the treatment of these true-ups but requested assurance that the same amounts used in this Docket be reflected in AT&T Communications' general rate case Docket No. 83.11.80. On August 16, 1985 a stipulation was filed between Mountain Bell, Montana Consumer Counsel, and AT&T that set forth the amounts that all parties agree should be reflected in these two cases. The Commission finds that the amounts contained in the stipulation are reasonable. The true-up for the Percent Interstate Usage Factor increases Mountain Bell's revenue requirement by $569,000 and the true-up for the 1984 Standard Network Facilities Agreement increases revenue requirements by $840,000.

Equal Access Costs

13. Ms. Bright proposed an adjustment to test year expenses to eliminate equal access costs. Ms. Bright explains:

> Mountain Bell incurs Equal Access expenses in order to provide access to the local network for non-AT&T interLATA carriers equal to that of AT&T. Clearly, such expenses are related to interLATA services and should be recovered from interLATA carriers through carrier access charges. However the access charge revenues included in the test year resulted from tariffs designed to mirror FCC access charges together with a bulk bill to compensate for the profits lost by Mountain Bell because of the divestiture of intrastate interLATA service. Access charges were not set to recover Equal Access costs. Thus, inclusion of Equal Access expenses in the test year will result in a rate increase to intraLATA ratepayers to recover interLATA costs. (MCC 5(85))

14. During cross examination by Mr. Nelson Ms. Bright clarified her position regarding equal access costs.

> Q. Miss Bright, regarding equal access costs, is it your position that those costs should be

recovered by Mountain Bell?

A. Yes, but not from the local service ratepayers.

Q. From the interLATA carriers?

A. Yes. (Tr. pp. 273-274)

Mr. Johnston stated that he agreed to principle with the equal access adjustment, i.e. that as long as Mountain Bell is allowed to recover equal access costs it is appropriate to assign them to interLATA carriers. (MB 7(85))

15. Ms. Bright is correct in her assertion that carrier access charges currently mirror the interstate carrier access charges. However, this rate design was created due to the difficulties involved for local exchange companies if they were required to bill carriers off two different sets of tariffs and due to the fact that no Montana cost data was available during 1984 to justify any other level of access charges. No determination has yet been made as to the appropriate level of access charges. Therefore, it is currently unknown whether access charges are over priced or under priced. Docket No. 84.4.15 was created for the express purposes of reviewing the current level of carrier access charges. Therefore, since all parties agree that Mountain Bell should be allowed to recover equal access costs, the Commission finds that it would be unreasonable to exclude these costs from the allowable costs that rates will be set on in this case. The Commission agrees with Mr. Bright that equal access costs should be recovered from interLATA carriers. Since these costs related specifically to upgrading the network to allow equal access these costs probably should be recovered through Feature Group D access rates. The Commission directs Mountain Bell to include these costs in its calculation of Feature Group D access rates when it files these rates in Docket No. 84.4.15.

Abandoned Projects

16. Mountain Bell proposed to reclassify certain below-the-line costs as operating expenses. These costs related primarily to abandoned projects. The Uniform System of Accounts prescribed by the FCC classifies abandoned project costs as "below-the-line" or nonoperating costs and therefore does not allow these costs to be considered in revenue requirement calculations. The Commission disallowed these costs in Mountain Bell's last general rate case (see Order No. 4991b in Docket No. 83.3.18). Ms. Bright advocates continuing to exclude these costs from revenue requirement calculations. Ms. Bright explained that "Abandoned project costs to not benefit ratepayers and should not be reclassified as operating expenses absent a persuasive rationale for doing so, which the Company has not provided."

17. The Commission finds that it would be unreasonable to have ratepayers bear the costs of abandoned projects. These costs do not benefit current or future ratepayers. They represent expenditures for plant that is not used to provide service to ratepayers. Ratepayers should not be asked to pay for projects that will never be used to serve even the general body of customers.

Interest Synchronization

18. Ms. Bright proposed an adjustment to income tax expense to reflect a tax deduction for interest related to accumulated Job Development Investment Credits (JDIC). Ms. Bright explained:

> Mountain Bell's tax calculation reduced deductible interest by the amount of interest related to JDIC. If ratepayers are required to pay hypothetical capital costs associated with rate base actually financed by cost free capital in the form of accumulated JDIC, it is also appropriate to include the interest component of that hypothetical capital cost as a tax deduction for ratemaking purposes. My treatment of interest related to JDIC is the same as that adopted by the Commission in a past Mountain

Bell order that was recently affirmed on appeal. (MCC 5(85) p. 27)

19. Mr. Johnson, in his rebuttal testimony, opposed this adjustment noting that the interest calculated by Ms. Bright does not reflect interest actually paid by the company and that the adjustment is contrary to the IRS code and could jeopardize the Company's ability to take advantage of the JDIC. (MB 7(85) pp. 3-7) However, during the hearing Mr. Johnson notified the Commission and all parties that the IRS recently issued a proposed rule which would end the continuing controversy over whether or not this adjustment endangers the ability of the Company to take investment tax credits. The proposed rule states that a pro forma interest adjustment is not contrary to its regulations.

20. The Commission has continuously held that this type of interest adjustment is necessary to balance the interests of ratepayers and shareholders. The shareholders earn the overall allowed rate of return on the investment financed by cost free investment tax credit funds and the ratepayers receive an interest deduction as if the entire rate base were financed by debt and equity (i.e, as if no JDIC funds were available). As Ms. Bright pointed out this adjustment has been upheld at the district court level Mountain States Tel. and Tel. vs. the Dept. of Public Ser. Reg., et al, Cause No. 48964 (1st Judicial District, Feb. 10, 1985). The Commission once again finds this adjustment reasonable. The Commission has recalculated this adjustment to reflect the rate base found to be reasonable in this case. As recalculated this adjustment decreases operating taxes by $350,000.

Settlements

20. Independent telephone companies currently recover costs assigned to intrastate toll traffic through an intrastate toll pool. This pool is administered by Mountain Bell. All

revenues for independent company billed toll traffic are put into this toll pool. Mountain Bell then pays the independents from the pool an amount equal to their expenses and taxes allocated to intrastate toll plus a percentage return on their intrastate toll plant equal to the overall intrastate rate of return achieved by Mountain Bell. In past rate cases, when Mountain Bell has been granted an increase, this Commission has given Mountain Bell an additional amount to cover the increase in settlement payments that the Company will pay because the increase granted will raise Mountain Bell's achieved rate of return above what it would have been absent the increase and therefore Mountain Bell will have to pay additional amounts to the independents based on that higher achieved rate of return. In this case Montana Consumer Counsel's witness Mr. Buckalew recommends that no increase in revenues be granted to Mountain Bell to cover the calculated increase in settlements. Mr. Buckalew's rationale for this disallowance is that:

> ... as it stands now independent company expense increases are passed through to MB rates automatically without specific justification, that is, no data has been provided by any independent in this case. MB ratepayers should not be required to subsidize the other telephone companies within the state without specific Commission approval of the expense increases. ...The independents should be required to justify any expense increase before this Commission. (MCC 2(85) p. 35)

21. Mountain Bell rebuts Montana Consumer Counsel's proposal by pointing out that the $2,277,000 included in the revenue requirement for this case reflects the existing settlements contracts. Mr. Johnson also states that Mountain Bell is in the process of renegotiating all Montana independent company settlement contracts in an effort to reduce costs borne by Mountain Bell Montana ratepayers. (MB 7(85) p.24)

22. The Commission finds that Mr. Buckalew's proposal would be unworkable. This Commission does not exercise

jurisdiction over cooperative telephone companies and so has no authority to rule directly on the reasonableness of cooperative cost increases. Furthermore, in Order No. 5018a in Docket No. 83.6.47 the Commission directed telephone companies to continue the toll settlements pooling mechanism in effect until the Commission further investigated the area.

23. The settlements contained in Mr. Johnson's testimony reflect settlements on a "business-as-usual" basis. As Mr. Johnson points out, settlements contracts are currently being renegotiated and the end result may very well be a substantial deviation from the "business-as-usual" approach. If Mountain Bell negotiates contracts which substantially reduce the current level of payments to independents it would be very unfair to require the Mountain Bell Montana ratepayers to pay for settlement amounts that will not in fact be paid to independents. Mountain Bell would reap a large windfall if this were allowed. The Rural Montana Telephone Systems, a group of small independent telephone companies, is a party to this proceeding. This group did not sponsor testimony in objection to this disallowance of settlements, even though they realize that this would have the effect of pushing Mountain Bell to negotiate a settlements contract that contains a rate of return no higher than that achieved by Mountain Bell in 1984.

24. The Commission finds that to allow any increase to Mountain Bell for settlements at this time would be unreasonable. The Commission is currently conducting an investigation into carrier access charges in Docket No. 84.4.15. This proceeding will also examine the settlements issue. If the outcome of that proceeding is to find that a substantially different level of settlements than that reflected in this order is reasonable, some further adjustment to Mountain Bell's revenue level may be needed at that time.

AT&T Refunds

25. AT&T was ordered by the FCC to refund certain amounts which related to preoperational expenses for CPE, Enhanced Services, and AMPS that had originally been paid by the Bell Operating Companies, primarily through license contracts, back to the BOC's. Ms. Bright made an adjustment in this case to flow through to ratepayers the 1982, 1983, and 1984 refunds. Part of these refunds (the 1982 and 1983 amounts) were examined in Docket No. 83.3.18, Mountain Bell's last general rate case. The Commission flowed the non-license contract portion of the refunds through to ratepayers at the time (Order No. 4991b). The remaining amount, the 1984 refund, relates to amounts paid through license contract payments in years that this Commission disallowed some or all of the license contract payments. (Ms. Saracino calculated that $24,000 of the refund received in 1984 was paid in 1980 when license contract payments were not disallowed.) Ms. Bright does not contest the factual situation surrounding the AT&T refunds. Instead Ms. Bright makes the case that there will be a windfall to USWest if these amounts are not flowed through to ratepayers:

> The fact that the Commission disallowed the recovery of certain License Contract costs in previous cases does not mean that the FCC-ordered refunds should accrue as a windfall to Mountain Bell stockholders... I would, of course, acknowledge that to some extent MB's jurisdictional ratepayers will thereby receive a windfall benefit -- because the commission originally shielded ratepayers from certain License contract cost burdens and, now, under by proposal, ratepayers would derive a revenue offset benefit for the refund...AT&T, Mountain Bell's former owner, was forced to bear the burden of the disallowance. AT&T is no longer the owner of Mountain Bell; USWest is. Moreover, USWest and AT&T are not even affiliated. (MCC 5(85) p. 15-17)

26. Ms. Saracino points out in her rebuttal testimony that "Since the shareholders of USWest are essentially the same body of shareholders that owned AT&T stock before divestiture, it is appropriate for them to receive the benefit of the refunds

since the impact of the previous License Contract disallowance was on the shareholders and not the ratepayers." Ms. Saracino is correct. In the divestiture process shareholders of AT&T received one share of stock in each of the seven regional holding companies for every ten shares of AT&T stock that they held. This meant that for at least part of 1984 the two groups of shareholders (the AT&T shareholders and the USWest shareholders) were almost identical. Therefore, to flow the benefits of the AT&T refunds to ratepayers would mean that the ultimate owners of Mountain Bell, the stockholders, would not receive the refund that they are entitled to since it was they, and not the ratepayers that paid the License Contract amounts originally.

Advertising

27. Ms. Bright proposed an adjustment to test year advertising expenses of $528,000. Montana statutes do not allow advertising costs to be considered in setting public utility rates unless the advertising "encourages the conservation of energy or product safety or informs the public of the availability of alternative forms of energy or recommends usage at time of lower rates or lower demand. Furthermore, for communications public utilities, the provisions for this section shall not apply to advertising which relates to special equipment that is available to aid the handicapped or to special services that are designed to protect the public health, welfare, and safety or promote more efficient use of a communications system." MCA Sec. 69-3-307. Ms. Bright analyzed the 1984 advertising campaigns and proposed disallowance of advertisements which relate to either divestiture or sales.

28. It is true that some of the divestiture related advertisement that the company included in allowable costs are informational in nature and perhaps contributed somewhat to more efficient use of the communications system. However, the Commission received many complaints from customers about the

advertising campaigns that were launched at divestiture. It was clear that Mountain Bell's customers viewed these ads as primarily public relations in nature. Divestiture advertising is also a nonrecurring cost. The Commission agrees with Ms. Bright that divestiture advertising should not be paid by ratepayers.

29. The Commission also agrees with Ms. Bright's assessment of the advertisements that she excluded as promotional in nature. The Company's argument that ads which promote Centron and custom calling services "promote more efficient use of the communications system" or that subscribing to these services will lower the customers bills is rather hard to buy. Ms. Bright did exclude one advertisement for a Special Hour Discount rate for long distance. This advertisement clearly promotes usage at a lower rate and the Commission finds that this ad should be allowed. The intrastate cost of this ad was $9,000. At times Mountain Bell does advertising that informs customers of discount periods and also is PR in nature or sells other services. The Commission views ads that inform customers of discount periods as recommending usage at times of lower rates. In the future Mountain Bell should either refrain from mixing these types of advertising or recommend some allocation of the cost of these ads.

30. Ms. Bright also recommended disallowance of equal access advertising. Pursuant to the Modified Final Judgement Mountain Bell must work towards allowing all interexchange carriers (AT&T, MCI, Sprint, etc.) "equal" access to the local network. Carriers have equal access when a customer can subscribe to its service and have interLATA calls go over that carriers network when they pick up the phone and dial 1+ any number in another LATA. It is important that customers understand the options they have when their exchange cuts over to equal access capability. It is especially important now that Mountain Bell will allocate customers who do not subscribe to a specific carrier to any one of the carriers in the area (prior to this time customers who did not subscribe to a carrier remained

with AT&T). Mountain Bell should have a responsibility to make sure its customers understand what is happening so that the customers can make a choice. The Commission finds that the cost of these ads should be considered allowable costs that are recovered in the same way as other equal access costs. In 1984 the intrastate portion of these costs was $32,000. Since this is the first year in which customers who do not subscribe to a carrier will be allocated to a carrier the Commission directs Mountain Bell to submit the material it plans to send out to its customers for review. The Commission wishes to be assured that Mountain Bell adequately explains the new procedures to its customers. Reviewing these materials will also assist the Commission in answering ratepayer questions.

31. Ms. Bright proposed disallowing $528,000 of advertising costs. After adjusting this amount for the two items discussed above the Commission find a disallowance of $487,000 is appropriate.

Antitrust Costs

32. Mountain Bell's test year contains $582,000 of expenses for antitrust settlements and $136,000 of antitrust litigation expenses. Ms. Bright proposed total disallowance of both of these costs. Ms. Bright explained:

> Prior to divestiture, the Bell system was the defendant in numerous lawsuits brought by private plaintiffs and by the United States government. The suits alleged massive violations of the antitrust laws. The Bell System eventually agreed to settlements in a number of these cases, including payments of over $300 million to the private plaintiffs. Because these lawsuits were settled, it is impossible to determine what judgements may ultimately have been entered against the Bell System had the law suits been litigated to their conclusion. It is beyond dispute that costs incurred as the result of illegal acts should not be imputed as a cost of utility service and

> recovered from ratepayers. Also, where settlements are paid for the apparent motive of avoiding an ultimate adverse judgement, the settlement should not be recoverable from ratepayers any more than the judgement itself would be recoverable. If these settlements were deemed recoverable utility expenses, utilities would have little incentive to refrain from such illegal acts whenever they appeared to be privately advantageous, with the knowledge that stockholders could ultimately pass the entire cost of subsequent settlements on to ratepayers. (MCC 5(85) pp. 20-21)

33. Mr. Johnson rebutted Ms. Bright's testimony:

> I disagree with both her method of handling these expenses and her presumption of guilt on the part of the former Bell System. Ms. Bright, in her attempt to artificially lower the revenue requirement for Mountain Bell, makes an erroneous assumption that all litigation and settlement expenses are the result of "...apparent violations of antitrust statutes." It is my understanding that there is absolutely no presumption of guilt when a settlement is reached. (MB 7(85) p. 22)

Mr. Johnson goes on to note that companies may settle antitrust actions if it appears the cost of defense may be very high or if the Company perceives a risk of being found guilty even if it is innocent (the big bad company syndrome) or if outstanding actions are affecting the capital markets by creating uncertainty.

34. The Commission realizes that an ongoing policy needs to be established regarding antitrust costs. There are three possible outcomes of an antitrust suit:

a. A court of law finds the Company innocent - In cases where the Company successfully defends itself all costs of litigating the case will be allowed. Anyone can file a harassment suit. The Company should not be penalized for being sued.

b. A court of law finds the Company guilty - In cases where the Company is actually judged to be guilty costs of litigation as well as damages will be disallowed. Ms. Bright is correct. It is beyond dispute that costs of illegal acts of management should not be recovered from ratepayers through the rates for a monopoly service.

c. The case is settled out of court and guilt or innocence is not determined - This appears to be the only gray area. Mr. Johnson is correct in his assertion that Mountain Bell should not be assumed to be guilty if it settles an antitrust case. However, to require the Commission to look at each settlement and determine whether or not the costs relating to the settlements should be allowed would require the Commission to have access to all of the information and considerations that went into the decision to settle and may require some judgement on the part of the Commission as to the guilt or innocence of the Company. Obviously this Commission should not be put in the position of an antitrust case jury. Antitrust actions are totally outside the jurisdiction or expertise of this Commission. It seems that the only possible action for the Commission is to either allow all settlement costs or no settlement costs. If the Commission were to allow all settlement costs to be flowed through to ratepayers in rates there would be obvious incentives for companies to settle at any cost. There would also not be very strong incentives to refrain from illegal acts. Therefore, the Commission finds that the only reasonable solution is to disallow all settlement costs.

CPE Phase-out

35. The FCC ordered that all new customer premises equipment (CPE) would be offered on a deregulated basis starting on January 1, 1983. Starting on that same date the embedded CPE investment and expenses were to be phased out of the separations process. The FCC adopted the Joint Board's recommendation that separations of CPE costs to the interstate jurisdiction would be phased out over a 60 month period. The amounts in the CPE plant accounts as of December 31, 1982, and the average amounts in the related expense accounts for the year 1982 would be "frozen" and constitute a "base amount" for the phase out. The phase out continues even though all of the embedded CPE was transferred to AT&T on January 1, 1984. This has the effect of continuing a subsidy from interstate services to intrastate services. The subsidy will end at the end of 1987. Mountain Bell estimated this subsidy at $4.5 million for 1984. Mr. Buckalew proposed an adjustment to increase the subsidy to $7.9 million. Mr. Buckalew explained that he did not agree with the 1982 "base amount" used by the Company to compute the CPE phase out amount:

> ...an estimate of the costs that existed in 1982 are reflected in the 1982 Embedded Direct Analysis (EDA). The EDA presents the direct costs for CPE operation...I have taken the 1982 total costs and applied the separation factors to determine the "base amount" that was frozen. (MCC 2(85) p. 30)

36. The EDA is not an FCC recognized accounting system. The EDA is an analysis Mountain Bell performs to reach conclusions about the profitability of its various lines of business. The EDA has often been used to justify rate design proposals to regulatory bodies. Mr. Johnson, in his rebuttal testimony, provides Appendix B of the FCC Order in Docket 80-286. That appendix is the FCC ordered changes to the Separations Manual. The appendix sets forth the accounts for which separations changes were authorized. (Changes in the Separations Manual are dictated by the Joint Board which is

composed of three FCC Commissioners and four state Commissioners.) Mr. Johnson also provided a letter from the FCC to the United States Telephone Association which specifically lists all investment, expense, tax and reserve accounts that are to be included in the "base amount". Mountain Bell is required to follow the Separations Manual in determining what types of costs and the amount of costs that are assigned to the interstate jurisdiction. It is clear that Mountain Bell followed the separations procedures required by the FCC. Therefore, it is unreasonable to impute a subsidy from the interstate jurisdiction which will not occur and over which Mountain Bell has no control.

<u>8% vs. 10% ITC Election</u>

37. In 1982 Congress passed the Tax Equity and Fiscal Responsibility Act (TEFRA). TEFRA required that for property placed after December 31, 1982 a taxpayer can claim either a 10% investment tax credit (ITC) or and 8% ITC (6% or 4% for 3-year property). However, if the higher ITC rate is elected the tax basis of the property must be reduced by 50% of the credit claimed. The election to use the 10% ITC rate or the 8% ITC rate is an asset by asset election. TEFRA also limited the amount of credit that can be used to offset tax liability to 85% of the tax liability. In all cases Mountain Bell has chosen to take the 10% and 6% ITC rate with the reduction to the tax basis of the asset.

38. Ms. Bright proposed an adjustment to reflect the revenue requirement that would be needed if the 8% and 4% ITC rates had been elected. Ms. Bright testified:

> The effect of choosing the higher credit with a tax basis reduction instead of the lower credit is to decrease deferred income taxes and to increase accumulated deferred investment tax credits (ADITC). The reduction in accumulated deferred income taxes and increase in ADITC raises the ratepayer revenue requirement because deferred taxes reduce the rate base while the ratepayer must pay the overall cost of capital rate on ADITC. Although the effect on gross revenue requirements of choosing the higher

> credit may vary with the type of property, the rule usually is the longer the book and tax life of the plant, the more advantageous for ratepayers it becomes for the Company to choose *the lower credit with no basis reduction...The* Company provided an analysis which compares the revenue requirement using 8 percent versus 10 percent credits with respect to four different types of telephone plant. In each case, the study shows the revenue requirement over the life of the plant is higher, both on a cumulative and a present value basis, using the 10 percent ITC compared to the 8 percent ITC. (MCC 5(85) pp. 29-30)

39. Mr. Johnson explained why Mountain Bell chose the 10% ITC option. Mr. Johnson explained that the higher ITC increases the Company's cash flow and that cash flow is important to utilities that are very capital intensive. Mr. Johnson stated that Mountain Bell has properly weighed the advantages of cash flow and revenue requirements and determined the proper course of action. (MB 7(85) pp. 17-18) Mountain Bell also sponsored the late filed exhibit MB 11(85) which is a Congressional Conference Committee report concerning this issue. The report states the reason an election was included in TEFRA: "the election is intended to deal with the case in which a taxpayer cannot claim all the regular investment credits he earns because of the 85-percent-of-tax-liability limitation."

40. The Commission understands that Mountain Bell prefers higher cash flow to lower revenue requirement. However, the Commission is not interested in increasing Mountain Bell's cash flow at the ratepayers expense. Mountain Bell may be correct as to the reason taxpayers are allowed to make an election as to their ITC rate. However, Congress did not choose to require taxpayers to choose the lower credit <u>only if</u> they reached the 85%-of-tax-liability limit. Taxpayers can chose the 10% or 8% ITC rate on a asset by asset basis for any reason. If Mountain Bell chooses to take 10% ITC option then costs allowed for ratemaking will vary somewhat from costs on the books. There is

nothing unique in this situation. Many items are treated differently for book purposes and ratemaking purposes. If Mountain Bell does not want to track the difference in the two options then Mountain Bell should choose the option that results in the lowest revenue requirement. The Commission will expect Mountain Bell to file a calculation of using the 8% ITC rate in all future rate cases. (Montana Public Service Commission Docket Nos. 81.11.81 & 84.4.19, Order No. 5046f, dated August 23,1985

#2

BCR Expenses

41. The seven Bell regional Holding Companies formed a partnership that owns Bell Communications Research (BCR). BCR works on projects for the operating companies and bills each operating company for the projects that the company participates in. Mr. Buckalew recommended that approximately 25% of the BCR expenses be disallowed because they do not benefit current ratepayers. The expenses that Mr. Buckalew recommended disallowing were associated with new services or research. Mr. Buckalew estimated the cost of these projects to be $455,000, $355,000 for development of new services and $100,000 for research.

42. Ms. Saracino filed rebuttal to Mr. Buckalew's proposal:

> First, Mr. Buckalew is using an analysis of 1985 Bellcore projects to make an adjustment to a 1984 test year expense. When asked in a data request why he chose to use the 1985 projects, he responded "1985 work packages represent a known and certain change in BCR activities". However, I believe this approach lacks validity in ratemaking. If Mr. Buckalew chooses to use the results of his analysis of 1985 projects, he should apply that analysis to the 1985 projects, he should apply that analysis to the 1985 estimated test year expense of $2,095,000... (MB 2(85) p. 4)
>
> ...Mr. Buckalew seems to be arguing that Mountain Bell should not be able to improve its existing plant or in any way search for new uses of its existing plant to provide new or improved services to its customers...Some of the projects Bellcore is now working on will put new service

> capability into the existing network. The intention is not to lay out a new network, but instead to generate more efficient uses of that network. (MB 2(85) pp. 10-11)

43. Under cross examination by Mr. Lopach Mr. Buckalew explained that the costs of developing new services should be paid through the process of producing that new service. (Trans. p. 69) The Commission agrees with Mr. Buckalew. Current ratepayers should not be asked to pay for the development of new services. This is especially true in today's competitive environment. The reason there were refunds from AT&T was because development costs for new products had been paid by monopoly ratepayers through license contracts. Since these services are now being offered by AT&T on an unregulated basis AT&T was required to refund the development costs. This type of a situation could easily occur again, especially in Montana. The 1985 Telecommunications ACT contains a much narrower definition of regulated telecommunications services than existed prior to the Act's passage. Therefore, some of the new services being developed by BCR could end up being offered by Mountain Bell as a deregulated service.

44. Although the Commission agrees with Mr. Buckalew's recommendation that new service development costs should be disallowed, the Commission finds that Mr. Buckalew's analysis of 1985 work projects is unreasonable. It is inconsistent and unfair to calculate the percentage of 1985 BCR costs that represent the development of new services based on the argument that "1985 work packages represent a known and certain change in BCR activities" and then apply that percentage to 1984 BCR expenses. If Montana Consumer Counsel feels that 1985 work packages represent a known and measurable change to the 1984 test year then an adjustment should have been proposed to bring the test year level of BCR expenses to 1985 levels. Ms. Saracino presented an analysis of 1984 work packages that relate to new services. The Commission finds that the 1984 level of BCR expenses presented by Ms. Saracino is reasonable. Acceptance of

this position changes the amount related to new services from $355,000 to $123,000 and makes the total adjustment for BCR expenses $223,000.

Employee Reductions

45. Ms. Bright recommended an adjustment to the test year employee related expenses to reflect the reductions in employee levels that have occurred through March of 1985. Ms. Bright explained:

> Since Mountain Bell's adjustments go beyond the booked test year costs to include 1984 wage increases on an annualized basis, and further increase actual test year costs by including out of period 1985 wage increases, it is also appropriate to adjust the test year results to reflect labor cost reductions made possible by the Company's personnel reductions... Since Mountain Bell has been able to maintain the same or an increasing level of service with fewer employees, it is reasonable to attribute workforce reductions to increased workforce productivity. It is also likely that increasing competitive pressures in many of Mountain Bell's markets have induced the Company to eliminate or reduce overstaffing that previously existed under monopoly condition.(Emphasis added) (MCC 5(85) pp. 7-8)

46. Mr. Johnson explained that the adjustment made by Ms. Bright violated historical test year principles:

> When a historical test year is used, there exist relationships between expenses, volumes of business, and investment that should not be disturbed. Price or cost level adjustments can be made to the test year, however these adjustments are made at test year volumes. When the volumes of a historical test year are altered, what has been introduced is a future test year.

Mr. Johnson presented an adjustment that reflected the revenue requirement needed if all volumes were brought up to March 1985 levels. The adjustment would increase revenue requirements by $3,118,000.

47. The Montana Consumer Counsel has advocated using productivity gains in past rate cases. The Commission has rejected productivity adjustment based on the facts that they are not known and measurable and that the Commission has refused to allow attrition adjustments. The Montana Consumer Counsel has specifically rejected using anything other than average test year employees in past rate cases based on the assumption that this type of adjustment violated test year principles. The Commission agrees with Mountain Bell's position and past Montana Consumer Counsel arguments that average test year employees should be used in a historical test year. The "known and measurable" criteria has been used to apply increases and decreases in cost or rate levels (i.e. adjustments for price increases, postage rate increases, social security rates, tax rates, etc.) but these rate changes are applied to test year volumes. The Commission typically requires large adjustments to be made to reflect rate increases that happened during or after the test year. However, these adjustments are made based on test year sales volumes. Finding of Fact No. 44 notes that Mr. Buckalew did not propose to adjust BCR expenses to 1985 levels even though he expressed the opinion that this was a "known and certain change". This Commission has continuously supported the use of historical test years. However, when historical test years are used the principles involved must be applied in a consistent and fair way. The Commission finds that the adjustment to employee levels is unreasonable.

MIPP/SIPP Payments

48. During the past several years Mountain Bell implemented both the Management Income Protection Plan (MIPP) and the Supplementary Income Protection Plan (SIPP). These plans offer financial incentives for employees to retire or terminate their employment with Mountain Bell. Ms. Bright recommended disallowance of all of the 1984 cash payments for these

programs. Ms. Bright explained that "It is clear that Mountain Bell has had an overstaffing problem for some time, and yet the cost of surplus employees has been included in the cost of service and paid by ratepayers. Ratepayers should not be required to pay twice for excess employees."

49. The Commission agrees with Ms. Bright. Employee levels have been decreasing rather drastically in Mountain Bell for several years as the Company attempts to lower costs and become more efficient in the face of increasing competition. The Commission certainly supports the efforts by Mountain Bell to cut costs. However, to the extent that these employees were not needed in the past and to the extent that Mountain Bell has not been an economically efficient company, ratepayers have been paid the cost. Requiring ratepayers to pay for inefficiencies twice is indeed unfair. The payments for the MIPP and SIPP plans are also nonrecurring in nature and hopefully will not continue as the employee levels in Mountain Bell stabilize. Since the Company only booked $194,000 in MIPP and SIPP payments in 1984 there is further evidence that these costs are indeed nonrecurring. The Commission finds that disallowance of the $1,380,000 of 1984 cash payments is reasonable.

Directory Revenues

50. On January 1, 1984 Mountain Bell transferred all of its yellow page directory assets and personnel to USWest Direct, a wholly-owned subsidiary of Landmark Publishing company, which is a subsidiary of USWest. Under a publishing agreement signed by USWest Direct and Mountain Bell, USWest Direct will provide the directory publishing service for Mountain Bell. Mountain Bell receives a preset level of revenues under the publishing contract. The Montana Consumer Counsel recommended an adjustment to the 1984 operating results to present a test year as if all directory operations had remained with Mountain Bell. Mr. Buckalew explained the reason for this adjustment:

> The provision of directory advertising is a very profitable business which has always been a part of the local operating company, and which is directly linked to the provision of local telephone service. Mountain Bell should not be allowed to siphon off any of the profits from directory operations and transfer them to another subsidiary of USWest. (MCC 1(85) p. 22)

51. Mountain Bell defends the current directory publishing arrangement pointing out the contribution to monopoly services has not decreased substantially and that Mountain Bell has substantially reduced its economic and antitrust risks by transferring directory operations to USWest Direct (MB 12(85)). Mountain Bell also submits that Yellow Page advertising is not directly linked to local telephone service since "telephone service could continue even if Yellow Pages advertising disappeared" (MB 12(85) p. 12).

52. Mountain Bell is currently responsible for the white pages listings, the names, addresses, and telephone numbers of subscribers in each exchange. Obviously this list has substantial value. Mountain Bell misses the point in stating that telephone service could continue even if Yellow Pages advertising disappeared. That is certainly true. However, Yellow Pages advertising could not exist without telephone service and in fact would be almost impossible without access to the white page listings produced by Mountain Bell. Therefore, the white page listings are a valuable commodity. As Mountain Bell points out, these list are sold to anyone wishing to publish a telephone directory. However, USWest Direct does not just publish a telephone directory. USWest Direct publishes the "official" Mountain Bell telephone directory. The contract between Mountain Bell and USWest Direct includes the sale of the white page listings and the co-binding rights. USWest Direct telephone directory has the Mountain Bell name and the Bell logo on the cover. Pursuant to tariffs on file with the Commission, Mountain Bell makes it clear that it retains ownership of the

directory. Telephone subscribers are given certain remedies for directory errors and omissions. The directories are furnished free of charge to every telephone subscriber. For all of these reasons co-binding rights have a substantial value of their own.

53. The Commission is very concerned that by transferring directory operations to USWest Direct Mountain Bell may be attempting to siphon off the profits of the directory business. There is certainly not the comfort of an arms-length transaction when the directory contract is between two wholly-owned subsidiaries of USWest. For purposes of this case the Commission finds that the assumption Ms. Bright makes that the contribution from directory operations should not be less under the new arrangement than it would have been if Mountain Bell had not transferred the directory operations is reasonable. Ms. Bright's original testimony contained an estimated net income effect of transferring directory operations provide by a Mountain Bell study held on early 1984 estimate of 1984 operating results. Ms. Bright later updated her testimony based on a review of the operating results of USWest Direct. Since Mountain Bell's estimates of 1984 operating results did not turn out to be extremely accurate, the Commission finds that the imputation of the USWest Direct net revenues over and above the authorized rate of return of Mountain Bell provides a much better estimate of what Mountain Bell could have earned in 1984 if the transfer had not taken place.

54. The Commission finds that Mountain Bell should have the burden of proof in future rate cases that the Company receives an adequate revenue stream from sale of its white page listings and co-binding rights. An adequate revenue stream will be deemed to be the amount that Mountain Bell would receive in an arms-length transaction. The ideal situation would be for Mountain Bell to get competitive bids for the right to publish the "official" Mountain bell directories. In absence of actually getting bids, Mountain Bell must be able to show that the

contracts between the Company and USWest Direct reflect an amount at least equal to what would have been received in the competitive market place.

Revenue Requirement

55. Schedules 1 and 2 contain the calculation of Mountain Bell's adjusted net operating income and rate base as found to be reasonable by this Commission. The Commission finds that Mountain Bell is entitled to $18,541,000 in additional revenues as follows:

MOUNTAIN BELL
TEST YEAR 1984

Average Rate Base	$193,766
Overall Rate of Return	11.64%
Required Return	22,554
Adjusted NOI - Schedule 1	13,081
NOI Deficiency	9,474
Income to Revenue Multiplier	2.0334
Revenue Deficiency	19,264
Adjustment for 8% ITC	(37)
Adjustment for Directory	(685)
Revenue Requirement	18,541

RATE DESIGN

Mountain Bell Direct Testimony

56. MBT (Direct Testimony of Mr. L. Frank Cooper, Exh. 15) proposes a change in prices that features a uniform percent increase to existing prices with four exclusions from that increase and three specific price changes.

57. MBT cites four reasons for the general uniform percent treatment: 1) in the post-divestiture environment, CPE

and interLATA prices are no longer an issue, 2) recent cases have brought prices for ancillary services to a compensatory level, 3) in this case, there are no major restructuring proposals, and 4) policy changes by the FCC, the courts, and congress have left the industry in a generally unsettled environment (Exh. 15 p. 3-8).[1]

58. The three specific pricing proposals include 1) increasing the coin usage price from 10 cents to 25 cents, 2) extending the same operator handled charges that apply to intraLATA MTS/WATS and intraexchange measured usage to message-measured (IMB) and flat-rated access, 3) and making the Colstrip area a Base Rate Area, eliminating the LRA charges.

59. The coin proposal represents the sixth consecutive case in which MBT has proposed an increase in the coin charge. MBT maintains that "local coin service is presently noncompensatory" and has been identified by the MPSC as "'a reasonable source of additional revenues.'"

60. An increase in the coin charge would generate $1,909,654 in annual revenues before repression -- $1,035,522 after repression. Converting coin stations to 25 cents also would entail a onetime conversion cost of $109,073 (Exh. 15, p. 12).

61. The operator handled charges proposal is an extension of existing prices to operator handled calls originating from coin, flat-rated, and message-measured access lines. MBT argues that the proposal would "eliminate customer confusion," maintain the exemption for handicapped and emergency uses, and generate $82,956 in annual revenues (Exh. 15, p. 13).

62. The Colstrip proposal relates to a situation that features the Forsyth and Colstrip central offices in the Forsyth exchange. With the center of the exchange in Forsyth, Colstrip residents are levied an additional Locality Rate Area (LRA) charge of $6 and $4 per line per month for one and two party subscriber access, respectively. Colstrip has grown to the point where it now is a larger community (1700 versus 1200 terminals)

than Forsyth. MBT proposes to make the Colstrip area an "island" Base Rate Area, eliminating the LRA charges. The annual revenue effect is a loss of $112,656 (Exh. 15 p. 14).

63. MBT proposes that recurring Zone Increment Charges (ZIC) nonrecurring Zone Construction Charges (ZCC) and Centron nonaccess prices be excluded from the uniform percent increase. MBT argues that these prices have been recently treated and should therefore be excluded from any increase in this Docket (Exh. 15 p. 11-12).

64. In its direct testimony, MBT argues that because LMS usage "represents a low cost exchange service alternative," it should be excluded from the uniform percent increase (Exh. 15 p. 11-12).

In support of its proposal to exclude MTS/WATS from the uniform percent increase MBT testifies that:

> Toll and toll related services are competitive in nature and are presently provided at rates above their costs. Any increases to intra-LATA toll services would only provide incentive for competitors who could easily undercut toll usage rates that are artificially inflated. This would result in a further erosion of revenue that currently supports basic exchange service."

65. MBT also cites previous MPSC findings on the MTS/WATS issue and concludes that MTS/WATS prices should be left at their existing level (Exh. 15 p. 10-11).

66. MBT (Direct Testimony of Ms. Estella Berryhill, Exh. 14) proposes recognition of revenue repression associated with its package of proposed price changes. Less the cost savings and private line cross-elasticity (i.e. substitution of MTS/WATS for private line), the decreases in demand due to the repricing proposal effectively adds $4.4 million to the revenue level the repricing is to achieve. Of the $4.4 million, $1 million is related to the coin proposal, the remainder resulting from the MBT original 48.10% uniform percent increase (Exh. 14, Schedule 4, p. 1).

MCC Direct Testimony

67. The MCC (Direct Testimony of Mr. Allen G. Buckalew, Exh. MCC-3 and MCC-3A) argues for a rejection of the MBT uniform-percent-with-certain-exclusions approach and instead argues for the use of a Fully Distributed Cost (FDC) study. The FDC study submitted by the MCC features a full distribution of the 1983 predivestiture accounting cost data to service categories. The central theme in the FDC study is a functional allocation of common costs and an allocation of access costs to the service categories that use the switched loop (Exh. 3 p. 36-45).

68. The MCC FDC study utilizes the Joint Board's recommended nontraffic sensitive (NTS) jurisdictional separation factors to allocate NTS access costs to local (50%), intrastate (25%), and interstate (25%) service categories. A peak-adjusted traffic sensitive (TS) allocator is used to allocate TS costs to recognize the divestiture, the FDC provides an intraLATA/interLATA separation of costs on a minute-of-use basis (Exh. 3, p. 58-61).

69. The MCC concludes that if any increase in revenues is provided (the MCC did not recommended increased revenues), the increase should be reflected exclusively in increased intraLATA usage, intraLATA private line, and Centrex prices (Exh. 3, p. 58-61).

70. The MCC argues that MTS/WATS should not be excluded from an increase. MBT has provided no evidence that MTS/WATS prices are compensatory while the FDC concludes that the intraLATA toll operations are earning a negative return. The MCC also argues that LMS usage prices should not be excluded from increases, but rather should be treated the same as other local exchange services (Exh. 3, p. 61-62).

MBT Rebuttal Testimony

71. In response to the MCC testimony, MBT submitted the rebuttal testimony of Mr. Dallas R. Elder (Exh. 13) and Mr. Cooper (Exh 16).

72. MBT testifies that the general issue of recovering access costs belongs in Docket No. 84.4.15. Furthermore, the MCC FDC study ignores "the reality" of previous MPSC findings and only serves to exacerbate the existing bypass threat (Exh. 16, p. 2-6).

73. Regarding the LMS usage issue, MBT adds the fact that those prices were recently examined and established at a cost based level and should therefore be excluded from any increase (Exh. 16, p. 7).

74. The testimony of Mr. Elder addresses the MCC FDC study and introduces the 1983 EDA. MBT argues that the allocation of nontraffic sensitive accounting costs between the "local" and "toll" categories is flawed. The NTS allocators are arbitrarily chosen, have varied continuously from case to case and state to state, and have no logical basis (Exh. 13, p-10).

75. MBT also argues that the traffic sensitive allocators featured in the FDC study have varied widely and now result in artificially shifting one half of the "local" TS costs from "local" to "toll." The issue here is the use of weighted Dial Equipment Minutes (DEM) versus the use of peak adjusted Minute Message Miles (Exh. 13, p. 11-15).

76. MBT provided the 1983 EDA results including a tracking of "contribution" by each category of usage over time. MBT concludes that recent pricing changes have reversed the trend of the late 70's, but still leave interexchange usage with a "large disparity between the levels of contribution and actual usage (Exh. 13, p. 17-24)."

MPSC DECISION

The Interim Order

77. For purposes of an interim increase, MBT had proposed the coin increase, the Colstrip related decrease, and a uniform percent increase to exclusively subscriber access prices. In order No. 5046e, the MPSC deferred action on the coin and the Colstrip BRA proposals. The MPSC did grant a uniform 18.27 percent increase, but to the broader base found in the MBT final proposal rather than only subscriber access. The exception was nonrecurring Dual Element Service Charges (DESC). The MPSC found that there was a significant possibility of a final revenue rebate situation and it would be difficult to rebate excessive (DESC).

Coin

78. The MPSC rejects the proposal to increase the coin message charge to 25 cents. The MPSC had previously concluded, as alleged by MBT, that coin is a "reasonable source of additional revenues." However, the MBT assertion that nearly one-half of the increased revenues would be lost to repression has made the reasonableness questionable. MBT has not submitted evidence that the coin message price does not fully recover coin message costs. As such the question becomes one of arriving at the revenues needed to support the nonmessage related costs of the coin operations. The MPSC finds that, given the MBT repression calculation, recovering those costs in a coin message price is questionable.

Colstrip BRA

79. The MPSC finds merit in changing the Forsyth/Colstrip situation. There is no apparent reason for charging Colstrip residents an LRA increment of up to $6 per month for access. However, there is also no apparent reason for not applying MTS prices for usage between the two communities. Forsyth and

Colstrip are twenty seven miles apart, are large enough to have separate communities of interest, and meet system criteria for separate exchanges (See Tr. p. 655).

80. There is simply no reason to exclude the Forsyth/Colstrip traffic from the same MTS prices that the other residents of the State must pay.

81. Eliminating the LRA charges results in a loss of $113,000 in annual revenues. However, the application of MTS prices to what will become interexchange usage will result in an uncertain positive revenue effect. Without specific Forsyth/Colstrip usage data adjusted for repression, the positive revenue effect can not be easily calculated.

82. Discovery Document No. 223 suggests that the 3256 access lines in Colstrip and Forsyth would tend to generate over $300,000 annually in intraLATA MTS revenues. However, this estimate would appear to include all intraLATA MTS traffic originating in Colstrip and Forsyth -- not just the traffic between Forsyth and Colstrip.

83. At this point, the MPSC can only assume that increased MTS revenues will fully offset the loss of LRA revenues. MBT can provide specific analysis of the Colstrip/Forsyth traffic in its compliance filing. Otherwise the MPSC will assume there is no revenue effect.

<u>Operator Handled Charges</u>

84. The MPSC finds this proposal reasonable. It applies the same set of operator handled prices to all consumption of those services. In addition to the clarity benefits, it is equitable and results in annual revenues of $83,000.

ZIC/ZCC and Centron

85. The proposal to exclude these prices from any uniform percentage change also appears reasonable. The MCC concurs with the MBT proposal and the MPSC finds the exclusion appropriate.

LMS Usage

86. The merit in excluding LMS usage from any across-the-board increase is less clear. The LMS usage prices were not established as a "low cost alternative." They were established in Docket No. 83.2.9 as a cost-based optional alternative to the bundled flat-rated service. The MPSC expects the LMS usage prices to track changes in interexchange usage cost. Docket No. 83.2.9 featured on examination of long run marginal usage costs in 1983 dollars. Three years of inflation alone would argue for an upward adjustment to LMS usage prices.

87. The MCC testimony is, at best, difficult to interpret. In Docket No. 83.2.9 the MCC testified that the LMS usage prices at issue here represented drastic overcharges" (Tr. p. 261-264). However, the overriding basis of the FDC is that usage congestion causes most, if not all, access costs (Tr. p. 254 and 259). This would suggest a basis for substantial increases in local usage prices, bringing the LMS usage prices to a level similar to the MTS schedule (See Tr. p. 268).[2]

88. Given the structure of LMS usage prices in 5 mill increments, the MPSC finds that those prices should be excluded from a percentage increase. However, in future cases MBT should be prepared to address those prices, including their relationship to costs. The LMS usage exclusion is to apply to message measured usage, as well. There is no apparent basis to distinguish the LMS usage from the message-measured usage.

MTS/WATS

89. The issue here is whether the MPSC should utilize the MCC's FDC study as a basis for increasing intraLATA MTS/WATS prices instead of, or in addition to, the uniform percent increase proposed by MBT.[3]

90. In resolving this issue, the MPSC must determine whether or not, and to what extent, access costs result from (or vary with) 1) the number of customers subscribing to the switched network or 2) the level of usage distributed by the network. The MPSC must also address the appropriateness of the FDC NTS and TS allocators. Depending on the determination as to what portion of access costs are usage-related, the TS allocator becomes an important factor.

91. The MPSC finds the evidence linking access costs to usage to be weak. It is not clear whether the MCC maintains that all, some, or none of the NTS costs are related to usage (See, e.g., Tr. p 254, l. 3-25 and p. 266, l. 8-17). The MCC does explicitly state that "costs that are truly nontraffic sensitive should be recovered on a fixed basis, a nontraffic sensitive basis" (Tr. p. 254).

92. The MCC does not maintain that its use of the 50/25/25/ separations factor is singularly precise. Instead it is "open to the Commission to determine how they want to allocate it" (Tr. p. 258). However, any allocation of NTS to the MTS/WATS (or local usage) prices hinges on the finding that the "NTS" is usage sensitive.

93. Assuming that it is traffic congestion that causes the usage - sensitive NTS cost (Tr. p. 259 and 268), it would appear that peak usage would be the proper allocator. An issue here is "width" of the peak period. The MCC adjustment to the usage data is based on the presumption that busy hour usage is dominated by interexchange usage. MBT maintains that the busy hour usage is generally proportional to average minutes of use.

94. It is not clear that the proper measurement of peak

usage is busy hour. The reason the peak period in time-of-day price schedules does not feature only the busy hour is because of the probability of peak over a broader period. Regardless of the peak definition, it is not clear that there would be any allocation of usage-related NTS costs -- the usage price schedules (including local usage) would simply reflect the usage costs.

95. The MPSC finds that the MTS/WATS prices should be excluded from a uniform percentage increase. To do otherwise would require the MPSC to conclude 1) that the NTS costs are truly usage - sensitive and 2) peak-usage is dominated by interexchange usage, as apposed to intraexchange usage. The MPSC finds the evidence presented insufficient to arrive at either conclusion.

96. The uniform percent proposal is approved. This will require that the interim percentage be applied to DESC, leaving as a residual, a final uniform percentage increase to the base proposed by MBT, including DESC.

38

Repression

97. MBT's repression proposal is extremely significant. Depending on final revenue authorization, the proposed repression associated with the MBT pricing proposal is in the area of $3 million -- approximately 20% of the revenue at issue.[4] If the MPSC were to follow the MCC pricing recommendation, the repression would be even greater, due to MTS/WATS repression.

98. If the net revenue repression truly does occur, the MPSC ruling on it will not affect its occurrence -- only the timing of its recognition in prices. The MCC, without a recommendation to increase prices, does not address the repression issue. As such, the MPSC is not in a position to reject the actual occurrence. Therefore, the MPSC finds the proper treatment of repression in this Docket is to minimize the actual occurrence.

99. In rejecting the MBT coin proposal and the MCC MTS/WATS proposal, the MPSC has avoided increases in areas with substantial repression. Without a coin increase, and depending on the final revenue level, the repression amount would be reduced to the $2 million level.

100. At this time it appears likely that Docket No. 83.11.80 is going to feature a significant reduction in AT&T's interim MTS/WATS prices.[5] Resulting stimulation will produce carrier access charge revenue stimulation to MBT. If MTS/WATS is as price elastic (i.e. competition and bypass) and over priced, as MBT (and AT&T) maintains, then one would expect significant quantity stimulation (See, e.g. Tr. p. 608-609) without an offsetting increase in costs -- e.r., net revenue stimulation.

101. Before the MPSC reflects the proposed revenue repression in prices, MBT will have to demonstrate the stimulation resulting from Docket No. 83.11.80 and compare that stimulation with the repression resulting from the repricing provided in this Docket.

Conclusion

102. For purposes of arriving at the authorized revenue level, prices should be charged in the following manner

1)	Interim Price Charges	$10,495,000
2)	Operator Handled Charges	83,000
3)	Colstrip/Forsyth LRA/MTS	0
4)	DESC	1,459,000
5)	Residual uniform percent increase (residual)	

In addition to usual subscriber access "price out," complying tariffs should be supported by the prices, quantities (sales), and revenues for each price charged.

103. As a final note, the MPSC wishes to indicate that it expects any future proposals to change prices to be supported with cost information. While recognizing that Docket No. 84.4.19 originated in the immediate post-divestiture turmoil, the MPSC

has found disturbing the resulting major increases in sensitive prices (e.g., residential DESC) under a blanket uniform percent proposal. Along these lines, the MPSC would be receptive to an MCC response in the repression area -- particularly with respect to any proposal to increase MTS/WATS prices.

CONCLUSIONS OF LAW

1. Applicant, Mountain States Telephone and Telegraph Company is a corporation providing telephone and other communication services within the state of Montana and as such is a "public utility" within the meaning of Section 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's Montana operations pursuant to Title 69, Chapter 3, MCA.

3. The Commission has the authority to inquire into the management of the business of Mountain Bell and is required to keep itself informed as to the manner and method in which the same is conducted, Section 69-3-106(1), MCA.

4. The rate base adopted herein reflects original cost depreciated values and as such complies with the requirements of Section 69-3-109, MCA, that the value placed upon a utility's property for ratemaking purposes "...may not exceed the original cost of the property."

5. The rate structure authorized by the Commission herein is just, reasonable and not unjustly discriminatory, Section 69-3-201, MCA.

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. For purposes of final relief in this docket, Mountain States Telephone and Telegraph Company is granted increased revenues in the amount of $18,541,000. This represents a $8,046,000 increase in revenues from the level authorized in Interim Rate Order No. 5046e in this docket.

2. Mountain Bell is directed to collect the increased revenues in the manner described in the RATE DESIGN part of the Commission's Findings of Fact in this order.

DONE IN OPEN SESSION at Helena, Montana this 19th day of August, 1985 by a vote of 5-0 .

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

Clyde Jarvis, Chairman

John B. Driscoll, Commissioner

Howard L. Ellis, Commissioner

Tom Monahan, Commissioner

Danny Oberg, Commissioner

ATTEST:

Trenna Scoffield
Commission Secretary

Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 28.2.4806, ARM.

FOOTNOTES

1. The MBT testimony was originally field in April, 1984 -- in the immediate post-divestiture period.

2. Of course, the average usage component to the bundled flat rate price would receive similar treatment.

3. Neither party proposes to exclude private line from a price increase.

4. The $3 million represents a simple linear ratioing of proposed revenue/repression to final revenue/repression for the non coin prices, plus the coin repression.

5. Preliminary calculations indicate the potential for a 13% decrease.

SCHEDULE:

	Company Adjusted Test Year	Total Uncont. Adjusts.	NIPP/ SIPP	Advert.	Antitrust	BCRI	Abandoned Projects	Interest Synchron.	Commission Adjusted Test Year
REVENUES									
Local Services	$56,843								$56,843
IntraLATA Toll	38,000	(836)							$37,164
Intrastate Access Charges	17,773	(555)							$17,218
Miscellaneous	8,969								$8,969
Less: Uncollectibles	(581)								($581)
Total Revenues	121,004	(1,391)	0	0	0	0	0	0	119,613
EXPENSES									
Maintenance	24,450		(398)						24,052
Depreciation	17,412	(850)							16,562
Traffic	4,453		(157)						4,296
Commercial	12,041		(367)	(487)					11,187
Revenue Accounting	2,707		(2)						2,705
Other General	11,868	47	(454)		(718)		(87)		10,674
Operating Rents	10,252	819							11,071
Relief and Pensions	9,443								9,443
Centralized/Regional Expenses	1,861					(233)			1,628
Total Operating Expenses	94,487	36	(1,380)	(487)	(718)	(233)	(87)	0	91,618
Net Operating Revenues	26,517	(1,427)	1,380	487	718	233	87	0	27,995
OPERATING TAXES									
Federal Income	1,437	(612)	592	209	308	100	37	(302)	1,989
State Income	(1,312)	(96)	93	33	48	16	6	(48)	(1,260)
Social Security	2,034								2,034
Other	12,351								11,351
Total Operating Taxes	14,530	(708)	685	242	354	116	43	(350)	14,914
NET OPERATING INCOME	$11,987	($719)	$695	$245	$362	$117	$44	$350	$13,081
RATE BASE									
Plant in Service	$298,345	($1,308)							$297,037
Depreciation Reserve	(74,777)								(74,777)
Property Held for Future Use	58								58
Materials and Supplies	2,371								2,371
Deferred Income Taxes	(30,719)								(30,719)
Unamortized Pre-1971 ITC	(198)								(196)
	[illegible]	[illegible]	$0	$0	$0	$0	$0	$0	$193,766

SCHEDULE 2

	Customer Deposits	Unrecov Capital	Const. Charges	GenTel True-up	PIU True-up	SNFA True-up	Total Uncontested Adjustments
REVENUES							
Local Services							
IntraLATA Toll				(836)			(836)
Intrastate Access Charges					(555)		(555)
Miscellaneous							
Less: Uncollectibles							
Total Revenues	0	0	0	(836)	(555)	0	(1,391)
EXPENSES							
Maintenance							
Depreciation		(850)					(850)
Traffic							
Commercial							
Revenue Accounting							
Other General	67						67
Operating Rents						819	819
Relief and Pensions							
Centralized/Regional Expenses							
Total Operating Expenses	67	(850)	0	0	0	819	34
Net Operating Revenues	(67)	850	0	(836)	(555)	(819)	(1,427)
OPERATING TAXES							
Federal Income	(29)	365	0	(359)	(238)	(351)	(612)
State Income	(5)	57	0	(56)	(37)	(55)	(96)
Social Security							
Other							
Total Operating Taxes	(33)	422	0	(415)	(276)	(407)	(788)
NET OPERATING INCOME	($34)	$428	$0	($421)	($279)	($412)	($719)
RATE BASE							
Plant in Service	($561)	($170)	($577)				($1,308)
Depreciation Reserve							
Property Held for Future Use							
Materials and Supplies							
Deferred Income Taxes							
Unamortized Pre-1971 ITC							