Service Date: August 10, 1988

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 of the Regulated Members of the TELEPHONE EXCHANGE CARRIERS OF MONTANA (TECOM) for Authority to Increase Rates for Intrastate Access Services.	)	UTILITY DIVISION DOCKET NO. 87.12.84 ORDER NO. 5336a

BACKGROUND

On December 29, 1987, the regulated members of the Telephone Exchange Carriers of Montana (TECOM), Lincoln Telephone Company, Project Telephone Company, and Southern Montana Telephone Company, hereinafter TECOM or Applicants, applied for authority to increase rates for intrastate carrier access services by $1,027,806.

Concurrent with the filing, Applicants also applied for an interim rate increase pursuant to 69-3-301, MCA, and ARM 38.5.501, et seq. On March 16, 1988, the Commission granted TECOM's request for an interim rate increase in the amount of $1,027,806.

Applicants, as well as the unregulated members of TECOM, recover their costs of providing access to their local networks for origination and completion of interexchange long distance calls by imposing access charges on interexchange carriers. Currently only two customers, Mountain Bell and AT&T Communications, receive intrastate carrier access services from the Applicants.

Pursuant to the terms of the Mountain Bell/RMTS (Rural Montana Telephone System) stipulation accepted by the Commission in Docket No. 84.4.15, Order No. 5055g, Applicants' access service costs have been established using FCC Part 67 and 69 cost studies.

As support for their rate increase proposal, Applicants submitted 1986 Part 67 and 69 cost studies. Applicants assert that current access rates are inadequate to allow recovery of access costs as identified in the 1986 studies. They claim a revenue deficiency of $1,027,806 for the total TECOM pool. They further point out that, as full pool participants, they would each sustain a 9.7 percent revenue deficiency if no rate relief were forthcoming.

The following parties intervened in this Docket: Montana Consumer Counsel, Mountain Bell, AT&T Communications, Ronan Telephone Company, Hot Springs Telephone Company, Interbel Telephone Cooperative, Inc., and MCI. Mountain Bell, AT&T Communications, and Ronan Telephone were the only intervenors that filed testimony in this Docket. Mountain Bell and AT&T both opposed any increase. Ronan Telephone filed testimony concerning directory assistance issues.

FINDINGS OF FACT

Demand used to Calculate Rates

Both AT&T and Mountain Bell filed testimony objecting to Applicant's use of 1986 demand to calculate carrier access rates. AT&T states that Applicant should use forecasted 1988 volumes to calculate carrier access rates. AT&T witness, William Gavel, testified that 1988 demand is necessary to set "an access rate that permits a recovery of the total revenues necessary to satisfy an appropriate revenue requirement determined by the Commission" (AT&T-1, p. 3). Mountain Bell's concern centers around its assertion that TECOM estimated 1986 demand. Mountain Bell's witness, Sandy Holmquist, testified that "The estimated demand was developed by studying customer billing records and access records, and converting billed or conversation minutes into an estimate of access minutes" (MB-1, p. 11). Mountain Bell proposed using 1987 actual billed minutes to calculate TECOM access rates.

TECOM's rebuttal testimony points out that 1988 demand should be used only if a prospective (future) test year is used; i.e. 1988 demand should on be used if 1988 costs are used. However, since TECOM used 1986 costs it states that 1986 demand should be used to match costs and volumes. Further, TECOM witness, Dennis Felder, testified that Mountain Bell is wrong when it states that the access minutes used to develop access charges are estimated. TECOM used actual conversation minutes to develop access minutes. Where conversation minutes were not available, TECOM converted actual billed toll minutes to conversation minutes.

All local exchange companies (LECs) start with conversation minutes to calculate access minutes. The procedures for converting conversation minutes are set forth in the access tariffs of both Mountain Bell and TECOM. The LEC starts with measured minutes (conversation minutes) and applies a non-conversation time additive to account for time to set up a call, the ring time, and the time associated with uncompleted calls. Because some of the participating TECOM companies were not recording conversation minutes in 1986, toll billed minutes were converted to conversation minutes. Toll billed minutes are conversation minutes rounded to the next highest minute. For instance, a 2 minute, 10 second call would be billed as 3 minutes. Therefore, a ratio is applied to reduce the total billed minutes to conversation minutes.

Mountain Bell did not indicate a problem with TECOM's calculations. In response to cross examination by TECOM's attorney, Holmquist testified:

> Q. Is that conversion from billed toll to conversation minutes a conversion that's common and accepted practice in the industry?
> A. I think it's common. I don't believe it's quite as acceptable as using pure conversation minutes, but it is used. (Tr. p. 120)

In response to TECOM data request 11, Mountain Bell agreed with the methodology used by TECOM to calculate 1986 access minutes but noted a concern with TECOM's use of an estimated base. However, TECOM's base was not estimated. In companies not recording conversation minutes the base was actual toll billings. In response to cross examination by TECOM's attorney, Holmquist explained Mountain Bell's concern:

> Q. Could you go back one step, and again, I'm trying to pin down why it is you feel that the 1986 are bad minutes. Is it that you don't trust that what TECOM has told you were billed minutes are billed minutes?
>
> A. The numbers just do not look correct, and we've discussed some of the discrepancies. I would refer you, in fact, to my Schedule 5 that was just distributed here. We discussed at length the discrepancy on 3-Rivers, and why in one year, they would have an increase of two million access minutes that really is unsubstantiated. It just does not look right to Mountain Bell.

Holmquist's Schedule 5 (MB-3) compares 1987 billed access minutes to the 1986 minutes used for this case. The schedule shows a 5.54 percent growth in access minutes. For Three Rivers the growth was 2,064,095 minutes or 10.62 percent. Subsequent to the hearing, TECOM found errors in both 1986 minutes and 1987 minutes. The 1987 minutes were overstated by 763,892 minutes and the 1986 minutes were understated by 478,143 minutes. This correction results in a growth rate from 1986 to 1987 of 3.98 percent. For Three Rivers, the correction results in growth of 4.75 percent.

This Commission requires utilities to file rate cases that use historical test years. The minimum filing requirements set forth in ARM 38.5.2801 to 38.5.2821 require applications for rate increases to be based on historical test years. ARM 38.5.2820 requires a statement to be filed that compares sales and revenues. The rule states:

> The application for a rate increase shall include a statement comparing rates, sales, and the revenues therefrom under the currently approved rate schedules and the rate schedules proposed to be superseded or supplemented. Such comparisons shall be applied to the sales levels <u>for the 12 months of the test period.</u> (Emphasis added)

The Commission's mandate in a rate case is to set reasonable rates. To accomplish this, the Commission develops a revenue requirement for a test year and compares the revenues achieved during that test year to the revenue requirement. If the rates do not adequately recover that revenue requirement the rates are adjusted. The Commission does not set an absolute level of revenues for some future period as AT&T suggests (AT&T-1, p. 3, ll. 8-11). The theory implicit in a <u>test</u> year is the development of relationships between output and the costs of producing the output. When any volume measures are introduced into a test year those relationships can no longer be assumed to be valid. For instance, if demand increases after the end of the test year, it would be reasonable to assume that expenses such as switching costs, operator costs, billing costs, etc., would also increase. This is especially true when reviewing costs that have been allocated using usage sensitive factors. Part 67 has many such usage based allocators.

The Commission sets rates prospectively. The relevant question is not whether the rates set in a proceeding will recover the revenues set in a test year, but will the rates recover the costs of the utility in the year that the rates are actually billed. If the average cost per demand unit increases substantially from the test year to the period the rates are in effect the utility will not achieve its authorized rate of return. If the average costs per unit go down then the utility will exceed its rate of return.

In recent dockets the Commission has required utilities to break away from historic test year standards for the calculation of marginal costs. By definition, marginal costs measure the cost of the next increment of resources. The Commission believes that the forward looking nature of marginal costs requires that these cost be expressed in terms of dollars reflective of the period for which rates will be in effect. However, in each instance, the use of forward looking marginal costs has been appropriately tied to historical, test period billing determinants (see MDU Docket No. 86.5.28, Order No. 5219b, PP&L Docket No. 86.12.76, Order No. 5311, and MPC Docket No. 87.4.21, Order No. 5340).

The Commission finds AT&T's proposal to violate the Commission's rules and test year principles. The Commission is not swayed by either AT&T's or Mountain Bell's arguments. TECOM did not propose, and the Commission has not required, any adjustments for increases in TECOM's costs after the close of the test year. The growth in TECOM demand does not look excessive. This is especially true in light of the adjustments made by TECOM. The Commission finds that the demand used by TECOM in this Docket is reasonable.

25 Percent Allocator for NTS Loop Costs

Mountain Bell's direct testimony objects to the phase up to a 25 percent gross allocator for two of the TECOM companies, Southern Montana Telephone and Valley Rural Telephone. Mountain Bell asserts that the intent of the stipulation in Docket No. 84.4.15 was never to allow any increase in Non-Traffic Sensitive (NTS) costs assigned to intrastate toll. Therefore, for companies with intrastate toll Subscriber Plant Factors (SPFs) less than 25 percent the amount recovered through carrier access charges should be frozen.

TECOM rebuts the assertion that the intent of the stipulation did not allow for phase-ups if needed. TECOM notes that the language in the stipulation refers to the assignment of NTS costs as an aggregate for all companies. The stipulation states that:

> For 1989, the revenue requirement developed in Paragraph D above shall be determined by requiring a contribution not to exceed the effect of 25% of the non-traffic sensitive costs. Provided, however, that such reduction shall not cause the contribution to recovery of non-traffic sensitive costs to fall below 25% in any year referenced above.

TECOM states that to use a frozen intrastate toll SPF would have the effect of reducing the amount of NTS costs allocated to toll in the aggregate for all TECOM companies to fall below 25 percent.

Prior to 1984 the arrangements that compensated all independent companies for the costs assigned to toll were inter state and intrastate settlement pools. Settlements allowed companies to assign costs to interstate and intrastate toll using Part 67 separations procedures. Part 67 allocated loop costs (often referred to as NTS costs) based on the subscriber plant factor (SPF). SPF was a usage factor weighted for distance. This weighting resulted in some very high percentage allocations to toll. An LEC could not allocate over 85 percent of its total NTS costs to toll. The interstate allocation was made first so that for any company with an 85 percent allocation to interstate, there was no intrastate allocation. The interstate allocation is now being phased down to 25 percent. However, realizing that high cost companies might have large rate increases caused by this phase-down, the FCC created an interstate high cost fund.

The Commission agrees with TECOM that the use of the "frozen," i.e. 1984, SPF for Southern and Valley would have the effect of reducing the NTS contribution below 25 percent for the pool as a whole. However, the Commission finds that it is not reasonable or desirable to allow companies to recover in excess of 100 percent of their NTS loop costs from toll. Mountain Bell testified that this may be the result if the Commission allows these two companies to phase-up to 25 percent:

> Q. That would be a minority of the recovery of their total costs or, as you speculate, the recovery of more than their total costs; is that right?
>
> A. In fact, I don't have their traffic factors in front of me right now, but I believe they start at a 70 or 80 percent interstate SPF. That is why the intrastate SPF is as low as it is. If you're talking about a 5 percent reduction a year, which is the cap on the interstate, it would have reduced their interstate by 1988 by 15 percent, and we're talking about increasing intrastate to 25%. (Tr. p. 109)

Both Valley and Southern also receive money from the interstate high cost fund.

The Commission finds that the cap previously used for settlements should be used to calculate the allocator used for NTS loop costs. Southern and Valley will be allowed to phase-up to 25 percent provided that the total amount of NTS loop costs recovered through interstate carrier access charges, the interstate high cost fund, and the intrastate carrier access charge pool does not exceed 85 percent. The Commission recognizes that 85 percent recovery of NTS costs through toll may be an excessive allocation, but will maintain the status quo until further review of all elements impacting small companies.

Directory Assistance

TECOM included the minutes of use associated with directory assistance (DA) in its calculation of carrier access charges. TECOM's position is that the end user is the DA customer and Mountain Bell is the DA provider and that its companies should charge Mountain Bell for access to the network. Mountain Bell would then bill customers for DA (assumably through a billing and collection agreement with the local exchange company).

Mountain Bell's testimony as originally filed stated that DA is the responsibility of the LEC. Under this scenario Mountain Bell would bill the local exchange company for DA and the local exchange company could then bill DA calls to its customers if it wished and set up the terms and conditions (for instance on the free calls) for DA.

At the public hearing in this Docket, Mountain Bell's witness modified her testimony. Mountain Bell continues its position that the LEC is its DA customer but on an interim basis, at least through 1990, it will bill the independent LEC's basic exchange customers for DA. Mountain Bell's witness explained:

> Q. Why is Mountain Bell now modifying its position?
>
> A. Mountain Bell believes that this issue is extremely complex, that in fact it would take considerable time and probably additional witnesses on our behalf perhaps for the other companies to truly address this issue in depth.
>
> We believe that it would be better addressed in an informal proceeding, and that's why we've agreed on an interim basis at least through 1990 to charge the exchange carrier customers.
>
> * * * *
>
> Q. Would you please explain to the Commission specifically what it is that Mountain Bell is proposing to do with respect to the initiation of DA charging to end user customers in the independents' territories?
>
> A. If it's agreeable with the Commission, Mountain Bell would propose to file in our pending general rate case a change to our DA tariff to make it effective to the exchange carrier customer as well, and we would seek interim approval of that tariff both for local and toll DA at this time.
>
> We would as quickly as possible file modified testimony in that general case, and we would look at the costs that Mountain Bell is going to incur for access to the exchange carriers for directory assistance services for potential billing and collection charges that we will be paying the exchange carriers for this service, and we will look at the difference between the current prices that we're looking at in our case and what this additional cost might do to that, and might look at permission to

implement a separate rate structure, depending on what that study shows. (Tr. 102-104)

The Commission finds that this is a reasonable solution to the DA issue and approves this charging scheme. Obviously customers in independent areas will require notice that Mountain Bell will begin charging them for DA. The Commission directs Mountain Bell to provide notice to these DA customers through LEC bill stuffers, news letters, or other means of the effective date and other details concerning the new charging scheme before Mountain Bell begins charging these customers.

All parties in Mountain Bell's general rate case, Docket No. 88.1.2, will have an opportunity to comment on any changes Mountain Bell proposes to its DA rate structure. If Mountain Bell proposes to charge rates for DA to its own basic exchange customers that are different than DA rates charged to basic exchange customers of other companies, Mountain Bell must calculate and file testimony reflecting not only the increased costs of serving other LEC's basic exchange customers but also any costs it incurs for DA services to its basic exchange customers that it does not incur for serving other LEC's basic exchange customers.

Intracompany IntraLATA Toll Traffic (I-I)

IntraLATA toll for a TECOM company's basic exchange customer can be classified into two groups - one, toll calls that originate and terminate with the same LEC's serving area, and two, toll calls that originate within one LEC's serving area and terminate in another LEC's serving area. Mountain Bell has been the carrier for all intraLATA long distance traffic. This means the TECOM companies do not have any toll rate schedules and do not bill and keep toll revenues. For a call that originates and terminates inside an TECOM service area, the LEC bills Mountain Bell for access on both the originating and terminating end of the call. The LEC bills the toll customer based on Mountain Bell's toll rates and remits the revenue to Mountain Bell under a billing and collection contract.

For purposes of this order, all intraLATA toll traffic originating and terminating within one LEC's serving area will by referred to as I-I. Historically, most of these calls were routed through Mountain Bell toll switches and Mountain Bell participated in transporting these calls. However, it is becoming more common for these calls to never go through any Mountain Bell toll facilities. Mountain Bell plays no part in handling any of the call.

Mountain Bell does not wish to continue the existing arrangement where it is considered the carrier for calls it does not handle. Mountain Bell's position is that this is indepen dent company traffic and a bill and keep situation should exist.

TECOM's position is that the stipulation is clear on this issue. Mountain Bell agreed to be the contract carrier of all intraLATA toll traffic. The stipulation, while not stating a specific termination date, mentions 1989 compensation arrangements and should be interpreted as being in effect at least through 1989. TECOM's witness also notes that Part 67 costs, which were agreed to in the stipulation, have always included this traffic.

The record in this Docket provides no testimony on the effect of removing I-I traffic from access and going to a bill and keep situation. Mountain Bell's witness testified she did not know what effect this would have (MB-1, p. .45, l. 21). It seems that there is a high probability that the effect would be a revenue loss for the TECOM companies. Holmquist noted that most of these calls are probably short haul. (Tr. p. 152) TECOM's total per minute access rate is $.1132. Since this rate applies on both the originating end and the terminating end, Mountain Bell would pay $.2264 per minute in access for I-I traffic. When compared to Mountain Bell's toll rates this means that Mountain Bell pays more for access than it charges for toll on every call under 22 miles, every call over 2 minutes up to 55 miles, and every evening or night call over 7 minutes up to 196 miles. Obviously any shortfall caused by a change to bill and keep would need to be made up by each TECOM company. It could either increase local rates, or increase the charges for these toll calls. The Commission has no indication of the magnitude of these increases.

Mountain Bell is only proposing to cease being the carrier for calls that it does not switch or transport. It is unknown what percentage of all I-I toll this would effect. Mountain Bell does continue to handle much of the I-I traffic. For instance, all operator assisted intracompany intraLATA traffic is handled by Mountain Bell. The Commission does not find adequate justification to make distinctions in the carriers for this traffic based on the physical routing of a call. If the effect of Mountain Bell's proposal was to deaverage toll rates significantly, and independent rates were significantly higher than Mountain Bell rates, customers may start making unnecessary operator assisted calls to circumvent the higher rates. If an independent changes out an existing switch with a remote and no longer needs to route I-I calls from that exchange through Mountain Bell facilities, the customers may suddenly see a jump in rates for the call and a change in carrier even though, from the customer viewpoint, nothing has changed. The Commission may also be faced with constant arguments concerning the routing of toll calls. Companies may route calls needlessly through Mountain Bell facilities to avoid becoming the carrier for the call.

This important issue was not well developed in the testimony submitted in this docket. There are too many unknowns to resolve the issue at this time. Mountain Bell should continue as the carrier of I-I in TECOM service areas until issues concerning I-I can be resolved.

It may be preferable for Mountain Bell to cease being the carrier for I-I calls. Obviously this would require substantial changes. The following issues should be addressed in the task force set up in the Findings of this Order:

1. Quantifying the financial impacts of moving this traffic to bill and keep;
2. Addressing how shortfalls resulting from the arrangement would be recovered;
3. Addressing appropriate charging mechanisms for Mountain Bell switching and transport where necessary;
4. Addressing how operator assisted calls would be handled;
5. Establishing appropriate methodology for removing I-I from carrier access cost studies.

Long Range Compensation Arrangements

Although there is some disagreement between Mountain Bell and TECOM as to the expiration date of the stipulation (Mountain Bell believes it expires in 1988 and TECOM believes it does not expire until at least 1989) it is fairly clear that it does not extend beyond 1989. Mountain Bell testified concerning the compensation arrangement that it advocates for 1990 and beyond. Mountain Bell does not want to be the main toll carrier for intraLATA traffic. Mountain Bell advocates ending the TECOM pool so that each company must file carrier access tariffs. Mountain Bell then advocates an originating responsibility plan (ORP) for intraLATA traffic with the independents. Under this arrangement, Mountain Bell would bill other LEC's carrier access charges for traffic terminating in Mountain Bell's service area. The independent would bill and keep the toll revenue. The independent would bill Mountain Bell terminating access for calls originating in Mountain Bell territory and Mountain Bell would bill and keep the toll revenue. Mountain Bell proposes a Commission ordered and directed study to examine replacements to the existing access arrangement.

TECOM's position is that any changes in the current compensation arrangements are not of a pressing nature and any changes made prior to 1992 would be premature. TECOM witness Dennis Felder testified that the TECOM pool has been sucessful and benefical to the parties involved. It has reduced administrative costs to both LEC's and carriers. An ORP plan "and its potential to affect universal services, as well as to deaverage toll rates, cannot be properly addressed in this Docket" (TECOM-4, p. 37, ll. 11-13).

Mountain Bell's position raises some fundamental questions. An ORP could deaverage toll rates in the extreme. Not only could there be route deaveraging but their could be directional deaveraging (i.e. a call from point A to point B would be more expensive than from point B to point A).

The Commission finds that long range compensation arrangements are beyond the scope of this proceeding. However, the Commission endorses Mountain Bell's proposal to begin an industry forum to examine long range compensation. Many of the issues involved in an adequate review of the process are very complex and require cooperation between all parties. The Commission will direct its staff to set up and chair an industry task force to begin working through compensation arrangements between the independent telephone companies and carriers. Realizing that similiar efforts have been unsucessful and extremely unproductive in the past, the Commission grants the staff acting as chairperson on this task force authority to terminate the task force if, in the judgement of the chair, parties are unwilling to be cooperative and strive to resolve issues.

The Commission does not wish to dictate any specific arrangements be the necessary outcome of this task force or limit the issues that it may address. However, the Commission provides the following general guidance to the task force:

a. Any compensation arrangements must address and quantify the financial impacts on both carriers and LEC's;

b. If financial impacts are significant, the question of how any gains or losses are to be recovered must be addressed;

c. If the task force recommends that independent LEC's become interexchange carriers and maintain separate toll schedules then the extent to which deaveraging will occur must be addressed;

d. The solutions proposed by the task force must follow the policy of the State of Montana set forth in the 1985 Montana Telecommunications Act that competition should be encouraged when it is consistent with Universal Service;

e. Significant reductions, if any, in compensation to LEC's must address universal service impacts and the need for a state high cost fund;

f. Proposals for a high cost fund, if any, must include a funding source;

g. Toll rates should not be deaveraged on a directional basis;

h. No LEC toll rates in the state should be significantly higher than the toll rates for another LEC for similiar time of day and distance.

The Commission endorses the creation of a task force in this area in the hopes that it will provide a forum to explore issues and quantify impacts of the changing telecommunications environment. Montana Consumer Counsel and all parties involved with these arrangements are encouraged to participate in the task force.

TECOM proposed several rate structure changes in this Docket. None of these changes were contested. The Commission finds that the changes are reasonable.

TECOM submitted Late-Filed Exhibit 2 on June 17, 1988. This exhibit compares access minutes from 1-1-87 to 5-15-87 to the same period in 1988. This schedule reflects nearly a 13 percent increase in demand. This increase is certainly significant. In order to assess the impacts of increasing demand on TECOM's rates, the Commission directs TECOM to file 1987 cost studies and demand no later than October 15, 1988. If at that time, any carrier wishes to request further investigation into TECOM's rates they may do so within 30 days.

The task force created in this Docket is directed to file a comprehensive report on carrier/independent LEC compensation arrangements no later than June 1, 1989. The report should consider I-I traffic, and appropriate costing methodologies for carrier access charges at a minimum. The Commission will then set a schedule for comment and hearing on the task force proposals. If the task force is desolved by the chair, or fails to file any report with the Commission, any party may file a complaint concerning the current compensation arrangements.

CONCLUSIONS OF LAW

1. The Applicants, Lincoln Telephone Company, Project Telephone Company, and Southern Montana Telephone Company, are corporations providing regulated telecommunications services within the State of Montana and, as such, are public utilities within the meaning of Section 69-3-101, MCA.

2. The Montana Public Service Commission is properly exercising jurisdiction in this Docket pursuant to Applicants request under Section 69-3-904 (1)(b), MCA.

ORDER

1. TECOM is GRANTED additional annual revenues with the modification stated in the Finding 19 of this Order.

2. Rates approved in this Order are effective for service rendered on and after August 16, 1988.

3. TECOM will refund the difference in rates granted in this Order compared to the Interim Order No. 5336. Interest is due at 8.46 percent.

4. TECOM will make a compliance filing in accordance with the Findings of Fact of this Order showing the impact of the 85 percent cap on NTS recovery and the corrected demand for access.

DONE AND DATED this 8th day of August, 1988, in open session by a 5 to 0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

TOM MONAHAN, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Ann Purcell
Acting Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.