

Service Date: December 20, 1985

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

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IN THE MATTER of the Application	)	UTILITY DIVISION
of MOUNTAIN STATES TELEPHONE AND)		
TELEGPAPH (MOUNTAIN BELL) to	)	DOCKET NO. 85.5.17
Implement Revised Depreciation	)	
Schedules and Recover Revenue	)	ORDER NO. 5173
Requirement.	)	

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FINAL ORDER

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FINAL ORDER

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APPEARANCES

FOR THE APPLICANT:

Dennis R. Lopach and Lawrence D. Huss, Mountain Bell Legal Department, P.O. Box 1716, Helena, Montana 59624

FOR THE MONTANA CONSUMER COUNSEL:

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

FOR THE COMMISSION:

Geralyn Driscoll, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620

BEFORE:

HOWARD L. ELLIS, Commissioner, Presiding  
JOHN B. DRISCOLL, Commissioner  
TOM MONAHAN, Commissioner  
DANNY OBERG, Commissioner

## FINDINGS OF FACT

### Introduction

1. On May 21, 1985 Mountain Bell (MBT) filed with the Montana Public Service Commission (MPSC) a proposal to increase its regulated telecommunications prices in the State of Montana. MBT proposes that the prices be increased to generate an additional \$4,856,000 in annual revenues.
2. The Montana Consumer Counsel (MCC) requested and was granted intervenor status.
3. The MPSC originally combined Docket No. 85.5.17 with Docket No. 84.4.19, the general rate case in May, 1985, but, at the request of the MCC, bifurcated the two Dockets.
4. On November 6 and 8, 1985, a public hearing was conducted on these matters.

### Revenue Requirement

5. Mountain Bell requested \$4,856,000 in additional annual revenues to recover the increased costs resulting from the 1985 depreciation represcription. Section 220(b) of the 1934 Communications Act states that the Federal Communications Commission (FCC) shall prescribe for telephone carriers subject to the Act the depreciation rates to be used in developing depreciation amounts reflected in operating expenses. In its Memorandum Opinion and Order, CC Docket No, 79-105, the FCC preempted state commission jurisdiction over depreciation rates and methods. That order found “that the most logical and reasonable interpretation of Section 220(b) of the Act is that where the Commission prescribes depreciation rates for classes of property, state commissions are precluded from departing from those rates.” (p.17) Because this Commission does not have jurisdiction over depreciation rates, the depreciation rates used to calculate the revenue requirement in this order were not contested and are not at issue in this order.

6. Montana Consumer Counsel raised an issue concerning the treatment of deferred taxes. MCC witness Allen Buckalew explained the proposed adjustment:

MB's calculation of the rate base effect of the proposed increase includes a decrease in the accumulated deferred income tax balance of \$1.433 million. This adjustment to the deferred tax balance is not appropriate since the actual deferred tax balance will not decline due to the implementation of the increased depreciation rates, but will grow at a slower rate in the future.

7. Mountain Bell offset the increased depreciation expense by \$2,866,000 to recognize the deferred taxes realized and amortized. Because this Commission uses an average rate base, the rate base increases by only half of this amount, or \$1,433,000. It is inconsistent to use deferred taxes to decrease expenses yet fail to recognize the effect on rate base. The Commission has consistently favored flow-through rather than normalization for timing differences arising from the use of accelerated depreciation methods for tax purposes. However, that is not at issue in this case, Mr. Buckalew's assertion that the deferred tax balance will continue to grow and offset other rate base items is correct. However, other rate base amounts will also continue to increase. For instance, plant in service will increase as plant is added subsequent to the 1984 test year. However, the Commission does not allow Mountain Bell to add any of these increases to rate base even though we are now at the end of 1985. The Commission finds that the adjustment proposed by Montana Consumer Counsel is unreasonable,

8. The Commission finds that, under the depreciation rates prescribed by the FCC, Mountain Bell is entitled to an additional \$4,856,000 in additional annual revenues.

#### Rate Design

9. MBT's filing originally contemplated that revised prices resulting from this Docket would be effective simultaneous with revised prices resulting from Docket No. 84.4.19 (Mr. L.F.

Cooper, Exh. 6, p. 4) . The proposed rate design in this docket mirrored the MBT proposal in Docket No. 84.4.19 - apply a broad uniform percent increase across – the - board, excluding prices that are:

- 1) already priced too high and should not be further distorted (MTS/WATS);
- 2) have recently been set at fully compensatory levels and should therefore not be subject to a disruptive change in this Docket (Centron and local usage);
- 3) are the subject of a different Docket and should therefore not be subject to a change in this Docket (intrastate carrier access and ZIC/ZCC) ; or
- 4) legally (wiring) or practically (coin) cannot lend themselves to percent increases.

(Exh. 6, pp. 2 - 4).

10. MBT, in this Docket, additionally proposes to exclude business subscriber access service in the larger communities (IFB-2, etc.) from an increase (Exh. 6, p. 6).

11. The MCC (Mr. A.G. Buckalew Exh. A) testified against the MBT proposal. The MCC argues that the additional revenue requirement in this Docket - - \$4.586 million increased depreciation costs - - is the result of growth, competition, and changes in technology in areas other than residential subscriber access. The MCC maintains that it is largely competitive pressures in business markets that is causing the increased depreciation; it is therefore efficient and equitable to adjust those prices - - not residential subscriber access - - to reflect the increased depreciation cost.

12. In rebuttal, MBT (Exhs. 2 and 7) argues that plant replacement is subject to economic efficiency criterion and provides service that even its residential customers demand.

13. MBT initially proposed that prices be increased by an additional \$375,000 to account for the negative effect of the proposed prices on sales and net revenues (Exh. 6, pp. 4--5)

14. The MCC testified that the net revenue repression proposal was not adequately supported by evidence and should therefore be rejected (Exh. A, p. 6)

15. In its rebuttal testimony, MBT withdraws from this Docket its net revenue repression proposal, deferring it to a future proceeding, that is, to consider it in 1) Docket No. 84.4.19 repression and 2) Docket No. 83.11.80 stimulation (Exh, 7, p. 7).

16. It is not clear whether this Docket was ever intended to present anything more than a routine pass - through of additional revenue requirement. This would not be a unique situation. For example, in Docket No, 85.9.37 Montana Power Company applied for and was granted a pass-through of increased Kerr Dam rental expense without any pricing evidence.

17. The pricing issue that has developed in this Docket is: should the increment of revenue requirement at issue here - - increased depreciation costs - - be singled out, functional - ized, and reflected in prices accordingly? For the Kerr Dam case, this would amount to examining what caused the Kerr Dam rental increase and adjusting the electricity prices accordingly. Since it was not increased electricity sales that caused the rental increase, then presumably the MPSC would increase customer charges to recover the increased rental expense - - without any examination of marginal production costs, etc. This is clearly an inappropriate pricing method, It would possibly be appropriate to “ear tag” an increment of embedded revenue requirement, functionalize it, and adjust prices accordingly, if: 1) the base of prices to which you were applying the change fairly accurately reflected marginal cost and 2) the “ear tagged” increment of embedded revenue requirement was a marginal cost. But this is not the case with MBT. The MPSC has found that the existing base of prices - - due to historical separations, settlements, and value – of - service pricing - is very much inaccurate. To ignore this inaccuracy and address only the increment of embedded revenue requirement would only serve to further perpetuate pricing errors. Not only would this result in the standard losses in economic efficiency

(consumer surplus) , but now the MPSC must deal with the revenue effect of repression. The MCC's testimony argues for ignoring the existing base of prices and increasing the most competitive prices, These increases would have the most negative effect on sales (causing even more economic depreciation of sunk plant) and, because the base prices are in excess of marginal costs, the decrease in sales would result in net revenue repression. The net revenue repression would translate directly into additional millions of revenue requirement.

18. The MPSC finds that the increased revenue requirement should not be separated and treated without consideration of the set of base prices. It should be recognized for what it is: another chunk of embedded revenue requirement. The proper objective in this Docket is to set MBT prices that reflect marginal costs, generate the authorized revenue level, and avoid major economic dislocation.

19. Including 1FB-2, MBT proposes that eight areas be excluded from a price increase in this Docket:

- 1) Intrapremise wiring (\$957,473)
- 2) Coin usage (\$1,327,334)
- 3) ZIC/ZCC (\$4,536,899)
- 4) Intrastate carrier access (\$17,775,000)
- 5) Intraexchange usage (\$217,300)
- 6) Centron nonaccess (\$102,342)
- 7) MTS/WATS (\$45,520,831)
- 8) 1FB - 2 (\$18,491,000)\*

\* (Data Response MPSC-MBT-4 plus 10.42% increase per Order No. 5046f)

20. Intrapremise wiring and coin are nondebatable - - wiring is being expensed and coin cannot be readily subject to a percent increase. ZIC/ZCC and intrastate carrier access charges are being examined in the RTIP (Docket No. 85.11.46) and access charge dockets (Docket No. 84.4.15) and should not be increased here. Intraexchange usage and Centron

nonaccess are debatable, They are priced at a level greater than cost (e.g., see Data Request MPSC-MBT-2) and, since they were recently set a change may be disruptive. But, the arguments to exclude them are now dated and weak. These two exclusions are small ticket items, though -- excluding them has little affect on other prices. The MPSC finds that they should be excluded in this Docket with the understanding that the associated costs and revenues will be addressed in future dockets.

21. MTS/WATS should be excluded, The evidence presented to the MPSC over the last several years indicates that MTS/WATS prices should be reduced. At a minimum, the MPSC should not be increasing them further above cost. The resulting net revenue repression is the market reality of bypass and competitive (economic efficiency) pressures. It is for these reasons that California has adopted a SPF to SLU transition and New York has REDUCED MTS prices by 25 percent. To increase MTS/WATS prices would cause a more severe affect on other prices as soon as the elasticity incorporates the price change.

22. The ratio of IFB-2 to 1FR prices in Montana is over 50 percent greater than in every US West state - - with the exception of Minnesota, where it has been recently reduced (Exh. 6, Sch. 2, p. 1) . It is apparently another area that was allowed to escalate unabated to keep residential access prices at an artificially low level, This value - of - service pricing allowed AT&T to charge business customers who needed access (i.e. low price elasticity, or high willingness-to-pay) a high price so that AT&T could extend its business into the more marginal markets (residential and rural, where the willingness-to-pay was low relative to the cost) . However, the excess monopoly profits earned in the urban business (IFB-2) market is leading to the entry of alternative producers. The availability of these alternatives is now reducing the relative value of MBT's 1FB-2 service - - no product or service is more valuable than its least cost alternative. The same value -of - service pricing that lead to 1FB-2 prices four times greater than 1FR prices now argues for reducing 1FB-2 prices (higher elasticity) and increasing 1FR prices (lower elasticity).

23. There is also no apparent cost basis for having 1FB prices four times greater than 1FR prices. The average cost of business loops appears to be actually less than the average cost

of residential loops - - logically due to less distance from the central office and higher density. Business drop lines are more costly according to MBT, but the total access service cost is roughly the same as residential (Data Request MPSC-MBT-6). To the extent that 1FB includes more intraexchange usage than 1FR, the prices should reflect it. However, intraexchange usage is relatively low cost and the Billings SLU study does not indicate a substantial difference in usage patterns between business and residence (Data Request MPSC-MBT-9) Regardless, unbundled access service (i.e., local measured service) includes no usage - - still the business access prices are four times greater than the residential.

24. The MPSC finds that 1FB-2 should be excluded from an increase in this Docket. However, the exclusion should be treated differently than proposed by MBT. MBT calculates a percent increase net of the exclusions and then further excludes 1FB - 2 from the subscriber access increase, The effective result is that subscriber access prices are increased by a greater amount (11%) than other nonexcluded prices (7%) to make up for the IFB - 2 exclusion, An alternative approach would treat IFB-2 as all other exclusions - - calculate the single percent increase (8%) that would apply to all nonexcluded prices. The MPSC finds that the record features no evidence that, for example, Private Line should be increased by a lesser amount than 1FB (TR p. 78). The 1FB-2 exclusion should be treated as the other exclusions are treated.

25. The exclusions from an increase granted by the MPSC in this Order are consistent with the MPSC's ruling on the same issues in Docket No. 84.4.19 (Order No. 5046f, Findings of Fact Nos. 56 - 96).

26. Given the exclusions provided above, the residual uniform percentage increase is as follows:

	(\$ millions/year)
Existing Revenue	\$239,627
Interstate Rev	<u>89,841</u>
Intrastate Rev	149,786
Intrastate Rev	149,786

Exclusions	- 88,930
Revenue Base	<u>60,856</u>
Revenue Increase	4,856
Revenue Base	- <u>60,856</u>
Percent Increase	7.98%

27. The 7.98 percent increase causes the IFR price to increase to \$12.46. Where available, residential local measured service access price would increase to \$7.32. The residential service installation charge was recently (August, 1985, Docket No. 84.4.19) increased from \$33.00 to \$43.15 (30.8%) - - a further 8 percent increase would increase it to \$46.58. In comparison, the nonregulated Helena Cable TV Company charges \$15 for residential service installation.

28. The installation of service charge is particularly burdensome to low income, relatively transient, renters who may incur that charge several times in one year. Excluding that charge from an increase raises the remaining percentage to 8.1 percent.

29. The MPSC finds that it is now appropriate to consider a lifeline price option. The residential service installation charge should be excluded from an increase in this Docket. Furthermore, MBT should examine the possibilities for providing a targeted waiver (or reduced charge) for qualifying low income customers. Along these lines, MBT should examine the possibilities for providing a single-element (frequency) measured access service to residential customers who may choose such an option where four-element measured service is not available. Presumably, the unbundled access element would be priced at the same level (\$7.32) as the four-element measured access is priced.

30. In Order No. 5046f, Docket Nos. 83.11.81 and 84.4.19, Service Date August 23, 1985, at page 37, paragraph 103 this Commission stated:

[T]he MPSC wishes to indicate that it expects any future proposals to change prices to be supported with cost information. ....

[T]he MPSC has found disturbing the resulting major increases in

sensitive prices. ....under a blanket uniform percent proposal.

This statement continues to be the Commission's position. Any future price change proposals should be supported by cost information in order to be considered by this Commission.

### CONCLUSIONS OF LAW

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

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

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

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

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

### ORDER

THE MONTANA PUBLIC SERVICE COMMISSION ORDERS THAT:

1. For the purposes of final relief in this docket, Mountain States Telephone and Telegraph Company is granted increased revenues in the amount of \$4,856,000.

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

DONE IN OPEN SESSION at Helena, Montana this 16th day of December, 1985 by a vote of 3 - 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

HOWARD L. ELLIS, Commissioner  
& Acting Chairman

TOM MONAHAN, Commissioner

DANNY OERG, 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 38.2.4806, ARM.