

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

\* \* \* \* \*

IN THE MATTER of the Application of )	UTILITY DIVISION
The MOUNTAIN STATES TELEPHONE )	
AND TELEGRAPH COMPANY For )	DOCKET NO. 82.2.8
Authority to Increase Rates and For )	
Approval of Tariff Changes for Tele- )	ORDER NO. 4948
communications Service. )	

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Communications Service. )	ORDER NO. 4948

APPEARANCES

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BEFORE:

GORDON E. BOLLINGER, Chairman  
JOHN B. DRISCOLL, Commissioner  
HOWARD L. ELLIS, Commissioner  
CLYDE JARVIS, Commissioner  
THOMAS J. SCHNEIDER, Commissioner

FINDINGS OF FACT

PART A

GENERAL

1. On February 18, 1982, Mountain States Telephone and Telegraph Company (Mountain Bell, Applicant or Company) applied to the Commission for authority to increase rates for telephone services. The tariffs filed with the application would increase revenues from Montana customers by \$31,008,029 over those of the test year.
2. On April 6, 1982 a Procedural Order was issued by the Commission which set forth dates for intervention, discovery, filing of testimony, and hearing on the above application.
3. The Montana Consumer Counsel (MCC) has participated in this Docket on behalf of the consuming public since its inception.

4. In addition to the Montana Consumer Counsel, intervention in this proceeding was granted to the following parties: Telephone Answering Services of the Mountain States, Inc. (TAS); Northwestern Telephone Systems, Inc. (NWTS); Department of Defense (DOD); and Datatel, Inc.

5. During the months of August and September, 1982, satellite hearings were held in the following cities: Missoula, August 5th; Great Falls, August 16th; Miles City, August 17th; Billings, August 18th; Choteau, August 19th; Bozeman, August 25th; Helena, August 30th; and Harlowton, September 20th. These hearings are designed to explain the reasons for increased rates to Mountain Bell customers and to afford them the opportunity to voice opinions on the application.

6. Pursuant to appropriate Notice of Public Hearing, a hearing was held on the application on August 24-27 and August 30 - September 2, 1982 in the Senate Chambers of the State Capitol in Helena, Montana.

7. The Company has proposed a test year comprised of the 12 months ended September 30, 1981. The Commission finds this test year to be a reasonable period, within which to measure the Company's revenues, expenses and required return for the purpose of determining fair and reasonable rates for telecommunications services .

## PART B

### COST OF CAPITAL

8. Four witnesses gave testimony addressing Mountain Bell's cost of capital. Mr. Charles M. Linke, Chairman of the Department of Finance at the University of Illinois, testified on behalf of the Company that the minimum required return on book equity for American Telephone and Telegraph, Inc . (hereinafter AT&T) is in the range of 18.0 percent to 18.4 percent. Mr. Bruce Wilson, Assistant Treasurer-Finance, also testified on behalf of the Applicant. Mr. Wilson concluded that the cost of common equity is 17.5 percent to 19 percent and recommended an overall cost of capital of 13.51 percent. Dr. John Wilson, President of J. W.

Wilson & Associates, Inc., testifying on behalf of the Montana Consumer Counsel, recommended a cost of common equity of 14.25 percent and an overall cost of capital of 11.1 percent. Mr. Mark Langsam testified on behalf of the Department of Defense. Mr. Langsam concluded that an appropriate return on common equity is 13 . 5 percent to 15.0 percent and an appropriate overall rate of return is 11.7 percent.

### Capital Structure

9. The Company's witness Mr. Wilson, recommended using a Bell System consolidated capital structure as of September 30, 1981. The ratios in the consolidated capital structure are: debt - 45.7 percent, preferred stock - 2.4 percent, and common equity - 51.9 percent (Exh. 2, Sch. 1).

10. MCC witness, Dr. Wilson, testified that the capital structure which most accurately portrays the cost of capital to Mountain Bell is the Company's own nominal capital structure, taking into account AT&T's use of double leverage in financing the investment in its totally owned subsidiary. Dr. Wilson then separated the Company's operations into three service categories, competitive, potentially competitive and monopoly. He assigned a hypothetical capital structure to each of the categories. These capital structures, when weighted by net investment in each category and combined, result in a capital structure that is 52.14 percent debt, 2.92 percent preferred stock and 44.94 percent common equity.

11. Mr. Langsam, DOD witness, recommended using a hypothetical capital structure of 50 percent debt and 50 percent common equity. Mr. Langsam stated that this capital structure would allow the Company to maintain its financial integrity, i. e. to raise additional capital at reasonable rates and maintain its credit.

12. The use of a double leverage capital structure, as opposed to a consolidated or hypothetical capital structure, has been extensively studied and reviewed by this Commission in the past three Mountain Bell general rate cases (Docket Nos. 6496, 6652 and 80.12.100). In each

of those dockets the Commission has accepted the use of a double leveraged capital structure to be the best method of recognizing AT&T's use of leveraging its investment in Mountain Bell, its wholly owned subsidiary. The Commission's application of the direct double leverage approach has been specifically upheld in the Montana Supreme Court, Mountain States Telephone and Telegraph Co. v. PSC, 38 St. Rep. 165 (1981) .

13. Mountain Bell does not issue any stock to the public. All of Mountain Bell's stock is held by AT&T. AT&T finances its investments with funds from various sources, i. e. common stockholders, preferred stockholders and creditors. Because preferred stock and debt have lower cost rates, a return to AT&T equal to its cost of common equity from all of its investments would result in a windfall profit to AT&T's common stockholders. A portion of the return required at the AT&T level is one which is sufficient to pay interest on debt and dividends on preferred stock. Only the balance needs a return high enough to attract adequate common equity funds.

Several methods of recognizing AT&T's use of leveraging have been recognized in the past and proposed in this case. Among these are the use of direct double leveraging, the use of a consolidated capital structure; and the use of a hypothetical capital structure. This Commission continues to accept a direct double leverage as the most accurate approach because it allows the Commission to scrutinize the capital costs that are specific to Mountain Bell. A consolidated capital structure assumes that all companies in the system have similar costs of capital. The Commission disagrees with Mr. Langsam's statement that the cost of capital associated with a particular service or equipment offering in one part of the system is the same as its cost of capital in other parts of the system (Langsam, Exh. Fed. 2, Direct, p. 22). At the very least different BOC's have different costs of senior securities. Costs of equity may also vary depending on perceived risk. Costs of capital for Mountain Bell are probably very different than capital costs associated with Pacific Telephone. The difference in appropriate capital structures has been recognized by Judge Greene in his Modified Final Judgment when he ordered the Bell Operating Companies be divested at a 45 percent debt ratio with the exception of Pacific Telephone which will be divested at a 50 percent debt ratio. If the Commission decided to accept a consolidated or hypothetical capital structure and ignore differences in costs of senior securities and probable

differences in risk between companies and jurisdictions, Mountain Bell ratepayers could subsidize other jurisdictions within the Bell System.

14. Before Dr. Wilson applies double leveraging he removes Western Electric from AT&T's capital structure at 100 percent equity. Western Electric is a non-consolidated subsidiary of AT&T which has supplied 54 to 55 percent of Mountain Bell's total plant. When Mountain Bell purchases equipment from Western Electric the price paid is equal to Western Electric's cost plus a profit. This cost plus profit is the amount which Mountain Bell includes in its rate base and uses as the basis for depreciation calculations. Western Electric's equity return for Bell System business in 1981 was 15.5 percent. Dr. Wilson states that if AT&T's use of double leverage were accounted for in this computation, the return would be much higher (Exh. MCC-1, p. 61). Dr. Wilson testified that since Western Electric profits are included in rate base, double counting will occur unless AT&T's investment in Western Electric is removed from AT&T's common equity balance before leveraging .

15. In Docket No. 80.12.100 Dr. Caroline Smith, Senior Consultant for J.W. Wilson and Associates, proposed this same adjustment to AT&T's capital structure. The Commission agreed with Dr. Smith to the extent that it was also concerned that Montana ratepayers may be contributing toward a return to Western Electric which incorrectly assumed that the equity portion of Western Electric's capital structure is in fact equity financed. However, the Commission did not accept Dr. Smith's proposal to eliminate the problem. The Commission perceived the problem to be related to rate base rather than capital structure (Docket No. 80.12.100, Order No. 4786b, pp. 12-13). Dr. Wilson stated that AT&T does in fact use leveraging in financing its non-consolidated subsidiaries (Exh. MCC-1, p. 60). To eliminate AT&T's investment in Western Electric at 100 percent equity assumes that this is not the case. Dr. Wilson, having adequate knowledge of the Commission's order in Docket No. 80.12.100, did not propose an adjustment to rate base for an "excess" profit contained in Mountain Bell's purchase price for Western Electric equipment. Instead Dr. Wilson makes the same adjustment that this Commission rejected in the last Mountain Bell rate case. The Commission again rejects this adjustment to AT&T's capital structure as an acceptable remedy to this problem.

16. The second stage of Dr. Wilson's capital structure recommendation consisted of breaking down Mountain Bell's total company double leveraged capital structure into three separate capital structures which Dr. Wilson feels are appropriate for the following service categories: Monopoly (local exchange and vertical services); potentially competitive (state toll and private line); and competitive (interstate toll and private line). Dr. Wilson makes this break down in order that each service category receive a return which is commensurate with its risk. Competitive services tend to be more risky than monopoly services. Competitive ventures are subject to more risk because the level of earning is less predictable than the level of earning for monopoly operations. Monopoly services are regulated and rates are set on the basis of reasonable and prudent costs plus a return on capital. This provides a fairly consistent income stream. Competitive products and services are subject to more uncertainty because competitors may erode the companies market share or bring down market prices.

17. The Commission agrees that appropriate returns probably differ for various service categories within the Company. The assumptions contained in Dr. Wilson's hypothetical category capital structure and rate of return recommendations generally appear reasonable. However, the Commission declines to adopt this approach for purposes of revenue requirement. Rather, the Commission accepts the traditional double leverage approach and DCF cost of equity method to establish Mountain Bell's revenue requirement.

The Commission finds that the category capital structure and cost of capital approach is an appropriate and useful tool for use in the cost of service/rate design issues discussed later.

18. The capital structure of AT&T as of December 31, 1981 which is appropriate for double leverage calculations is as follows:

	Amount	
	<u>(dollars in millions)</u>	<u>Ratio</u>
AT&T Consolidated Common		
Equity Capital	\$55,034.80	85.0%
AT&T Preferred Stock	1,898.30	3.0

AT&T Long-Term Debt	<u>7,787.30</u>	<u>12.0</u>
Total	\$64,720.40	100.0%

This capital structure includes AT&T common equity capital and subsidiary retained earnings. (Exh. MCC-1, J. W. -13, p. 1 of 3.)

19. The nominal capital structure of Mountain Bell as of December 31, 1981 is as follows:

	Amount (dollars in millions )	<u>Ratio</u>
Common Equity Capital	\$ 3,309.10	61.4%
Long-Term Debt	<u>2,077.80</u>	<u>38.6</u>
Total	\$ 5,386.90	100.0%

(Exh. MCC-1, J.W.-13, p. 2 of 3)

20. Double leveraging assumes that the return on common equity at the subsidiary level is equal to the weighted cost of capital at the holding company level. For Mountain Bell double leverage assumes that the 61.4 percent common equity in its own nominal capital structure is financed by 85 percent AT&T common equity, 3 percent AT&T preferred stock and 12 percent AT&T debt. Therefore, applying double leveraging results in the following capital structure:

AT&T Common Equity	52.2%
AT&T Preferred Stock	1.8
AT&T Long-Term Debt	7.4
Mountain Bell Long-Term Debt	<u>38.6</u>
	100.0%

This capital structure is accepted by the Commission as appropriate for purposes of determining a revenue requirement for the Company in this Docket.

### Cost of Debt

21. Mr. Wilson recommended a 9.05 percent cost of debt. This is the embedded cost of debt for the consolidated Bell System as of the end of the test period. It includes both long-term and short-term debt. (Exh. 2, p. 19) Mr. Langsam's cost of capital calculations included a 9.12 percent cost of debt. Mr. Langsam used the embedded cost of debt for the consolidated Bell System as of February, 1982. Long-term and short-term debt are included (Exh. Fed. 2, Table B, p. 24a). Dr. Wilson used the embedded cost of long-term debt as of December 31, 1981 for AT&T and for Mountain Bell. These rates are 7.0 percent and 9.0 percent respectively (Exh. MCC-1, J. W. -13, p. 3 of 3).

22. The Commission accepted a double leveraged capital structure over the consolidated and hypothetical capital structures proposed by Mr. Wilson and Mr. Langsam. It would be inconsistent to couple a consolidated cost of debt with a double leveraged capital structure. Therefore, the Commission rejects using a consolidated cost of debt. Double leverage calculations require separate costs of debt for the holding company and the subsidiary. The Commission accepts Dr. Wilson's recommended costs of debt to AT&T and Mountain Bell as appropriate for use in double leverage calculations.

### Cost of Preferred Stock

23. Mr. Wilson and Mr. Langsam recommended using the embedded cost of preferred stock for the consolidated Bell System of 7.83 percent. (Exh. 2, p. 20 and Exh. Fed. 2, p. 24a.) Dr. Wilson recommended using 7.70 percent cost of preferred stock. This is the embedded cost of AT&T preferred stock. Mountain Bell does not float preferred stock of its own. The Commission finds that the embedded cost of preferred stock to AT&T is the appropriate cost for use in double leverage calculations.

## Cost of Common Equity

24. Four witnesses testified concerning the cost of common equity. All witnesses analyzed the cost of equity at the AT&T level using a discounted cash flow (DCF) method. The DCF method equates the return investors require with the sum of the dividend yield and the expected dividend growth rate. The DCF method has widespread acceptability in the regulatory arena because it lessens the degree of subjectivity inherent in analyzing the return investors require on common equity. Although all cost of capital witnesses presented DCF analyses, the results of each analysis varied substantially. The variances were due largely to differing opinions as to expected dividend growth rates and differing opinions on whether issuance costs and possible dilutive effects of new issuance should be considered in cost of common equity calculations.

25. The first component in the DCF equation is the current dividend yield. Although the appropriate time frame to measure market price varied slightly among witnesses, the general consensus was that the current dividend yield is 9.3 percent to 10.5 percent. All witnesses used the current quarterly dividend for AT&T of \$1.35. Mr. Linke compounded the quarterly dividend for an annual dividend of \$5.80. The other three witnesses used an annual dividend amount of \$5.40. Since not all shareholders reinvest their dividends, the Commission finds the un compounded amount of \$5.40 to be appropriate.

26. Mr. Linke used a market price of \$58.50 to calculate the current dividend yield. This was the December 18, 1981 market price (Exh. 3, p. 22). Mr. Wilson, using "recent" price of \$57, calculated the current dividend yield to be 9.5 percent (Exh. 2, p. 28). Mr. Langsam used a range of 9.5 percent to 10.5 percent for a current dividend yield using the low and high market prices for the first quarter of 1982 (Exh. Fed. 2 pp. 45-46). These percentages would indicate market prices between \$51.40 and \$56.80. Dr. Wilson used the average market price for the six months ended April 30, 1982 of \$58.06 to calculate a current dividend yield of 9.3 percent (Exh. MCC-1, p. 26).

27. The Commission finds the current dividend yield on AT&T common stock to be 9.5 percent. Use of an average market price assures a more representative dividend yield because it lessens market fluctuations. Both Mr. Langsam and Dr. Wilson used average prices. Nine point five percent falls in the low range of first quarter 1982 prices and only slightly above the six month average price used by Dr. Wilson. This is also the dividend yield utilized by Mr. Wilson.

28. The second component in the DCF analysis is the expected dividend growth rate. Mr. Linke conducted two surveys with the assistance of the University of Illinois Survey Research Laboratory in connection with a consulting project for Southwestern Bell. The goal of the surveys was to determine the growth rate estimates actually being used by institutional investors making investment decisions in general and specifically in regard to AT&T. Mr. Linke's first survey was conducted in July and August of 1980. In April and May of 1981 Mr. Linke conducted a second survey to update the AT&T growth expectation data. The results of Mr. Linke's survey showed that approximately 90 percent of the surveyed institutional investors that use long-term growth estimates rely on expected earnings per -share (EPS) growth, dividends per share (DPS) growth, or a combination of the two, in making AT&T investment decisions. Very little emphasis is placed on book value per share (BVPS) growth. (Exh. 3, p. 15) It also revealed that the time horizon over which investors actually make the growth projections that they rely on is approximately five years (Exh. 5, p. 16). Mr. Linke's April-May, 1981 survey results showed that expected growth rates used by institutional investors in making AT&T investment decisions were in the range of 6.8 percent to 9.0 percent. Relying more on the very large institutional investors (managing equity investments of \$100 million or more) Mr. Linke used a growth rate of 6.8 percent to 7.2 percent.

29. Mr. Wilson gathered and surveyed published market forecasts to determine what growth rate analysts and investors were projecting for AT&T. From these published forecasts Mr. Wilson concluded that the expected DPS and EPS growth rate was 7.5 percent to 8.5 percent. (Exh. 2, pp . 29-30) .

30. Mr. Langsam testified that the appropriate growth rate for estimating AT&T's cost of common equity is the expected growth in book value. Mr. Langsam estimated that the growth in book value for 1982-1983 can be expected to be between 3.0 percent and 4.5 percent (Exh. Fed. 2, p. 49).

31. Dr. Wilson testified that the long-term dividend growth which investors now expect for AT&T is in the range of 4 percent to 6 percent (Exh. MCC-1, p. 27). Dr. Wilson states that both earnings and dividends have experienced unusually high growth in recent years but it is generally expected that the growth will taper off in the future due to competitive pressures and more stable growth in non-competitive operations.

32. In Docket No. 80.12.100, Order No. 4786b, the Commission found that it was proper to rely mostly on dividend growth rates when analyzing investor expectations. Mr. Linke's study seems to reinforce the belief that the dividend growth rate is what investors rely on to make investment decisions. Mr. Linke, Mr. Wilson and Dr. Wilson all recommend dividend growth rates. Mr. Linke and Mr. Wilson use expected dividend growth rates ranging from 6.8 percent to 8.5 percent. When added to a current dividend yield of 9.5 percent, the resulting cost of equity is in the 16.3 percent to 18 percent range. The cost of capital recommended by Mr. Linke and Mr. Wilson is a range of 17.5 percent to 19.0 percent. The Commission rejects these growth estimates as unrealistic. Although these estimated growth rates are from published sources and investor surveys, they also must pass a common sense test. Dr. Wilson explained that:

Your witnesses argue vigorously that the expected growth for AT&T stock is 8 or 9 percent. That, combined with AT&T's dividend yield, suggests to them that there ought to be a 19 per cent return . If investors really believe that, given the price of common stock that's existed in the market over the past six months, what they would be telling you is that they really expect a 22 to 26 percent return on investments in AT&T. Now, if that were true, everybody in this room, including Mr. Hyer, would run out and borrow all the money they possibly could and put it all on AT&T. Nobody really believes that AT&T is going to earn 26 percent per year on equity investments that investors make at current market prices.

Your witnesses may want to try to argue that for a high rate-of-return allowance, but it's certainly not something that investors really believe. There wouldn't be any sense putting

money into any other investments at all. There's nothing that's paying anything like 26 percent. But yet a 9 percent growth expectation and a 10 percent dividend yield, coupled with a 50 to 55 dollar price for the stock, implies a 22 to 26 percent return. Now, you know that's nuts. Investors really don't expect that. If they expected that type of growth and they expected that type of earnings, the market price of the common stock would be much higher than it is.

(TR, pp. 294-295)

33. Dr. Wilson also states that the high recent growth rates are attributable in part to operations in markets which are presently competitive or potentially competitive. The growth in calling volume has decreased in the past five years primarily due to the decreasing growth rate in local calls (Exh. MCC-1, p. 29). Dr. Wilson recommends using a long-term dividend growth expectation of 4 percent to 6 percent. The Commission finds an appropriate dividend growth rate to be 5.00 percent. Coupled with a current dividend yield of 9.5 percent, this growth rate results in a cost of common equity of 14.50 percent. The Commission finds 14.50 percent to be a reasonable cost of common equity for purposes of setting intrastate rates for Montana.

34. Both Mr. Wilson and Mr. Linke state a need for an additional 50 to 100 basis points added to the cost of common equity to cover issuance expenses and underwriting fees and to avoid dilution of current stockholder's equity. Mr. Langsam testified that since AT&T is continually issuing new common stock through Savings Plans, Dividend Reinvestment Plans and regular offerings, market pressure effects are already included in AT&T's cost of common equity. (Exh. Fed. 2, p. 52) Dr. Wilson testified that there is no need to authorize this type of an allowance in the absence of some demonstration that such expenses will be incurred and that they are properly chargeable to ratepayers (Exh. MCC-1, p. 52). The Commission agrees with Mr. Langsam and Dr. Wilson and denies the Applicant's request for additional basis points to cover issuance expenses and dilution. This denial is consistent with the Commission's position in Docket No. 80.12.100, Order No. 4786b.

### Overall Rate of Return

35. In order to develop an appropriate overall rate of return for Mountain Bell, the cost rates developed above for debt, preferred stock and common equity, are applied to the capital structure set forth in Finding No. 20 as follows:

<u>Component</u>	<u>Percent of Total</u>	<u>Cost Rate</u>	<u>Weighted Cost</u>
AT&T Common Equity	52.2%	14.50%	7.57%
AT&T Preferred Stock	1.8	7.70	.14
AT&T Debt	7.4	7.00	.52
Mountain Bell Debt	<u>38.6</u>	9.00	<u>3.47</u>
	100.0%		11.70%

36. By granting an 11.70 percent overall return on capital in this case the Commission has recognized and properly accounted for all of the costs of capital associated with investment in Montana intrastate operations including an adequate return to the ultimate common equity holder. The 11.70 percent overall return will allow for a 14.50 percent return to the AT&T common stockholder (for that portion of his investment that ultimately supports Montana intrastate operations ) after allowing for the payment of Mountain Bell's debt, AT&T's debt and AT&T's return to preferred stockholders.

### PART C

#### REVENUES, EXPENSES AND REVENUE REQUIREMENT

37. Ms. Irene G. Chavira, Mountain Bell District Staff Manager-Financial Analysis, sponsored testimony and exhibits supporting the Applicant's revenue request of \$27,050,000. Ms. Chavira also presented testimony on the Company's current financial condition and need for rate relief. Mr. George F. Hess, consulting engineer for MCC, presented testimony and exhibits

concerning the Company's overall revenue requirements for Montana intrastate operations. After reviewing Ms. Chavira's underlying workpapers, Mr. Hess sponsored certain adjustments to test year revenues, expenses and rate base which resulted in a recommendation to the Commission to decrease revenues by \$3,478,000. Several revisions were made by Ms. Chavira in her rebuttal testimony and at the hearing in this Docket which resulted in an amended revenue request of \$26,038,000. Mr. Hess noted that the revision concerning non-management wage increases would also impact his exhibits and they should be adjusted accordingly.

38. To calculate a revenue requirement Ms. Chavira started with revenues, expenses and rate base as booked for the 12 months ending September 30, 1981. Ms. Chavira then made adjustments falling into three categories: Accounting Adjustments; Commission or Statutory Adjustments; and Pro Forma Adjustments. These adjustments are fairly numerous and many were uncontested. Therefore, unless specifically addressed, these adjustments are accepted by the Commission.

#### Revenues

39. Mr. Chavira made a revenue pro forma adjustment that increased test year revenues by \$90,000 because in this Commission's Order No. 4786b, the Commission approved a rate increase to offset Equal Life Group depreciation expense which was not booked subsequently. It also decreased test year revenues by \$40,000 to give effect to additional revenues granted by this Commission as a result of the Company's request for reconsideration without an increase in rates. Mr. Hess testified that these adjustments should not have been made because pro forma test year revenues should reflect revenues that would have been produced at present rates. The fact that present rates reflect an expense not booked or do not reflect a past test year expense approved is not relevant to that determination (Exh. MCC-3, p. 3). The Commission agrees with Mr. Hess' assessment and eliminates \$50,000 of Ms. Chavira's adjustment to test year revenues. This has the effect of increasing the current revenue requirement by \$50,000.

### Out-of-Period Expenses

40. Mr. Hess made an adjustment increasing Net Operating Income (NOI) in the amount of \$41,000 to reflect year-end accruals for unbilled charges to operations of certain activities rendered under conduit and cost sharing agreements with AT&T. Ms. Chavira supplied Mr. Hess with appropriate expense amounts and he calculated the income tax effects of making the expense adjustments (Exh. MCC-3, p. 4). Since neither the dollar amount nor the appropriateness of this adjustment was rebutted by the Company, the Commission accepts the adjustment.

### Legislative Advocacy

41. Mr. Hess adjusted test year expenses downward by \$12,000 to exclude legislative advocacy expense charged to other general expenses during the test year (Exh. MCC-3, p. 4). Mr. Hess testified that, although the Company has the right to promote legislation, where legislation is primarily in the stockholder's interest, the stockholder should bear the cost. In Order No. 4786b this Commission accepted a reduction - in test year expenses for legislative advocacy expenses because there was no evidence in the record that the expense resulted in a benefit to the ratepayers. In the current docket the Company has not shown that these legislative advocacy expenses benefited the ratepayers. Therefore, the reduction in test year expenses of \$12,000 is accepted.

### Depreciation

42. On June 8, 1982 this Commission initiated Docket No. 82.6.37 to consider changes in depreciation rates and methods, changes in accounting and charging for station connections, and investigation into the deregulation of customer premises equipment ordered by the FCC. Mountain Bell is a participant in this docket. All parties have agreed that any changes in depreciation rates and methods contained in this application would be considered in Docket No. 82.6.37. Eliminating depreciation issues from this docket has the effect of increasing

Company adjusted test Year NOI by \$2,274,000 and increasing the average rate base by \$1,341,000. The depreciation portion of the order in Docket No . 82.6.37 will be issued simultaneously with this order.

#### Management Wage Increase

43. In calculating a revenue requirement in this docket, Mr. Hess eliminated the adjustment Ms. Chavira made for 1982 management wage increases. Mr. Hess explained that he was told management increases are based on merit. This suggests that management will achieve economies of operation that will at least offset the additional cost of the higher wages and benefits awarded in 1982, and thus, there is no reason to adjust the test year for these management increases (Exh. MCC-3, pp. 7-8). Mr. Hess also testified that in difficult economic times, management should be asked to refrain from granting themselves large increases in wages and benefits that would be passed on to ratepayers absent achievable economies to balance such increases (Exh. MCC-3, p. 8).

44. The Company rebutted MCC's position by pointing out that this Commission has rejected productivity adjustments in Docket Nos. 6496 and 6652. Ms. Chavira states that it is her opinion Mr. Hess is attempting to do something indirectly which the Montana Commission has specifically rejected in the past (Exh. 9R, p. 7). In Docket No. 6496, Order No. 4389b the Commission discussed the use of historic productivity gains to reduce expenses associated with labor during the test year. The Commission rejected Mr. Hess' productivity adjustment stating, "(1) Hess has not shown a cause-and-effect relationship between the higher wages and increased productivity; . . . (2) this Commission declines to base rate-making decisions on projections of the future. . . "

45. The Commission continues to find that there is not a direct cause and-effect relationship between higher wages and increased productivity. However, the Commission strongly supports the position that in difficult economic times, unless the Company can show that wage increases will be partially offset by achievable economies or be of benefit to the ratepayers,

management should not grant themselves large wage and benefit increases to be born by the ratepayers. The Commission realizes that in periods of high inflation some increase is justified. The Commission also finds merit in Ms. Chavira's argument that for proper management reasons, there is a reasonable gap that should be maintained between your non-management and your management (TR, p . 768) . 1982 management increases averaged 13.4 percent.

46. Ms. Chavira states that non-management wage increases are based primarily on the Consumer Price Index (CPI) (TR, pp. 824-825). The 1982 non-management "CPI related" wage increase was 7.6 percent. The Commission finds that since this percentage is set forth by the Company to be based primarily on the CPI it represents a reasonable increase to management as well as to non-management. The Commission disallows the 1982 management wage and benefit increase over and above 7.6 percent as an unreasonable expense .

47. In Ms. Chavira's rebuttal testimony she updates estimates included in her direct testimony for 1982 wage, salary, and benefit increases. The actual contract wage adjustment was 3.3 percent lower than estimated which increases the Company's adjusted NOI by \$502,000. In Ms. Chavira's direct testimony, 1982 management increases were estimated to be 11.5 percent. This estimate was revised to 13.4 percent in Ms . Chavira's rebuttal testimony. The Commission's disallowance of 1982 management increases over and above 7.6 percent results in an increase to the Company's adjusted NOI presented in Ms. Chavira's direct testimony by \$356,000.

#### Amortization of Excess Balances

48. In Docket No. 80.12.100, Order No. 4786b, this Commission ordered the Company to amortize deferred federal income taxes accumulated at tax rates in excess of 46 percent over a two year period. The Commission also ordered the Company to reflect on a current basis state income tax benefits resulting from the use of accelerated depreciation for tax purposes and to amortize accumulated deferred state income taxes over a five year period. This approach is commonly referred to as flow-through accounting. The Company did not make these

adjustments in this docket. Mr. Hess calculated the effects of these two adjustments and supported them in his testimony.

49. The Commission made determinations on these issues in Docket No. 80.12.100 and in numerous electric and gas cases. The Commission decisions have been upheld in District Court. The Commission continues to find that these adjustments are reasonable and appropriate. The adjustments increase adjusted NOI in the amount of \$1,518,000 and increase average rate base by \$2,285,000.

#### Pro Forma Interest

50. Mr. Hess proposed a reduction in tax expense to reflect the level of interest expense allowed in Dr. Wilson's rate of return recommendation (Exh. MCC-3, p. 10). Ms. Chavira agreed with Mr. Hess that an interest adjustment is required to match interest expense to the recommended capital structure and cost of debt (Exh. 9R, p. 7). However, Ms. Chavira disagreed with the method Mr. Hess used to calculate the amount of the adjustment. The disagreement between MCC and the Company centers on whether or not interest should be imputed to the portion of rate base financed with un-amortized job development investment tax credits (JDIC).

51. Ms. Chavira testified that this portion of plant is financed exclusively by the reduction in taxes mandated by the tax laws. Since there is no borrowing for plant financed with JDIC capital, there can be no associated interest expense (Exh. 9R, p. 10). Mr. Hess argues that customers pay rates which include an allowance for income taxes not in fact paid by the utility. Since the Internal Revenue Code prohibits deductions of un-amortized investment tax credits from rate base, the Commission must give the Company a return on rate base financed through JDIC. This being the case, ratepayers should get the benefit of the tax deductibility of all the interest expense they are required to pay through the return allowance (Exh. MCC-3, p. 11).

52. The Commission agrees with Mr. Hess' argument. Since ratepayers are required to pay a return on the portion of rate base financed with JDIC which includes an allowance for

interest, ratepayers should get the benefit of the tax savings as if the interest were actually paid. This position is consistent with the finding of the Commission in Docket No. 80.12.100.

53. Because the Commission did not accept the capital structure proposed by MCC, the Commission has recalculated the pro forma interest expense adjustment using the methodology proposed by Mr. Hess. This adjustment increases the Company's adjusted NOI by \$172,000.

#### Subscriber Plant Factor

54. On February 24, 1982 the FCC adopted the recommendation of the Federal-State Joint Board to freeze the subscriber plant factor (SPF) at the average 1981 level (Decision and Order CC Docket No. 80-286, released Feb. 26, 1982). As a result of this action Ms. Chavira included an additional \$3,026,000 in her revenue requirement calculation . This is the amount of revenue requirement that would have been shifted from intrastate to interstate during 1982 had SPF not been frozen. Ms. Chavira testified that "the freezing of SPF will cause greater attrition than has occurred in the past and will negatively impact the Company's earnings. It is for this reason that I have included \$3M in the Company's test year revenue requirement for the freezing of SPF" (Exh. 9R, p. 11).

55. Mr. Hess argued that SPF has been growing in recent years resulting in a continuing increase in the allocation of plant and expenses to interstate. The freezing of SPF will stop this trend, but will not reverse it. Mr. Hess also noted that the test year SPF are lower, not higher than the 1981 average frozen level. Therefore, an adjustment of test year SPF to the frozen 1981 level would allocate less cost to intrastate, not more (Exh. MCC-3, p . 13) .

56. In the two previous Mountain Bell general rate cases, Docket Nos. 6652 and 80.12.100, this Commission specifically rejected attrition adjustments proposed by the Company. Attrition adjustments have consistently been rejected by this Commission because their use directly contributes to future inflationary pressures. Ms. Chavira stated several times in the

record of this case that this adjustment is predominately attrition-related. The Commission rejects the Company's SPF adjustment and continues its policy of disallowing attrition adjustments.

#### License Contract and BIS Expenses

57. Mr. Joseph T. Dwyer, Mountain Bell District Staff Manager-Affiliated Interests, filed direct testimony concerning the services Mountain Bell receives through the License Contract with AT&T, the Business Information Systems (BIS) agreement with Bell Labs, Cost Sharing agreements, and Conduit Billing arrangements. The purpose of Mr. Dwyer's testimony was to describe the nature and the principal benefits of these services. He attempted to show that the services provide substantial value and savings to Mountain Bell and Montana customers and the payments made for them are reasonable.

58. Mr. Allen G. Buckalew, Economist for J. W. Wilson and Associates, Inc., testified on behalf of the MCC. Mr. Buckalew recommended total disallowance of License Contract and BIS expenses. Mr. Buckalew stated that the basic reason for his recommendation is that the benefits are more related to the future than present, and current ratepayers are being asked to pay for expenses that will benefit AT&T's competitive organization.

59. Mr. Dwyer and John A. McCarthy, Director of the Corporate Studies Center at Bell Laboratories, rebutted Mr. Buckalew's recommendation reiterating the Company's position that these agreements provide current benefits to Montana ratepayers.

60. In his pre-filed testimony Mr. Dwyer describes the nature of the License Contract Agreement with AT&T and the BIS Agreement with Bell Labs:

#### License Contract Agreement with AT&T

License Contract services address the full range of activities for the long and short term planning and implementation of telephone service. Examples of work areas are fundamental planning for the conceptual evolution of telecommunications,

coordination of the nationwide network to maintain its integrity and viability, and problem solving and consulting with the operating companies on immediate concerns.

#### Business Information Systems (BIS) Agreement with Bell Labs and Other Bell Operating Companies

This agreement provides for the development and continuous evaluation of electronic data processing and business information systems. Examples of work include systems to control inventory levels and establish efficient business office processes.

(Exh. 13, pp. 2-3)

61. Before making a recommendation to disallow License Contract expenses, Mr. Buckalew reviewed Bell Laboratories' Case Authorizations and AT&T's General Department Budget Decision Packages. Case Authorizations are the budget documents used by Bell Labs to determine the annual amount of money to be spent on each of its activities. The Budget Decision Packages are used to accomplish the same budgeting function for AT&T's General Department (Exh. MCC-5, p. 13). Mr. Buckalew testified that his examination of the Case Authorizations indicated that 57 percent are directly related to competitive activity; 2 percent are directly related to exchange activity; 3 percent relate to all services; 6 percent related to network access; and 32 percent are related to basic research (Exh. MCC-5, pp. 16-17). Mr. Buckalew stated that although 2 percent to 8 percent of Bell Labs activities are related to exchange activities, even these activities provide no immediate benefit. He noted that less than 5 percent of the work performed by the General Department in 1981 can be directly and solely related to exchange service .

62. Although Mr. Buckalew furnished the information in Finding No. 60, he testified that this information only supported his recommendation but was not the basic reasoning behind it. Under cross-examination by Mr. Hyer, Mr. Buckalew explained the basis of his proposed adjustment:

Q All right, and if I understand the basis of your proposed adjustment, essentially, it's reported on Page 5 of your testimony wherein you say that the basic reason for this recommendation is that the benefits are more related to the future than the present, and the current rate payers are being asked to pay for expenses that will benefit AT&T's competitive organization. Is that

correct?

- A That's a part of it. We have to look -- At the time that I wrote this testimony, Judge Green had not acted on the recommendations -- or not proposed or his recommendations had not been accepted I think is more correct. At this time, his recommendations with respect to some changes in the settlement agreement between AT&T and the Department of Justice have been approved, and he has ordered that within 18 months, that Bell Labs will be divested from the operating companies; that the license-contract agreement will terminate; that any and all agreements between AT&T and the operating companies will terminate.

Now, Dr. McCarthy testified yesterday that often these things take from two to four years. These rates will go into effect sometime in let's say, at earliest, October, November. Through that period, you'll be asking ratepayers to pay for research that's going to benefit American Bell. And I think at the same time, we can logically assume that because this is an organization that is going to serve American Bell in 18 months, that a substantial change in the direction and focus of the research will take place over the next 18 months to serve American Bell and not the operating companies.

63. The Commission agrees with MCC. Montana rate payers should not be asked to pay for expenses incurred by Bell Labs and AT&T General Department that will primarily benefit American Bell, Inc. and other AT&T operations. The Commission disallows the total amount of License Contract and BIS expenses. This adjustment has the effect of increasing the Company's adjusted NOI for the test year in the amount of \$1,365,000.

#### Separations

64. Mr. Paul M. Hartman, Mountain Bell District Staff Manager-Corporate Accounting and Financial Analysis, filed direct testimony on behalf of the Applicant. The purpose of Mr. Hartman's testimony was to provide the Commission with information concerning the purpose and nature of jurisdictional separations from both an historical and currently functional basis. Mr. Hartman testified that it is improper to adjust revenue requirements in this docket by accepting the same separations adjustments that the Commission adopted in Docket No. 80.12.100, Order No. 4786b.

65. Mr. Buckalew filed testimony for MCC concerning separations procedures. He recommended making two adjustments to rate base, expenses and revenue requirement for investments and their related expenses which, he testified, should be assigned to the interstate jurisdiction. The first adjustment Mr. Buckalew proposed assigns interstate Foreign Exchange Service (FX) and Common Control Switching Arrangements (CCSA) minutes of use to the interstate jurisdiction. Mr. Buckalew testified that interstate FX services are subject to FCC jurisdiction and are clearly interstate in nature (Exh. MCC-5, p. 53). He also points out that FX is a substitutable service for MTS or WATS. If a subscriber chooses to substitute FX service for WATS the intrastate subscriber's revenue responsibility would increase. In addition, AT&T has proposed this same modification to the current Federal-State Joint Board. This adjustment would decrease intrastate revenue requirements by \$1, 300, 000.

66. The second adjustment Mr. Buckalew recommended concerned the usage studies the Company uses in the separations process. The Company currently uses data obtained from 5-day studies to develop holding times. Mountain Bell also conducts calendar day (7-day) usage studies, but does not use them to calculate separations factors. Mr. Buckalew recommended that the calendar day usage studies should be used to calculate the current level of intrastate expenses and rate base. Mr. Buckalew stated that the calendar day usage studies are more representative of actual use than are the 5-day studies. This adjustment would decrease intrastate revenue requirements by approximately \$4, 200, 000.

67. Mr. Hartman rebutted both of the separations adjustments Mr. Buckalew recommended. Mr. Hartman stated that both of these adjustments require a departure from the Company's current interpretation and implementation of the Separations Manual. Therefore, both of the adjustments would require the Montana Public Service Commission to make unilateral changes in the separation process. This would disrupt the uniformity of the current separations procedures between the state and federal level and leave a gap because neither jurisdiction would recognize certain investment and expenses. Should such a gap occur, the Company would not

have an opportunity to earn a fair rate of return on its entire investment (Exh. 14R, pp. 2-3). Mr. Hartman also testified that there is currently a Federal-State Joint Board convened to consider both of these adjustments.

68. The Commission is of the opinion that both of the adjustments proposed by Mr. Buckalew would improve on the current separations procedures. However, the Commission also finds merit in Mr. Hartman's argument that in accepting these adjustments the Commission would be taking unilateral action that could preclude the Company from having the opportunity to earn a fair rate of return. The Commission will wait for the outcome of FCC Docket No. 80-286 before reconsidering this issue. The Commission finds that these adjustments are inappropriate at this time. If the Federal-State Joint Board accepts these two adjustments to the separations process, the Company is directed to immediately decrease annual revenues by \$5,538,000.

#### Settlements

69. Mr. Vern K. Dunham, Senior Vice President of Northwestern Telephone Systems, Inc. (NWTS) filed testimony on behalf of NWTS concerning the settlements agreement between NWTS and the Company. Mr. Dunham requested the Commission, after determining a fair rate of return for the Applicant, grant Mountain Bell additional revenues in an amount sufficient to pay NWTS a 14.32 percent return on its intrastate toll settlement base of \$10,867,708.

70. In the last NWTS general rate case, Docket No. 81.8.69, Mr. Buckalew recommended that local rates not be increased because local services were presently earning a 16.84 percent rate of return. In addition, the expected rate of return from toll settlements was less than the Company's overall proposed rate of return (Exh. NTS 1, VRD-6). Mr. Buckalew suggested that NWTS obtain any needed revenue increase from toll settlements. NWTS withdrew its request for a general rate increase and the Commission was not required to rule on this issue. In response to Mr. Buckalew's testimony in Docket No. 81.8.69, NWTS intervened in this docket to request increased toll settlements.

71. Although the Commission perceives a problem with the toll settlements process, the solution proposed by NWTS is inappropriate. To the extent that small independent telephone companies have higher costs of capital than the Applicant, under the current toll settlements procedures independents will never achieve their fair rate of return on the toll portion of their operations. However, there are several problems with NWTS's proposal that prohibit the Commission from accepting it.

72. Mr. Dunham's proposal is to grant the Company sufficient revenues to pay NWTS a 14.32 percent rate of return on its intrastate toll investment. The 14.32 percent was the overall rate of return recommended by MCC in Docket No. 81.8. 69. Because NWTS withdrew its rate application, the Commission did not find a fair rate of return for NWTS. Had that docket continued, the Commission might have decided that a fair rate of return for NWTS was substantially below 14.32 percent.

73. Ms. Chavira testified that there are 12 cost type independent companies in Montana. To the extent a problem exists in the settlement area for NWTS it also exists for the other independents. The Commission finds a basic inequity in changing the settlement agreement for only one company. The Commission would be amenable to the independents and Mountain Bell forming a new settlements contract and asking that settlement revenues be based on the new agreement. There is a high probability that settlements will be replaced by access charges in the near future. If so, this argument will be moot.

#### Revenue Requirement

74. The Commission finds the Company's test year Net Operating Income to be \$18,147, 000 as follows:

SCHEDULE 1  
MOUNTAIN BELL  
MONTANA INTRASTATE  
TWELVE MONTHS ENDING SEPTEMBER 30, 1981  
(000)

<u>Commission</u>	<u>Adjusted Accepted Per Company</u>	<u>Adjustments</u>	<u>By The</u>
1. Local Service Revenues 70,413	\$ 70,463	\$ (50)	\$
2. Toll Service Revenues 46,901	46,901		
3. Miscellaneous Revenues 8,805	8,805		
4. Less: Uncollectibles <u>(575)</u>	<u>(575)</u>		
5. Total Operating Revenues	125,594	(50)	125,544
6. Maintenance	25,509	(487)	25,022
7. Depreciation	16,918	(4,795)	12,123
8. Traffic	9,990	(303)	9,687
9. Commercial	19,312	(450)	18,862
10. Revenue Accounting	2,640	(81)	2,559
11. Other General	8,678	(286)	8,392
12. Operating Rents	2,955	(3)	2,952
13. Relief and Pensions 11,267	11,436	(169)	
14. General Services and Licenses	2,387	(2,387)	--
15. Unclassified Adjustments <u>(323)</u>	<u>--</u>	<u>(323)</u>	
16. Total Operating Expenses 90,541	99,825	(9,284)	
17. Federal Income Tax 4,834	1,044	3,790	
18. State Income Tax 208	906	(698)	

19. Social Security Tax	3,040	(66)	
2,974			
20. Other Taxes	<u>8,841</u>	<u>(1)</u>	
<u>8,840</u>			
21. Total Operating Taxes	13,831	3,025	
16,856			
22. Net Operating Income	<u>\$ 11,938</u>	<u>\$6,209</u>	<u>\$</u>
<u>18,147</u>			
23. Average Rate Base	\$175,140	\$3,626	
\$178,766			
24. Rate of Return	6.82%		
10.15%			

75. The Commission finds that the Company is entitled to \$5, 604, 000 additional annual revenues as follows:

SCHEDULE 2  
MOUNTAIN BELL  
MONTANA INTRASTATE  
REVENUE DEFICIENCY AT PRESENT RATES  
TWELVE MONTHS ENDING SEPTEMBER 30, 1981  
(000)

1.	Average Rate Base	\$178.766
2.	Rate of Return – Finding No. 35	<u>11.70%</u>
3.	Required Return	20,916
4.	Adjusted NOI – Finding No. 74	<u>18,147</u>
5.	NOI Deficiency	2,769
6.	Income to Revenue Multiplier	<u>2.0239</u>
7.	Revenue Deficiency	<u>\$ 5,604</u>

In its application the Company made provision for increased independent company toll settlements. The Commission recognizes that because of rate increases granted by this order, Mountain Bell will incur additional expenses in its toll settlement procedures with independent telephone companies. The Commission finds that the Company is entitled to revenues to offset toll settlements expenses. It is expected that the additional revenues needed shall be approximately \$806,000 annually. Thus, Mountain Bell's revenue deficiency including toll settlements is \$6,410,000.

## PART D

### RATE DESIGN

#### SUMMARY OF TESTIMONY AND EXHIBITS

76. In Docket No. 82.2.8 four parties presented rate design testimony and exhibits. The Applicant (MBT) presented cost studies and rate proposals as summarized on Schedule 3. The MCC sponsored the testimony of Dr. Wilson and Mr. Buckalew. Dr. Wilson presented a service category cost of service study and Mr. Buckalew addressed various local exchange rates. The TAS sponsored the testimony and exhibits of Messrs. Wesley Anderson and Jim Erickson on the issue of costs, rates, and charges for 557B switchboards and TAS patron service charges, respectively. The DOD, through its witness Mr. Rodney Frame, addressed the issue of costs, rates and charges for CENTREX service.



SCHEDULE 3

DOCKET NO. 82.2.8  
 RE: FEBRUARY 18, 1982 RATE CASE  
 DOCUMENT NO. 829

SUMMARY OF MOUNTAIN BELL RATE PROPOSALS<sup>1</sup>

ITEM	REVENUE EFFECT	EXISTING REVENUE	PROPOSED REVENUE	PERCENT INCREASE	COST
VERTICAL SERVICES					
1. Centrex	\$ 437,260.35	\$ 1,116,128.09	\$ 1,553,388.44	39.18%	Avoidable Direct
2. Connecting Arrangements	17,888.20	89,038.34	106,926.54	20.09	Percent
3. Custom Calling Service	0.0	262,509.36	262,509.36	0.00	None
4. Data Service	199,831.07	824,389.45	1,024,220.52	24.24	FDC
5. Directory Listings					
(a) Additional Listings	46,861.02	248,245.47	295,106.49	18.88	None
(b) Non-published / Non-listed	46,981.90	234,909.48	281,891.38	20.00	Percent
6. Electronic Switching System					
Service	0	0.00	0.00	0.00	Percent
7. Emergency Reporting Service	3,874.04	19,151.61	23,025.65	20.23	Percent
8. Equipment to Equipment Arrangements	517.98	2,551.05	3,069.03	20.30	Percent
9. Horizon	6,547.08	141,714.72	148,261.80	4.61	FDC
10. Key (Recurring and Non recurring)	1,381,215.60	8,112,477.30	9,463,692.90	17.03	FDC
11. PBX	900,234.24	3,811,085.76	4,711,320.00	23.62	FDC
12. Mobile	65,037.87	368,420.67	433,458.54	17.65	FDC
13. Public Announcement Service	2,361.60	11,672.40	14,034.00	20.23	Percent
14. Rural Radio	1,328.04	3,582.00	4,910.04	37.08	FDC
15. Secretarial Bureau Service	44,278.23	53,723.78	98,002.01	82.42	FDC
16. Service Observing Equipment	417.60	976.80	1,394.40	42.75	FDC
17. Special Assemblies	127,232.07	516,049.98	643,282.05	24.65	FDC
18. Special System and Service	30,974.42	159,143.22	190,117.64	19.46	Percent
19. Supplemental Equipment	534,741.40	1,681,260.05	2,216,001.45	31.81	FDC

20. TOUCH-TONE	155,918.25	1,274,651.68	1,430,569.93	12.23	Percent
"					
"					
21. Traditional, Princess, and					
"					
Trimline Telephones	717,104.77	9,617,748.77	10,334,853.54	7.46	FDC
22. Design Line	23,941.84	72,658.92	96,600.76	32.95	FDC
Sub-Total	\$4,744,547.57	\$28,622,088.90	\$33,336,636.47	16.57%	
"					
"					
"					

<sup>1</sup>SOURCE: RESPONSE TO MPSC DATA REQUEST, DOCUMENT NO. 829

"

"

"

"

PERCENT ITEM INCREASE COST STATE PRIVATE LINE	REVENUE EFFECT	EXISTING REVENUE	PROPOSED REVENUE
1. GET Mileage Service, Recurring Rates			
"			
(a) Extension and Tie Line			
"			
Mileage	\$1,197,413.91	\$ 1,714,026.60	\$ 2,911,440.51
69.86% (Based on fully			
(b) Foreign Central Office	6,821.92	17,336.52	24,158.44
39.35 distributed			
(c) Package Key CP Mileage	85,551.79	185,293.56	270,845.35
46.17 embedded/			
(d) Patron Line Mileage	139,707.79	225,094.56	364,802.35
62.07 prospective			
(e) Foreign Exchange	3,729.29	6,977.16	10,706.45
53.45 See Note 1)			
2. GET Mileage Services, Non recurring Charges	79,489.00	88,081.00	167,570.00
90.25			
3. PLT Mileage Services, Recurring Charges	598,152.64	1,659,703.68	2,257,856.32
36.04			
4. PLT Mileage Services, Non recurring Charges	62,067.00	62,101.00	124,168.00
99.95			
5. TELPACK Mileage Services,			
"			
Recurring Rates and Nonrecurring Charges	245,417.33	406,245.12	705,662.45
53.32			
6. Network Channel Equipment/ Services	<u>42,919.79</u>	<u>80,529.23</u>	<u>123,449.02</u>
53.30			
Sub-Total	\$2,461,270.46	\$ 4,499,388.43	\$ 6,960,658.89
54.70%			
<u>INTRASTATE TOLL</u>			
1. (a) Conference Service	\$ (97,853.00)	\$ 152,853.00	\$ 62,000.00
-61.2.% Same as Toll			
(b) Message Toll	(3,678.00)	56,212,430.00	56,208,752.00
-00.01 Prospective			
2. WATS	372,146.00	5,448,342.00	5,820,488.00
6.83 Prospective			
3. Time and Charges	<u>3,900.00</u>	<u>6,900.00</u>	<u>10,800.00</u>
56.52 None			
"			
Sub-Total	274 515.00	\$61 827 525.00	\$62 102 040.00
00.44%			
<u>SERVICE CHARGES</u>			

1. Maintenance of Service Charge	\$ 14,690.00	\$ 5,130.00	\$ 19,820.00
286.35% Direct			
2. Multi-Element Service Charges	2,901,067.00	2,369,403.00	5,270,470.00
122.44 Direct			
3. Suspension and Restoration	65,240.00	47,285.00	112,525.00
137.97 Direct			
4. Customer Provided Inside Wire	<u>271,378.34</u>	<u>1,042,057.80</u>	<u>1,313,436.14</u>
<u>26.04</u> Direct			
Sub-Total	\$3,252,375.34	\$ 3,463,875.80	\$ 6,716,251.14
93.89%			

NOTE (1) - TOTAL PRIVATE LINE REVENUE INCREASE DETERMINED BY FULLY DISTRIBUTED EMBEDDED STUDY, ALLOCATION OF REVENUE INCREASES BY SERVICE TYPE BASED ON PROSPECTIVE PRIVATE LINE STUDIES.



ITEM	REVENUE EFFECT	EXISTING REVENUE	PROPOSED REVENUE	PERCENT INCREASE	COST
<u>EXCHANGE SERVICES</u>					
1. Coin Service	\$1,003,219.16	\$ 1,104,210.26	\$ 2,107,429.42	90.85%	(Projections on embedded data)
Exchange Access					
(a) Joint User	10,610.09	15,693.76	26,303.35	67.61	NOTE (1)
(b) Main Station and Related	19,026,037.80	24,051,824.80	43,077,862.60	79.10	
(c) Flat Trunk and Related	213,111.92	1,339,065.59	1,552,177.51	15.91	
(d) Measured Access	146,906.38	258,172.87	405,079.25	56.90	
(e) Measured Trunk	272,390.66	265,216.10	537,606.76	102.71	
(f) Mobile Telephone Access	7,583.31	66,165.03	73,748.34	11.46	
(g) Rotary Equipped Services	1,071,560.91	387,140.43	1,458,701.34	276.79	
(h) Semipublic Coin Access	194,185.40	247,664.19	441,849.59	78.41	
(i) Service Stations	1,263.96	4,339.70	5,603.66	29.13	
(j) Special Assemblies	9,176.05	51,463.62	60,639.67	17.83	
(k) Specially Classified Service	103,149.90	80,956.97	184,106.87	127.41	
(1) Centrex Access	444,558.01	1,216,062.04	1,660,620.05	36.56	
Single Element Measured					
3. Service	36,715.00	257,010.94	293,726.78	14.29	None
4. Optional Local Calling Plans	1,119.10	4,850.88	5,969.98	23.07	Percent
Sub-Total	<u>22,541,590.65</u>				
<u>FACILITIES FOR COMMON CARRIERS</u>	<u>2,299.80</u>	<u>10,044.00</u>	<u>12,343.00</u>	<u>22.90</u>	Percent
TARIFF REPRICE TOTAL	<u>33,276,598.82</u>				
<u>REPRESSION</u>	<u>(2,268,570.15)</u>				
INDEPENDENT COMPANY SETTLEMENTS	<u>(3,958,059.00)</u>				
REVENUE REQUIREMENT AMOUNT	<u>27,049,969.67</u>				

RATE WITNESS = \* HATZENBUEHLER  
\*\* MARQUAARDT

NOTE (1) THE MONTANA EDA WAS USED TO INDICATE THE NEED FOR TREATMENT OF PRICING IN THIS CATEGORY.



77. Both Mountain Bell and the MCC submit that rates should be designed such that they reflect costs, possibly tempered to allow for universal service. (See e. q. Exh. 1. P.5. Exh. 24. pp . 2-6. and Exh. MCC-1, pp. 90, 103-105. ) The TAS and DOD, as well, do not contest the contention that rates should reflect costs, but rather the calculation of costs which support the Company's proposed rates and charges (See e. g. TR, p. 1236 and Exh. DOD-1, p. 11. )

78. The efforts in arriving at calculations of costs and resulting rate proposals are segregated into two levels: (1) service category costs and revenues and (2) product and service costs and rates. The Company and the MCC differ at both levels although the MCC testimony on rates is limited to local, coin and service charges. The TAS and DOD challenge only CENTREX and Secretarial Bureau Service rates.

#### SERVICE CATEGORY OPERATING RESULTS

79. The rate design methods proposed by the Company and the MCC entail first examining the service category costs and revenues as a "frame of reference" (Exh. 24, p. 7) or "ultimate foundation" (TR, p. 422), respectively, for further examining individual product and service costs and rates.

#### Proposed Service Category Operating Results

80. Mountain Bell has submitted three embedded service category costs studies: The 1980 Montana Embedded Direct Analysis (EDA); a modified version of the 1980 EDA, hereinafter referred to as the Fully Distributed Embedded Direct Analysis (FDEDA); and an exclusively Private Line EDA ( Cost Filing Material Vol. I Embedded Studies, Section 1 Tab . 2, 3, and 4 respectively.) Schedule 4 provides the 1980 EDA results. The private line study relates exclusively to private line products and keys off of the 1980 EDA. The FDEDA, as provided in Schedule 5, was filed in response to

Commission direction in Docket No . 80.12.100 (Order No. 4786b, Finding No.202 ) and is sponsored by the Company only to the extent it complies with Order No. 4786b as evidenced by the following dialogue with Company witness Mr. Brown:

- Q. In making its determinations in pricing in this docket would you urge the Commission to use the Fully Distributed EDA material that the Company presented over Dr. Wilson's Cost-of-Service Study or neither?
- A. Is there a third choice which might be an EDA with common and access held out separately?
- Q. I guess that's what I meant by the "neither."
- A. Okay.
- (TR, pp. 653-654. )

#### SCHEDULE 4

#### 1980 MONTANA EMBEDDED DIRECT ANALYSIS <sup>1</sup> (Millions)

Category	Revenues	Costs <sup>2</sup>	<u>Revenues</u>
			Costs
Interstate Services	\$ 73.7	\$ 32.6	2.26
State Toll	43.4	25.1	1.73
Exchange-Usage <sup>3</sup>	28.4	13.0	2.18
Private Line	2.8	5.0	.55
Vertical Business	17.8	19.7	.90
Vertical Residence	7.0	8.8	.80
Directory & Other	6.9	3.5	1.96
Network Access	.0	55.4	.0
Common	.0	16.9	.0
Total	\$180.1	\$180.1	1.00

- 1 Source: Cost Filing Material Vol. I Embedded Studies, Section 1, Tab 2, Attachment 1
- 2 The Costs as stated include return on net investment.
- 3 Network Access is separated from Local Network Usage per, e.g., TR, pp. 597 and 606. Also see page 5 of Tab 1, Section 1, Embedded Studies, Cost Filing Material Vol. I.

SCHEDULE 5

1980 MONTANA FULLY DISTRIBUTED EMBEDDED DIRECT ANALYSIS 1  
(Millions)

<u>Revenues</u> Category	Revenues	Costs <sup>2</sup>	Costs
Interstate Services	\$ 73.7	\$ 43.0	1.71
State Toll	43.4	34.7	1.25
Exchange-Usage	28.4	62.6	.45
Private Line	2.8	5.8	.48
Vertical Business	17.8	21.2	.84
Vertical Residence	7.0	9.4	.75
Directory & Other	6.9	3.6	1.94
Total	\$180.1	\$180.1	1.00

- 1 Source: Cost Filing Material Vol. I Embedded Studies, Section 1, Tab 2
- 2 The FDEDA provides three alternative allocations of common: total costs, net investment, and revenues. These costs reflect the net investment option which corresponds with Montana FDC Per Docket No. 6714.

81. The MCC also sponsored an embedded service category cost of service study (CSS). Schedule 6 provides a summary of the CSS.

SCHEDULE 6

## 1980 MONTANA CLASS COST OF SERVICE STUDY <sup>1</sup>

(Millions of Dollars)

Category	Return	Investment	Rate of Return
Interstate Services	\$ 25.6	\$ 88.0	29.02%
Interstate Private Line	.6	16.0	4.02
State Toll	8.2	74.6	11.03
Local Exchange	6.9	77.7	8.85
State Private Line	-2.2	14.6	-15.82
Customer Premise Equip.	-12.1	47.4	-25.41
Other (Vertical) Serv.	.3	2.7	11.35
Total	\$ 27.3	\$320.6	8.52%

<sup>1</sup> Source: Exh. MCC-1 (J.W.-20) p. 1

82. The EDA, as opposed to the FDEDA and the CSS, is not a fully distributed cost of service study. As evident from Schedule 4, one-half of the intrastate revenue requirement is left unallocated in the Common and Network Access categories. This fact severely limits the usefulness of the EDA for purposes of measuring the utilities operations per service category. The conclusions resulting from the EDA are that, in 1980:

- (1) The Company's Private Line operations failed to cover even the direct cost of those operations by \$2.3 million.
- (2) The Company's Vertical utility operations failed to cover even the direct cost of those operations by \$3.6 million.
- (3) State Toll, Local Network Usage, and Directory Advertising provided \$37.1 million, while Interstate Services provided the remaining \$41.1 million, towards offsetting the joint Network Access and Common costs (\$72.3) as well as the Vertical and Private Line net direct costs (\$5.9).

83. The conclusions relating to Vertical and Private Line utility operations -- that those utility operations are generating deficient revenues -- are not contested by the MCC (See e. g. Exh. 8R, p. 4, and TR, p . 439) .

84. The third conclusion -- that relating to network usage revenues and joint access

Service Category            Revenue    Cost            Cost            Revenue    Cost    Cost            Revenue<sup>4</sup>    Cost<sup>5</sup>            Cost

and common costs -- is also not necessarily contested, but rather, is of little use in measuring the service category operating results. Mountain Bell does utilize the EDA results as apparently its only cost basis for proposing a \$22.5 million increase in "Exchange Services" rates (See Schedule 3. p. 2, Note (1), Discovery Document No. 921, and Exh. 8R). This conclusion, of course, requires at least an implicit allocation of joint network access to local network usage.

85. The FDEDA and CSS differ from the EDA in that the joint Network Access and Common costs are fully distributed to the service categories. Mountain Bell witness, Mr. Glenn Brown, provided a detailed comparison of the EDA/FDEDA/CSS (See Exh. 8R). Schedule 7 provides a similar initial comparison. The service categories have been slightly altered to allow for a comparative analysis. The CSS format has also been altered to reflect a revenue/cost format.

86. Schedule 7 indicates the MBT and MCC calculation of service category operating results. The MBT interpretation leads to their proposal that vertical, private line, and local exchange services be re-priced upward to reflect the found increase in authorized revenues.

SCHEDULE 7  
COMPARISON OF THE 1980 EDA, FDEDA, AND CSS RESULTS  
(Millions of Dollars)

	EDA <sup>1</sup>	Revenue	FDEDA <sup>2</sup>	Revenue    CSS <sup>3</sup>
Revenue				

<sup>4</sup> Source: Exh. MCC-1 (J.W.-20) p. 2

Interstate Services	73.7	32.6	2.26	73.7	43.0	1.71	73.7	56.4	1.31
State Toll	43.4	25.1	1.73	43.4	34.7	1.25	43.5	41.6	1.04
Exchange-Usage	28.4	13.0	2.18	28.4	62.6	.45	35.7	35.5	1.01
Private Line	2.8	5.0	.55	2.8	5.8	.48	2.8	6.2	.45
CPE and Other Vert.	24.9	28.5	.87	24.9	30.5	.81	24.4	40.4	.60
Directory Advertising	6.9	3.5	1.96	6.9	3.6	1.94	--	--	--
Network Access	.0	55.4	.0	--	--	--	--	--	--
Common	.0	16.9	.0	--	--	--	--	--	--
Total		180.1	180.1	1.00	180.1	180.1	1.00	180.1	180.1

<sup>1</sup> Source: Schedule 4, Vertical Business and Vertical Residues have been combined

<sup>2</sup> Source: Schedule 5, Vertical Business and Vertical Residues have been combined

<sup>3</sup> Source: Schedule 6, Interstate Toll and Interstate Private Line have been combined CPE

<sup>5</sup> Source: Exh. MCC-1 (J.W.-20) pp. 1 and 3. Cost = expenses and taxes + (rate of ret investment)

87. The MCC witness Dr. Wilson, in contrast, concludes that the Company's Local Exchange utility operations, in 1980, generated a return approximating the Company's overall return and therefore should be subjected to increased rates only in proportion to increased returns (Exh. MCC-1, p. 121-123, and TR, pp. 439-440).

#### Analysis of Service Category Operating Results

88. In this proceeding, the Commission is charged with establishing tariffed rates for regulated products and services which generate the authorized revenue requirement determined herein. The authorized increase in revenues is approximately \$6.4 million as set forth in Finding No. 75. In addition to the \$6.4 million, Order No. 4951 authorizes \$2 .5 million in increased depreciation-related revenues, bringing the total design revenue increase to \$8.9 million.

89. The Commission finds that it is necessary to arrive at an indication of service category operating results. Furthermore, these operating results must be of a fully distributed nature. The MBT approach to rate design entails a selective application of individual rate element cost analysis as a result of some combination of limited costing resources, the EDA results, or marketing objectives (e.g. See TR, p. 554.) This selective approach leaves many rate elements with an arbitrary across-the-board increase which does not necessarily follow costs or as in the case of local network rates, a residual across-the-board increase which only coincidentally could follow costs (See Schedule 3.)

90. The calculation of service category costs and revenues, as presented in Schedules 4 through 7, however, do not alone result in product prices:

Mr. Marquardt:

"The (Embedded Direct Analysis) studies, in themselves, do not provide costs for any particular service for a pricing decision". (Exh. 24, p. 7. )

Dr. Wilson:

"Well, (with the Cost of Service Study) we're not really talking about a particular service or product. We're talking about category cost responsibility, allocating costs among categories of service in relation to the costs that are attributable to those categories of service. And that's an important distinction, because I don't intend to suggest that the allocation of costs between service categories should constrain rate-design determinations which the Commission may make within service categories. " (TR, p. 421. )

91. One problem faced by the Commission in this proceeding is to determine the analytical connection between the two levels of costing efforts -- service categories and individual rate elements. The Commission has found at least three major obstacles in relating the service category operating results presented in this proceeding to the task of establishing rates.

92. The first obstacle is the fact that the EDA/FDEDA/CSS represent calendar year 1980 accounting costs. They do not reflect the annualized effect of either Docket No. 6652 or Docket No. 89.12.100 rates. Both Dockets resulted in substantial repricing of Private Line Services (See Order No. 4584a, Finding No. 128-143 and Order No 4786b, Finding Nos. 179-187.) while the latter Docket implemented the re-pricing of Vertical Services resulting from Docket No. 6714 (See order No. 4786b, Finding No 226.)

93. The significance of this factor can be seen by comparing the 1980 EDA results for Private Line and Vertical Services with those resulting from the 1981 EDA modified to incorporate the annualized effect of Docket No. 80.12.100 rate design.

SCHEDULE 8 <sup>3</sup>

COMPARISON OF 1980 EDA WITH MODIFIED 1981 EDA

	1980 EDA <sup>1</sup>	Modified <sup>2</sup> 1981 EDA
	<u>Revenue</u>	<u>Revenue</u>
	Cost	Cost
Private Line	.55	.68
Vertical Business	.90	.93
Vertical Residence	.80	.93

Vertical Total .87 .93

- 1 Source: Schedule 4
- 2 Source: Discovery Document No. 832, p. 2
- 3 Note that the differences in the 1980 versus 1981 EDA also reflect methodological changes, as described in Discovery Document No. 832.

Schedule 8 indicates that while the revenue/cost ratio for Vertical Business is interestingly altered relatively little, the ratio for Private Line increases by 20 percent and Vertical Residence increases by 16 percent.

94. The second obstacle is that the service categories or segregated utility operations, do not necessarily correspond to rate elements. An example is "State Toll." Dr. Wilson's CSS makes a commendable attempt to allocate network access costs. His resulting recommendation that the found intrastate network access costs belong with the Company's "State Toll" operations, however, leaves unresolved the issue of cost based access and usage rates for toll service. That is, should the Commission establish a new monthly rate element that reflects intrastate network access costs caused by the jurisdictional utility ratepayer, or other common carrier, who demands intrastate network access, thus threatening universal service? Or, should the Commission load the Intrastate Network Usage rate element with these non-traffic sensitive costs, thus distorting the consumer (e. g. See TR, pp.1069-1070) and producer (e. g. See TR, pp. 660-666) price signals regarding the true cost of intrastate network usage and intrastate network access?

95. The testimony presented to the Commission, although not explicit, would at least imply that the position of the MBT is more closely aligned with the former access rate option while the position of the MCC is the latter.

96. A similar contradiction between rate elements and service category is with service charges and coin costs. In the case of these "inter-category" rate elements, however, the proposed rate treatment is explicit.

97. The MBT proposes to bundle these "inter-category" costs and establish a single rate element level that reflects these costs. (See Exh. 24, pp. 15, 47. ) MCC witness, Mr. Buckalew, alternatively, proposes to load intrastate network usage rate elements with these "State Toll" costs, not in the interest of promoting cost based rates, but in the name of universal service and interstate jurisdictional separations (See TR, pp. 1063-1068. )

98. The third and final obstacle facing the Commission relates to the voluminous nature of the EDA/FDEDA/CSS line item allocations which, for purposes of this proceeding, essentially preclude the recognized (e. g. See TR, p. 512) requirement that the Commission apply its judgement in resolving critical methodological issues which differentiate the service category operating results testimony presented.

99. Given the obstacles outlined above, the Commission finds that the proper approach to arriving at a rate design is to, for purposes of this proceeding, draw several relatively crude conclusions from Schedule 7, while, as solicited by both the MBT and MCC (See Reply Briefs), provide specific direction for arriving at a more refined calculation of service category operating results to be addressed in a subsequent proceeding.

100. Schedules 7 and 8, indicate that the Company's Private Line and Vertical operations continue to generate a revenue deficiency. Although the Commission's Orders in Docket Nos . 6652 and 80.12. 100 are successfully moving these service categories toward a fully compensatory level, the Commission finds that the Private Line and Vertical Service categories continue to warrant increases of greater than proportional in magnitude.

101. In the area of State Toll, Schedule 7 indicates that the intrastate network usage rate elements are generating revenues which sufficiently, by all calculations, cover all elements of "State Toll" costs. The Commission finds that the State Toll rate elements should not be subjected to increases beyond the restructuring granted herein.

102. Finally, with respect to Local Exchange, even the most optimistic evidence sponsored by the MCC suggests that the Local Exchange category of service should be subjected to increases proportional to the total increased revenues granted (roughly 6.2 percent). Pending a more refined calculation of service category operating results, the Commission finds that increases in Local Exchange revenues, on a residual basis, shall be limited to a level roughly proportional to the overall increase granted herein.

103. As for arriving at a refined calculation of fully distributed service category operating results, the Commission accepts the MCC offer to revise the CSS. The Commission agrees with Dr. Wilson that the CSS represents "a major step in the right direction. " (Tr, p. 582. ) The Commission's unsuccessful efforts in attempting to arrive at fully distributed costs per service category date back four years to Docket No. 6496 and include the unsupported FDEDA as well as a series of three way meetings which, to date, have resulted in no methodological breakthroughs.

104. The Company is directed to provide the required data as well as assist in its interpretation. The Company is not constrained from a simultaneous filing of alternative calculations. The forum for examining the revised CSS will be the contemplated access charge proceeding (as related to the staff by Mr. R. A. Remington) which will go to hearing in the Spring of 1983.

105. The Commission would point out the following requested revisions. The list of revisions is not intended to be restrictive and the Commission would encourage the cooperative resolution of contested issues not referenced below (e. g. operator wages, motor vehicle investments, phone center salaries, etc. )

106. Test year data. For a calculation of service category operating results to be useful on an empirical basis in designing rates, revenues per category should reflect the annualized effect of existing rates -- those resulting from this Order.

107. Service Categories. The Commission finds merit in Dr. Wilson's distinction between monopoly and competitive operations. A second criterion is possibly the trichotomy of the Company's operations in the A-B-C tariffs: network, private line, and CPE. Regardless of the level of service category dis-aggregation, the categories should be structured so that the results can be applied on an empirical basis to rate elements. For example, although the results of the Company's Directory Advertising operations is useful information the Commission fully intends to apply these net revenues to the structuring of network rates. With respect to Other Vertical, it appears that the competitive/monopoly and the A-B-C criteria would possibly include this category with the Local Exchange category. Regardless of whether or not these categories are dis-aggregated, they should be in a format allowing them to be combined into the basic A-B-C categorization.

108. Rotary "500" Revenues. The rotary set is possibly the most widely available telephone instrument on the competitive market and is subject to the deregulation implications of Computer II. The Commission finds that the proper approach is "Option B " -- both costs and annualized revenues calculated at the prevailing rate are CPE-related.

109. Debt/Equity Ratios. The Commission finds merit in Dr. Wilson's capital structure distinction which reflects the reality of the cost distinction in competitive versus monopoly utility operations.

110. Complex Allocators. Through the course of the proceedings, the structure of Dr. Wilson's complex allocators have been subject to criticism to the point of ridicule. The Commission, however, finds merit in Dr. Wilson's analysis which relates access costs to engineering design and causation factors and would point out that the Company has, to date, made no comparable effort.

111. With respect to both the non-traffic sensitive (NTS) and traffic sensitive (TS ) complex allocators, the Commission requests that the weighting within the demand component be addressed in further detail. The Commission is concerned about the implied significance of

the State boundary with respect to the functional engineering design of NTS access. It would appear that a neutral allocation of demand availability would entail a 50/50 allocation between local and toll.

112. With respect to the NTS complex allocator, the Commission would request further justification for the implied significance (2/3 weight) of traffic-related factors in the engineering design of non-traffic sensitive plant. Unless there is evidence that the design of the non-traffic sensitive plant is sensitive on a cause-effect basis to traffic-related factors, it would appear that the weighting given those factors should at least be reduced in significance.

113. Rate Design. Lastly, the Commission also requests that the refined calculation of service category operating results include proposed implementation of those results. To prevent the refined results from becoming a futile exercise, several issues relating the results to rate elements need to be resolved.

114. One such issue is in the area of CPE. The Company's filing in this proceeding includes a nearly exhaustive pricing of CPE per Docket No. 6714 at a floor of Montana FDC upwards to six times Montana FDC. In that the sum of the revenues generated by pricing every CPE item at a floor of Montana FDC leaves, as the CSS would suggest, a substantial deficiency, then there necessarily must be a contradiction between Montana FDC and CSS methodology that must be resolved. Whether the contradiction is in the incremental nature of the FDC versus the embedded CSS, or in the allocation of cost components, it appears that a deviation of pricing from Montana FDC is necessary. For example, one obvious alternative is an equi-proportional increase over FDC to reflect the CSS.

115. A second area requiring examination, which tends to overlap with designation of service categories, is the rate design issue regarding access, usage, and service charge rate elements. The Montana Commission intends to establish rates for jurisdictional service based upon the most competent cost evidence available. It is essential that the problem of relating the categorized "State Toll" and "Local Exchange" costs to rates be addressed. If it is intended that

"State Toll" is to represent monthly usage rates sensitive to usage of the regulated network and "Local Exchange" is intended to represent flat non-traffic sensitive charges, then the reason for including NTS costs in the former and TS costs in the latter must be established. The cost basis for and rate design of access rates are of paramount interest to the Commission.

### INDIVIDUAL SERVICE COSTS AND RATES

#### Summary of Commission Ratemaking Methodology

116. The Commission has attempted to set rates in this Docket on the basis of a product's or service's characteristics, i. e., competitive, fungible characteristics. A barrier to achieving this objective is whether or not the Applicant has completed an appropriate cost study. It is evident from a review of Schedule 3, that the Applicant has based its proposed rates on a variety of different costing methodologies, i.e., "Avoidable Direct," "Avoidable. " "Direct, " "Fully Distributed Embedded/Prospective, " "Prospective, " "FDC" and "percent. " In a large number of cases the Applicant simply applied the latter "percent" increase to existing rates.

117. Regardless of the cost study completed by the Applicant, the Commission finds that rates for products and services -- items -- should be established in the following manner. Competitive items should be priced at least at the floor of incremental Montana Fully Distributed Costs (FDC); rates for the capital component of non-fungible items should be based at least at the floor of an embedded FDC. Rates for items that are noncompetitive should be set at the floor of one of the above appropriate rates.

#### Vertical Services.

118. Centrex Non-access. The Applicant has proposed rate design and rate increases for Centrex Non-access -- intercom -- resulting in a total revenue effect of \$437,260. This total increase is shared between Special School Centrex (\$158,646) and other customers (\$278,614). (See Document No. 856 for this split of the total revenue effect. ) Specific proposals that contribute to the above total revenue effect include: (1) setting Special School Centrex intercom rates equal to Centrex I rates; (2) establishing a \$2.00 differential between each line in the first

block of 100 lines and the second block of 100 lines, and the same differential for the second versus the third and additional blocks of 100 lines -- a declining block rate structure; (3) establishing a \$1.00 differential between Centrex I and II service; and (4) establishing a \$0.50 higher rate for CO versus CU centrex. While a Montana Fully Distributed Cost (Montana FDC) study was not performed for Centrex non-access, the Applicant has stated that, "Costs were studied by system line sizes on a state-by-state basis and then weighted together by the number of stations. . . ." (Exh. No. 21, p. 8). The Applicant's proposed rates for Centrex non-access are based on avoided cost principles (Exh. No. 22, p. 26).

119. Regarding Centrex non-access, Mr. Frame testified on behalf of the Department of Defense that avoidable costs are ". . . certainly the minimum appropriate prices for such services." (Exh. No. FE-1, p. 11) Mr. Frame, however, contests the Applicant's averaging of CU and CO costs on a system wide basis arguing that, "Because there are only three Centrex CU customers in Montana and because the avoidable costs for each have been determined separately, these cost estimates should be used in the rate calculations." Mr. Frame also finds "artificial and unnecessary" the Applicant's declining block rate structure for Centrex non-access (Exh. No. FE-1, pp. 18-19) .

120. Regarding the Applicant's rate-making policy for Centrex non-access, the Commission concludes the following. First, the appropriate costs on which rates should be based for Centrex non-access depend on the fungibility of the equipment in question given the competitive nature of the service. If Centrex CO is fungible, then the appropriate cost is at least the floor of incremental FDC. If Centrex CU is non-fungible, the appropriate cost is at least the floor of incremental O&M plus embedded fully distributed capital costs. Although the Applicant has performed individual cost studies for each Centrex CU customer in this case (Exh. No. FE-1, Sch. No. 4), the Commission finds appropriate the averaging of Centrex CO and CU costs on a system wide basis. The Commission also concurs with the proposal to establish both a \$1.00 differential between Centrex I and Centrex II, and a \$0.50 differential between Centrex CO and CU. Although these are not cost based decisions, they do recognize that a difference in costs exists.

121. The proposal to retain the declining block rate structure for each block of 100 lines is unsupported (TR, p. 1202). The Applicant must establish a weighted average price for each of CU and CO Centrex service. The weights shall equal the test year quantities -- number of lines -- in each of the proposed blocks.

122. The Commission concurs with the Applicant in that there exists no cost basis for the current rate distinction between Special School Centrex and Centrex I service. To moderate the burden on this customer class, however, the allowed rate increase is to be constrained by a rate no greater than 75 percent of the new weighted average for Centrex I, or a 50 percent increase above each existing Special School Centrex customer's existing weighted average rate, whichever is less. The Applicant's proposed rate increases for other customers (\$278,614.00) is approved in total.

123. Key Systems. The Applicant has proposed rate increases for categories of Key System equipment, resulting in a revenue effect of \$1,531,828. The Applicant also proposed service charge rates for Key System equipment that result in a negative revenue effect equal to \$150,612. A Montana FDC was performed for each type of Key System equipment (Exh. No. 22, Sch. 1 and 2), and the Applicant's ratemaking policy was stated by Mr. Frank Hatzenbuelher:

In general, I am proposing changes which would increase the rates of an illustrative Key System in the range of 20%. In the process of establishing this proposal, I have made sure that every item of equipment has at least been increased to its Montana FDC.

(Exh. No. 22, p. 12)

The categories of Key System equipment and the proposed revenue effects

are as follows:

<u>Category</u>	<u>Revenue Effect</u>
Flexible Key	\$531,138
Flexible Multiline	850,637

ComKey	148,159
Key Related	<u>1,894</u>
Total	\$1,531,828

The Applicant also proposed to unbundle the key station line into a station set rate element and an inside wire rate element.

124. Lacking in the Applicant's description of cost studies completed is detail of whether an incremental or embedded FDC was performed for the capital portion of each study. Assuming that Key Systems are competitive offerings, the non-obsolete items should be priced at least at incremental FDC. The obsolete flexible multi-line equipment should be priced at a rate equal to the floor of the embedded FDC of capital plus the incremental FDC for O&M. Although detailed information on the exact cost study completed for each category of Key System equipment was not stated, the Commission approves the proposed revenue effect of \$1,531,828. The proposed unbundling of the key station line and the resulting zero revenue effect, is also approved by the Commission.

125. The Applicant's rate-making policy for Key System service charges was also stated by Mr. Hatzenbuelher:

I have proposed increased service charges for these services where the current charge is below Montana FDC. For other items of equipment, where the service charge was significantly above cost, I have proposed to decrease the charge. In all cases the proposed service charges are above Montana FDC.

(Exh . No . 22, P . 14)

The annual revenue effect for Key System service charges equals a negative \$150,612.

126. The Commission approves of the Applicant's proposed rates and the resulting negative revenue effect for Key System service charges.

127. PBX The Applicant has proposed an aggregate increase in revenue from this vertical service item in the amount of \$900,234. This aggregate increase derives from the following categories, each of which is discussed in turn: Dimension PBX (\$35,919), Mitel PBX

(\$345), Obsolete PBX (\$721,295) and \$142,667 for PBX related Optional, Custom and Tie-Line offerings . Also, netted into the above aggregate increase is a \$30,800 annual reduction in revenue due to rate design and rate changes for Direct Inward Dialing; this latter proposal is also discussed in the following.

128. For Dimension and Mitel PBX, Mr. Hatzenbuelher stated the Applicant's pricing policy as follows: for Dimension PBX, ". . . I have proposed not to increase rates. . . except in those instances where the existing rate level is below Montana FDC. In those instances I have proposed to increase rate levels to equal Montana FDC. "; and for Mitel PBX, "The Mitel PBX is currently priced at market levels. Therefore, the only increases I am proposing are for those items which are currently priced below Montana FDC. " (Exh. No. 22, pp. 15-16)

129. As these two categories of PBX offerings are competitive and fungible, the Commission accepts the proposed rate increases resulting in a revenue effect of \$36,264.

130. Regarding obsolete PBX offerings, Mr. Hatzenbuelher stated the Applicant's ratemaking policy:

I am proposing to re-price only those items of obsolete equipment which are currently priced below Montana FDC. I propose to increase rate levels for those items to equal Montana FDC. If costs are not available for an item, I am proposing a vertical service percentage (20%) increase.

(Exh. No. 22, p. 17)

131. Evident from a comparison of the above testimony and the Applicant's Schedule 6 (Exh. No. 22) is an apparent inconsistency between the Applicant's rate-making policy and its proposed rates. From Schedule 6 it is clear that the Applicant intends to increase obsolete PBX rates regardless of whether the current rate lies below or exceeds Montana FDC; moreover, all rates are not raised at least to Montana FDC. Based on the Commission's rate-making methodology, the correct rate for obsolete PBX offerings should equal the floor of embedded capital plus current O&M. The Commission approves the proposed rate increases that were established in this manner except for the Applicant's proposed rate increase for 20 station obsolete PBX systems; due to the excessive rate increase that would result from pricing this

product at Montana FDC, the Commission finds it necessary to limit the rate increase to the overall vertical service percent increase. All other items are to have rate increases that equal the overall vertical service percent increase. Rates for obsolete PBX items that already exceed Montana FDC shall not receive additional increases.

132. From the Vertical Services section of the Inventory Book (Tab 11) it is evident that a revenue effect of \$142,667 is proposed for Optional, Custom and Tie-Line PBX offerings. The Applicant is directed to apply the appropriate pricing policy to these items, e. g., the floor of incremental FDC for competitive items, and the overall vertical service percent increase for items for which the Applicant has not completed a cost study.

133. Direct Inward Dialing. The Applicant has proposed rate design and rate changes for Direct Inward Dialing (DID ) that result in an annual revenue decrease of \$30,800. Based on a "forward-looking" resource cost study sponsored by Company witness Mr. Miner (Exh. No . 21), Mr. Hatzenbuelher proposed the following rate design structure:

<u>Proposed Rates</u>	
<u>Element</u>	<u>Monthly Rate</u>
Per DID Trunk	\$28.00
Per 20 Numbers	2.00

134. On behalf of the Telephone Answering Services (TAS) of the Mountain States, Mr. Anderson testified in support of the Applicants rate-design proposal:

Q. Has Mountain Bell proposed changes in its Montana DID rates in this proceeding?

A . Yes, it has . Mountain B ell is proposing the following rates for Montana DID service:

<u>Item</u>	<u>USOC</u>	<u>Monthly Rate</u>
Trunk Circuit Termination (ea)	NDT	\$28.00
Each Block of 20 Numbers	ND4	\$ 2 .00

Q. Does this proposal reflect a change in the DID structure  
As well as the rates?

A. Yes, instead of a system charge, the customer will now pay for the actual number of trunks used. The number block size has been reduced from 100 to 20 which will also more accurately reflect exactly what the customer is using.

Q. Do the telephone answering service intervenors object to this proposal?

A. No, the telephone answering service intervenors are not objecting to the proposal. We are pleased that Mountain Bell has been responsive to our concern about the overpricing of DID service as used by telephone answering services presented in Docket No. 80.12.100. We believe that such rates should have been in effect long before this and that telephone answering services have been overcharged for DID service. We think the study and the proposed structure and rates affirm our position that DID rates as applied to telephone answering services have been excessive.  
(Exh. No. TAS-1, pp. 37-38)

135. The Applicant proposes to only offer DID in cross-bar offices already equipped for DID, and to not increase the DID capacity of these switching offices. DID will continue to be offered out of ESS central offices (TR, p. 183).

136. Given that the proposed rate structure and rates are based on a forward-looking cost study, the Commission approves the proposed rates and consequent revenue effect. The Commission is less certain of the merits of the proposal to effectively grandfather the existing DID capacity of crossbar offices, but accepts the Applicant's proposal in the absence of intervenor testimony to the contrary.

137. Mobile Radio. Although there exists several distinct elements with Mobile Radio service, e.g., service charges and vertical equipment charges, the Applicant has pooled these services and applied a 20 percent increase to existing rates (Exh. No. 24, p. 68). One exception to this proposal is an apparent cost based 8.8 percent rate increase for the Deluxe Control Head, although the type of cost analysis conducted was not stated (Exh. No. 24, p. 69). The proposed annual revenue effect equals \$65,037.

138. Due to the lack of evidence in the record indicating the presence and type of cost study conducted, the Applicant's rate design proposals and resulting \$65,037 revenue effect are denied . The Applicant is directed to apply the resulting vertical service percent increase to existing Mobile Radio rates.

139. Rural Radio Service. The Applicant proposes that Rural Radio Service (RRS) for existing customers be "disaggregated, expensed and grandfathered," and a modified RRS "with rates based on cost for all future customers. " The proposed disaggregation is intended to position the Applicant to comply with the FCC order in the Second Computer Inquiry which mandates that all new customer premise equipment be de-tariffed by January 1, 1983. Currently, an existing RRS customer pays a flat rate of \$80 per month .

140. The proposed rate structure includes the following components and rates: (1) Access (50% 1FB or 1FR per month); (2) Rural Radio Service (\$18.04 per month); (3) Rural Radio Station Equipment (\$108.00 per month); (4) Directional Antenna (\$7.60 per month); and (5) Mobile Usage (24¢ per minute after the first minute). The proposed revenue affect equals \$1,328.

141. The Commission finds, with respect to the access rate, that no basis exists for establishing a different percent relationship of the appropriate 1FR or 1FB rate for RRS than for Mobile Radio Service. Due to the significant increase RRS customers will incur from the other components of RRS, however, the Commission finds reason to moderate the impact and concurs with the 50 percent proposal. In a similar vein, the proposed mobile usage rate of 24¢ per minute is not cost supported. The current 20¢ rate for each minute after the first minute that applies to existing Mobile Radio Service customers shall also apply to RRS customers as increased by the vertical service percent increase. The Commission finds appropriate the application of the existing Mobile Radio equipment charge of \$108 for the equipment component and also the avoided cost rate plus 10 percent contribution for the antenna. In the absence of a cost study, however, the Commission finds no merit in the \$18.04 Rural Radio Service charge. Finally the

above determined rates for an existing RRS customer shall also apply to new RRS customers. The revenue effect of the above modifications is unknown to the Commission at this time.

142. Secretarial Bureau Service Equipment. In Order No. 4786b the Commission directed the Applicant "to file new cost studies on Secretarial Bureau Service (SBS) Equipment based on original cost less depreciation plus ongoing maintenance. " (See Finding of Fact No. 208 in Order No. 4786b.) In this Docket, the Applicant proposes to increase rates to avoided cost levels based on current prices for 557B switchboards, ongoing operating and maintenance expenses, administrative expenses and ad valorem and gross receipts taxes. The proposed rates result in increases of between 80 percent and 96 percent for the 557B switchboard (Exh. No. 22, Sch. 7). The resulting annual revenue effect equals \$39,611. The Applicant also proposed to increase service charge rates for SBS equipment resulting in an additional revenue increase of \$4,667.

143. On behalf of the TAS of the Mountain States, Mr. Anderson requests that the rate increases proposed by Mountain Bell for 557B switchboards not be accepted because they fail to comply with the Commission directed study in Order No. 4786b (Exh. No. TAS-1, p. 15). Mr. Anderson's basic contention is that the "First Costs" which are used to compute avoided costs, and finally rates, are "grossly overstated. " Rather than using a most recent cost estimate based on prices paid Western Electric (TR, p. 1169), Mr. Anderson proposes that the "average original purchase price" (\$6,143.52) of all installed 557B switchboards be used (Exh. No. TAS-1, p. 16). Mr. Anderson also requests that the Commission condemn the Applicant's migration strategy regarding the Company's alleged attempt to coerce TAS bureaus to terminate their lease of 557B switchboards in favor of the Applicant's AUTOTAS system.

144. In rebuttal, Mr. Hatzenbuelher analyzed Mr. Anderson's development of the average original cost for 557B switchboards and illuminated the different applications of first cost and original cost:

First cost is just what it sounds like. Net Original Cost is simply first cost (original investment) less depreciation. Net Cost is used when calculating capital related expenses such as depreciation, return and income taxes. The

factors used to estimate administrative expense and property taxes, however, were designed to be used with first cost. . . the factors developed to compute administrative expense and property taxes in Mountain Bell's cost studies are designed to be used with first cost.

(Exh. No. 22R, p. 4)

145. Although the TAS has testified that there exists competition in the marketing of TAS equipment (TR, p. 1266), the Applicant's testimony indicates that the competition is in the form of new technology and not 30 year old technology (TR, p. 1182). It is the Commission's understanding, however, that competition from new technology such as the AUTOTAS system, for example, requires an ESS central office, or an office that is equipped with Direct Inward Dialing; only five offices in Montana, however, are ESS equipped (it is not known to the Commission how many offices provide Direct Inward Dialing) out of a total of 127 offices (TR, p. 1183). Based on the above testimony, the Commission concludes that the 557B switchboard is not a competitive offering.

146. Regarding the fungibility of the 557B switchboard, it was stated in Order No. 4786b (Order No. 6, p. 101) that, "Mountain Bell shall maintain a supply of jack strips and other parts necessary for the continued operation of currently in-place 557B switchboards in Montana. " As the Applicant is required to maintain parts etc., to keep the existing stock of 557B switchboards in operating condition, the Commission finds appropriate the use of an incremental cost for O&M based on current or "first costs, " such as is computed and supplied by the Applicant (Exh. No. 22, Sch. 7). Because the 557B switchboard is a noncompetitive offering, the Commission finds that the incremental FDC for capital should also be added to the incremental FDC for O&M. That is, the costs on which the Applicant's rates are based are not fully compensatory.

147. It is the Commission's opinion that the TAS industry rationally, but incorrectly, seeks the best of two worlds: that is, to have the 557B switchboard priced as though obsolete but yet to have the switchboard maintained in operable condition. The Commission approves of the Applicant's proposed rates and intends to move towards fully compensatory rates for the 557B switchboard in latter dockets.

148. The Applicant proposes to modify the 557B contingent termination liability rate. The Applicant's testimony, however, indicates a lack of knowledge of the proposed change (TR, p. 1181) although from a comparison of existing and proposed tariff sheets it is clear that the Applicant intended to increase the contingent termination liability rate from \$2,670 to \$3,500. While the Commission rejects the proposal, as there is no justification provided in the Applicant's direct testimony, it finds interesting that the Applicant desires to discourage early disconnection of this service; this result counters the TAS allegation of a migration strategy on the Applicant's part.

149. Service Charges For Secretarial Bureau Service Equipment. Although a Montana FDC study was completed for SBS service charges, the Applicant proposed rates based on avoided cost principles. Specifically, the proposed rates equal one-half of the computed full avoided cost rates. Rates set at full avoided costs would have required rate increases of up to 382 percent. The annual revenue effect of the proposed rate equals \$4,667.

150. Testifying on behalf of all the TAS intervenors, Mr Erickson presented testimony protesting the Applicant's proposed installation service charges for 557B switchboards (Exh. No. TAS-2, p. 7).

151. It is the Commission's position that avoided cost rates, as computed by the Applicant, are the correct rates for installation service charges. The Applicant's proposal to set rates at 50 percent of this rate is the minimal price signal that the TAS industry should receive. For a 40 line system the resulting installation charge will increase 42 percent, and for a 100 line system the increase equals 192 percent; percent increases for 60 and 80 line systems fall in this range.

152. Rotary and Touch-Tone. The Applicant's testimony states that the proposed rates for rotary and Touch-Tone telephones are priced at or above their respective Montana FDC rates (Exh. No. 22, p. 31). Currently, some telephone lease options a customer of Mountain Bell has include the traditional rotary dial phone at a monthly rate of \$1.00, or Touch-Tone phones in the

Princess, Trimline or Traditional styles. The current monthly rate for a traditional Touch-Tone phone equals \$2.15. The Applicant's proposed rates for the traditional rotary and Touch-Tone equal \$1.50 and \$2.50, respectively; moreover, these two phone types account for \$716,220.00 of the total proposed revenue effect of \$717,104.00 for all non-Design Line phone types .

153. The Montana FDC for new traditional rotary and Touch-Tone phones equals \$1.29 and \$2.07, respectively (see Volume VII, Section 10, Tab 4 of the Applicant's cost filing material). The Commission approves of rates equal to \$1.30 and \$2.15 respectively for the traditional rotary and Touch-Tone phones and notes that rates less than incremental Montana FDC are anti-competitive. Customers who find these rates excessive have the option to purchase telephones from competitors of Mountain Bell.

154. Touch-Tone Line Rate. The provision of Touch-Tone service currently includes a line rate charge of \$0.85 per month. Based on an argument that the service is discretionary -- no cost basis -- the Applicant proposes to increase the monthly rate to \$1.00 resulting in an annual revenue effect of \$155,918.00 (Exh. No. 24, p. 66).

155. While the provision of the Touch-Tone line rate is a monopoly offering, the Touch-Tone line is also a necessary complimentary service for a discretionary competitive offering. Due to the nature of the product and the lack of supporting cost studies, the Commission directs the Company to apply the overall vertical service percent increase.

156. Additional Vertical Service Items. For certain vertical service items the Applicant proposes the overall vertical service percent increase of 20 percent. This percent increase derives from " . . . dividing the revenue effect resulting from the specifically treated vertical services by the present revenue associated with those same items." (Exh. No. 22, pp. 10-11)

157. The Applicant also proposed revenue increases for certain Directory Listing items without any cost analysis. The list proposed is to increase the business additional listing rate from

\$1.00 to \$1.25. Second, a flat 20 percent increase is proposed for both non-published and non-listed service rates.

The products and the proposed revenue effects discussed in Finding Nos. 156 and 157 above include:

<u>Product/Item</u>	<u>Revenue Effect</u>
1. Connecting Arrangements	\$17,900.00
2. Equipment to Equipment Arg.	519.00
3. Emergency Reporting Service	3,874.00
4. Special Systems and Services	30,974.00
5. Public Announcement Services	2,362.00
6. Directory Listings	<u>93,843.00</u>
Total	\$149,472.00

As noted in Finding of Fact Nos. 131 and 132, there also exists certain obsolete and related PBX offerings that were priced on an overall vertical service percent increase basis. As these items were not quantifiable by the Commission, they were excluded from the above schedule.

158. As the proposed rates for the above items are not cost based, the resulting overall vertical service percent increase shall apply.

159. For certain other vertical service items, the Applicant proposes rates that at least equal Montana FDC. These items and their corresponding revenue effects include:

<u>Product/Item</u>	<u>Revenue Effect</u>
1. Data Service	\$199,831.00
2. Service Observing	471.00
3. Special Assemblies	127,232.00
4. Supplemental Equipment	534,741.00
5. Horizon	6,547.00

6. Design Line	<u>23,941.00</u>
Total	\$892.709.00

Because an appropriate Montana FDC study has been completed for each and every item, the Commission approves the proposed increases.

Private Line

160. The Applicant has proposed a \$2,461,270.00 revenue effect for the Private Line (PL) category based on the 1980 EDA study. Proposed rates for individual PL items are based on either a prospective cost study (i. e., direct incremental, TR, p. 1134) or the PL overall percent increase. Rates for all but TELPAK and Network Channel Equipment services are based on prospective cost studies. The Applicant also proposes to decrease the minimum charge for business continuous property channels from 2/10 mile down to 1/10 mile (Exh. No. 24, pp. 27-29).

161. The TAS industry provided intervening testimony opposing the proposed increases for nonrecurring (service charges) and recurring (patron line charges) charges assessed their patrons (see Exh. Nos. TAS-1 and TAS-2). Mr. Anderson specifically requests the Commission to reject the private line rate proposals that effect patrons of the TAS industry (Exh. No. TAS-1, p. 34). In a related matter, Mr. Anderson discussed the dependency of the TAS industry on the availability of the Concentrator/ Identifier. Finally, Mr. Anderson requests that the Commission require Mountain Bell to file an optional plan for bulk cabling, otherwise known as Customer Operating Center Service (COCS), such as is currently tariffed in the State of Kentucky.

162. Although the proposed PL rates, which are based on a version of direct incremental costs, are probably less than fully compensatory, the Commission finds that it is necessary to moderate the potentially burdensome impact of the Company's proposal. Presently, TAS patrons pay a \$9.86 recurring rate for the hard-wired secretarial line (patron line) between

the Applicant's central office and the TAS bureau. In lieu of the proposed rate of \$15.98, the Commission approves of a 30 percent increase -- \$12.82 per month. TAS patrons are currently charged a nonrecurring service charge rate of \$37.50 upon initiating telephone answering service. The proposed rate for this service equals \$63. In line with its allowed increases for the non-avoidable component of the Multi-Element Service Charges for basic business and residential customers (Finding No. 186), the Commission approves of a rate equal to \$51.00 (81% of the Company's proposed rate) . Finally, the Commission finds it necessary to moderate the Applicant's 1111 percent proposed increase for the off premise extension rate. The Applicant is allowed to increase rates 100 percent above the existing \$1.98 level; moreover, the Applicant is directed to file a mileage sensitive cost study for this service in its next general rate case. Except for the items in Finding No. 164 below, all other recurring and nonrecurring rate proposals are approved .

163. The Commission does not approve of the Applicant's decision to pull the offering of the Concentrator/Identifier (C/I). As testified by Company witness Hatzenbuelher, this was apparently an individual decision (TR, p. 1167). Due to the increased rates that patrons of TAS bureaus will experience, the Commission holds that an option such as the C/I, which may enable a TAS bureau to remain viable, should be offered in Montana as it is in other Mountain states (TR, p. 1261). In a related matter, the Commission finds merit in the TAS request to have the Applicant file an optional plan for bulk cabling. The Applicant is directed to submit such a plan in its next general filing.

164. Finally, the Commission directs the Applicant to increase rates for TELPAK and Network Channel Equipment/Services on the basis of the overall PL percent increase. The proposal to decrease the minimum charge for business continuous property channels from 2/10 mile down to 1/10 mile is also approved.

#### Intrastate Toll

165. In the area of Intrastate Toll the Applicant has proposed rate design and rate changes that result in an increase in revenues equal to \$274,515. The items and the resulting revenue effects are as follows: (1) Wide Area Telecommunications Service (WATS), \$372,146; (2) Message Toll Service (MTS), and Operator Service Charges, -\$3,678; (3) Conference Calls, -\$97,853; and (4) Mechanized Time and Charges, \$3,900.

166. WATS. Presently the Applicant provides both Outward and Inward (800 Service) WATS on either a Full Time or partial Measured Time Basis. Full Time service is tariffed at \$790/month with unlimited usage; partial Measured Time service is tariffed at \$307/month for the first 15 hours of usage and \$18.40 for each hour thereafter.

167. The Applicant's proposed changes for WATS include: (1) an access charge rate of \$30 per month; (2) replacement of both Full Time and partial Measured Time service with Full Measured Time service. This latter proposal features a different declining block rate structure for 800 Service than for Outward WATS. Essentially, 800 Service would be priced higher than Outward WATS to reflect the higher costs of providing the service, and would have similar taper points except for the tail block; (3) a one-minute minimum per call to reflect the higher costs for the first minute of service due to set up costs; (4) to allow resale and shared use of WATS; and (5) to establish installation charges equal to those proposed for simple business customers.

168. The Commission by and large finds considerable merit in the Company's proposal to restructure WATS. On a few points, however, there is disagreement. First, the Applicant has proposed a \$30.00 access charge for both types of WATS; it is evident, however, that there exists no basis for a \$30 access fee for 800 Service other than to maximize contribution (TR, p. 1364). The Company is directed to institute an access rate for 800 Service equal to \$15.14; this rate was provided by the Applicant's cost witness Mr. Miner (TR, p. 1135).

169. A second point of disagreement regards the Applicant's proposal to adopt the proposed installation service charge for simple business customers. The Applicant has provided no evidence of parallelism between the service charge requirements -- costs -- of WATS and

simple business service. The Commission denies this request and the resulting revenue effect of \$9,510.

170. The Commission accepts the proposed usage rate structure for both types of WATS with the following caveats. While full measured service is an improvement over the existing rate structure, the Applicant has provided no analysis justifying a declining block rate structure. Such a request will likely arise in the next general rate case. The Applicant has also excluded from its proposed WATS revenue effect analysis of the direct effects of the Resale and Shared use proposal on the rate structure -- taper points -- and analysis of the substitutability of WATS for MTS via the Resale and Shared use proposal. Requests for such analysis will likely emerge in the Applicant's next general filing.

171. Mechanized Time and Charges. The Applicant proposed to increase the rates for Mechanized Time and Charges to \$50 per month from the present \$25 with a resulting annual revenue effect of \$3,900.

172. As there exists no testimony or cost analysis supporting this proposed increase, the Commission denies the request.

173. MTS and Operator/Credit Card Charges. Based on cost analysis, the Applicant proposes to restructure the existing MTS rate structure and to increase charges for certain operator assisted and credit card calls. The revenue effect equals a negative \$3,678.

174. The Applicant's rate design proposal for MTS, which is to establish a monotonically increasing rate as a function of distance for the first minute of a MTS call, has merit and is approved by the Commission: the further the distance involved in an intrastate call the more likely it will be switched through two or more central offices. The logic of a constant differential between the first and additional minutes -- a 10¢ lower rate has merit and is also approved by the Commission. As the proposed rate

increases for operator assisted station-to-station and person-to-person calls, and station-to-station credit calls are based on a 1980 "cost per message" study, the Commission approves of the proposed increases.

175. Although the Commission approves of the proposed rate design and rate changes discussed above, the Commission does not approve of the repression analysis that underlies the overall revenue effect of a negative \$3,678, as this is not a known and measurable change. As indicated by the Applicant's repression witness, any analysis of repression is subject to a great degree of subjectivity (TR, p. 1415). The Commission finds that the MTS rates in each mileage band should be adjusted upward by an equal percent so that additional revenues equal to the Company's repression estimate are generated so that the initial proposed revenue effect of -\$3,678.00 is retained. The Commission further notes that it will continue to exclude the consideration of repression in future dockets until such time a complete record is established.

176. Conference Call. The Applicant has proposed both rate design and rate changes for this service with a resulting negative revenue effect of \$97,853. The proposed rate structure would result in each leg or branch of a conference call being charged the appropriate long-distance rate plus an operator person-to-person charge.

177. As the Commission approved the Applicant's proposed MTS and operator person-to-person rates, it necessarily approves of the same for conference calls. The proposed rate design changes are also approved with the following exception. It is the Commission's position that conference call service is a competitive offering within an exchange but a monopoly offering when two or more exchanges are involved. As a result, the Applicant's rate design proposal is not appropriate for inter-exchange conference calls.

178. The Applicant proposes to charge different rates for the same inter-exchange conference call depending on the originating party to the conference call (see Document 882). The Commission can find no reason why the mileage charge component of total conference call costs should vary with the originator of the call; that is, if there exists more than one method of

linking up an inter-exchange conference call, a revenue maximization/minimization problem arises. As the inter-exchange conference call is a monopoly service, the Commission holds that the total revenues from providing the service should be minimized, and directs the Applicant to establish inter-exchange conference call rates that do not vary with the originator of the conference call, but rather are cost minimizing.

### Service Charges

179. In the following, the Applicant's rate design and rate proposals for basic business and residential service charges, maintenance of service, suspension and restoration of service and customer provided inside wire are provided followed by the Commission's response.

180. Basic Residential/Business Service. The Applicant's proposed multi-element service charge (MESC) for basic residential and business customers derived from cost estimates for service order activity involved in processing a service order. The proposed rates would increase the total MESC for residential customers from the current \$27.70 to \$63.50. and for business customers from \$48.20 to \$88.50. The proposed rates for the non-avoidable (certain elements of the MESC can be performed by the customer, resulting in the avoidance of the associated costs assessed by the Applicant) portion of the MESC (the service order and central office line changes) equal \$37 and \$54, respectively, for residential and business customers; the Applicant has stated that, for at least the basic residential customer, the non-avoidable component is only 49 percent compensatory (Exh. No. 24, p. 15). In its argument for the proposed MESC rate increases, the Applicant states:

Failure by the Commission to allow rates which compensate us for these expenses places an unfair burden on the general body of subscribers many of whom are retired customers living on fixed incomes, who do not move frequently.  
( Exh . No . 24, p . 22)

The revenue effect from the above proposal equals \$2,901,067.

181. Suspension and Restoration of Service. An unavoidable restoration change is currently assessed a customer to restore temporarily suspended service and equals \$5.50. The proposed rate equals \$14 and results in a revenue effect of \$65,240 (Exh. No. 24,p. 25). In a

related matter the Applicant proposes to increase the service order charge for a record change from \$2.00 to \$3.25.

182. Maintenance of Service. Presently Mountain Bell assesses a \$15 charge for a visit to any customer's premise for the repair of non-Company provided terminal equipment that resulted in service related problems. Based on a 1982 cost study (non-Montana FDC) on labor rates and work times plus gross receipts tax expenses, the Applicant proposed the following maintenance of service charges:

<u>Problem Type</u>	<u>Proposed Charge</u>
Exchange Non-data Residence	\$38.25
Exchange Non-data Business	54.00
Exchange Data or Private Line	83.00

The combined revenue effect of these Maintenance of Service proposals equals \$14,690.

183. The Montana Consumer Counsel presented testimony regarding the Applicant's proposed MESC rates. The Counsel's position was given by Mr. Buckalew:

Q. HAVE YOU EXAMINED THE SUPPORT MATERIAL THAT HAS BEEN FILED BY THE COMPANY FOR THE PROPOSED SERVICE CHARGES ?

A. Yes; I have examined Mountain Bell's Service Charges Cost Study. The cost study can be used to determine rates. However, the cost study presents the total company cost of providing service connections even though over 40% these costs are assigned to the interstate jurisdiction and recovered from interstate rates. The total costs presented by the Company need to be separated .

Q. WHAT DO YOU MEAN BY SEPARATED?

A. Just as the cost for local coin service must be separated and allocated to interstate toll, and local, so must the cost of establishing service. Service is established not only to make local calls but also for interstate and intra-state toll calls.

Although the FCC has moved companies toward the expensing of station connections, it has not removed those expenses from jurisdictional separations. In fact, Account 605 is still separated based on the subscriber plant factor. In calculating an alternative cost based rate, I have recognized the jurisdictional separations procedures. This simply means that the rate established for service connections should reflect the actual local costs .

Q. WHAT COSTS SHOULD BE ASSIGNED TO THE TOLL JURISDICTIONS?

A. The current procedures for separating these costs would apply the Subscriber Plant Factor be equal to .414502. The -Company does not determine an intrastate SPF but does calculate Subscribe Line Usage (SLU) at .120597. Using intrastate SLU it has estimated the intrastate SPF to be equal to .343701. Adding the intrastate and interstate SPF together equals .758203. This means that 75.8203 percent of service charges should be recovered from toll rates (41.45 percent from interstate toll and 34.37 percent from intrastate toll). I have calculated the cost of service charges to exchange customers using the present toll assignments. The results are presented in Exhibit (A. B . -9) .

In addition, I am recommending that an additional element for disconnection be added to the service charge tariff. The element should have the components Service Order work and Central Office work for disconnection. These charges would be included in the customers final bill. If these expenses are included at the time of service installation there will be mismatching of revenue and expenses.

(Exh. No. MCC5, pp . 39-41)

184. As evident from the above testimony, the MCC does not disagree with the total MESC cost estimates developed by the Applicant, but rather in how these costs are shared between local service and toll service. It is also the Commission's position that MESC rates should be based on the Applicant's cost study. The issue regarding MESC rates then, is whether a consumer should bear all or a fraction of the costs of his/her actions. Although the Commission finds merit in Mr. Buckalew's proposal to promote universal service through non-compensatory service charges, based on a strict application of the jurisdictional separations procedure, the Commission does not agree that it simply follows that a consumer should face only a fraction of the costs he/she causes Mountain Bell to incur.

185. The Commission disagrees with the testimony of Mr. Buckalew regarding how the separations process allocates costs, related to service connections, to the intrastate jurisdiction. Evident from the following testimony is Mr. Buckalew's belief that a fraction of the service charge cost is assigned to intrastate toll:

Q Turning to your rate-structure recommendations. You have recommended rates for service-connection charges significantly lower than the Company's recommendation, and if I may paraphrase, you do that on the basis that the separations process already allocates a significant portion of the costs to the interstate jurisdiction, and for that matter, to intrastate toll. Is that an accurate - -

A Yes, that s accurate. In other words, they're recovered in the interstate toll rates or intrastate toll rates.  
( TR . D . 1063 )

The Commission has not authorized the assigning of a portion of the service charge cost to intrastate toll nor does the Commission agree that access to the toll network should be billed on a usage basis via the recovering of service charges through toll rates. It is the Commission's position that such a practice would lead to the under-consumption of toll services.

186. The Commission directs the Applicant to institute its proposed MESC rates for basic residential and business customers with the following modifications. The proposed increases for the avoidable elements of the MESC are accepted in full. Rates for the unavoidable elements are to be increased to 81 percent of the proposed rates; as a result, a residential customer, for example, will incur a \$30 charge rather than the proposed \$37 for the Service Order and Central Office Line charges. (The unavoidable charges for Suspension and Restoration of Service and Record charges shall also be constrained by a rate equal to 81 percent of the Applicant's proposed. ) As the Commission believes this allowed increase for the MESC may pose a burden on certain customers, the payment shall be automatically prorated over a three month period unless a customer explicitly chooses to pay the full amount on a one-time up front basis.

187. Although the Commission finds merit in Mr. Buckalew's proposal to unbundle a disconnect rate element from the MESC, it rejects the proposal in that customers are less likely to

pay such charges upon termination of service. The charge would also tend to discourage customers from returning leased telephone sets thus potentially leading to higher costs.

188. The Commission finds merit in the proposal to charge different Maintenance of Service charges for different customer types and approves the proposed rates. It is the Commission's opinion that once a Standard Network Interface is in place, and a problem is determined to result from difficulties with customer-provided equipment that interfaces with the network, that the Applicant is in a competitive environment and should at least charge competitive rates.

189. The Applicant's Customer Provided Inside Wire proposals will be considered in Docket No. 82.6.37.

#### Exchange Service

190. Many of the Applicant's proposed rates for items in the Exchange Services category (Exh. No. 24, Sch. 1 and 2 of 2) are either directly or indirectly affected by the proposed increases for "Main Station and Related" exchange access rates e. g., 1FR, 1FB, etc. In turn, the Applicant based the increases in the "Main Station and Related" exchange access rates on its 1980 EDA. The following discusses the Applicant's proposed and the Commission approved rate and rate design changes for coin service-rates, semipublic coin commissions, collapsing of the nine business rate groups, special school centrex and specially classified service. The Commission approved rate increases for all other exchange service items are treated on a residual basis as discussed in the revenue reconciliation section of this order.

191. Local Coin Rates. The Applicant has proposed rate charges for both local exchange coin rates and for the commissions paid on semipublic coin collections . First, based on a 1977 Exchange Class of Service (ECS ) study, trends in annual embedded exchange costs (1977 to 1980) from the EDA and other factors e. g., recession, the Applicant estimated an annual revenue shortfall of \$1,884,982 for coin service assuming a 10¢ coin rate . With a 25¢ coin rate,

the annual revenue shortfall is reduced to \$994,341. Based on this analysis, the Applicant proposed a 25¢ coin rate. In addition, the Applicant proposed to eliminate commissions paid on semipublic coin box collections resulting in an annual savings of \$107,677.

192. The MCC's expert witness Mr. Buckalew analyzed the cost study underlying the proposed 25¢ coin rate and concluded that no increase in the current 10¢ rate is justified. The MCC's essential criticism is as follows:

Q. DOES THE ECS STUDY ACCURATELY REFLECT THE COST OF PROVIDING LOCAL COIN SERVICE?

A. No. The Company's study includes costs which should not be included in a local coin cost study. For example, access costs, or loop costs (the non-traffic sensitive costs of coin service) should also be assigned in part to interstate or intrastate toll services, not solely to local service. That is, the Company should have applied the separations procedures, which would have assigned about 76 percent of these costs to toll.  
(Exh. No. MCC 5, p . 43)

193. While not in disagreement with the Applicant's cost study, the Commission does not support an increase in the local coin rate. Unlike the MCC argument for retaining the 10¢ coin rate, which is based on the jurisdictional separations of costs, the Commission simply holds that the overriding goal in setting the local coin rate is the objective of maintaining universal service.

194. The Commission concurs with the proposal to eliminate commissions on semipublic coin service. The reasons cited by the Company e . g . , the monthly rate for access is less than the 1FB rate, the additional business derived from providing coin service etc., indicate that there indeed exists additional benefits that render unnecessary the payment of commissions on coin box collections.

195. Local Exchange Service. In Order No. 4786b, " . . . the Commission established a single rate group throughout the state for one and two-party residence service. " (Exh. No. 24, p.

43) The basis for this proposal was to establish rates on a cost of service rather than value of service basis.

In this Docket, the Applicant has made a similar rate design proposal for the 1FB and 2FB business rate groups. Existing exchange rate groups one through four would become rate group I and existing groups five through nine would become rate group II under this proposal. Also, Sidney would be shifted into the proposed rate group II.

196. The Commission finds merit in the proposal to base exchange rates for business customers e. g., -1FB, 2FB on a cost rather than value of service basis. The Commission, however, does not favor as large an increase for business exchange rates as proposed by the Company. On the other hand, the Commission does not believe it to be timely for a rate decrease, a result that would derive from computing a weighted average 1FB rate for each of the Applicant's two proposed rate groups. Consequently, the Commission directs the Company to establish two exchange rate groups for 1FB and 2FB service. The rate for each new group shall equal the existing rate for exchange group four and nine. That is, for example, the 1FB rate for exchange rate groups I and II shall equal \$15 . 98 and \$22.43, respectively. The shifting of Sidney into exchange rate group II is also approved. As a consequence of restructuring the 1FB rates, an additional \$622,685 in revenues will be generated.

197. Special School Centrex. The Applicant has proffered several rate changes for Special School Centrex service including: (1) an access rate equal to the 1FR rate; (2) a \$0.50 reduction in the access rate if a dormitory is served by Centrex CU; (3) an additional \$0.84 credit in the access rate if the University/College assumes responsibility to collect rates and charges from students; and (4) a \$0 .45 rate for extension station lines (Exh. No. 22, p. 27).

198. The Commission finds merit in each of these proposals and concurs with the Applicant that similarity does exist between dormitory service and residential service. The Commission is less certain of the merit to establish an extension station line rate and defers to the

generic docket (Docket No. 82 . 6. 37) a decision on this proposal; all other proposals are approved .

199. Specially Classified Service. Specially Classified Service is an exchange access service rate provided to schools that do not assess tuition fees and/or are supported in part by a church or religious group (Exh. No. 24, p. 63). The current rate for this service equals the Rate Group I 1FB rate when provided within the Base Rate Area; otherwise the appropriate rural or four party business rate for Rate Group I applies. The Applicant proposes to eliminate this service and withdraw the offering.

200. The Commission finds merit and approves of the Applicant proposal to eliminate this discriminatory offering from the tariffs.

201. Rotary Equipped Service. Currently, the Applicant's rates differ for Companion Line and PBX Trunks- equipped with Rotary Service -- the hunting function. The current rates were designed to reflect the different end-use applications of a Trunk versus a Companion Line. Due to the advent of Multifunction communication equipment, however, the Applicant can no longer determine the end use of a Companion Line with Rotary Service. Consequently, the Applicant proposes to collapse the rates for Trunks and Companion Lines, setting a new rate equal to 125 percent of the 1FB rate.

202. The Commission finds merit in and approves of this proposal. PBX Trunks and Companion Lines with Rotary Service shall have rates equal to 125 percent of the 1FB rate.

### Repression

203. In Docket No. 80.12.100 the Commission's position regarding repression was stated for toll service (see Finding of Fact No. 205 of Order No. 4786b). Essentially the Commission's position was that repression adjustments would only be based on "comprehensive price elasticity studies. " In this Docket, the Applicant has proposed a repression effect of

\$2,268,570 which derives from the following sources: Intrastate Private Line and recurring and nonrecurring residence and business services. The Applicant also proposed repression adjustments for Message Toll Service and local coin rates; the former was discussed in Finding of Fact No. 175 and the latter is a moot point due to the Commission's finding that a 10¢ coin rate is, appropriate.

204. The Commission's position regarding repression adjustments is that they are not known and measurable and as a result will not be granted. The Applicant's own expert witness has testified to the subjectivity involved with such analysis (TR, pp. 1414-1415). The Commission once more notes that it will continue to exclude the consideration of repression until such time as a complete record is established.

#### Revenue Reconciliation: A Summary

205. The revenue requirements portion of this order identified a need for increased revenues, including toll settlements, equal to \$8,954,000. As evident from Schedule 9, the Commission "known and approved" revenue effects fall short of this total revenue effect. The Applicant is to generate the residual unknown revenue requirement in the following manner.

206. Vertical Services. The known and approved revenue effect in the vertical service category equals \$2,915,000. An undetermined additional increase of up to \$1,394,362.00 remains. The major share of this unknown potential (\$863,972) derives from the obsolete PBX category (\$721,295) and Optional Custom and Tie-Line PBX offerings (\$142,667). The problem the Commission faced regarding this proposed \$863,972 increase is not knowing what share is based on Montana FDC studies versus an overall vertical service percent increase of 20 percent. The Commission approves of the share based on Montana FDC, per Finding of Fact No. 131, unless the current rates exceed Montana FDC, and directs the Applicant to increase rates for other items by the resulting overall percent increase for this service category.

	Known and Approved
<u>Service Category</u>	<u>Revenue Effects</u> <u>(1,000 \$)</u>
Vertical Services	\$ 2,915.00
State Private Line	1,861.00
Intrastate Toll	-101.00
Service Charges	2,406.00
Exchange Services	<u>730.00</u>
Total	\$ 7,811.00

<sup>1</sup> The amounts listed are approximations and will necessarily be modified per the Findings of Fact in this order.

207. Private Line. Although the rate modifications made by the Commission are minimal, primarily effecting rates for Off Premise Extensions and SBS patrons, the final revenue impact is unknown. The estimate of \$1,861,000.00 in Schedule 9 was developed by the Applicant and excludes the overall vertical service percent increase that will be allowed for Network and TELPAK services .

208. Intrastate Toll. The final revenue effect for the Intrastate Toll Category is unknown. While several known rate increase proposals were denied by the Commission, other Commission directed rate design and rate modifications made uncertain whether the final revenue effect is positive or negative.

209. Service Charges. The known and approved component for the Service Charge category equals \$2,406,000. The unknown increase derives from the Commission's decision to moderate the Applicant's proposed increases for Suspension and Restoration of service and record changes. The potential revenue increase, however, approximately equals \$52,844 -- 81 percent of the Company proposed revenue effect of \$65,240.

210. Exchange Service. As a consequence of both rate design and rate changes, this category generates a known and approved revenue effect of \$730,362. To the extent there exists a revenue deficiency after accounting for all increases approved by the Commission in the previous four service categories, the Exchange Service category shall serve as the residual category to insure that the Applicant generates \$8,954,000 in increased revenues. The Company is directed to increase all "Main Station and Related" rates and all other rates that are tied to these rates by a uniform percent increase so that the total revenue effect of \$8,954,000 is generated. The Applicant shall include Facilities for Common Carriers in this service category for purposes of rate increases.

### QUALITY OF SERVICE

211. During the course of public testimony throughout the state frequent service problems were discussed, including the problems resulting from centralization, reporting of repairs, delayed repairs, etc. The Commission is deeply concerned about these persistent complaints about the quality and timeliness of service and has on several occasions advised Mountain Bell of those concerns. (Reference letter. )

Periodically, the Commission received reports detailing certain service criteria, and, although small in number, these criteria are extremely important. They are listed below.

<u>Montana</u>	<u>October, 1981</u>
<u>October, 1982</u>	
Unfilled Orders-Main Total	459
670	
Unfilled Orders-Main Over 30 Days	301
447	
Unfilled Regrades-30 Days	1,393
1,339	
Installations Over 5 Days-Regular	8.6
15.8	

Installation Appointments Not Met-Regular	1.9
2.2	
Customer Reports Per 100 Stations	3.5
4.4	
Repeated Repair Reports	15.3
18.7	

212. It can be readily seen that there has been a significant, numerical change for the worse. The Commission, however, does not have telephone quality of service rules and regulations with which to ascertain the reasonableness of these numbers, although a common sense approach could be satisfactorily applied. To remedy this problem the Commission orders Mountain Bell to submit with its next general rate case filing or by December 31, 1983, whichever comes earlier, a comprehensive set of telephone quality of service rules and regulations for consideration by the Commission. The submission should include performance standards and thorough documentation to establish performance benchmarks. The Commission would also request that the Montana Consumer Counsel evaluate the Company's submission and indicate its acceptability. The Commission also requests that other telephone utilities under its jurisdiction comment on Mountain Bell's proposal since the intention is to use this information to establish rules and regulations of general applicability.

#### 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 MCA § 69-3-101.

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

3. 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 rate-making purposes "...may not exceed the original cost of the property."

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

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

### ORDER

#### THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. The Mountain States Telephone and Telegraph Company shall file rate schedules designed to produce a test year revenue increase of \$8,954,000 from its Montana subscribers .
2. The increased revenues authorized herein shall be collected from tariffed services in the manner described in the Findings of Fact of this Order.
3. The increased rates authorized herein shall be effective upon the filing and approval of revised tariffs consistent with this Order.
4. Mountain Bell's final rate calculations are to be supported by detailed working papers showing: 1 ) test year sales; 2 ) Docket No . 82 . 2 .8 rates; and 3 ) the product of 1 ) and 2 ), summed, equaling the total revenue requirement, less the existing revenue requirement.
5. The Applicant is directed to begin collecting peak network usage data per service category.
6. All motions and objections made by parties in this Docket not ruled upon in the Findings in this order are hereby denied.
7. At such time as the Federal-State Joint Board accepts the FX/ CCSA adjustments and the 7-day usage adjustment in FCC Docket No. 80-286, the Company shall immediately- file tariffs which decrease rates by \$5,538,000. This decision is anticipated March 16-17, 1983. See Finding Nos. 64-68.
8. The Applicant is directed to file the following information with its tariffs supporting this filing. For each of the "Big Six" phones (rotary and Touch-Tone phones in the

Princess, Trimline and Traditional styles ) the Applicant is directed to file, 1) estimates of the embedded costs for capital -- exclusive of common and joint costs -- for each phone in place and in inventory, 2 ) estimates of transaction-type costs - - administrative -- for selling each phone type, and 3) estimates of any other costs that would be incurred as a result of selling off the "Big Six" phones. The format and intent of this request is to establish sales prices for the Big Six and the associated revenue requirement that will result from either the sale of such equipment to customers or the transfer of such equipment to American Bell under the Modified Final Judgment.

9. Currently, businesses leasing obsolete PBX equipment are effectively locked into their leases: they are burdened by increases in their monthly lease rates on one hand and penalized for early termination of the lease on the other. The Commission intends to rectify this dilemma and orders the Applicant to submit a plan within 60 days with a proposed solution.

DONE AND DATED this 29th day of November, 1982, by a vote of 4-1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

JOHN B. DRISCOLL, Commissioner

(Dissent)

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. Cottrill

Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38.2.4806 ARM.

November 24, 1982

JOHN B. DRISCOLL  
COMMISSIONER  
DISSENTING OPINION

I have concurred with the majority of decisions we made during the construction of this very complicated Order. Unfortunately, three of the areas wherein I disagree are simply too important not to dissent from the entire Final Order. 1. We should not be allowing AT & T's continued use of "five business day usage studies" to allocate joint telephone costs and expenses to intrastate rate payers in Montana. 2. We should recognize in this Order, as we did in our last, that interstate Foreign Exchange Service (FX) and Common Control Switching Arrangements (e.g. Federal FTS lines) are causing costs that should not be borne by the rate payer in our intrastate jurisdiction. 3. And, finally, we should allow revenue for 7.6% salary increases based on this year's employee levels, rather than last year's. If we made these three adjustments to this Order (\$4.2 million, \$1.3 million, and \$8.2 million, respectively), we would be authorizing a revenue level that is \$13.7 million less than the one allowed. Hopefully, from the following points, one can see that there is more at stake than just money.

1. The Consumer Counsel advocates, the Commission accepts, and the Company does not disagree that "seven day usage studies " give a more accurate allocation of joint

telephone plant costs and expenses to intrastate rate payers. All agree that the Company has chosen to use "five day studies" because no one on the Federal or State levels directed the Company to use the more accurate means of apportionment. Consequently, captive intrastate ratepayers around the country are paying for costs caused by interstate users. The Company argues that we should allow the continued misallocation for the sake of "uniformity between jurisdictions"; this Order agrees. Central to the uniformity argument is the fact that the FCC has deferred the misallocation problem to a State/Federal Joint Board, rather than unilaterally base interstate rates on seven day usage studies. Rather than interpret this deferral as a reaffirmation of the wisdom of AT&T's five day studies, it's clear to me that the FCC has no alternative. If the Federal regulators recognized the improved seven day method, there would be a windfall of excess revenues to the phone company nationwide. A temporary over-collection of revenue would result at both the State and Federal levels until such time as cumbersome state regulatory proceedings and court tests could allow state commissions to change to the seven day method. In the rate payer's interest, the FCC cannot be the first to require the more accurate allocation method.

Meanwhile state commissions like ours, faced with NOTHING MORE THAN A COMPANY POLICY, and constantly barraged with charges by the utility that we are being unfair, are reluctant to force a change until the utility can pick up lost revenue from intrastate rates with a change of FCC policy. By adopting the five day usage basis and successfully playing the states off against the Federal regulators, AT&T has unfairly shifted costs to the more captive intrastate ratepayer around the country.

I think it's time for the farce to stop. AT&T analysts and management have had plenty of time to review the impact of their policy. They best of all, could have addressed the misallocation by uniformly filing 7 day usage based studies in all jurisdictions...rather than continue to ride the good will and reasonableness of state commissions and courts around the country. This Commissioner's reservoir of good will on this point is exhausted. Our Commission is charged legally with allowing revenues (only) that cover the legitimate costs of the intrastate utility, plus a reasonable opportunity for a fair rate of return. If we already recognize the seven day usage rate as a more accurate measurement of the costs actually caused by the intrastate ratepayer, then we

are bound to not recognize costs based on a known misallocation process. We have given the Company long enough to address the problem in a business like manner; now its the ratepayer who must be treated fairly.

2. The Company, the Consumer Counsel, and this Commission all acknowledge that minutes of telephone use associated with essentially interstate services (FX and FTS) are being included in intrastate costs for this rate case. However, the Company argues that the calculation procedure they have adopted (again NOTHING MORE THAN A COMPANY POLICY in the absence of specific state or federal direction to the contrary) has acquired the legitimacy of "common practice". I would refer again to the same dilemma for state and federal commissions that I presented in item #1. Furthermore, this Commission in its last Order told the Company to change its calculations, and disallowed such interstate costs from being in the intrastate rate-base. The Company is now appealing that provision, among others, in Court.

Why should the Commission change its mind now? What was true for the last Order is true for this one, at least until the contending views have been heard by a judge. By allowing these interstate costs into the intrastate rate base, we are not only being unfair to the intrastate ratepayer, we are offering the utilities we regulate still another incentive to pancake more repeat rate cases onto an already overworked Commission and Staff. To our credit we have again dutifully and laboriously examined every detail of the record out of a sense of responsibility to our job. At some point, however, the utility has to stop abusing our sense of fairness for every ridiculous notion it feels it can cram into a rate case. Our reversed decision on this matter in this Order simply feeds fuel to the Company's apparent strategy of non-restraint.

3. Finally, the Commission has taken a step in the right direction by restricting revenue for management salaries to an increase of 7.6% in 1982. We are told that labor increases are already held to a 7.6% increase by contract. What we have failed to do, however, is even more important. We failed to recognize the significant unprecedented decrease in numbers of employees working for the Company...in 1982. By limiting revenue requirements related to compensation to a 7.6% increase for the 3257 employees working for the Company in 1981, we are making available enough revenue for a 21% increase to the estimated 2906 employees actually working in 1982.

TABLE Id: \*

	1981	1982 (7.6% increase on test yr. Employee employee level.)	1982 (7.6% increase on estimated 1982 level.)
Salary & Wage payments (000) ,	\$71,278 <sup>1</sup>	\$76,695 <sup>2</sup>	\$76,695 <sup>2</sup>
Employees	3,257 <sup>1</sup>	3,257 <sup>1</sup>	2,906 <sup>3</sup>
Avg. Salary/yr.	\$21,885	\$23,548	\$26,392
Avg. Increase over 1981	7.6%		21%
Excess Revenue Requirement over that necessary for a 7.6% increase in average salary for expected employees:			\$8.264 million

\*Footnotes on next page.

If you consider, further, that most of the Company's non-management employees are already held to a 7.6% increase by labor contract, then the management employees will have sufficient revenue to enjoy far in excess of even the 21% increase. In spite of the rhetoric in our Order, the sky is the limit for management salaries.

The Commission has been reluctant to recognize the decreasing number of employees in this Order, because of past rate-making practices. Usually, we allow scheduled pay increases beyond the test year into the revenue requirement on the notion that those scheduled increases are "known and precisely measurable" changes to the test year. On the other hand we have usually not spread those scheduled revenue requirements over expected employee levels beyond the test year on the argument that projected employee numbers are not "precisely measurable". Recognizing expected wage and salary costs has been to the benefit of the utilities in every case. Not recognizing expected employment levels has accrued to the benefit of the rate payer in years when employment was increasing. Conversely, the ratepayer was damaged in years when

employment decreased; the utility enjoyed not only forecast salary related revenues, but all of the savings associated with not having to spend those revenues at the higher test Year employee levels.

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<sup>1</sup> Taken from R. Remington's pre-filed Schedule 7; p. 2 of 2 (Not clear whether these include significant increases in fringes, pension and Social Security costs mention elsewhere in testimony).

<sup>2</sup> 1.076 X \$71,278 million.

<sup>3</sup> Taken from R. Remington's updated filing to Commission during Hearing.

<sup>4</sup>  $\$26,392 - \$23,548 \times 2906 = \$8.264$  Million.

Now, we are faced with extremely significant declines of employs . in the year that follows the test year. The subsequent year ended a month ago. The decline is due largely to the planned centralization of a variety of operator and maintenance services, the Company assuredly knows certainly, if not precisely, the magnitude of employee decreases associated with planned centralization. It has to consider such information in the decision to embark on such important programs. Perhaps the last dozen or so employees to be lost are the .most difficult to predict; they won't be "known and precisely measurable" until 1982 is a historical test year., long enough to have personnel records checked and summarized. For this reason, I will grant that estimated employment is slightly less known or measurable than expected salary levels.

In this case, however, two other important considerations have been made very clear to the Commission:

a. Montana intrastate ratepayers have not been sharing as much in the efficiencies of the Bell system, as rate payers in the rest of the country do in their respective variations of the Bell system. The Total Factor Productivity Index, presented in this case by the Company, says to me that over the last ten years Montanans have gradually been paying relatively more (in real 1967 dollars) for services of the telephone company (cost in real 1967 dollars) than rate payers in any other part of Mountain Bell, or AT&T. If we attributed Montana Bell's higher productivity index solely to its management efficiency (as the Company would like), rather than to over pricing or under investment, one still has to ask: Why haven't Montana ratepayers shared in increasing productivity to the same degree as their counterparts of the United States?

b. The quality of service is fast deteriorating around Montana due to the centralization programs that have caused the employee drop. Un-audited company records substantiate the public testimony and letters we have received claiming that the quality of service response is in a nosedive.

In conclusion, I believe that there are too many important variables changing drastically in relation to each other. The Commission must not be restrained by rigid interpretation of a past

rate making policy. An absolute downturn in employee levels is known-: Its major magnitude is certain, though not precisely measurable. Any "unfair cost" that might inure to the Company because expected employee levels end up slightly higher than expected (Est 2906), will more than adequately be offset by the fact that Montana intrastate ratepayers are currently experiencing a decidedly inferior quality of service due to centralization.

ATTEST:

Madeline L. Cottrill

Commissioner Secretary

(SEAL)