MASTER FILE COPY

Service Date: November 6, 1985

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

* * * * * *

IN THE MATTER Of The Application of AT&T COMMUNICATIONS OF THE MOUNTAIN STATES, INC. for Interim and Final Approval of Interim and Final Intrastate Tariffs.	)	UTILITY DIVISION DOCKET NO. 83.11.80 ORDER NO. 5044d

APPEARANCES

REPRESENTING AT&T COMMUNICATIONS OF THE MOUNTAIN STATES, INC.:

THOMAS HANKLEY AND T. LARRY BARNES, 1875 Lawrence, Denver, Colorado 80202

REPRESENTING MOUNTAIN BELL:

LAWRENCE D. HUSS AND DENNIS R. LOPACH, 560 North Park, Helena, Montana 59601

REPRESENTING THE RURAL MONTANA TELEPHONE SYSTEMS:

CALVIN K. SIMSHAW Montana Telephone Association, P.O. Box 2166, Great Falls, Montana 59401

REPRESENTING THE MONTANA CONSUMER COUNSEL:

JAMES C. PAINE, 34 West Sixth Avenue, Helena, Montana 59601

REPRESENTING THE MONTANA PUBLIC SERVICE COMMISSION:

ROBERT NELSON, 2701 Prospect Avenue, Helena, Montana 59620

BEFORE:

CLYDE JARVIS, Chairman
HOWARD ELLIS, Commissioner
TOM MONAHAN, Commissioner
DANNY OBERG, Commissioner

FINDINGS OF FACT

* * * * * *

General

1. On November 22, 1983 AT&T Communications of the Mountain States, Inc. (hereafter AT&T or Company) filed its original application in this Docket. Interim Order Nos. 5044, 5044a, and 5044b are the basis for the tariffs which established the rates for AT&T's Montana intrastate services.

2. On July 13, 1984 AT&T revised its application, testimony, and revenue requirement. Concurrent with this revised filing the Company requested additional interim earnings relief in the amount of $1,357,000. This would translate into an increase in revenues or a decrease in expenses of $2,695,000. In Order No. 5044c the Commission granted interim earnings relief in the amount of $816,000. This was accomplished by authorizing a decrease in access charges of $1,620,000.

3. On February 26, 1985 AT&T filed supplemental testimony based on its actual results of operations for 1984. In the supplemental testimony AT&T stated a need for additional earnings in the amount of $440,000.

4. On April 23, 1985 AT&T filed an update to its supplemental testimony which revised its requested earnings increase to $904,000.

5. The following parties intervened in this Docket:

Montana Consumer Counsel
Mountain Bell
Rural Montana Telephone Systems
Northwestern Telephone Systems
State of Montana - Dept. of Administration

Cost of Capital

6. Steve Vinson presented testimony on cost of capital issues on behalf of AT&T. Mr. Vinson recommended the following capital structure and capital costs be authorized for AT&T:

Component	Weight	Cost	Weighted Cost
Equity	60%	17.10%	10.26%
Debt	40%	7.69%	3.08%
	100%		13.34%

John Wilson testified on behalf of the Montana Consumer Counsel on cost of capital issues. Dr. Wilson recommended the following capital structure and capital costs be authorized for AT&T:

Component	Weight	Cost	Weighted Cost
Equity	60%	15.00%	9.00%
Debt	40%	7.69%	3.08%
	100%		12.08%

7. The appropriate cost of debt and capital structure were not contested issues. The Commission finds that a cost of debt of 7.69% and a capital structure of 60% equity and 40% debt are reasonable for the purpose of determining an authorized rate of return in this Docket.

Cost of Equity

8. Mr. Vinson arrived at his recommended required return on equity by applying the Discounted Cash Flow (DCF) method to a

broad composite of industrial firms (268 companies drawn from the S&P 400) and by applying the DCF method to a sample of 10 nonregulated firms analytically comparable in investment risk to AT&T Communications. Mr. Vinson testified that AT&T Communications has financial risk characteristics very similiar to that of the average industrial company. Therefore, Mr. Vinson performed his DCF analysis for a set of companies drawn from the S&P 400 and uses this as a proxy of the cost of equity to AT&T Communications. These DCF analyses resulted in a cost of equity of 16.7%. Mr. Vinson then added 40 basis points to this cost for a flotation adjustment, resulting in his recommended return on equity of 17.1%.

9. Dr. Wilson performed a DCF analysis for the telephone utility industry. That study revealed that the cost of equity equity capital for the nine telephone companies used in Dr. Wilson's cost of capital study and for the seven Bell Regional Holding Companies is in the range of 12 to 14 percent (MCC 2, Exhibit J.W.-2). Dr. Wilson recommended 15 percent in recognition of the fact that AT&T Communications' Montana operations are somewhat more risky than the average telephone utility. Dr. Wilson then compared this result to the earned returns on equity capital in recent years by both regulated companies and unregulated companies and determined that based on recent earned returns a cost of equity of 15 percent is reasonable.

10. It seems that the major disagreement between the parties is whether AT&T Communications more closely resembles a

telephone utility or a unregulated industrial firm. Both parties agree that, given the vast changes in AT&T during 1984 a typical DCF analysis of AT&T should not be used in this case because there is not yet enough actual data to do a meaningful DCF study on AT&T. Both parties also agree that AT&T Communications is more risky than the typical telephone utility (AT&T 3, p.5 and MCC 2, pp. 21-22). The Commission realizes that it is difficult to examine the cost of capital to a utility on a state by state basis. None the less, this Commission has attempted to take into account the unique nature of Montana in the telecommunications field when examining the risk of a company's Montana operations. Mr. Vinson points out several reasons why the risk of AT&T's telecommunications operations has increased. Among the reasons Mr. Vinson lists are competition, access charges, risks of being a new organization, technology, and regulatory lag. The Commission certainly is aware that AT&T's risk has increased since divestiture. However, the risk in AT&T's Montana operations is probably considerably less in Montana than in other states. As Mr. Vinson points out, currently no other common carriers are doing business within the state of Montana. The Commission and the Montana legislature have also recognized AT&T's need to be able to react to competition. They have responded to the new telephone environment in such a manner as to mitigate the risk or adverse effects AT&T confronts in states where lawmakers and regulators have not responded to changes by permitting AT&T to effectively compete in the marketplace.The request of AT&T for flexible pricing in this Docket is granted in this order. The 1985 Montana Telecommunications Act contained sections which allows AT&T to apply for further flexible pricing or detariffing when competition develops and to offer specific customers detariffed bids or contracts if that customer is considering another carrier or bypassing the telephone network. The Commission has also allowed AT&T considerable flexibility in pricing by approving Reach Out Montana, Pro Montana, and the Software Defined Network Package. These steps should help substantially in allowing AT&T to react to the new competitive environment. Montana has taken these steps with the realization that the rural nature of Montana will mean that competition developes much slower in this state than in many if not most other states. Therefore the Commission finds that AT&T's arguments that the risk of its operations are equal to that of an industrial firm, at least as those operations relate to Montana, to be unpersuasive.

11. Dr. Wilson added 100 basis points to the high end of the results of his DCF analysis of telephone companies. The Commission finds that this results in a fair and reasonable rate of return and adequately recognizes the increased risks of AT&T's Montana operations. This is the highest return on equity ever granted by this Commission for a major Montana utility. It is also granted based on a capital structure that is much more equity rich than that allowed to Mountain Bell or any other major Montana utility.

12. Mr. Vinson proposed an adjustment of 40 basis points for flotation costs and market pressure. Mr. Vinson explains

that each dollar raised in the capital market exceeds the amount recorded on the books by the amount of issuance costs and any drop in price caused by market pressure. Mr. Vinson ignores the fact that if stock is selling significantly above book value the net proceeds from a sale may still be in excess of the book value per share. The Commission has routinely rejected this type of adjustment absent a showing that the costs are actually incurred and should be paid by ratepayers.

13. The Commission authorizes AT&T Communications an overall return of 12.08% as follows:

Component	Ratio	Cost	Weighted Cost
Equity	60%	15.00%	9.00%
Debt	40	7.69%	3.08
	100%		12.08%

Revenue Requirements

14. Mr. Glenn Waller testified in the area of revenue requirements on behalf of AT&T Communications. Mr. Waller recommends an additional earnings requirement of $904,000.
Dr. Wilson testified on behalf of the Montana Consumer Counsel on issues concerning revenue requirement. Dr. Wilson recommends the Commission allow AT&T no additional revenues in this case. The following revenue requirement issues where presented to the Commission in this case:

1. Contract Float Revenues
2. Revenue Annualization
3. 1985 Pension Accrual
4. Contract Labor
5. Employee Reductions
6. Interest Synchronization

7. Inclusion of contract data in revenue requirement calculation.
8. Northwestern Telephone Systems traffic.
9. Standard Network Facilities Agreement (SNFA) and Percent Interstate Usage (PIU) True-ups.

Contracts

15. Four Issues in this docket relate to contracts between Mountain Bell and AT&T. The issue of the SNFA true-up will be addressed seperately in this order. The major issue in the contract area is whether or not the revenues, expenses and rate base of AT&T related to contacts between AT&T and Mountain Bell should be included in AT&T's revenue requirement calculations. The Modified Final Judgement required the ownership of multifunction facilities (i.e. facilities used for both interLATA and intraLATA services) to be assigned to either AT&T or the Bell operating company. Joint ownership of facilities was not allowed. Ownership was assigned based on the predominant use of the facilities. To avoid requiring AT&T and the BOC's to replace or duplicate these costly facilities the companies were allowed to enter into contracts for sharing of multifunction network and operator facilities. These contracts are the Shared Network Facilities Agreement (SNFA) and the Operator Service Contract. The SNFA included facilities such as switching equipment, cable and transmission facilities, central office equipment, land and buildings, support systems, etc. AT&T leases facilities to Mountain Bell for use in providing intraLATA service and Mountain Bell leases facitilities to AT&T for use in providing both interLATA intrastate and interstate services. It is the position of AT&T that facilities leased from Mountain Bell are used by

AT&T to provide Montana interLATA services. However, facilities leased to Mountain Bell from AT&T are not used by AT&T to provide interLATA services to its Montana customers and therefore should not be included in the calculation of AT&T's revenue requirement. Montana Consumer Counsel objects to AT&T's treatment of contract revenues noting that although these facilities are not used to provide interLATA services to Montana customers they are used to provide intrastate services to Mountain Bell and have been included in Mountain Bell's cost of service. Dr. Wilson also notes that the contracts are based on a rate of return of 12.75% which is in excess of the rate of return granted to either Mountain Bell or AT&T. Since the SNFA costs have been included in Mountain Bell's rate case and have been paid by Montana intrastate telephone customers it would be unfair for these revenues and costs to be excluded from AT&T's cost of service.

16. The Commission agrees with Mountain Bell that the revenues, costs and investment associated with contracts should be included in the revenue requirement calculations of AT&T. It would be inconsistent and unfair to include contracts in Mountain Bell's revenue requirement and then exclude these same amounts from AT&T's revenue requirement. All revenues and costs to provide telephone service to Montana intrastate customers should be taken into account in viewing the financial situation of the telephone companies. Companies should not be allowed to avoid regulatory scrutiny by placing intercompany transactions into contracts rather than tariffs. Placing these contracts outside

of regulatory scrutiny could also cause problems in the future. For instance as the terms of these contracts end and the companies cannot or chose not to renew them the costs of the facilities will remain. Assuming that growth within the lessors business has expanded to require the use of these facilities the costs could be placed back into the regulated revenue requirements. This could result inconsistent treatment from case to case. Therefore, the Commission finds the request of AT&T for exclusion of contracts from its revenue requirements to be unreasonable.

17. The second issue concerning contracts is the treatment the Montana Consumer Counsel recommends for 1985 wage increases. Dr. Wilson recommends an adjustment to remove the portion of 1985 wages that will be recovered through the intercompany contracts. The Commission uses the AT&T adjusted results shown in Mr. Waller's Updated Supplemental Testimony dated April 22, 1985. In this testimony Mr. Waller made an adjustment to "reflect the impact of the correct 1985 management and nonmanagement wage assumptions and to included the proper treatment of the credits received from service contracts". Therefore, the Commission does not reflect this adjustment in its revenue requirement calculations since it was contained in AT&T's adjusted results.

18. The third issue concerning contracts is the treatment of contract float revenues. Dr. Wilson explained that float payments are designed to provide AT&T with a return on its contract-related cash working capital. (MCC 3, p.8) Mr. Waller excluded these revenues based on the fact that the revenue

requirement he calculated contained no allowance for cash working capital. Therefore, to include the contract revenues associated with cash working capital without including a cash working capital component in rate base would be inconsistent.

19. Dr. Wilson recommended inclusion of these revenues in AT&T's revenue requirements. Dr. Wilson explained that since AT&T did not present a lead-lag study in this case there was no basis to assume that the float return is a reasonable approximation of the return for cash working capital. Dr. Wilson also testified that AT&T's costs reflected the float return paid to Mountain Bell and that these expenses reflected the fact that AT&T has a lag in the payment of contract expenses to Mountain Bell, thus offsetting to at least some extent any working capital provided by AT&T to Mountain Bell.

20. The Commission finds that inclusion of contract float revenues is appropriate in this case. If a lead-lag study had been presented in this case there is no evidence that the result would have been positive or negative. It certainly seems inconsistent to include the cost of float revenues paid to Mountain Bell and not to include the revenues for float revenues paid to AT&T.

Revenue Annualization

21. In January of 1984, AT&T was granted an additional $293,954 in annual revenues. However, due to billing problems these rates were not effective until May of 1984. Dr. Wilson proposed an adjustment to annualize the effect of this revenue

increase. AT&T has no objection to this adjustment with the majority of this adjustment. During cross examination by Mr. Paine Mr. Waller explained:

> Q. So would you agree that the test year in this case, 1984, should fully reflect rate increases already granted by the Commission?
>
> A. With a limitation that -- yes, I would, with a limitation that a portion of the 200 -- 293954 that related to the FX open end, and I think the amount was 43,805, it is my understanding that it could not be implemented, so it would not be appropriate to include an annualization effect on that ...

22. The Commission has consistently required annualizing the impact of both expense and revenue changes that occurred during the test year. An excellent example of this type of adjustment is the adjustment Mr. Waller makes to annualize 1984 wage increases. Therefore, the Commission finds that Mr. Wilson's adjustment is appropriate. However, Mr. Waller is correct in pointing out that not all of the $293,954 has been implemented. Which company should bill for the open end of interLATA FX services was an issue which continued throughout 1984. At the start of this hearing AT&T and Mountain Bell presented a stipulation whereby Mountain Bell would bill customers for the open end of an interLATA FX service. This stipulation was accepted by the Commission. Therefore, the Commission has reduced Dr. Wilson's adjustment by $43,805.

Pension Accrual

23. The pension accrual rates that AT&T was booking during 1984 reflect an estimated or interim pension accrual rate (i.e. a

rate that is not based on an actuarial study). (Trans. pp. 97-98) Dr. Wilson recommended an adjustment to reflect the pension accrual rate that was being used during 1985. This rate is also an interim rate. The Commission accepts Dr. Wilson's adjustment. While the Commission acknowledges that it would probably be more accurate to use rates based on an actuarial study, neither the rates used in 1984 or 1985 reflect such a study. Therefore, the next best alternative is to use the best estimate possible. Obviously AT&T would not have changed its pension accrual rates if it did not think that the revised rates more accurately reflect what pension accrual rates will eventually be based on actuarial data. Therefore, it would certainly seem that the new rates provide a better estimate than the rates used in 1984.

Interest Synchronization

24. This Commission has consistently accepted an adjustment to reflect state and federal income taxes as if the portion of rate base funded by Investment Tax Credits was actually funded similarly to all other rate base. This adjustment is made because the Commission is required to allow companies the overall cost of capital on this portion of rate base. Since in reality this portion of rate base is funded by cost free capital it has been deemed fair to allow ratepayers a tax benefit similar to that afforded other rate base that is funded partially by debt, the interest on which is tax deductible. In this way all effects of investment tax credits

are ignored. Dr. Wilson proposed a similar adjustment in this case. The Commission once again finds this adjustment to be appropriate. The Commission has specifically been upheld on this adjustment in District Court Mountain Bell Tel. and Tel. vs. the Dept. of Public ser. Reg., et al, Cause No. 48964 (1st Judicial District, Feb. 10, 1985).

Employee Reductions

25. Dr. Wilson proposed an adjustment for declining employee levels after the test year. Dr. Wilson explained:

> Mr. Waller's adjustment goes beyond the booked test year costs by including out of period 1985 wage increases, it is also appropriate to adjust the test year results to reflect labor cost reductions made possible by the Company's personnel reductions.... By adjusting the test year only for increases in the price of labor while ignoring reductions in the quantity, ATTCOM has failed to consider that employee reductions may offset or more than offset increases in wage and salary rates.

26. In the past the Commission has insisted that the average test year employee levels and average rate base be used to calculate revenue requirements because any other level of employees violated the historical test year concept used in Montana. When a historical test year is used the relationship between volumes and investment should remain constant. Dr. Wilson points out the reason for this principle:

> One of the things that could happen when you change the number of employees either up or down is that you may be making a substitution of labor for capital. You may becoming more or less capital intensive, change your production.

This was precisely the position of the Montana Consumer Counsel when they successfully recommended rejecting the request of

Montana-Dakota Utilities to use year end employee levels (see Order No. 4834c in Docket No. 81.7.62). Dr. Wilson asserts that AT&T incorrectly changes the price of labor while ignoring employee reductions. However, it is typical to change price levels for items included in a historical test year while leaving quantities undisturbed. This is the same type of adjustment Consumer Counsel proposed and the Commission accepted in annualizing past rate increases. Revenues are typically adjusted for rate increases during or past the test year. However, the adjustments are calculated using test year sales. Any increase or decrease in the volume of sales would be ignored. The Commission finds that Dr. Wilson's adjustment for employee levels is unreasonable and violates the concept of a historical test year.

Independent Company Adjustment

27. Northwestern Telephone Systems elected to use AT&T to carry all traffic into and out of the Northwestern Telephone Systems territory effective January 1, 1984. This includes both interLATA and intraLATA traffic. The situation for the intraLATA traffic (the traffic between areas in the Mountain Bell Great Falls LATA and the Northwestern Telephone Systems territory) was not settled until October of 1984. Therefore, all revenues and expenses were booked correctly starting in October. However, negotiations continued for the period from January 1, 1984 to September 30, 1984. The Supplemental Testimony of Mr. Waller filed on February 26, 1985 reflected an adjustment to recognize

the revenues and access charges associated with traffic from the Great Falls LATA into the Northwestern Telephone territory not included in the actual 1984 operating results. Mr. Waller eliminated this adjustment in his updated supplemental testimony noting that since the adjustment was based on an estimate that could change since negotiations with Mountain Bell concerning the Northwestern Telephone were not complete and that the nature of the adjustment did not meet the "known and measurable" criteria for adjustments to a test year. Montana Consumer Counsel included this adjustment in its calculation of AT&T's revenue requirement since AT&T's updated supplemental testimony had not been filed at the time that Montana Consumer Counsel filed testimony. However, throughout the hearing Montana Consumer Counsel maintained its position that this was an appropriate adjustment.

28. The Commission finds that this adjustment is appropriate. The adjustment affects net revenues by $94,000. There was no showing in this case that the arrangement with Northwestern TelephoneSystems will cause AT&T to lose money. Since negotiations between AT&T and Northwestern were not mandatory it is doubtful that AT&T would have entered into an agreement with Northwestern unless AT&T felt that it was profitable. Therefore, adding nine months of revenues and access charges should increase AT&T's net revenues to some extent. The magnitude of this adjustment is not unreasonable and should reflect a better indication of the ongoing business of AT&T than if no adjustment is made.

SNFA and Percent Interstate Use Adjustments

29. Mr. Waller's supplemental testimony reflected an adjustment to reflect an estimate of a major adjustment to the percent interstate use (PIU) factors. Mountain Bell also presented an adjustment for PIU factors and the amount of the 1984 SNFA in its general rate case Docket No. 84.4.19. Montana Consumer Counsel expressed concern that the same amounts be used in both cases since both cases were based on 1984 test years. A stipulation was entered into between AT&T, Mountain Bell, and the Montana Consumer Counsel concerning these items. The stipulated amount of the PIU adjustment is reflected in this order. AT&T had booked somewhat different amounts during 1984 than had Mountain Bell for the SNFA. An adjustment is also reflected in this order for the difference between the amounts booked by AT&T for SNFA as reflected in attachment A and the correct amounts stipulated to by the parties.

Revenue Requirement

30. The Commission finds that AT&T has excess revenues in the amount of $145,000 as follows:

Average Rate Base	$13,473
Rate of Return	12.08%
Required NOI	1,628
Adjusted NOI-Sch.1	1,701
Difference	(73)
Net to Gross Multiplier	1.9859
Revenue Deficiency	$ (145)

This revenue requirement represents a decrease in revenues of $1,765,000 from the interim increases granted in this docket.

PRICES AND TARIFFS

31. On November 22, 1983, AT&T filed proposed divestiture tariffs which reflected the then existing Mountain Bell tariff for the applicable products and services. On December 31, 1983, Order No. 5044 granted interim approval to this set of divestiture tariffs. That same Order increased the pre-divestiture prices uniformly and on an interim basis by 14.97%. At that time, the 14.97% represented an increase of $3,743,000 in annual revenues.

32. On February 6, 1984 Order No. 5044a ordered AT&T to increase operator services prices by $293,954, annually. Order No. 5044b (May 18, 1984) revised the direction so that 1) operator services were increased by $65,112, 2) private line prices were increased by $185,037 (17.2%), and 3) Foreign Exchange (FX) prices were increased by $43,805. The revised FX prices were never implemented due to billing arrangement problems with Mountain Bell.

33. Order No. 5044c (November 14, 1984) recognized a $1,620,000 annual revenue deficiency. On December 5, 1984, <u>in Docket No. 84.4.15</u>, Order No. 5055c, the carrier access charges AT&T pays to intrastate access companies were reduced by $1,620,000.

34. In addition to the previous interim changes described above, AT&T's tariffs, over the course of Docket No. 83.11.80, have changed numerous times to provide new offerings, withdrawal of certain offerings, and various changes in the tariff provisions. These changes include 1) Reach Out Montana (Agenda 84-28), 2) Automatic Time and Charge Reporting (Agenda 84-41), 3) government competitive bidding (Agenda 85-27), and 4) Software Defined Network Service (Agenda 85-27). These filings received approval at the regular Commission meetings indicated, and thus do not require further action.

35. In this Docket AT&T proposes final approval of each of the interim rulings, in addition to the original set of divestiture tariffs. AT&T further proposes the following:

1) Withdrawal of Telpak with an annual revenue effect of $151,900 (Exh. 13, p.8).
2) Direct billing of Feature Group A to interLATA FX customers with a net revenue impact of $33,000 (Exh. 13, p.9).
3) Statewide WATS (initially filed with the original 83.11.80 filing, deferred in Order No. 5044, refiled on April 16, 1984 and again deferred at Agenda 84-16).
4) Flexible pricing , whereby AT&T's tariffed prices would represent maximum prices only (Exh 14, p.2).

36. AT&T's proposal would generate an annual revenue increase over the pre-divestiture level of approximately $5.8 million, as shown below.

	Annual Revenue Effect (000)
5044 MTS/WATS	$3,640
5044 Private Line	140
5044a/b Operator Services	65
5044a/b Private Line	185
5044a/b FX	0
5044c/5055c Access Charges	1,620
Telpak	152
FX	33
Total	$5,835

37. The Montana Consumer Counsel proposes that any increase in AT&T revenues from the base level (pre-divestiture) result from increased AT&T prices -- not decreased access charges (Exh. MCC-2, pp. 72-73). Alternatively stated, any decrease in AT&T's existing interim revenue level should result in a retroactive increase in the interim access charge level (Exh. MCC-3, p. 19-20).

38. The Montana Consumer Counsel proposal would generate a $4.1 million increase in annual revenues over pre-divestiture levels, as shown below.

	Annual Revenue Effect (000)
5044 MTS/WATS	$3,640
5044 Private Line	140
5044a/b Operator Services	65
5044a/b Private Line	185
5044a/b FX	44
5044c/5055c Access Charges	0
Total	$4,074

39. AT&T and Montana Consumer Counsel are the only parties who filed testimony in Docket No. 83.11.80.

40. As a starting point in establishing a set of final tariffs for AT&T, the Commission hereby approves the November 22, 1983 divestiture tariff. With a few minor administrative exceptions, this tariff represents the pre-divestiture Mountain Bell tariff for largely interLATA services.

41. From the original pre-divestiture prices, AT&T is authorized an increase in annual revenue level of $3,845,000 (i.e., a $145,000 decrease from the 5044b revenue level or a $1,765,000 decrease from the 5044c revenue level per Finding No. 30).

42. Neither Mountain Bell nor Montana Consumer Counsel object to the FX direct billing proposal (Tr. pp. 14 & 16). Upon withdrawal of the State of Montana's testimony, no party opposes the removal of Telpak from the tariff. The Docket also features no apparent opposition to the increased operator services prices nor the 17.2% increase in private line prices (per Order No. 5044b). Of the 14.97% uniform increase provided in Order No. 5044, no party appears to object to the increase in private line prices (See Exh. 13, p.9, l. 19-25). As such the Commission approves 1) the Telpak and FX proposal, 2) the interim price changes found in Order No. 5044b (i.e. the 17.2% private line increase and the increase in operator services) and 3) the 14.97% increase in private line prices provided in Order No. 5044. The total increase in private line prices from the initial set of pre-divestiture tariffs is 34.7% (1.1497*1.172).

43. The remaining pricing issues -- MTS/WATS, access charges, statewide WATS, and flexible pricing -- are somewhat contested.

MTS/WATS and Access Charges

44. If found to be in a revenue reduction position, AT&T argues for a rollback of the interim 14.97% increase in MTS/WATS prices. The interim interLATA MTS prices paid by Montana consumers are greater than intraLATA prices, interstate prices, and the prices found in all adjacent states (Exh. 13, Schedule 2). The second reason is bypass. Increases to MTS/WATS prices signals consumers to choose substitute goods and services without an offsetting reduction in costs, thus increasing the prices to remaining customers (Exh. 13, p.7). The third reason is the impact on the residential customers of Montana who utilize interLATA MTS to communicate with family and friends (Exh. 13, p.7). For these reasons AT&T argues that the interim reduction in access charges should be made permanent.

45. The Montana Consumer Counsel argues that the current imbalance in MTS/WATS prices among jurisdictions is not relevant and possibly the result of artificially low MTS prices in the other jurisdictions (Exh. MCC-3, p. 18-19). Proper cost allocation would attribute a significant portion of access costs to AT&T (Exh. MCC-2, p. 42-73).

46. The Commission finds that revenues should be reduced from the interim level by reducing the MTS/WATS prices resulting from Order No. 5044. The reduction in MTS/WATS prices leaves

them at a final level representing a 6.9% increase ($1.7 million) from the original pre-divestiture level. In the absence of a more analytical basis for setting prices, the reduction in MTS/WATS leaves an equitable balance between reduced access charges and increased MTS/WATS prices. That is, for the primary access carrier, Mountain Bell, the reduced carrier access charges resulted in a 3.6% increase in subscriber access prices. In this Order, the Commission has balanced that increase with a rollback in the interim MTS/WATS prices to a final level representing a 6.9% increase.

47. The reduction in MTS prices can be structured in a way that alleviates the disparity between interstate and intrastate MTS usage prices. Beginning with the 71-124 mileage band, the existing AT&T intrastate MTS prices are higher than the AT&T interstate prices as shown below.

AT&T MTS Usage Prices

	Intrastate		Interstate	
Mileage Band	Set-Up Init. Min. (¢/message)	Duration Ea. Add. Min. (¢/message)	Set-Up Init. Min. (¢/message)	Duration Ea. Add. Min. (¢/message)
71-124	46	34	51	33
125-196	51	39	51	35
197-292	55	44	51	35
>292	59	47	52	37

48. AT&T is to revise its MTS prices by applying the portion of the MTS/WATS decrease that applies to MTS in the following manner:

1) The duration charges in the 71-124 and 125-196 mileage bands should be reduced to 33¢ (3% reduction) and 35¢ (10%), respectively.

2) The set-up charges in the 197-292 and greater than 292 mileage bands should be reduced to 51¢(7%) and 52¢ (12%) respectively.

3) The duration charges in the 197-292 and greater than 292 mileage bands should be reduced on a residual basis to complete the overall 8.0% reduction.

49. Access charges are the subject of Docket No. 84.4.15. In that Docket "cost allocation" will be examined and ruled upon. As such, AT&T's proposal for final approval of the interim access charge reduction is neither possible nor appropriate, in this Docket. Likewise, the Montana Consumer Counsel proposal to retroactively rollback the interim reduction in access charges and instead increase MTS the full 14.97% would require an Order in Docket No. 84.4.15 as well as a technical basis for increasing MTS prices by 14.97%.

<u>Repression</u>

50. This Docket features no examination of repression or stimulation. As such, the changes in prices must be based on a "straight reprice", ignoring any quantity and revenue repression or stimulation.

<u>Rebate</u>

51. AT&T is in a position to rebate revenue to Montana consumers (Finding No.30). The rebate is to occur by applying a temporary credit to MTS/WATS prices on a uniform percent basis for a period of one year. Effectively, the rebate is a refund of

excessive MTS/WATS charges (14.97% interim increase versus 6.9% final increase). The one year period will provide an equitable refund to consumers with seasonal usage patterns.

Statewide WATS

52. The Commission finds no reason to preclude AT&T from offering statewide WATS service to Montana consumers who desire statewide service (See, e.g., Tr. p. 175). However, there does not appear to be a basis for establishing an initial price level at the pre-divestiture level (Tr. p. 140 and 144). The Statewide WATS prices should be subjected to the same final increase provided in this Order (approximately 6.9%) to the other MTS/WATS price schedules.

Flexible Pricing

53. AT&T argues that its financial nature -- low capital/expense ratio -- requires flexible prices to maintain a stable return on capital assets (Exh. 14, p. 2). The Montana Consumer Counsel cautions the Commission, but does not offer an explicit objection (Tr. p. 176, 186-188).

54. The Commission recognizes the need to allow market-sensitive flexibility in pricing in a competitive, price-elastic market. However, the Commission chooses to approach the concept cautiously. The concern is not with price floors for those prices AT&T chooses to reduce, but with price ceilings for the remaining prices. Any future proposal to increase any ceiling price will require AT&T to fully demonstrate

that the reduced prices did not produce net costs. The occurrence of net costs will be treated "below-the-line".

55. The flexible pricing proposal is approved, with the following condition: AT&T is to maintain internal documentation which is sufficiently detailed to demonstrate that reduced prices cover incremental costs.

Direction

56. This Order provides a final revenue increase as summarized below:

	Annual Revenue Effect (000)
MTS/WATS	$1,690
Private Line	325
Operator Services	65
Interim Access Charge Order	1,620
Telpak	152
FX	33
Total	$3,885

57. In filing revised prices, AT&T is to provide "price-outs" as traditionally used by Mountain Bell. The price-outs are to show prices, quantity of sales, and revenues which generate the authorized revenue level. The price-out is to be at as disaggregated a level as possible, but practical. The MTS repricing will require a price-out for each mileage band and a summary of revenues per product line would also be useful. It will also be necessary to demonstrate the refund of revenues via a calculation of a temporary credit.

CONCLUSIONS OF LAW

1. Applicant, AT&T Communications of the Mountain States, Inc., is a corporation providing telephone and other communication services within the state of Montana and as such is a "public utility" within the meaining of Sec. 69-3-101, MCA.

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

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

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

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

ORDER

THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. For purposes of final relief in this Docket, AT&T Communications of the Mountain States, Inc. is ordered to reduce revenues in the amount of $1,765,000 from the level granted in interim Order No. 5044c.

2. AT&T Communications is directed decrease the rates charged for intrastate services in the manner described in the Commission's Findings of Fact in the Order.

3. The rate levels specified in the Findings of Fact of this Order shall be effective for service on and after October 31, 1985.

DONE IN OPEN SESSION at Helena, Montana this 31st day of October, 1985 by a vote of 4-0.

AT&T DOCKET NO. 83.11.80, ORDER NO. 5044d

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

Clyde Jarvis, Chairman

Tom Monahan, Commissioner

Howard L. Ellis, Commissioner

Danny Oberg, Commissioner

ATTEST:

Trenna Scoffield
Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.406, ARM.

	Per ATTCOM	Contract Float Revenues	Revenue Annual.	1985 Pension Accrual	Contract Labor	Interest Synch.	Contract True-up	Nwts Adjustmt.	PIU	Total
REVENUES										
Intrastate Toll	$30,674		$83					$1,694		$32,451
Contact Revenues	3,876	286					682			4,844
Less: Uncollectibles	484		2					27		513
Total Revenues	34,066	286	81	0	0	0	682	1,667	0	36,782
EXPENSES										
Depreciation	934						107			1,041
Maintenance	2,139				(10)		177			2,306
Operator Services	620									620
Marketing	502									502
Other General Engin.	240									240
Access Charges	24,164							1,480	(1,190)	24,454
Operating Rents	2,181						1			2,182
Accounting Services	144						4			148
Employee Benefits	580			(31)	(1)		16			564
Other General	229						4			233
Exp. Charged Const.	6									6
Total Expenses	31,727	0	0	(31)	(11)	0	309	1,480	(1,190)	32,284
Net Operating Rev.	2,339	286	81	31	11	0	373	187	1,190	4,498
TAXES										
Federal Income Taxes	87	123	35	13	5	12	201	80	510	1,066
Other Taxes	1,482	19	5	2	0	2	128	13	80	1,731
Total Taxes	1,569	142	40	15	5	14	329	93	590	2,797
Net Operating Income	$770	$144	$41	$16	$6	($14)	$44	$94	$600	$1,701
Rate Base										
Plant in Service	$21,766						573			22,339
Depreciation Reserve	(5,320)						(137)			(5,457)
Prop. for Future Use	0									0
Materials & Supplies	0									0
Unamort. Pre-'71 ITC	(3)									(3)
Deferred Inc. Taxes	(3,318)						(88)			(3,406)
Average Rate Base	$13,125	$0	$0	$0	$0	$0	$348	$0	$0	$13,473

ATTACHMENT A

AT&T
Communications

R. A. Little
District Manager
Regulatory Relations

One N. Last Chance Gulch
Helena, Montana 59601
Phone (406) 449-6776

October 29, 1985

Joan Mandeville, Rate Analyst
Montana Public Service Commission
2701 Prospect
Helena, MT 59620

Dear Joan:

Attached are financial data for AT&T Communications for the year ended December 31, 1984. This data is provided pursuant to the stipulation dated August 15, 1985, Montana PSC Docket No. 83.11.80.

Yours truly,

Bob Little

R. A. Little

attachment

...ANA - INTRASTATE OPERATIONS
EARNINGS ANALYSIS   DATE PREPARED: 05-Aug-85
YEAR TO DATE: DECEMBER 31, 1984 (ADJUSTED) FILE NAME: ERN84ADJ

DOLLARS IN THOUSANDS

	INTERLATA	100% CONTRACT AMOUNT	TOTAL
..DJUSTED AVERAGE NET REGULATORY RATE BASE (NOTE 1)	$4,885	$8,433	$13,318
..UTHORIZED RATE OF RETURN (NOTE 2)	13.34%	12.40%	13.34%
3. TOTAL EARNINGS REQUIRED (L1 x L2)	$652	$1,046	$1,777
4. ANNUALIZED EARNINGS AVAILABLE (NOTE 3)	$701	$1,046	$1,747
5. ADDITIONAL EARNINGS REQUIRED (L3 -L4)	($49)	$0	$30

NOTE 1: PG. 2, L9
NOTE 2: DOCKET 83.11.80 PROPOSED
NOTE 3: PG. 3, L23 x 1

*** AT&T COMMINCATIONS - PROPRIETARY ***
*** USE PURSANT TO COMPANY INSTRUCTIONS ***

[illegible] COMMUNICATIONS OF THE MOUNTAIN STATES
[illegible]ANA - INTRASTATE OPERATIONS
AVERAGE NET REGULATORY RATE BASE   DATE PREPARED: 05-Aug-85
YEAR TO DATE: DECEMBER 31, 1984 (ADJUSTED) FILE NAME: ERN84ADJ

DOLLARS IN THOUSANDS

	INTERLATA (NOTE 1)	100% CONTRACT AMOUNT (NOTE 2)	INCLUDING CONTRACTS (COL.1+2)
[illegible]LANT IN SERVICE	$8,329	$13,874	$22,203
[illegible]EPRECIATION RESERVE	$2,119	$3,322	$5,441
3. NET PLANT IN SERVICE	$6,210	$10,552	$16,762
4. PROPERTY HELD FOR FUTURE USE	$0	$0	$0
5. MATERIALS & SUPPLIES	$0	$0	$0
6. CASH WORKING CAPITAL	$0	$0	$0
7. UNAMORTIZED Pre 1971 I.T.C. (NOTE 3)	$3	$0	$3
8. DEFERRED INCOME TAXES	$1,322	$2,119	$3,441
9. AVERAGE NET REGULATORY RATE BASE (NOTE 4, COL.2)	$4,885	$8,433	$13,318

NOTE 1: PG. 2D,"AVERAGE COL." TOTAL LINES
NOTE 2: PG. 2G, COL. 3.
NOTE 3: PG. 2B, L16
[illegible] 4: PG. 2A, L34

*** AT&T COMMINCATIONS - PROPRIETARY ***
*** USE PURSANT TO COMPANY INSTRUCTIONS ***

\ COMMUNICATIONS OF THE MOUNTAIN STATES
. ...IANA - INTRASTATE OPERATIONS
STATEMENT OF OPERATIONS DATE PREPARED: 05-Aug-85
YEAR TO DATE: DECEMBER 31, 1984 (ADJUSTED) FILE NAME: ERN84ADJ

DOLLARS IN THOUSANDS

	EXCLUDING CONTRACTS (NOTE 1)	100% COTRACT AMOUNT (NOTE 2)	INCLUDING CONTRACTS (COL.1+2)
.NTRASTATE TOLL REVENUE	$31,197		$31,197
2. SHARED FACILITIES REVENUE		$4,558	$4,558
3. MISCELLANEOUS REVENUE			$0
4. UNCOLLECTIBLE REVENUE	$486		$486
5. TOTAL OPERATING REVENUE (L1+2+3-4)	$30,711	$4,558	$35,269
6. DEPRECIATION	$378	$638	$1,016
7. MAITENANCE	$952	$1,297	$2,249
8. OPERATOR SERVICES	$620		$620
9. MARKETING	$502		$502
10. OTHER GENERAL ENGINEERING	$240		$240
11. ACCESS CHARGE	$23,043		$23,043
12. OPERATING RENTS	$2,129	$1	$2,130
13. ACCOUNTING SERVICES	$121	$24	$145
14. EMPLOYEE BENEFITS	$463	$118	$581
OTHER GENERAL EXPENSES	$176	$41	$217
LESS: EXPENSE CHARGED CONST.	$6		$6
18. TOTAL OPERATING EXPENSE (L6 THRU 16-17)	$28,618	$2,119	$30,737
19. NET OPERATING REVENUE (L5-18)	$2,093	$2,439	$4,532
20. FEDERAL INCOME TAXES	$328	$751	$1,079
21. STATE, LOCAL + OTHER TAXES	$1,064	$642	$1,706
22. TOTAL OPERATING TAXES (L20+21)	$1,392	$1,393	$2,785
23. NET OPERATING INCOME (L19-22)	$701	$1,046	$1,747
AVERAGE NET INVESTMENT (NOTE 3)	$4,885	$8,433	$13,318
2.. RETURN ON AVG. NET INVESTMENT (L23 ANNUALIZED/L24)	14.35%	12.40%	13.12%

NOTE 1: PG. 3A, COL. D
NOTE 2: PG. 3B, COL. C (EXPENSES & TAXES ONLY)
NOTE 3: PG. 2, L9

*** AT&T COMMUNICATIONS - PROPRIETARY ***
*** USE PURSUANT TO COMPANY INSTRUCTIONS ***

AT&T COMMUNICATIONS OF THE MOUNTAIN STATES
MONTANA INTRASTATE OPERATIONS
PRO FORMA, COMMISSION AND STATUTORY ADJUSTMENTS
TEST YEAR 1984
(DOLLARS IN THOUSANDS)

FILE NAME: EXHIBIT1
DATE PREPARED: 05-Aug-85

	INTERLATA							100% CONTRACTS			TOTAL
	A	B	C	D	E	F	(G = A...F)	H	I	(J = H+I)	(K = G+J)
	1984 ACTUALS (NOTE 1)	REVENUE ADJ. (NOTE 2)	ACCESS ADJ. (NOTE 3)	WAGE ADJ. (NOTE 4)	COMM. ADJ. (NOTE 5)	STATU. ADJ. (NOTE 6)	TOTAL INTERLATA	CONTRACTS (NOTE 1)	WAGE ADJ. (NOTE 3)	TOTAL CONTRACTS	TOTAL INTRASTATE
1. INTRASTATE TOLL REVENUE	$30,987	$210					$31,197				$31,197
2. CONTRACT REVENUE							0	$4,547	$11	$4,558	4,558
3. UNCOLLECTIBLE REVENUE	483	3					486				486
4. TOTAL OPERATING REVENUE (LINE 1+2-3)	$30,504	$207	$0	$0	$0	$0	$30,711	$4,547	$11	$4,556	$35,269
5. DEPRECIATION	$378						$378	$638		$638	$1,016
6. MAINTENANCE	943			9			952	1,287	10	$1,297	2,249
7. OPERATOR SERVICES	580			40			620				620
8. MARKETING	729			13		(240)	502				502
9. OTHER GENERAL ENGINEERING	235			5			240				240
10. ACCESS CHARGES	24,233		(1,190)				23,043				23,043
11. OPERATING RENTS	2,129						2,129	1		$1	2,130
12. ACCOUNTING SERVICES	115			6			121	24		$24	145
13. EMPLOYEE BENEFITS	455			8			463	117	1	$118	581
14. OTHER GENERAL EXPENSES	172			4			176	41		$41	217
15. LESS: EXP. CHARGED CONST.	6						6				6
16. TOTAL OPERATING EXPENSES (LINE 5 THRU 14-15)	$29,963	$0	($1,190)	$85	$0	($240)	$28,618	$2,108	$11	$2,119	$30,737
17. NET OPERATING REVENUE (LINE 4-16)	$541	$207	$1,190	($85)	$0	$240	$2,093	$2,439	$0	$2,439	$4,532
18. FEDERAL INCOME TAXES	($335)	$89	$510	($38)	(1)	$103	$328	$751	$0	$751	$1,079
19. STATE, LOCAL, OTHER TAXES	978	14	80	(1)	(23)	16	1,064	642	---	$642	1,706
20. TOTAL OPERATING TAXES (LINE 18+19)	$643	$103	$590	($39)	($24)	$119	$1,392	$1,393	$0	$1,393	$2,785
21. NET OPERATING INCOME (LINE 17-20)	($102)	$104	$600	($46)	$24	$121	$701	$1,046	$0	$1,046	$1,747