

Service Date: May 3, 1989

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 MOUNTAIN STATES TELEPHONE AND) UTILITY DIVISION
TELEGRAPH (U S WEST Communications)
or Mountain Bell) for a General) DOCKET NO. 88.1.2
Rate Increase.)

IN THE MATTER of the Application)
of MOUNTAIN STATES TELEPHONE AND)
TELEGRAPH (U S West Communications)
or Mountain Bell) for Authority to) DOCKET NO. 88.9.33
Incorporate An 800 Service Circuit)
Termination on a Centron 6 or 30)
Service.)

IN THE MATTER Of The Application)
Of MOUNTAIN STATES TELEPHONE AND)
TELEGRAPH (Mountain Bell or U S) DOCKET NO. 88.8.44
West Communications) for Authority)
To Incorporate Revised Directory)
Assistance Tariffs Into Its Tariff)
To State Alternative Terms of) ORDER NO. 5354d
Service For Customers of Independ-)
ent Local Exchange Carriers.)

FINAL ORDER

APPEARANCES

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DOCKET NOS. 88.1.2, 88.9.33, 88.8.44, ORDER NO. 5354d

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Eric Eck, Joan Mandeville, Mark Lee and Joe Holliman, Rate
Analysts

BEFORE:

CLYDE JARVIS, Chairman
JOHN B. DRISCOLL, Commissioner
HOWARD L. ELLIS, Commissioner
WALLACE W. "WALLY" MERCER, Commissioner
DANNY OBERG, Commissioner

FINDINGS OF FACT

Procedural Background

On January 22, 1988 U S West Communications (USWC, Company or Applicant) (formerly Mountain Bell) filed an application for a general rate increase with the Montana Public Service Commission (MPSC or Commission). The application requested rate increases to produce an additional \$13.9 million in annual revenues.

On February 29, 1988 USWC filed an application for an interim rate increase to generate \$5.5 million in additional annual revenues.

On April 7, 1988 the Montana Consumer Counsel (MCC) filed a Motion to Dismiss the case based on the fact the filing was based on a September 30, 1987 test year but 1986 financial data and cost studies were used to separate deregulated services from regulated services. MCC's motion stated that the mismatch created made it impossible to assess the application.

On April 21, 1988 MCC and USWC filed a stipulation withdrawing the Motion to Dismiss and suspending the procedural schedule. USWC agreed to file an updated case using a 1987 test year and 1987 data to remove deregulated results of operations.

On June 8, 1988 USWC filed a request for an interim rate increase of \$8.5 million annually. USWC updated this request to \$10.1 million on June 22, 1988, based on revision of the deregulated financial data.

The MPSC granted intervention to the following parties in this Docket:

Montana Consumer Counsel,
AT&T Communications of the Mountain States, Inc. (AT&T),
MCI Telecommunications Corporation (MCI),
Department of Defense and other Executive Agencies of the
Federal Government (DOD),
Montana Telephone Association (MTA),
Northwest Telephone Systems, Inc. (NWTS), and
Tel-Tec-Billings, Montana.

NWTS and Tel-Tec did not appear at the hearings herein.

On June 16, 1988 USWC filed an application with the MPSC for authority to incorporate 800 service circuit termination on a Centron 6 or Centron 30 service (Docket No. 88.9.33). The MPSC granted interim approval of said application in Order No. 5364 on September 30, 1988. Order No. 5364 also consolidated said filing into Docket No. 88.1.2.

On June 30, 1988 USWC filed an updated final rate request. The revised filing requested additional annual revenues of \$17.5 million. USWC requested that \$10.1 million of this increase be granted on an interim basis, pending a final decision.

On August 18, 1988 USWC filed an application for authority to revise its Montana tariff to state alternative terms of service for Directory Assistance (DA) customers of Local Exchange Carriers (LECs) (Docket No. 88.8.44). USWC made this filing pursuant to Finding of Fact Nos. 24 and 25 of Order No. 5336a in Docket No. 87.12.84. On September 20, 1988 USWC filed supplementary testimony in support of said filing. On October 3, 1988 in Order No. 5372 the MPSC approved this filing on an interim basis and consolidated it into Docket No. 88.1.2.

On September 19, 1988 the Commission issued Interim Order No. 5354 granting USWC additional annual revenues of \$6,366,000 to recover the additional intrastate revenue requirement associated with Federal Communications Commission (FCC) mandated 1988 separations shifts, the Uniform System Of Accounts rewrite costs and Telephone Exchange Carriers of Montana (TECOM) carrier access rate increases.

Hearings were held on the issues in this Docket from December 5 - 16, 1988.

On January 19, 1989 a stipulation between USWC and MCC was submitted to the Commission. The stipulation represents an agreement between those two parties to dispose of the revenue requirement issues of this case. The stipulation states that a permanent rate award of \$5.5 million in this Docket will result in rates that are not excessive and that are otherwise reasonable.

USWC currently has a request for a revenue increase of \$3,095,000 pending before the Commission in Docket No. 88.12.55. In that case USWC seeks to recover the intrastate revenue requirement associated with the effects of certain FCC mandated separations changes that took effect on January 1, 1989. USWC requested immediate interim relief for the full amount requested in Docket No. 88.12.55.

The MCC/USWC stipulation suggested the Commission issue a further interim order to coincide with any interim order in Docket No. 88.12.55, reducing the interim in place in this Docket from \$6,366,000 to the stipulated \$5,500,000.

On February 3, 1989 the Commission issued a "Notice of Stipulation and Opportunity to Comment" which gave interested parties an opportunity to submit written comments or to comment at a public meeting on February 9, 1989, regarding the USWC/MCC stipulation.

On March 3, 1989 the MPSC issued Interim Order No. 5354a reducing the interim increase in this Docket by \$866,000, resulting in a revised interim increase of \$5,500,000. The Commission simultaneously issued Interim Order No. 5398 in Docket No. 88.12.55 granting USWC an interim annual revenue increase of \$3,095,000.

On March 8, 1989 USWC filed a Motion for Reconsideration of Order No. 5354a regarding the prohibition against compounding the Late Payment Charge (LPC) approved therein. On March 20, 1989 the MPSC issued Order No. 5354b granting the motion to permit compounding of the LPC.

On March 23, 1989 USWC filed a Motion for Reconsideration of Order No. 5354a regarding the exemption from the LPC for alternative payment arrangement agreements. On May 1, 1989, in Order No. 5354c, the MPSC granted the motion and clarified its previous order.

The remainder of this Order is divided into three general sections. The first section, entitled "Revenue Requirements," discusses the stipulated revenue requirement and other issues addressed by revenue requirement witnesses which do not directly affect the revenue requirement in this case. Second, "Cost of Service" issues will be discussed. A main theme of the Applicant in this Docket, is the desirability of cost compensatory price

levels. It is therefore crucial for the Commission to review and comment on USWC's cost analysis. However, due to the proprietary nature of USWC's long-run incremental cost studies and results, a detailed examination of its cost development methodology is in the proprietary portion of this order, designated as Appendix A. The general methodology of USWC's long-run incremental cost analysis is summarized in the main body of the Order. Third, the "Rate Design" issues in the above captioned Dockets will be reviewed. This section begins with a survey of the witnesses which testified on behalf of the various parties herein. The remainder of this section reviews the Applicant's Rate Design proposals, intervenors' direct testimony, USWC's rebuttal, and a summary of the three filed stipulations. This section concludes with the Commission's decision on the Rate Design issues.

REVENUE REQUIREMENTSRevenue Level

USWC requested a revenue increase in this Docket of \$15,973,000 in annual revenues. The increase was based on an overall rate of return of 11.64 percent and a return on equity of 13.60 percent. The overall return incorporated the Company's actual capital structure. MCC proposed a revenue decrease of \$1,549,000 in annual revenues. The MCC proposal was based on an overall rate of return of 9.93 percent and a return on equity of 11.00 percent. MCC based its proposal on a hypothetical capital structure of 50 percent equity and 50 percent debt.

The MCC/USWC stipulation states:

3. The parties to this Stipulation agree that a permanent rate award in this Docket of \$5.5 million will result in rates that are not excessive and that are otherwise reasonable.

4. The parties agree that USWC should not be required to make any refund for the revenues representing the difference between the higher interim award and the proposed final award. Instead, the amount potentially subject to refund was taken into account at arriving at the \$5.5 million figure.

No other parties filed testimony concerning the revenue increase requested by USWC. The Commission did not receive any comments or replies on the stipulation.

The Commission finds that the stipulation represents a reasonable overall revenue increase and balances the interests of USWC's Montana ratepayers and USWC's stockholders. In granting USWC \$5.5 million in additional annual revenues, the Commission is not accepting any particular ratemaking adjustments or methodologies, with the one exception concerning income taxes noted below.

The 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) required taxpayers to elect either a 10 percent investment tax credit (ITC) under Section 48(q)(1) of the Internal Revenue Code or an 8 percent ITC under Section 48(q)(4) for property placed in service after December 31, 1982. If the 10 percent ITC was elected, the taxpayer was required to reduce the tax basis of the property by 50 percent of the ITC claimed. The election was made for each asset placed in service. In all cases, USWC chose the 10 percent ITC rate and the basis reduction. This election resulted in a higher revenue requirement than that produced by electing the 8 percent ITC rate with no basis reduction. In Docket No. 84.4.19, Order No. 5046f, the Commission reduced tax expenses for ratemaking purposes as if the 8 percent ITC election had been chosen for all assets. The Commission's decision was based solely on arguments

concerning the overall revenue requirement effect of the Company's election. Normalization requirements were not addressed.

In this Docket MCC proposed to continue to adjust revenue requirements to reflect the 8 percent ITC election. USWC filed extensive rebuttal which raised concerns about possible normalization violations caused by the Commission's acceptance of this type of an adjustment for ratemaking purposes. The Commission continues to disagree with the election USWC made for ITC's. However, the Commission recognizes that determining USWC's revenue requirement by imputing the election of Section 48(q)(4) when, in fact, USWC elected the Section 48(q)(1) option, may be a violation of the normalization rules of Section 168(e)(b)(ii) of the Internal Revenue Code of 1954 and Sections 168(f)(2) and 168(i)(9) of the Internal Revenue Code of 1986. Therefore, the Commission specifically rejects this MCC adjustment.

Further, the Commission recognizes that Order No. 5046f directed USWC to calculate rates on the basis of the Section 48(q)(4) election. In order to avoid any possible violation of the normalization rules, the Commission finds the revenue requirement in this case to be adequate to allow a recoupment of the \$129,448 in revenues foregone as a result of the imputation of the Section 48(q)(4) election. USWC will amortize the difference in deferred

taxes and accumulated ITC used for ratemaking back to the level that would have existed absent Order No. 5046f over a period of one year.

Affiliated Interests

In Order No. 5354, the first interim order in this Docket, the Commission expressed concern with the level of transactions with affiliated companies. The interaction with nonregulated affiliated companies has increased dramatically since divestiture. In Order No. 5046f, Docket No. 84.4.19, affiliated transactions were limited to Bell Communications Research and U S West Direct. The Commission expressed concern with ratepayer funding of research to benefit deregulated services, and U S West's possible attempts to siphon off profits associated with the directory business by transferring directory operations to a separate subsidiary (U S West Direct), and decreasing the fees that U S West Direct pays to USWC (Order No. 5046, pp. 21, 26). Since that Order, the publishing fees paid by U S West Direct to USWC have been more than halved. However, starting in 1989 this amount will be reduced much further. Mr. J. Walter Hyer III, an employee of U S West Direct, stated that the "subsidy" piece of the payments to USWC will be discontinued (TR p. 307).

In addition to the problems with affiliated transactions described in the last general rate order, U S West, Inc. has created many more nonregulated affiliates which do business with USWC. U S West Advanced Technologies was created in 1985 and provides research and development services to USWC over and above those provided by Bell Communications Research. Material Resources, Inc. was created in 1986 to provide procurement services. Material Resources is organized as a "for profit" corporation, which creates questions concerning the prices that USWC pays for those services. U S West Corporate Communications provides official communications services for USWC. Beta West Properties provides site selection and design services for office buildings and relocation services. It also leases building space to USWC. U S West, Inc. provides shareholder services, handles federal relations, and manages pension plans. Several other affiliates provide services such as third-party leasing and marketing mobile and paging services. USWC provides personnel management, legal services, marketing, billing and collection, communication services, consulting services, various support services, and the like, to the nonregulated U S West, Inc. holding company and its subsidiaries.

These affiliate transactions have substantial financial impacts on USWC rates. MCC witness Mr. Allen Buckalew proposes six criteria or standards for testing the reasonableness of transactions with affiliated companies (MCC-14, pp. 8-11). USWC witness Mr. Rueben Hernandez filed rebuttal testimony stating that existing standards are sufficient and there is no need for additional standards. Mr. Hernandez testified that USWC has undergone two extensive reviews of its operations, a Colorado Management Audit and a Utah audit of affiliated interest transactions conducted by Price Waterhouse. The recommendations from those reviews are in the process of being implemented with the exception of the requirement that services to be provided from outside USWC be put out to bid (TR p. 529). During cross-examination by Commission staff attorney Mr. I. Charles Evilsizer, Mr. Hernandez testified that, with the one exception, there is no differences left between USWC and Mr. Buckalew's recommendations to the Commission (TR p. 532).

The Commission remains concerned that adequate information be provided to evaluate the reasonableness of affiliated transactions. It seems reasonable to attempt to formulate a uniform set of standards to facilitate the Commission's needs in

this regard. The MCC/USWC stipulation addressed this issue, stating:

6. MCC's testimony in this proceeding discussed a series of potential standards to govern future consideration by the PSC of USWC's dealings with its affiliated entities. MCC also proposed a special proceeding for the consideration and refinement of standards of the type proposed. USWC opposed such a proceeding as unnecessary and duplicative of similar studies and investigations recently concluded by regulatory bodies in other states in which it does business. The parties now agree that the issue of standards and reporting procedures regarding affiliate interest transactions should remain open in this proceeding. The parties agree to attempt to arrive at a workable set of standards through negotiations. If those negotiations prove to be unsuccessful, the PSC would then be in a position to write an order related to this issue on the basis of the record evidence received at hearing in this matter.

The Commission finds that the stipulation on this issue is reasonable. The Commission will allow the parties until August 15, 1989, to develop standards and reporting requirements. MCC and USWC shall be required to file a report of their progress with the Commission by this date. Following consideration of the report, the Commission may proceed to issue a final order on this subject, based upon the record before it in this Docket, or take other action which it deems appropriate.

Accounting for Deregulated Services

Several issues were raised in this Docket concerning accounting for deregulated services. The 1985 Montana Telecommunications Act permitted deregulation of several USWC services.

Private line, inside wire, and carrier billing and collection have been deregulated pursuant to the Act. The Act also prohibits regulated telecommunications services from subsidizing services that are not regulated (Section 69-3-806, MCA). To comply with this provision, USWC has presented an Accounting Separations Plan (ASP) to separate the revenues and costs of deregulated services from regulated services.

MCC addresses this area in its prefiled testimony. MCC witness Mr. Buckalew recommends the Commission accept USWC's ASP as a "starting point" for allocating costs to deregulated products and services. However, Mr. Buckalew requests the Commission reject the assignment methodology for loop costs presented in USWC's ASP. Mr. Buckalew explains:

MB reduced loop costs based on hypothetical analysis of plant designs and costs, not embedded costs. In this analysis, a current resource cost study (LAPGAP Local and Pair Gain Analysis Program) was applied to factor up residence costs and drastically lower its competitive costs. LAPGAP has nothing to do with how MB incurred its embedded costs. In addition, the analysis did not separate pri-

vate line customers as a class but assumed that they had the same general pattern as all business customers. (MCC 14, p. 32)

Mr. Buckalew proposes an adjustment to USWC's deregulated service results to reflect an allocation for loop investment based on relative loop counts. This methodology results in allocations based on the embedded average cost of all loops (i.e. all loops are assumed to have similar cost characteristics).

USWC witness Mr. Dallas Elder rebuts Mr. Buckalew's adjustment:

The company used the deaveraged loop concept in the cost study presented to the Commission due to its superior reflection of actual costs incurred.

Simply stated, the deaveraged loop recognizes that shorter loops cost less than longer loops. This obvious fact has been recognized by both Mr. Buckalew and this Commission. (USWC Exh. 19-R, p. 18)

Mr. Elder also maintains that Mr. Buckalew overstates his adjustment. Mr. Elder explains that Mr. Buckalew applies the same factor he uses for net investment to maintenance, depreciation, relief and pensions, other employee benefits, general services and licenses, and other general expenses. Because many of these items are not driven by investment, the adjustment is overstated. Mr. Buckalew

admits that his adjustment is an estimate (USWC Exh. 19-R, pp. 10-12).

The Commission recognizes the validity of many of USWC's arguments. However, USWC acknowledges that its methodology decreased investment costs assigned to the private line category from 1986 to 1987, even though the total Montana investment in loops increased and the number of private line loops (both on an absolute basis and as a percentage of all loops) increased (TR pp. 548-552 & 557-558). Because of the stipulated revenue requirement in this case, the Commission need not decide this issue at this time. However, the Commission directs USWC to file results using the averaged loop concept in its next proceeding addressing this issue. USWC may, of course, also file results using a deaveraged loop concept, if it so desires. However, the Commission expects to have detailed testimony addressing Mr. Buckalew's concerns regarding the hypothetical or prospective nature of the LAPGAP study (if that study is used), the justification for the assumption that private lines have the same characteristics as business loops, and the reason the investment in loops assigned to the private line category decreased between 1986 and 1987.

USWC witness Mr. L. Wayne Anderson addresses accounting for deregulated products and services not covered by the ASP. Mr.

Anderson proposes "these products be handled similarly to the way incidental products were treated by the FCC in Docket 86-111" (USWC Exh. 9, p. 10). Mr. Anderson explained that:

The FCC recognized that it is not feasible to segregate product finances for all products and ruled that carriers could classify some incidental activities as related activities without distorting the ratemaking process. The FCC further ruled that it would allow incidental treatment of activities which produce, in the aggregate, no more than one percent of a company's total revenue. (USWC Exh. 9, pp. 10-11)

Mr. Anderson notes the 1 percent rule applied to Montana total state revenues results in a threshold of about \$2.5 million. Because in his opinion this amount is too small, Mr. Anderson proposes a cap on incidental product revenues of \$5 million. This treatment would apply to any deregulated products for which there is no available ASP information (USWC Exh. 9, p. 11).

The Commission finds the guidelines proposed by Mr. Anderson to be reasonable. The Commission will accept the FCC guidelines for incidental products with the exception of the 1 percent limitation, which will be replaced by a \$5 million cap, and with the further proviso that there be no deregulated product category for which there is current ASP procedures to separate costs. USWC must abide by the FCC qualitative guidelines as well

as the \$5 million cap. The FCC qualitative guidelines only allow nonline-of-business activities to be treated as incidental, and activities may not be treated as incidental if the carrier has not traditionally treated them in that way. To insure compliance with these guidelines, USWC must file, as part of the documentation filed with each rate case for the removal of deregulated products:

- 1) a list of activities it is treating as incidental deregulated activities,
- 2) the total revenues from each activity, and
- 3) the regulated product category in which each has been included.

Proprietary Information

Some information provided during the course of a proceeding will be of such a sensitive nature that the Company could be financially harmed if the information is made public. In those instances the Commission has established a procedure whereby the information can be filed under a protective order and remain confidential. See < 69-3-105(2), MCA. USWC has used this procedure many times in this and other proceedings before the Commission. The problem, however, is that the Company does not apply enough discretion in determining what is or is not proprietary. The volume of information submitted in this proceeding on a proprietary basis is overwhelming. It is as if many items are labeled proprietary just to be on the safe side.

When USWC follows such a policy it causes many unnecessary burdens to arise. For instance, proprietary information must be sealed by the Commission, segregated in the files of the Commission, and withheld from inspection by any person not bound by the protective order. All parties in possession of proprietary information are also required to take reasonable precautions to keep the confidential information secure. This requires enormous amounts of clerical and administrative time to insure the information is properly filed and secured. Of equal concern is the

problem of incomplete records in the event that the proprietary information is ever needed again. The protective orders issued in this and previous dockets have required proprietary information to be returned to the providing party within 30 days following conclusion of the case. This means that the Commission's files are incomplete at the end of a proceeding. By declaring information to be proprietary when it should not be proprietary, the Company is causing the Commission and all intervenors many unnecessary hardships.

An obvious example of USWC incorrectly labeling information as proprietary can be found in the Company's response to PSC Data Request No. 9. That request asked for the Company's per line investment in 1984, 1985 and 1986. USWC responded that the "per line investment (calculated as Plant in Service/Total Service Lines) for 1984, 1985 and 1986 is proprietary." Interestingly enough the figures for both plant in service and total access lines were earlier provided in nonproprietary fashion, meaning the Company declared the mathematical operation of division to be proprietary. Perhaps it was best summed up by the Company's Montana CEO, Mr. George Ruff, when during cross-examination he stated:

So your question is valid. Why, one, if you are furnishing both ends of the equation, it doesn't take a mental giant to make the division, why should one be proprietary and the other not? (TR p. 56)

The current Company procedure regarding designation of proprietary information results in unneeded hardships for the Commission and all intervenors. The Commission finds that something must be done to correct the situation. Therefore, the Commission holds that in all instances where USWC designates information as "proprietary," it must comply with the following guidelines:

- a. At the beginning of each proceeding, the Company shall submit to the Commission the name of one officer that will be responsible for designating information to be proprietary.
- b. At the time proprietary information is submitted to the Commission and intervenors, the Company shall provide a detailed explanation outlining why the information constitutes a "trade secret," including a description of exactly how the information could be used by competitors or others to injure or devalue the Company's current or future competitive position. A generic or canned

explanation will not suffice. Each explanation must be specific to the item submitted.

- c. All proprietary information will be submitted on yellow paper so it is easily identified for filing purposes.
- d. All proprietary information submitted to the Commission will include down grading instructions that specify the date that information will no longer be considered to be proprietary. When the down grading date occurs for an item of proprietary information, that item must be resubmitted to the Commission.
- e. Bimonthly during a proceeding and two weeks before a scheduled hearing, a summary listing of all proprietary information provided in each proceeding shall be submitted to the Commission and all participating parties. The listing will contain columns that sequentially number the information, state why the information was filed (response to data request no. __, minimum filing requirement, etc.), describe what the information pertains to, show when it was filed, disclose the number of pages for each item, and list parties that were provided the information.

- f. The Company shall keep in a secured storage facility copies of all proprietary information submitted in all past, present and future proceedings before this Commission. Within 24 hours, the proprietary information stored therein (and made part of the record in a proceeding) must be made available upon request to the Commission, the MCC, and their staffs, pursuant to the terms of the protective orders in the respective dockets and consistent with the Montana Supreme Court decision in Mountain States Telephone and Telegraph v. Public Service Commission, 634 P.2d 181 (1981). The Company will be required to petition the Commission for permission to permanently remove or destroy any of the proprietary information in the storage facility.
- g. The Company shall submit to the Commission indexed and organized microfiche copies of all proprietary information provided in each proceeding. Each item will be recorded on microfiche so that the information is maintained in order (i.e. page 1 of a proprietary response will be followed by page 2 and then page 3, page 4, etc.). For the purposes of this proceeding, the Company must organize the microfiche in the following order:

1. Direct Testimony
2. Exhibits Related to Direct Testimony
3. Workpapers Related to Direct Testimony
4. Minimum Filing Requirements
5. Rebuttal Testimony
6. Exhibits Related to Rebuttal Testimony
7. Workpapers Related to Rebuttal Testimony
8. Data Responses Organized by Party and by Request Number
9. All Other Information as Required.

In future proceedings the Commission requires the Company to submit microfiche copies at the same time corresponding proprietary information is filed, when appropriate. For instance, it would be appropriate to file microfiche copies of direct testimony, exhibits, workpapers, and minimum filing requirements at the time the Commission accepts the Company's case as filed, while it would not be appropriate to file microfiche copies of incomplete data responses or data responses that are submitted out of order.

Additionally, USWC should completely review its internal procedures regarding designation of "proprietary" material. The goal of this review is to reduce to the maximum extent incorrect claims that information is proprietary. The Commission is very concerned about the Company's cavalier approach to this issue in Docket No. 88.1.2.

COST OF SERVICEBackground

The Cost of Service section of this Order is divided into two sections, public and proprietary. In the public section a general overview of USWC's long-run incremental cost (LRIC) methodology is reviewed per the direct testimonies of Dr. Robert M. Bowman and Mr. Robert B. Carnes. This section also reviews the methodology USWC uses to develop the LRICs to provide an incorporated 800 service circuit termination on a Centron 6 or Centron 30 service (Docket No. 88.9.33).

The Commission has determined that it is necessary to discuss USWC's LRIC methodology in some detail, including its proprietary aspects. This discussion (and Commission decision) is contained in Appendix A of this Order, which is attached hereto and incorporated herein by this reference. The security and dissemination of Appendix A are governed by the provisions of the Protective Order issued in this Docket on January 20, 1988. The cost analysis supporting the Company's Directory Assistance price proposal for independent LECs and their customers (Docket No. 88.8.44) is also reviewed in Appendix A.

USWC Long-Run Incremental Cost Methodology

USWC uses a LRIC methodology to develop and support its price and detariffing proposals in this Docket. The following is an overview of its LRIC methodology applied in the cost of service studies (Table 1). Dr. Bowman presented cost studies numbered 1 through 16 in Table 1, and Mr. Carnes presented the remainder (Exh. Nos. 32 and 33).

TABLE 1

LRIC Studies - Docket No. 88.1.2

| | |
|--------------------------------|--|
| 1. Local Measured Usage | 15. New Number Referral Service |
| 2. Local Message Usage | 16. Late Payment Charge |
| 3. Extended Area Service | 17. Nonrecurring Cost Study for Residence, Business and Complex Services |
| 4. IntraLATA Toll | 18. Recurring Access Line |
| 5. IntraLATA 800 Service Usage | 19. Recurring WATS Access Line |
| 6. IntraLATA OutWATS usage | 20. Nonrecurring Costs for Private Line Access Service |
| 7. Public Coin Services | 21. Analog Recurring Private Line Access and Switched Private |
| 8. Centron 6 and 30 | |
| 9. Custom Calling | |
| 10. Toll Restriction ** | |
| 11. Companion Line | |
| 12. Directory Assistance * | |
| 13. Customer Listings ** | |
| 14. Operator Handled Surcharge | |

* Cost studies for both USWC service territory customers and Independent LEC's and their customers were filed.

** All studies listed above other than these appear to have been done specifically for USWC's Montana service area.

Source: USWC Exh. Nos. 32 and 33.

The LRICs developed for the services in this docket are defined as the costs directly associated with supplying additional units of additional product. As such, USWC asserts that "common costs" of the Company will not vary as output increases and are therefore not included in the analysis.

Since short-run costs of providing additional service are relatively low when there are large amounts of excess capacity, but high when facilities reach their capacity limits, Dr. Bowman holds it is more practical to estimate costs in long-run increments (USWC Exh. No. 32, pp. 5-6). Hence, the method used by USWC seeks to smooth out the "lumpy" incremental costs associated with large, economical blocks of additional capacity. All customers, whether individually cost causers or not, face the same costs, so no single customer carries the burden of being the cost causer. This is done by expressing costs in terms of long-run "average" incremental costs.

USWC holds that LRICs should be based upon "forward-looking" technology. This assumes that additional units of demand will be served by "technology that will be used in the future ... which may or may not be the same as the existing technology" (USWC Exh. No. 32, pp. 5 and 10, emphasis added). The resulting costs are based on investments associated with forward-looking technology since it will be used to serve the additional units of product in the future. It appears that this same assumption is used throughout most of USWC's cost studies.

Recurring and nonrecurring costs are the two distinct types of costs examined in the USWC LRIC studies. Nonrecurring costs are

those which the Company incurs only once when a particular service is initiated, discontinued or altered, and are usually labor-related. For instance, the costs associated with initiating a flat rate exchange service is an example of a nonrecurring cost. With the exception of a few services, such as toll restriction, customers are charged only once for these costs. Recurring costs, however, are those costs which occur as a result of continuing service, and include capital costs and operating expenses. A customer repeatedly pays recurring costs as service is continued.

Dr. Bowman's direct testimony describes the general procedures used to identify nonrecurring LRICs:

- . The service under study is identified, along with the forward-looking technology (i.e., plant and equipment) and/or labor resources required to serve future demand.
- . When applicable, the investments associated with the plant and equipment are estimated.
- . The recurring monthly costs associated with investments and/or labor expenses are identified. This includes estimating one-time or nonrecurring expenses.
- . Product-specific expenses, such as advertising and sales compensation, are estimated and added to the investment or labor related monthly costs, as appropriate. (USWC Exh. No. 32, pp. 7-8.)

Since most pieces of switching and trunking facilities are used for more than one product, "cost modules" are used to estimate the various components of costs or unit investments associated with shared items of plant and equipment. The primary modules developed in this step are the "switching" and "facilities" modules. Dr. Bowman's description of the switching module generally epitomizes the procedures used to develop unit investments for each of the modules in the cost studies:

The switching module is used to develop incremental unit investments for each of the different switch technologies. It contains an investment database, of vendor prices, by equipment item, along with standard cost equations. These cost equations were developed by analyzing the equipment items in a number of sample switches and grouping them together according to major functions. The forward-looking switch technology along with detailed traffic data for each office is provided by the network engineers. This data is used with the cost equations to determine the equipment requirements for the office under study. This is then coupled with the investment data to generate unit investments which reflect the technology and traffic characteristics of each office. The Various offices under study are then weighted together to obtain the average unit investment for each technology which can then be weighted together in the various studies to obtain the average of all technology types. Each investment database is revised periodically and may be updated to the desired study year by using Telephone Plant Indices (TPIs). (Exh. No. 32, pp. 11-12)

Because of their different functions, other investment modules employ slightly different procedures.

Monthly recurring costs are determined by multiplying unit investments by annual cost factors and dividing by 12. Annual cost factors for capital investments include depreciation, cost of money, and income taxes. Maintenance and administrative costs, centralized service fees, and ad valorem and gross receipts taxes account for operating expense factors.

The cost studies sponsored by Mr. Carnes follow a somewhat different procedure than those of Dr. Bowman. In Mr. Carnes procedure, nonrecurring costs for residence, business, and complex services are considered to be costs related to the tasks of initiating those services. These tasks include writing, typing, and field cross-connection (USWC Exh. 33, p. 6). This study identified direct costs associated with connecting and disconnecting basic exchange services.

As used in USWC's cost studies, the following general definitions apply:

- a. "on-peak" refers to the highest usage period of facilities.

- b. "busy season busy hour" is used to define the on-peak period. For example, the busy season busy hour traffic data used in the switching module is an average of the three highest months usage. See STF-02-MPSC-137.
- c. "off-peak" refers to usage periods which are not "on-peak."

It appears that on-peak and off-peak costs are treated identically in the USWC LRIC methodology. The costs developed in each module are based on the load each facility has experienced (based on traffic data). Unit investments for each individual facility are based on the busy season busy hour, which vary across facilities. Dr. Bowman states that since busy hours vary across network components, attempting to charge for busy hour usage would be difficult to administer, unacceptable to customers, and cause shifts in traffic patterns. Hence, "busy hour investments are generally spread over all traffic in the day to obtain an average investment for all usage" (USWC Exh. No. 32, p. 13).

800 Service Circuit Termination On A Centron 6 or Centron 30 Service - Docket No. 88.9.33

Pursuant to MPSC Order No. 5364 in Docket No. 88.9.33, Mr. T. John Heberly submitted testimony on behalf of USWC regarding 800 Service circuit termination on a Centron 6 or Centron 30 Service (USWC Exh. No. 34). Mr. Heberly's testimony summarizes the methodology used to develop the costs associated with providing said service. These costs are developed on a Company-wide basis assuming three hours of network administration labor per installation, and a loaded labor rate of \$32.89 per hour. Other assumptions include 93 ESS offices and 627 lines. The resulting installation cost is \$14.64 per line.

Montana Consumer Counsel

Although the MCC did not file direct testimony regarding USWC's LRIC methods per se, costs were examined and MCC witness, Mr. Allen Buckalew was cross-examined regarding USWC's LRIC methodology. However, due to the proprietary nature of the LRIC studies and results, Mr. Buckalew's comments are summarized in the proprietary portion of this Order found in Appendix A.

Commission Decision: Cost of Service

The Commission finds four fundamental problem areas in the Company's LRIC methodology. Those areas are: 1) the treatment and allocation of peak costs, 2) the mix of applied technology, 3) the methods used to capitalize costs, and 4) treatment of common costs.

Due to the proprietary nature of USWC's LRIC cost studies and results, a detailed examination and Commission decision regarding the LRIC methodology is presented in Appendix A.

RATE DESIGN: SUMMARY OF TESTIMONY

Outline of Participating Witnesses

Seven witnesses sponsored testimony and exhibits on behalf of USWC in support of the several rate design and detariffing proposals in this Docket, as listed in table B1 (see Appendix B).

A summary of the testimony and issues is presented as follows. First, Mr. Frank Hatzenbuehler addressed the Company's general pricing philosophy applied to the rate design proposals. Second, Dr. Barbara M. Wilcox and Ms. Marcia K. Rounds sponsored the Company's Residential and Business Basic Exchange proposals, respectively. Dr. Wilcox also addressed EAS and Coin Telephone service. Ms. Rounds also addressed proposed changes to WATS, Directory Assistance, Operator Services, and Listings. Although Dr. Wilcox and Ms. Rounds sponsor testimony for residential and business service categories, respectively, due to some overlap in the service categories, their statements are not purely restricted to either residential or business services. Mr. Kenneth L. Greenwalt sponsored the proposed changes for Private Line Access (Special Access). Dr. Frank J. Allesio testified on the appropriate basis of USWC's carrier access charges, of which Private line is a component. Mr. Richard L. Lane's testimony addressed USWC's proposal to implement a late payment charge. Finally, Mr. L. Frank Cooper sponsored testimony regarding the pricing flexibility (detariffing) proposals for certain services.

Those services include Message Telecommunications Services (MTS or Toll), the nonaccess portions of Centron Services, Coin Telephone local message charge, and certain Custom Calling Services.

Mr. Cooper also sponsored testimony proposing retail and wholesale DA prices for independent local exchange carriers and their customers.

Mr. Buckalew presented testimony and exhibits on behalf of the MCC regarding several of the issues raised by the Applicant.

Those issues include Residence Basic Exchange Options, Business Exchange Rates, Extended Area Service (EAS), Directory Assistance, Coin Telephone Service, Operator Surcharges, Measured and Message Service, and Centrex and Centron. Mr. Buckalew also presented an extensive 13 page position regarding the four detariffing issues proposed in the Docket.

Ms. Roberta Ferguson adopted Mr. Timothy Gates testimony filed of behalf of MCI Telecommunications Corporation. Ms. Ferguson addressed USWC's request to detariff MTS, 1-plus dialing parity, equal access in USWC's Montana Service area, and USWC's Imputation of Carrier Access Charges (CACs) into its MTS costs. Another area MCI appears to have addressed is time-of-day CACs for Interexchange Carriers (IXCs).

Testifying on behalf of AT&T, Mr. Michael V. Wood presented AT&T's position regarding USWC's market-based application to CACs and the price proposals for Private Line Access service. AT&T also addressed USWC's lack of imputing CACs into its MTS costs and the associated potential results of USWC not being required to impute CACs. USWC's request to detariff the nonaccess portions Centron Services was also addressed.

Testifying on behalf of the Department of Defense and the Federal Executive Agencies, Mr. Mark Langsam presented arguments concerning pricing flexibility for USWC's large customers, and "price deregulation" of competitive services.

Finally, Mr. Robert G. Orr sponsored testimony regarding the MTA position regarding USWC's proposed rates for providing independent LECs and their customers Directory Assistance.

Throughout this review, the term "current" refers to the price levels or market conditions prevailing during the test year used in this Docket.

USWC's General Price Policy

The following is a summary of the general pricing philosophies and policies underlying USWC's rate design proposals in this Docket.

Mr. Frank Hatzenbuehler presents USWC's proposal to implement "market-based" management pricing policies as opposed to "product based" policies. According to Mr. Hatzenbuehler, the application of market-based management mandates "services must be tailored to fit the unique needs and purchasing behavior of each market segment" (USWC Exh. No. 25, p. 3). Essentially, the Company is shifting its strategy from serving average customer groups to a policy of capturing the customer's "real and perceived value" (Id. pp. 3-4) inherent in its services. TeleChoice serves as an example of this new approach of pricing. "Unlike the average residential service, 1FR, which attempts to be all things to all people, TeleChoice (TM) offers a variety of options. Five different packages are available.... Each package has been designed to meet the needs of a particular segment of the residential consumer market" (Id. p. 3). The Company proposes to establish prices which are greater than cost but less than perceived value in order to "establish ... a win-win situation for customers, who get value for their money, and the Company, which realizes profits" (Id. p. 4). Another goal of the market-based pricing policy is to reduce "cross elastic effects, arbitrage and tariff shopping" (Id. p. 4).

Basic Exchange Services: Residential

According to Mr. Hatzenbuehler, Basic Exchange Service is currently subsidized by other services. He argues that even though the goal of increasing these prices is to bring them closer to the customer's value, USWC argues that prices first need to be increased in order to recover costs. Furthermore, the Company holds that Local Measured Service (LMS) and Block Usage Options will be more equitable for customers who use their Basic Exchange Service less frequently (USWC Exh. 25, pp. 6-8).

Flat-Rated Service. Dr. Wilcox proposes increases in recurring Residential flat-rated services. This proposed increase will also impact prices for the Low-income Telephone Assistance Program and TeenLink(SM). The price structure for LMS is also proposed to change congruently with the Business LMS changes as presented by Ms. Rounds, below. Ms. Wilcox is also introducing three usage block options to customers served by central offices capable of providing LMS (USWC Exh. No. 30, pp. 12-15). These options and the proposed prices are reviewed below. The revenue impact for these proposals, including the expected market response, is estimated to be \$9,711,578. (See Table B1 for the revenue impacts of each of these services.)

Dr. Wilcox also proposes increases in nonrecurring service and equipment charges for Measured Service Detailed Billing, Restoral of Service, Establishment or Changes in billing responsibilities, and TeenLink(SM) Service installations. Projected revenue impacts for these increases total \$13,643 (USWC Exh. No. 30, p. 11).

Companion Line. Dr. Wilcox proposes that all Companion Line services be priced equally for residential customers, regardless of whether they subscribe to flat or measured service. Companion Line provides a routing or hunting mechanism capable of redirecting incoming calls from a busy line to an alternate available line. Fees for these services are assessed according to the number of lines the customer requests with the service. The reasoning for the proposed price increase is to remove the price variances paid by customers subscribing to flat or measured service, since the Companion Line service is the same for both subscriptions. The Company proposes a \$5.00 price be charged, instead of \$3.28 and \$1.93 for Flat and Measured service, respectively. The revenue impact of this proposal is projected to be \$2,331.

A similar proposal for business customers is made for the same reasons. Currently the flat-rated line service price is \$8 for rate groups one and two (RG-1 and RG-2). The prices for

Companion Line services are less for measured and message services.

The Company proposes to set all business Companion Line prices at \$8 per access line. The revenue impact of this proposal is \$4,444.

Block Usage. As an alternative to flat-rated Residential and Local Measured Service, the Company proposes three hour block usage rates consisting of three, six, and nine hours of local usage per month. The proposed prices for these options are \$11.62, \$13.38, and \$15.14 per month for each of the 3, 6 and 9 hours of usage. Each minute of usage over each of the subscribed time allowances would result in an additional charge of 1.5 cents per minute. Dr. Wilcox asserts that "data on customer calling patterns show over half of residence customers could meet their calling needs by choosing one of these options" (USWC Exh. No. 30 p. 12 and Sch. 2).

The Company supplements this proposal with an introductory period to allow customers the opportunity to try the new options and switch back to their original service at no additional charge.

TeenLink(SM). Teenlink is a local service option which provides three permutations of Toll Restriction, Touch Tone, Three-Way Calling, and Call Waiting in addition to Flat Rated Residential Service. In addition to the nonrecurring price increase reviewed

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above, USWC proposes to increase recurring monthly prices from \$19.10 to \$20.75.

Basic Exchange Services: Business

Ms. Rounds proposes price increases for flat-rated business line services, and realignment of flat-rated Private Branch Exchange (PBX) trunk prices and other flat-rated related business services, all of which result in price increases. Flat-rated business exchange prices are proposed to increase from \$33.90 to \$36.55 and from \$36.62 to \$42.80 for Rate Groups one and two (RG-1 and RG-2), respectively. Rate Groups (RG) are differentiated by the number of terminating circuits in the serving wire center. Ms. Rounds also proposes Block Usage options offered in six, nine, and twelve hour increments of local usage. The proposed prices for these options are \$27.50, \$31.00, and \$33.50 per month for each of the 6, 9, and 12 hours of usage. Each minute of usage over the subscribed time allowances would result in an additional charge of 2.5 cents per minute. The rationale for this proposal is the same as that provided by Dr. Wilcox. A trial period with the same terms as explained above for the residential offering, would also be applicable to business customers. The block usage service will be provisional to rate group two customers served by Measured Service capable offices only (USWC Exh. No. 27).

In order to equate access line prices for Measured and Message services, the Company is proposing that business Message

Access Line prices be reduced for RG-1 and RG-2 customers. The Company also suggests that Public Access Line and Message PBX Trunk prices be decreased in order to be aligned with Measured and Message Access Line prices. The anticipated revenue impact of the above proposals is expected to be \$3,147,000.

In order maintain conformity with Dr. Wilcox's proposals for Companion Line, in-only and two-way PBX Trunk prices for Measured Services are proposed to be increased for RG-2 business customers.

Likewise, in-only and two-way PBX Trunk prices for Message Service are proposed to decrease for RG-1 and RG-2 business customers. The projected revenue impact of this proposal is \$141,368.

Network Access Registers. The Company proposes increases in all of its Network Access Register (NAR) prices. A Network Access Register is the central office component of the Centron service, which allows Centron customers access to the switched network. The Company's motive for increasing these prices is to achieve an equitable alignment of NAR and PBX Trunk prices (USWC Exh. No. 27, p. 5). The revenue impact of this proposal is projected to be \$57,163.

Measured and Message Usage. Ms. Rounds proposes that a "modification" to Measured Usage prices be made in order to be "more compensatory." She proposes that the current six mileage

tiers be "compressed" to four, and that prices for each mileage tier be increased. The argument for this change is supplemented by experienced low usage in the outer tiers. Public Access Line prices will also be affected by this change (USWC Exh. No. 27, pp. 5-6).

An increase in the per message price for Message Usage service is also proposed to be raised from 6.2 to 8 cents per message. This increase is allegedly proposed to establish a compensatory price. This increase will apply to Business Service, Message PBX Trunks and Public Access Line prices also(Id. at p. 6).

The Company's expected revenue impact from the proposed changes in Message and Measured Services is expected to be \$46,004.

Nonrecurring Prices

Ms. Rounds proposes changes in a wide assortment of nonrecurring prices. Allegedly, the purpose of these changes is to reduce prices for those services that are priced well above cost and increase prices for those services that are currently noncompensatory. Among the service prices receiving reductions are Termination of Business Services and Establishment or Changing of Billing Responsibilities for Business customers. Common Equipment, Station Lines and Network Access Registers for Centron 300 are those services for which price increases are proposed.

800 Service

Ms. Rounds proposes that several adjustments be made to the structure of 800 service. 800 service is a toll-type service provided to customers, so toll call initiators can call the 800 subscriber at the subscriber's expense. Four changes are proposed.

They include: the reduction of the minimum average time requirement from 60 seconds to 30 seconds, changes in 800 Service hour blocks and their rates, and a change from billing based on average hours of use per line to account-based billing. The Access line price is also proposed to increase from \$15.85 to \$25.00 per month in order to compensate costs (USWC Exh. No. 27, p. 7).

The rationale presented for these proposals presents a prime example of USWC's policy of market-based pricing. The proposal to reduce minimum average time requirements will benefit customers with short conversation times. The changes in hour blocks and their rates are designed to "more accurately reflect the usage levels of 800 customers" (Id. p. 8). Account based billing may benefit those 800 customers with several customers using their 800 line(s) while freeing them of in-house management. The revenue effect of these changes is expected to be a decrease of \$21,806.

OutWATS

Several structural and price changes are proposed for OutWATS service, in order to "better meet customers' usage patterns." They include compressing the current six taper points to four, and reducing prices (Id. pp. 8-9). The price reduction appears to be proposed in order to reduce tariff shopping and arbitrage. USWC expects a \$647,980 revenue decrease if the Commission adopts these changes.

Directory Assistance

Ms. Rounds proposes that the current five free call allowance for residence and business customers be reduced to one, and the price per call thereafter be set at \$.40 per nonoperator assisted DA call per month. The Company also proposes that DA calls from hotels, motels, mobile telephones, hospitals, and OutWATS should be treated the same as residential and business calls. To simplify charges, a \$.25 charge to local coin telephone DA is proposed. USWC contends that 68 percent of DA calls would be billed if the above changes are implemented, and only 29 percent of USWC's customers would be affected by the call allowance change. The Company also proposes that operator handled DA calls be priced at \$1.35 per call. This is an increase from \$.74. The alleged intent of USWC's DA proposal is to have customers bear the costs they cause. The resulting market and nonmarket response revenue impacts of these proposals are expected to be \$961,128 and \$877,877, respectively.

Operator Services (Surcharges)

Ms. Rounds proposes price increases for calling card, station-to-station, and person-to-person service from \$.50 to \$.60, \$1.20 to \$1.35, and \$3.50 to \$3.75, respectively. The asserted reason for these changes is that the new prices will be "more compensatory" (USWC Exh. No. 27, p. 12).

Ms. Rounds is also proposing to implement a series of monthly charges for a "specialized custom announcement detailing a customer's new telephone number when their old telephone number is dialed" (Exh. No. 27, p. 13). The proposed tariff for the service will allow a business customer up to 12 months of service, and residential customers up to 3 months. If the customer does not request this service, USWC will continue to provide a standard announcement, which is assumed to be the Company's basic interrupt service. Currently there are two tariffed intercept options, both provided at no charge to the customer. These options are Basic Intercept and New Number Referral Service, which are differentiated by whether or not they provide callers with new number information.

The projected market response revenue effect of these price changes is expected to be \$530,276, which includes both local and toll services, and New Number Referral service. The nonmarket

response revenue projection for the New Number Referral service is expected to be \$79,000.

Listing Services

The Company proposes increases in nonrecurring listing charges for residence customers from \$4.45 to \$4.50 and decreases for business customers from \$20.68 and \$29.55, to \$15.00. The revenue decrease for these changes is expected to be \$32,757.

With respect to recurring prices, the Company proposes that residential premium listings, such as Foreign (Exchange), Additional, and Client Main listings be increased from \$1.16 to \$1.25 per month. Listings such as these will show increases from \$1.80 and \$5.19, to \$2.00 and \$5.25, respectively for business customers. USWC proposes price increases for nonpublished and nonlisted services resulting in increases from \$1.80 to \$2.50, and \$.90 to \$1.25, for residential and business customers respectively.

The revenue impact of these changes is expected to be \$210,276, resulting in a net revenue impact for all listing services of \$177,519.

Coin Telephone Service

Dr. Wilcox proposes to increase the price for each local public and semi-public coin telephone message from 10 cents to 25 cents. This price increase allegedly stems largely from the cost of providing the service. The Company feels that general ratepayer subsidization of a competitive service, such as coin telephone, is "detrimental both to Mountain Bell and to its customers" (USWC Exh. No. 30, p. 3). USWC also argues that since coin telephone usage is relatively inelastic, a price increase will result in a net increase in revenues (Id. p. 3).

A second proposal is to remove statewide average installation charges for installing auxiliary terminal equipment for Semi-Public Telephone Service. This proposal entails "removing the installation charges from the tariff and charging customers according to the actual time and materials required for the installation" (USWC Exh. No. 30, p. 4). The currently tariffed labor prices will remain in effect for time spent on the job. The portion suggested for removal is found in section A5.5.2, page 69 of the tariffs.

Although no revenue effects have been anticipated for the latter of the above two proposals, the Applicant is anticipating

market and nonmarket response revenue increases for changes in coin message prices to be \$1,085,455 and \$1,596,936, respectively.

Centron 6 and 30

Price increases are proposed (USWC Exh. No. 30) for two of the three alternate answering features under the Centron 6 and 30 tariff. Alternate Answering - Busy Line provides a hunting feature similar to Companion Line, but is not technically performed in the same manner. The Company's argument is made from the customers perspective, that is, the Centron busy line and Companion Line features both provide essentially the same hunting service. Currently, residence and business customers both pay a \$6.50 service and equipment (S&E) charge and a monthly charge of \$1.00.

These prices will increase to \$11.20 for S&E and \$5.00 and \$6.00 per month for residence and business customers, respectively.

Since the Alternate Answer - Busy Line/Don't Answer is a synthesis of the other two Centron hunting features, namely, Alternate Answering - Busy Line and Don't Answer, USWC is proposing that S&E prices be raised from \$6.50 to \$11.20 and monthly charges for residential and business customers be raised to \$7.00 and \$8.00 respectively. The total revenue impact for these services is

expected to be \$172,114, which reflects the total effect of the recurring and nonrecurring price changes.

Custom Calling and IntraCall

Dr. Wilcox proposes a decrease in the nonrecurring charges for installing or changing the configuration of Custom Calling services. The proposed price decrease is from \$17.75 to \$11.00.

Two examples of Custom Calling features are Call Waiting and Call Forwarding. The Company proposes the same reduction in the nonrecurring charges for IntraCall in order to equal the proposed charge for Custom Calling. IntraCall is a service provided to noncomplex business and residential customers allowing intercom capabilities when two or more lines are in service.

The argument presented for this request is that a decrease in the nonrecurring charges coupled with the recurring price reductions out of Docket Nos. 86.11.62 Sub 11 et al. in Order No. 5279a will "make the overall price levels for Custom Calling Services more appropriate in the market place and affordable to more customers" (Exh. No. 30, p. 7).

The projected revenue effects of these changes are expected to be a decline of \$42,477, 99 percent of which is attributable to the proposed Custom Calling price changes.

Extended Area Service

EAS is a provision currently under tariff at no charge, which allows customers within a local exchange to call other customers in neighboring exchanges as if those customers were a part of the originating caller's exchange. Dr. Wilcox proposes that customers who currently have EAS be assessed an additional \$.25 fee per accessible exchange per month. It is noted by Dr. Wilcox that even though the Company considered instituting EAS as an optional service, customers currently receiving EAS will not have the option to choose whether or not they receive EAS under the proposed prices. USWC argues that by instituting this charge, current EAS customers will be paying for the services they receive (USWC Exh. No. 30, pp. 8-10).

The Company argues the proposed EAS price will cover the costs of providing the service, but will fail to capture lost toll revenues, since EAS acts as an alternative service. That is, the opportunity cost of providing EAS in Montana has been estimated to be \$1.6 million annually. USWC holds that EAS costs are currently borne by the general body of ratepayers, which should cease to be the case. Furthermore, since residential local exchange rates are

below cost, EAS is not being subsidized by that group of ratepayers (USWC Exh. No. 30, pp. 9-10).

Late Payment Charge

USWC proposes a charge of 1.5 percent per month to be applied to any customer's unpaid balances at the time the next bill is prepared. The proposed LPC would not apply in the following cases:

1) any balance not exceeding \$25; 2) billed amounts under dispute that are resolved in the customer's favor; and 3) bills rendered more than 10 days after the bill date (USWC Exh. No. 31).

Special Access

Two witnesses sponsored testimony on behalf of USWC in support of its proposal to increase prices for Private Line Access Service, formerly known as Special Access Service. Mr. Greenwalt's testimony describes the service, its history since divestiture, and the Company's rate development methodology (USWC Exh. No. 28). Dr. Alessio addresses "the importance of setting prices, including carrier access charges, on the basis of market conditions" and "the results of a study of a sustainable, market-based prices for switched carrier access in Montana" (Exh. No. 24, p. 18). "Carrier Access Charge" is a generic term referring to all special access.

Effectively, the Company is seeking to remove the discounts approved by the Commission on an interim basis in Docket No. 88.1.1 with a revenue impact of \$283,579.

Price Proposal

According to the USWC Montana Access Tariff, Special Access "provides a dedicated transmission path between customer premises, through a Telephone Company office or between customer designated premises and a Telephone Company hub where bridging and hubbing functions can be provided" (Mountain States Telephone and Telegraph Company Montana Access Service Tariff, p. 208, Release: 4, Sec. 7.1). The following is a brief description of Private Line and Special Access per Mr. Greenwalt's testimony:

The products are designed as full time twenty-four-hour-a-day transmission paths. The costs and prices do not vary with usage. The costs and prices do vary, however, depending on the distance between wire centers, the capacity of the circuit and the function of the circuit.

Private Line services are designed to provide end-to-end service for a customer. Special Access Services are designed for end link/mid link applications, that is, an end user's premises to an interexchange carrier's (IXC's) point of presence (POP). While the facilities used in provisioning both services are basically the same, the testing capabilities are different and the performance parameters for an individual piece of a circuit may also differ. On an end-to-end circuit, MB has total testing capabilities and performance responsibilities. With an end link/mid link facility, MB has testing capabilities and performance responsibilities only from the end user premises to the IXC's pop |point of presence|. The IXC has overall design and performance responsibility. (USWC Exh. No. 28, p. 6)

A chronological summary of events surrounding Private Line Access, based upon per Mr. Greenwalt's testimony, is presented in Table 2 below.

Table 2
HISTORY OF SPECIAL ACCESS SERVICES IN MONTANA

| <u>Time Period</u> | <u>Event</u> |
|--------------------|---|
| Divestiture | Mountain Bell (MB) filed Special Access tariffs with the MPSC. |
| 11-1-85 | MPSC deregulated MB's Private Line services. |
| 9-8-86 | MPSC Authorized MB to withdraw its Special Access Tariff in Order No. 5223. |
| 10-30-87 | In <u>AT&T Communications v. Montana Public Service Commission and Mountain States Telephone and Telegraph</u> (Cause No. CDV-86-1246), the Montana State District Court for Lewis and Clark County ordered that Special Access be re-regulated, on the grounds that deregulation was a violation of the Modified Final Judgment (MFJ). |
| 1-8-88 | Special Access was re-regulated under the Private Line title, although not designated as Private Line. A preface page to the access tariff was also filed stating discounts to the monthly rates and service and equipment charges. |
| Docket No. | USWC seeks to remove the discounts stated on the 88.1.2 Access Tariff's preface page which would result in a \$238,579 revenue increase. |

(USWC Exh. No. 28, pp. 3-5).

Mr. Greenwalt argues that since Special Access and Private Line are basically the same, their prices should be the same. He also states that synonymous prices will reduce confusion, duplicate administrative efforts, and the likelihood of discrimination claims (Id. at p. 7).

The development of prices for Private Line Access Services were based on relative prices of other USWC services including analysis of quality differences, substitutability, and consideration of high capacity and Special Access services. Competitive alternatives such as coaxial cable, fiber optics, microwave and satellite technologies were also considered. USWC also notes that the private line price has not changed in four years, and therefore, the market effects of a price change and the "optimum" price, is difficult to determine. USWC also included long-run incremental costs and revenue neutrality in its analysis (Exh. No. 28, pp. 7-10).

Sustainable Market-Based Price Study

Dr. Alessio contends that telecommunications markets have become increasingly competitive and that, as a result, carrier access prices should be based on market conditions, not artificial accounting cost allocations. Based on arguments of economic efficiency, he holds that nontraffic sensitive (NTS) costs should be recovered from basic exchange services, not toll services. In effect, Dr. Alessio's pricing basis for CACs is a Ramsey pricing proposal: lower CAC to a level that maximizes revenues, or to a level that is sustainable.

The method by which Dr. Alessio estimates a sustainable market-based price for Switched Carrier Access follows. It is a simulation model that incorporates market incentives and reactions of participants in the market; namely customers, USWC and other common carriers (OCCs), so that realistic responses by these market participants to changes in prices and costs are simulated. Since the demand for switched carrier access is derived from end user's demand for toll services, the sustainable market prices for CACs depend on the prices end users pay for toll services. Based on this fact, a sustainable market price for switched CACs is estimated by reducing IXC's prices for toll service from a prior period to reflect the competitive market price for toll services

under current conditions. The switched CAC levels associated with these competitive toll prices are then determined to be the sustainable market-based prices for switched CACs in Montana under current market conditions.

Additions to the Company's Base Rate Areas

Mr. Cooper also sponsors testimony requesting revenue impacts for certain Base Rate, Locality Rate and Suburban Rate Area boundary changes be recovered. These proposals carry a revenue loss of \$44,568.

Detariffing

Mr. Cooper sponsors testimony, on behalf of the Applicant, proposing to detariff several nonbasic exchange services including, Coin Telephone Service, nonaccess portions of Centron Service, certain Custom Calling services, and IntraLATA MTS. In doing so, Mr. Cooper addresses the area of increasing competition in both terms of current and potential competition.

By "detariffing," the Company means "exemption from regulation of price levels." USWC intends to retain regulatory oversight, including tariff description, maintained investments,

revenue, and expenses, for those services for which detariffing is proposed. The Company's expressed intention is to establish long-run incremental cost constrained pricing flexibility (Exh. No. 2, p. 26).

The Company's detariffing proposals are based on Section 69-3-807 of the Montana Code Annotated:

69-3-807. Regulation of rates and charges. (1) As to that telecommunications service which is provided under regulation, the commission may establish specific rates, tariffs, or fares for the provision of such service to the public. The rates, tariffs, or fares must be just, reasonable, and non-discriminatory.

(2) Alternatively, the commission may authorize the provision of regulated telecommunications service under such terms and conditions as may best serve the declared policy of this state. The commission is not required to fix and determine specific rates, tariffs, or fares for the service and in lieu thereof may:

- (a) totally detariff the service;
- (b) detariff rates for the service but retain tariffs for service standards and requirements;
- (c) detariff rates but require notice of price changes to the commission and subscribers;
- (d) establish only maximum rates, only minimum rates, or permissible price ranges as long as the minimum rate is cost compensatory; or
- (e) provide such other rate or service regulation as will promote the purposes of this part.

(3) In determining applications under subsection (2), the commission shall consider the following factors:

(a) the number, size, and distribution of alternative providers of service;

(b) the extent to which services are available from alternative providers in the relevant market;

(c) the ability of alternative providers to make functionally equivalent or substitute services readily available;

(d) the overall impact of the proposed terms and conditions on the continued availability of existing services at just and reasonable rates; and

(e) such other factors as the commission may prescribe through rulemaking which are appropriate to fulfill the purposes of this part.

(4) Nothing in this section shall authorize the application of subsection (2) to any services for which there are no alternative providers of such services.

USWC believes that the general body of ratepayers enjoy lower prices for competitive services and the Company must be allowed to "employ maximum pricing and market flexibility" in order to remain competitive. Furthermore, USWC holds that delays from the regulatory process tend to hinder USWC's repricing capabilities in contrast to those firms not bound by this constraint. The Company holds that greater flexibility is needed in order to meet the "dynamics of the market place." In the case of MTS, USWC claims that in "situations where |their- large toll users contemplate

alternatives for their long distance telecommunications needs" the Company will be better suited to retain customers if it can enter into long-term contracts (USWC Exh. No. 2, pp. 28-31).

In Schedule 9 of his exhibits, Mr. Cooper lists the information which the Company considers pertinent in examining the detariffing factors outlined in subsections (3)(a) - (3)(d) of < 69-3-807, MCA (See USWC Exh. 2 and Table 3).

Table 3

SUMMARY OF DATA FOR COMMISSION CONSIDERATION: DETARIFFING

Category / < 69-3-807(3), MCA, reference.

1) Coin Phone Service

- (a): Four active vendors and other telephone equipment firms operating in Montana.
- (b): Any customer having an interest in purchasing one Public Access Line (PAL) provided by all of USWC's Central Offices (COs).
- (c): Customer Owned Coin Telephones (COCTs) are set controlled, USWC coin phones are CO supervised.
- (d): USWC will adjust prices to be competitive and flexible prices will allow USWC to serve low revenue areas.

2) Centron (Non-access)

- (a): USWC lists 12 different companies serving up to 4 Montana cities with nine different brands.
- (b): Availability of terminal equipment and communications systems available through vendors and catalogs.
- (c): Availability from equipment vendors.
- (d): No change in service availability; incremental cost constrained pricing.

3. Custom Calling

- (a): Small sample of terminal equipment and answering service market includes 9 and 6 respectively in large towns.
- (b): Retail vendors in large towns / catalogs in small towns (terminal equipment); answering service in large towns.
- (c): Available from equipment vendors.
- (d): No change in service availability; incremental cost constrained pricing.

4. Message Telecommunications Service

- (a): 20 communications companies subscribing to access.
- (b): Alternate IXCs can be obtained in all exchanges.
- (c): Resellers in Montana have the ability to provide alternative MTS.

(d): USWC's ability to negotiate flexible prices with large toll customers will allow the Company to compete and retain large MTS customers, hence, keep toll rates just and reasonable.

Source: Exh. No. 2, Schedule 9 and CENTRON (NONACCESS) Attachment.

The following is a synopsis of Mr. Cooper's testimony supporting detariffing, for each of the four service categories listed above.

Coin Telephone Service. COCTs are the primary source of competition for USWC in the Coin Telephone Service market. According to the Company, there were approximately 279 COCTs in service as of September, 1987, or 6 percent of the market. This market share is based on the entire USWC Montana service area. The COCT market share is greater in some cities, e.g., 13 percent in Billings and 12 percent in Butte. The majority of advertising for COCT equipment has been concentrated in the Billings, Helena, Butte, and Great falls areas. Schedule 1 of Mr. Cooper's exhibits contains copies of several brochures describing COCT equipment currently available (USWC Exh. No. 2).

Centron (Non-Access). The Centron Service "is a central office based switching system that serves the same basic functions

as a customer-owned and housed switching system or other terminal equipment" (USWC Exh. No. 2, p. 7) which include PBXs and Key Telephone Systems (KTSS). Centron Custom and Centron 300 are primarily intended for large business customers and allow flexibility in the packages ordered for central office access and intercommunication capabilities. Centron 6 and Centron 30 are smaller access line enhancement packages serving from 2 to 30 lines for small business customers. Centron 6 and 30 are also available to residential customers.

USWC requests nonaccess portions of Centron services be price detariffed. USWC does not seek price detariffing for the central office access (dial tone) portion of centron (USWC Exh. No. 2, pp. 10-11). This appears to be the NAR portion of Centron. A description of a NAR is given above in FOF No. 78. USWC estimates that it currently holds approximately 11 percent of the Centron/PBX/KTS market (USWC Exh. No. 2, p. 9).

In anticipation of the contention that USWC Centron station lines are monopoly provided, Mr. Cooper notes that since Centron lines provide intercom functions through the local loops, while intercommunication between PBX stations is accomplished via in-house wiring, the result is the same, but it is accomplished by a

different method (USWC Exh. 2, p. 10). Therefore, Mr. Cooper contends that the monopoly argument is not valid.

Custom Calling Services. Among the four tariffed Custom Calling Services offered by USWC, the Company has requested price detariffing for Call Forwarding, Speed Calling, and Three-Way calling. Generally, the Company argues that "there is not a captive customer base for any of these services by Mountain Bell or any other supplier" and "customers have a large variety of reasonably available alternatives" (Exh. No. 2, p. 12). USWC also argues that "an alternative service need not be a virtual duplication of another service" (Id.). Moreover, "the main criterion is that customers have reasonable alternatives to meet their needs and do not require perfect knowledge of all the alternatives" (Id.). Mr. Cooper's Schedules 3, 4 and 5 present information about the various terminal equipment available which USWC contends are competitive alternatives for the three Custom Calling services (USWC Exh. No. 2).

Call Forwarding allows a customer to automatically forward calls to another number. Mr. Cooper cites telephone answering machines (with and without call forwarding capabilities) and personal paging and answering services as reasonable alternatives (USWC Exh. 2, pp. 13-14).

Speed Calling allows automatic dialing of local and long distance calls to be keyed with a one or two digit code. The Company has identified 34 types of terminal equipment capable of speed dialing. In citing one example, USWC admits that some equipment provides the service more easily than it can (USWC Exh. 2, pp. 14-15).

Three-Way Calling enables a customer to include an additional party in a two party call. The Company states that alternative services such as teleconferencing are available through USWC and other IXCs. In the area of alternative terminal equipment, Mr. Cooper also mentions multiple line equipment capable of conferencing. The Company holds that Three-Way Calling and conference capable terminal equipment are seen by the customer as being synonymous (USWC Exh. 2, pp. 15-16).

IntraLATA MTS (toll). USWC also requests price detariffing of intraLATA toll service for its 100 largest business customers. Mr. Cooper's testimony during the hearing further explains this proposal:

- Q. I would like to discuss now the proposed detariffing of MTS, Mr. Cooper. Can you state the criteria that U.S. West plans to use to define what it will use as a large business customer for purposes of detariffing and price flexibility?

A. Yes. My testimony requests that U.S. West be granted the ability to write contracts with large users, large message toll users. It's those users who are of a very competitive nature. They are also those customers that if we should lose them, we lose a substantial cash flow.

I would suggest, and what I would propose to this Commission, that should they grant us pricing flexibility, that we would limit that to the top 100 message toll users within the state.

Q. You are talking about businesses?

A. The top 100 business users. That would amount to three-tenths of one percent of all of the business customers that we have. That is not to say that we would write contracts with each and every one of these 100 contracts. That is to say that we would regard those as customers who potentially may be approached. They would not be approached unless we felt that account was in jeopardy. Jeopardy in losing them to some other competitor.

Q. Could you go back and determine for those 100 top volume users what their consumption was for a particular year? For example, in 1987 or after January 1, 1989, for the year '88?

A. I can do that. I don't have those numbers available to me at the present time.

Q. But you could calculate it?

A. Yes, and I think it may be of interest to the Commission to say that in order to better understand this submarket of large

users that we're looking at, that the very smallest of these large users might consume on the order of \$500 a month in toll.

Q. Of the smallest of the top 100?

A. Yes.

Q. You are talking the smallest of the 100?

A. Yes, the smallest of the biggest 100.

Q. Okay, now, you say it will be basically on a case-by-case basis that you would give them price flexibility. Would you also, then, be able to determine that volume of consumption after it's de-tariffed for some fixed time period; in other words, to determine what the change in their usage has been after detariffing as compared with before?

A. Their usage could certainly be compared, yes, from a prior-to-contract consummation and post that contract consummation in terms of minutes used. Hopefully, there would be stimulation, but to the extent that those numbers change, there may also be other factors involved.

Q. Mr. Cooper, with the view of trying to maintain stability for the other rate-payers from the results of this type of detariffing for business customers, would it be more helpful to, instead of just saying the top 100 users, to put a dollar limit on it and say that any business customers with toll usage above a certain dollar figure would be available for some type of price flexibility?

- A. That would certainly be an approach. It was something that we looked at, and to a certain extent, it is recognized within my proposal of saying the top 100 users. Incidentally, when I say top 100 years, I'm talking about nongovernmental users, but let me say that we have tried to recognize this volume usage, in that within our tariffs today, we have a volume discount tariff and any customer can avail themselves of that. If they use \$200 a month on a use-it-or-lose-it basis, we will provide them with a 25 percent discount. That's under tariff today. We wanted to provide the ability to then dovetail with that as a service that is now available, and so we then said that perhaps those customers which we could then carry forward and may be necessary to write contracts with, certainly want it to be greater than \$200, because if it was less than \$200, they can get it under tariff. We then said, Well, how about 500 or so, \$1000 a month? It just so happened that when you looked in that range, it turns out to be the top 100. It's a nice round number, if we went for that. We would certainly be receptive to any other number that you may have and want to volunteer.
- Q. Okay, my next question is, how does U.S. West plan to recover the revenue deficiencies which would result from the detariffing of MTS rates for business customers?
- A. I think the point that I would like to make here is that it is our challenge that if we go out to write a contract with customer X, that we would wish to be able to write that to the extent that our proposal will be about one dollar less

than what another competitor might provide them if they should approach them. That is our very challenge.

To that extent, what we are trying to avoid is the total loss of that revenue stream to our ratepayers. If we lose that account in total, which we have and are losing customers today, we get zero revenues. Under those conditions, if we lose the accounts, that shortfall is currently being picked up by the remaining customers on the system. Our proposal is to minimize those losses. (TR pp. 934-937)

* * * * *

- Q. Mr. Cooper, when Ms. Wright was cross-examining you, she asked you if -- I believe her term was custom tariffs in the area of intraLATA toll would address the Company's concern, and you agreed with her. When you agreed with her, what was your understanding of the term "custom tariffs"?
- A. The custom tariff was not and is not a term that I recall from my memory. That's not to say that Consumer Counsel did not say custom tariff. It registered in my mind as custom proposal. U.S. West would be attempting to write contracts on a custom-proposed individual case basis. That information would be made available to Commission staff under seal and to the Commission.
- Q. And then essentially you are saying that the contract would substitute for the tariff?
- A. Yes. (TR p. 971)

The Company cites resellers (firms who lease facilities from an IXC or LEC and sell them to other customers), and vendors of private networks such as Burlington Northern and Montana Power Company as competitive sources for USWC's MTS market. Mr. Cooper cites facility based carriers as the most serious long-term potential competition for USWC since they are not prohibited from providing intraLATA service in Montana (USWC Exh. No. 2, p. 18).

Mr. Cooper notes that 20 telecommunications companies currently purchase access services in Montana, and "at least ten of them offer intraLATA services" (Id. p. 19). USWC can only speculate on the actual extent of its competition by relying on a survey of Montana customers and its own records of purchased access. A review of that study follows.

The primary thrust of USWC's argument for detariffing MTS is based on a study conducted in July and August of 1987 entitled "Mountain Bell Survey of IntraLATA Competition: Montana." Data was gathered concerning customer IntraLATA calling habits using a telephone survey of Montana residential customers and small (single line), medium (2-6 lines) and large (7 or more lines) business customers. From this survey, USWC computed incidence rates, or "the percentage of customers who use an alternative provider (reseller) for long distance intraLATA calling in Montana" (USWC

Exh. No. 2, p. 20). The Company found the incidence rates were .9%, 4.4%, 19.2%, 23.0% for each of residential and small, medium, and large business customers, respectively (USWC Exh. No. 2, Sch. 6).

"Recent" and "continuing" growth trends were inferred from the study by examining the dates each segment commenced using the alternate provider. Five percent (Residential), ten percent (Small Business), ten percent (Medium Business) and twenty percent (Large Business) of the segments surveyed, who are currently using USWC, "indicated that it is very or somewhat likely that they will" shift to an alternative provider within one year (Id. p. 20). It was also found that alternate provider users saved 18 to 25 percent according to surveyed perception. The Company also found that nonalternate provider users would need a 21 to 28 percent savings in order to shift to an alternate provider. The Company holds that as more toll users realize the margin between the savings alternate providers perceive and the threshold of savings USWC customers would need to drive them off the system, more customers are expected to leave the system (Id. at p. 22).

By applying the survey results to April, 1986 through March, 1987 IntraLATA toll revenues, the Company calculated alternate provider annual equivalent revenues of \$1.9 million. This is the

amount of revenue USWC would have received if it had carried all the traffic. The Company holds that "this represents approximately 6.5 percent of the estimated total intraLATA toll market" (USWC Exh. No. 2, p. 23).

The Company also notes its average revenue per minute for intraLATA toll is \$0.211, while its average revenue for access services sold to resellers is only \$0.113 per minute (Id. at p. 24). Therefore, USWC contends that a tremendous amount of revenue is at risk in this area.

Finally, Mr. Cooper notes that "less than 50 customers generate 20 percent of the business toll revenue," emphasizing this sector's importance for USWC revenues (Id. at p. 25).

Pursuant to MPSC Order Nos. 5336a and 5372, USWC proposes that LECs and their customers be charged \$.50 per DA call with no free call allowances. Under this scenario, USWC would bill the independent LEC's customers directly. The Company maintains that the price level necessary to cover aggregate costs of providing independent LEC customers DA with one free call allowance is \$.78.

This figure is based on the assumption that independent LEC customers' calling habits would be the same as those of USWC customers. Furthermore, it is argued the \$.50 level is necessary

to cover costs of providing DA to independent LECs and their customers (USWC Exh. No. 2-5, p. 3). The revenue impact of this proposal is expected to be an increase of \$220,695.

USWC also proposes a wholesale price for DA of \$.35 per call for independent LECs. Under this proposal USWC will bill the LEC for each DA call as opposed to billing each customer (Id. p. 4).

No revenue impact was presented by USWC for this proposal, nor could it be calculated from the other evidence in the record.

Review of Intervenors' Testimony and USWC Rebuttal

The following is a summary of the intervenors' positions, as presented in their direct testimony. Each intervenor's testimony is segregated by service category, and USWC's rebuttal is discussed immediately thereafter. Intervenor testimony is presented in the following order: MCC, MTA, DOD, MCI and AT&T.

The Montana Consumer Counsel

Testifying on behalf of MCC, Mr. Allen Buckalew proposes the following rate design, resulting in a decrease in revenues totaling \$0.5 million. Table 4 below summarizes the revenue impacts associated with MCC's rate design proposals. In his testimony, Mr. Buckalew addresses Extended Area Service, Measured and Message Services and all of the service categories listed in Table 2, except for the Late Payment Charge, Companion Line, and Private Line Access. Finally, he addresses price detariffing by first examining the concept of "workable competition," and then applying this concept to each of USWC's price detariffing proposals.

Table 4
REVENUE IMPACTS: MCC PROPOSED RATE DESIGN

| <u>Service Category</u> | <u>Revenue Impacts 1/</u> |
|---------------------------|---------------------------|
| Local Exchange Flat Rates | \$(5,700,000) |
| Directory Assistance | 400,000 |
| Coin Telephone Service | 1,085,445 |
| Operator Surcharges | 572,584 |
| Late Payment Charge | 1,508,000 |
| Companion Line | 6,775 |
| Listings | 177,518 |
| Centron Services 1/ | **** |
| Private Line Access | 283,579 |
| | ----- |
| Total | \$ (466,099)2/ |

1/ The proposed revenue impact associated with Centron Services is proprietary.

2/ This Total includes the proposed revenue impact associated with Centron services.

Source: MCC Exh. No. 14, pp. 35-36

Basic Exchange Services: Residential

MCC. The MCC proposes to decrease local exchange flat rates by \$5.7 million.

USWC Rebuttal

In response to the MCC's proposal to reduce local exchange flat rates, USWC witness Dr. Wilcox makes four points. First, flat residential services are currently priced below LRIC and this "benefited service" makes no contribution to the Company's common costs. Second, Dr. Wilcox uses a national price survey of 60 major cities, conducted by USWC, to support the affordability of the current price. She states the price paid for flat service in Billings, prior to the interim price increase as a result of Order No. 5354, was more than \$10 less than the highest price in the survey and less than \$5 higher than the lowest. Furthermore, the Billings price was ranked 29th of 57 cities prior to the interim increase, and 26th following the interim. Third, the proposed usage options will offer customers a lower price in lieu of basic exchange prices. Fourth, lower prices for those customers in need or who may not be able to afford regularly priced telephone service can obtain service through the Low-income Telephone Assistance Program (USWC Exh. No. 30-R, pp. 2-3).

Residence Basic Exchange Usage Options

MCC. Although Mr. Buckalew does not appear to have any problem with the proposed residence basic exchange usage options (usage blocks), he does suggest the prices for the options will need to be adjusted downward to reflect MCC's suggestion to reduce overall Residence Basic Exchange prices. No projected revenue impacts associated with residential usage blocks were proposed by the MCC. If all calls in 1987 had been measured, Mr. Buckalew notes the additional costs would have totaled approximately \$15 million (MCC Exh. No. MCC-14, p. 36).

USWC Rebuttal

To this statement USWC responds that the \$15 million cost for measuring all calls in 1987 is a "non-realistic estimate of the added cost of offering these usage options" (USWC Exh. No. 30-R, p. 7). Dr. Wilcox states the Company expects most customers to stay with flat service which is not measured; and measuring costs are built into the usage option rates and will thereby be recovered from those customers.

Business Exchange Rate

MCC. The MCC recommends that Business Exchange Rates be increased similar to the Applicant's proposal, if the Commission finds USWC's revenue requirement proposal to be appropriate. However, if the Commission agrees to the MCC's revenue requirement analysis, he suggests that Business Basic Exchange prices be "equalized at the present (Rate) Group 1 rate of \$33.90" (MCC Exh. No. 14, p. 37). The revenue impact of this latter proposal is a reduction of approximately \$1 million.

USWC Rebuttal

USWC responds to MCC's proposal to set all business access line rates equal to the Rate Group 1 (RG-1) rate (which would lower the Rate Group 2 (RG-2) rate). In defense of the higher RG-2 price, Ms. Rounds notes that RG-2 customers have access to a wider variety of services than RG-1 customers, which aids in tailoring their service to their needs.

Extended Area Service

MCC. The MCC contends that USWC's cost analysis does not justify the \$.25 per month incremental exchange price proposed in this Docket. Mr. Buckalew argues the proposed price is inappropriately averaged to cover all calling areas. As regards the proposed charge itself, Mr. Buckalew cites the following four premises supporting the MCC's opposition.

First, it is noted "the costs for providing the extended service are small and similar to the costs in metropolitan areas where exchanges are connected through interoffice trunks" (Id. p. 38). Second, those customers which will be affected by the charge will not be accustomed to the charge. Third, since the Applicant's proposal does not allow for the charge to be optional, those customers who do not use the service will be adversely affected.

Fourth, the MCC recognizes that EAS costs are currently subsidized and USWC does not appear to be lowering other local exchange rates to compensate for potential EAS revenues.

In conclusion, the MCC recommends the Commission reject the proposed price structure for EAS.

USWC Rebuttal

Dr. Wilcox gave considerable attention to MCC's testimony regarding EAS by first addressing Mr. Buckalew's four premises. She first notes the LRICs estimated for EAS are not the only consideration used for pricing the service, since they are not the total costs. The value of service principle is also used for pricing considerations. Secondly, she holds that customers not being accustomed to being required to pay for a service they currently receive is not a valid reason for denying the charge. USWC supports its pricing proposal based on the cost-causer principle. Third, Dr. Wilcox agrees it would be "ideal" if the service were optional, however, as stated in her direct testimony, the Company chose not to offer this option due to the additional cost (USWC Exh. 30-R, pp. 3-4).

Lastly, Dr. Wilcox mentions that it would be nearly impossible to identify precisely which services are currently subsidizing EAS in order to lower those service prices. As an alternative to identifying the particular service or services that recover EAS costs, "Mountain Bell has presented a comprehensive set of price proposals in this case, in which price increases or decreases are recommended as appropriate for the individual services" (USWC Exh. No. 30-R, p. 5).

USWC also addresses price averaging to cover all calling areas or exchanges, by considering the issue of state-wide averaging. Dr. Wilcox makes the following three arguments: a) the differences in cost to provide exchange service, b) the relative differences across exchanges, in the number of other customers that can be contacted (urban verses rural), and c) the cost differences, across exchanges, to provide EAS. USWC argues exchange specific pricing would be unduly burdensome for the ratemaking process and cause customer confusion. Prices could quickly become outdated if tied directly to measures such as LRIC or the number of access lines. Finally, USWC holds that averaging not only provides consistency and value in price, but relief from administrative burdens (USWC Exh. No. 30-R, p. 6).

Directory Assistance

MCC. Although Mr. Buckalew agrees with USWC's position that DA calls made from hotels, motels, mobile, and hospital telephones should be treated the same as residence and business customers, he does not concur with the proposal to reduce the free DA call allowance to one. Rather, he proposes the call allowance be reduced to three in order to reduce the impact of a five to one call allowance on ratepayers. Although MCC notes USWC has shown a low number of DA customers will be affected by USWC's DA proposal, he also notes, referring to TeleChoice, that "it is obviously 'OK' to include the 25 free call allowance in the customers' basic rate provided he buys USWC's custom calling feature and deregulated wire maintenance service" (MCC Exh. No. 14, p. 40). In conjunction with this statement, Mr. Buckalew notes a recurring theme in his testimony -- namely, the Commission needs to look at what should or should not be included in basic rates (see MCC Exh. No. 14, pp. 39 and 40).

USWC Rebuttal

In her direct testimony, Ms. Rounds notes that based upon a 1986 study, 71 percent of USWC customers would not be affected by the shift from a five to one call allowance (USWC Exh. No. 27, p. 10). In her rebuttal, she notes a two call allowance incrementally impacts 10 percent fewer customers, while a three call allowance "adds" an additional 6 percent. Furthermore, she states a one call allowance better suits the cost-causer principle and DA costs have been separately identified (USWC Exh. 27-R, pp. 2-3).

USWC rebuts MCC's comment regarding USWC's TeleChoice package by stating that access lines are priced independent of the TeleChoice package features and the Company prices TeleChoice to include the 25 DA call allowance. USWC maintains that all TeleChoice features are cost compensatory.

Coin Telephone Service

MCC. The MCC does not oppose USWC's proposal to increase the per message Coin Telephone Service price. However, the MCC does not concur with the Company as to their cost calculations. MCC contends that 20 cents per message, as opposed to 25 cents, is a reasonable cost compensatory price. The MCC also disagrees with the Company's repression analysis since it is based on Utah data which may not appropriately reflect Montana responses to the proposed price change. MCC suggests that if the Commission bases its decision regarding Coin Telephone Service on market response revenues, it requires the Company to file monthly revenue reports to verify the market response in Montana, and that adjustments be made accordingly (MCC Exh. No. 14, p. 41).

Operator Surcharges: New Number Referral Service

MCC. Mr. Buckalew points out that in the past this service was provided for a limited period of time at no additional charge to the customer. He also points out, as with DA, the Commission must consider what should be included in basic exchange service. His argument is essentially that as existing basic exchange services are being unbundled from basic exchange rates, basic exchange rates are not falling, but the level of service received for those rates is being reduced (see MCC Exh. No. 14, pp. 42-43).

MCC warns the Commission that USWC could be creating a "profit center" (MCC Exh. No. 14, p. 43) for operator services opening the possibility to "transfer profits to a nonregulated operator services operation" (Id.).

USWC Rebuttal

In its rebuttal testimony, USWC describes the difference between the Basic Intercept Service (no charge) and the custom announcement (for which price assignment is proposed). The custom announcement includes the new number, but the Basic announcement does not.

Measured and Message Service

MCC. The MCC finds the proposed mileage band compression and the rate restructuring proposed by the Company for LMS to be reasonable. Mr. Buckalew notes USWC's evidence which suggests "a \$15 million 'bill' for measured service" (MCC Exh. No. 14, p. 44).

Centrex/Centron

MCC. Based on the Applicant's Marketing Management Information System (MMIS) study, MCC suggests the Centrex and Centron Services revenues be increased significantly more than the \$172,114 increase USWC requests (see proprietary Appendix A). This increase is suggested so the services will no longer be losing money (See MCC Exh. No. 14, p. 44).

USWC Rebuttal

In response to MCC's testimony, USWC notes its proposed changes in NAR prices "would alter any embedded analysis for Centron which is identified as a concern by Mr. Buckalew" (USWC Exh. No. 27-R, pp. 4-5).

Detariffing: MCC General Considerations

MCC. This section includes a summary of MCC's position on USWC's proposals for price detariffing, and USWC's rebuttal. The review is broken down into two sections. First, the foundation Mr. Buckalew uses to base his position on USWC's detariffing proposals, namely his concept of "workable competition." Second, he proposes four criteria or parameters, to be considered with respect to detariffing. USWC's rebuttal to the MCC's position regarding the competitive status of the telecommunications industry is summarized in this section.

Second, MCC's position regarding the four service categories for which USWC is requesting price flexibility is reviewed, and USWC's rebuttal thereto. MCC holds Mr. Cooper fails to establish that there is sufficient "workable competition" in the Coin Telephone, Custom Calling, and IntraLATA MTS markets, to warrant the abandonment of rate regulation (USWC Exh. No. MCC-14, pp. 45-46).

Mr. Buckalew's argument balances the benefits and costs of premature detariffing, and the contributions of regulation in cases where effective "workable competition" does not exist. MCC notes that if "workable competition" exists in a market, a firm who raises its prices above cost would expect to lose a substantial

share of the market. In contrast, a monopolistic firm would not expect to lose substantial market share if it raises its prices.

MCC notes that since divestiture, telecommunications markets have become more competitive, but not to the point of releasing telecommunications companies from cost-of-service based regulation. Mr. Buckalew goes on to state that "workable competition" is "a compromise that limits monopoly power while allowing firms to reap the economies of scale; it is a practical alternative to the often unattainable goal of perfect competition" (Id. p. 50). MCC maintains that workable competition does not exist in the current toll and local exchange markets. It asserts that price flexibility would only result in USWC retaining virtually 100 percent of those markets (Id. p. 51).

As an underlying theme, it appears MCC is claiming that if a telecommunications market is previously monopolized by one firm, that firm will tend to continue domination of the market following detariffing or deregulation, unless competition clearly exists. The crux of this argument seems to be based on Mr. Buckalew's remarks about protecting the basic ratepayer. He states that USWC "has no other regulatory policy entitlement other than a

reasonable opportunity to earn a fair rate of return on its utility investment" (Id. p. 52).

Recognizing that competition is both a dynamic and static concept, Mr. Buckalew states that making static short-run adjustments to the dynamic side of a potentially competitive environment could have adverse effects on the long-run state of a competitive environment. Based on this principle, he holds that if USWC is given price flexibility in the intraLATA toll markets which only show some current competition, USWC will completely dominate the intraLATA toll markets.

Based on this premise, MCC notes that Custom Calling Services and MTS prices are currently higher than what the Applicant has identified as the costs for those services (MCC Exh. No. 14, p. 41). Furthermore, the MCC notes USWC's statement regarding the small loss in Coin Telephone volumes as a result of the proposed increase in per message price (see MCC Exh. No. 14, p. 41 and USWC Exh. No. 30, p. 3).

MCC's criteria for consideration of detariffing are: 1) public protection from monopoly pricing, 2) essential services should not be detariffed, 3) cost separability should be possible between detariffed and tariffed services, and 4) any losses

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associated with detariffed services should not be the burden of
other customers (MCC Exh. No. 14, p. 53).

USWC Rebuttal

It appears the only rebuttal USWC gives regarding MCC's criticism of USWC's presentation of competition in Montana are: 1) That competition be addressed in this Docket before "customers make economic decisions that are virtually irreversible," and 2) That Mr. Buckalew overextends USWC's proposal to suggest that the Company is seeking deregulation, when, in fact is all it seeks is price detariffing with regulatory oversight (USWC Exh. No. 2-R, p. 3).

MCC's Position Regarding USWC's Detariffing Proposals, by Service

Based on these criteria and conditions, MCC's position regarding flexible pricing of specific services, follows:

Coin Telephone Service

MCC. Even though the MCC suggests the Commission allow USWC the flexibility to negotiate commissions for Coin Telephone Service locations, he is opposed to price flexibility due to a lack of "workable competition" in the Coin Telephone market.

USWC Rebuttal

Only the message portion of coin telephone service would be affected by USWC's pricing flexibility proposal. Mr. Cooper points out that although COCT's only have 6 percent of the coin phone market in Montana, the occurrence of COCT competition is the greatest in large towns. That is, the incidence of COCTs are twice the state average in high use areas. Moreover, Mr. Cooper notes that USWC is the provider of last resort in Montana for coin telephone service (USWC Exh. No. 2-R, p. 4).

Centron Services

MCC. MCC compares Centron services to a discounted local exchange service and recognizes it as a substitute for PBXs. However, MCC maintains that "one-time" Centron loop costs can be imposed on other ratepayers, and Centron should not be "deregulated" (MCC Exh. No. 14, pp. 54-55). The Commission notes here the Company has not requested "deregulation" of Centron, but merely "detariffing" of certain portions of Centron service.

Relying on USWC's MMIS study, the MCC asserts other ratepayers are currently subsidizing Centron and Centrex Services (MCC Exh. No. 14, p. 55).

USWC Rebuttal

Mr. Cooper notes two areas of concern regarding MCC's remarks on Centron. First, Mr. Buckalew is in error in concluding that Centron loops will be priced below their cost, since price flexibility will be under the regulatory oversight of the MPSC, which will insure these portions are compensatory. Second, USWC is only requesting price flexibility of the "ancillary portion of Centron," not total deregulation (USWC Exh. No. 2-R, pp. 4-5).

Custom Calling Services

MCC. Mr. Buckalew maintains that Custom Calling Service prices are currently well above costs and there is no competitive equivalent for Call-Forwarding, Call Waiting, and Three-Way Calling, since alternatives require an additional loop. Also, MCC bases its argument concerning Call Forwarding on the fact that alternate services, or terminal equipment providing similar services, do not capture certain time constraints customers may have. Since the same facilities used to provide other services are also used to provide Speed Calling, MCC holds that USWC will never face the possibility of loss (i.e. ratepayers will recover any loss) (Id. pp. 55-56).

However, Mr. Buckalew also states that "MB should be given flexibility for these custom calling services that would allow it to price the service under tariff anywhere above cost" (Id. p. 56).

During the hearing, MCC's witness stated:

Q. Mr. Cooper, are you aware of any customers of Mountain Bell who have both answering machines and call forwarding service?

A. Yes, I am. I do.

Q. Good answer. Call forwarding service gives the customer immediate access to the call because it's answered at another telephone; is that right?

A. As provided by U.S. West, that's correct.
(TR p. 908)

USWC Rebuttal

Mr. Cooper responds to MCC's position regarding Custom Calling Services by pointing out there are many alternatives available on the marketplace. He further states MCC improperly implies that an alternative must be a virtual duplication of another service (USWC Exh. No. 2-R, p. 5). He argues that telephone answering machines meet the same need as Call Forwarding in that they assure that calls will not be missed. He cites a national study performed by the Consumer and Technology Division of The Yankee Group, showing about 24 percent of total United States households have answering machines (Id.).

IntraLATA MTS

MCC. Finally, MCC concludes that since MTS is currently priced above cost, most resellers are not facility based, and "workable competition" does not exist in the intraLATA MTS market, USWC should not be permitted price flexibility.

USWC Rebuttal

Mr. Cooper's rebuttal testimony points out that although USWC has approximately 93.5 percent of the overall intraLATA toll market, more importantly, a substantial number of large businesses are now using alternative carriers (USWC Exh. 2-R, p. 6). USWC is merely seeking price flexibility for large nongovernment toll users. Mr. Cooper cites from the Company's "Survey of IntraLATA Competition: Montana" that 23 percent of the large businesses surveyed use an "alternative provider for some or all of their intraLATA long distance" and 20 percent are "very or somewhat likely to switch to an alternative carrier in the next 12 months" (Id. pp. 6-7). USWC holds these are highly significant figures and "The loss of even a few large business customers can significantly impact toll revenue" (Id.).

Montana Telephone AssociationDirectory Assistance

Mr. Robert G. Orr testified on behalf of the MTA in opposition to USWC's proposal to establish a distinct DA price for MTA member customers. The MTA opposes this proposal. Mr. Orr claims that 1) USWC's cost of providing DA to its rural customers is probably similar to the cost USWC's incurs by providing DA to MTA customers; 2) the higher proposed deaveraged rate will jeopardize universal service; and 3) if such a deaveraged rate philosophy were applied to other services (such as long distance), universal service would further deteriorate. However, Mr. Orr did acknowledge that USWC should be allowed to charge a DA rate that would cover its total DA costs (MTA Exh. No. 1).

Department of Defense and the Federal Executive Agencies

Mark Langsam testified on behalf of DOD. DOD proposes that USWC be allowed to offer large customers (such as itself), flexible pricing in the form of volume discounts, long-term fixed prices, and the ability to contract for individually designed telecommunications services. The DOD states marginal costs should be analyzed in consideration of any flexible pricing proposal. Furthermore, flexible pricing should be downward, not upward. The DOD also supports "price deregulation" if competitive services exist (DOD Exh. No. 2).

MCI and AT&T

In response to USWC's proposed price flexibility for intraLATA MTS, MCI and AT&T both maintain that USWC should be required to impute carrier access charges into its toll prices. Since both AT&T and MCI present strong arguments, USWC presented its position regarding imputation in its rebuttal testimony (USWC Exh. 25-R, pp. 2-8). A summary of this testimony follows the summaries of MCI's and AT&T's evidence.

MCI Telecommunications, Inc.

Ms. Roberta Ferguson adopted Mr. Timothy Gates' testimony on behalf of MCI. MCI's intervention in this Docket is primarily focused on USWC's proposal to detariff intraLATA MTS prices in Montana. Contrary to USWC, MCI maintains there is no competitive MTS environment in Montana which would allow USWC's proposal to be efficient. MCI supports this broad conclusion with five arguments.

First, MCI holds that resellers are more appropriately considered as USWC's customer rather than its competitors since they are nonfacility based and any competition of USWC would therefore be from itself.

Second, it is asserted the bypass which owners and vendors of private facilities provide is economically correct, since some of those instances are point to point transmission facilities and some provide services USWC cannot. This claim is buttressed by adding that if it is cheaper to bypass than it is to lease facilities, then leasing facilities would be an inefficient allocation of resources.

Third, MCI holds that USWC should be required to show that effective competition exists rather than merely potential competition (MCI Exh. No. 3A, p. 6). As noted above, USWC per-

formed a customer survey regarding competition in the intraLATA toll market. MCI maintains that USWC's customer study, is fatally flawed on the grounds of statistical significance and survey technique; and further, the studies rely upon the respondent's memory, and have been found to be un reliable in other states such as Colorado (Id. at p. 7).

It appears that for the sake of argument, MCI assumes the study is statistically correct and seeks to show several other flaws in the analysis. First, by asserting MCI's prices are higher than USWC's in all but one mileage band (292 +) by "31 and 71 percent" for initial and subsequent minutes, respectively, MCI claims "it is clear that MCI customers are not among the surveyed respondents, or that they had very little effect on the survey results" and no current USWC customer would switch to MCI service based on the results of the USWC study (Id. p. 8). MCI cites three problems with USWC's use of the "Survey of IntraLATA Competition: Montana" (aside from its statistical flaws): 1) the Company's assumption that any intraLATA traffic not carried by USWC should have been carried by USWC, and is therefore "lost revenue," 2) the market share USWC asserts its competitors hold still leaves USWC with 93.5 percent of the IntraLATA toll market, and 3) Mr. Cooper's Schedule 8, which shows the development of lost revenues, is

limited to the "Non-Government Market" and does not include any consideration of access charges paid to USWC by resellers (Id. pp. 9-10). MCI also contends, because of the lack of existing competition, USWC should not be allowed to enter into contracts with its customers.

Fourth, MCI holds the lack of further development of intraLATA equal access (the one-plus dialing parity issue), prevents the development of effective competition in the intraLATA market (Id. p. 10).

Fifth, USWC should be required to impute access charges in its intraLATA toll rates on the same basis it charges interexchange carriers (including resellers) for such services. MCI states it would be discriminatory for USWC not to impute access costs into its toll rates (Id. pp. 18-22).

It appears MCI used these proceedings to present its own policy agenda regarding the competitive environment of long distance toll in Montana. MCI claims that "effective" competition does not exist in the Montana toll market and it has a significant competitive disadvantage due to the lack of "1+" intraLATA equal access, and USWC's failure to impute carrier access charges in its intraLATA toll rates. MCI cites decisions and regulatory

activities in other states in support of its position (Id. pp. 19-22).

Regarding the carrier access imputation, MCI appears to suggest these charges be priced according to time-of-day usage.

Ms. Ferguson states:

It is clearly anti-competitive for Mountain Bell to charge MCI more for access than it charges its customers for an identical toll call. This occurs most frequently in the evening, night, and weekend discount periods. Interexchange carriers do not receive time of day discounts on access. The result is that MCI and the other interexchange carriers are paying a disproportionate share of the contribution for toll service. Consequently, it would be discriminatory for Mountain Bell not to include those same costs in developing its intraLATA rates. (Id. p. 19)

USWC Rebuttal

USWC's rebuttal of MCI's testimony is shared by Messrs. Hatzenbuehler and Cooper. Mr. Hatzenbuehler disagrees with MCI's assertion that non-USWC interexchange carriers are paying a disproportionate share of the contribution for toll services, on the grounds that if those carriers did receive discounts for off-peak period switched access, peak period prices would have to be increased in order to compensate for the lost contribution from traffic shifts to the off-peak period. USWC holds that such a shift in traffic could result in higher switched access prices for MCI, other IXCs and resellers. This argument appears to be consistent with the argument Mr. Hatzenbuehler makes regarding AT&T's opposition to USWC's market-based pricing application to Switched Carrier Access -- namely, if all of its services were priced at LRIC, there would be no contribution to common costs (USWC Exh. No. 25-R, pp. 8-9). The same argument appears to apply to peak-based pricing.

USWC recommends the Commission not consider making one-plus dialing available to other IXCs in Montana, since the costs of such an order would be overly burdensome to the general ratepayers.

USWC claims that such a requirement would diminish benefits to competition in light of USWC's "carrier of last resort requirement,

interLATA exclusion, statewide average toll rates, and need to address EAS concerns through low short-haul toll rates" (USWC Exh. No. 25-R, p. 12). USWC feels other IXCs have adequate opportunities to compete through 10XXX dialing and WATS-types service.

Mr. Cooper contends in his rebuttal testimony that USWC has met its equal access dialing obligations in Montana and, upon request by MCI, has installed adjunct equal access units in a number of nonelectronic offices (USWC Exh. No. 2-R, pp. 11-12).

Mr. Cooper also makes some general statements concerning MCI's direct testimony. First, MCI appears to state that toll prices should be held artificially high and stable to guarantee profits for IXCs that do not pose a competitive threat to USWC. USWC also apparently contends that imputation would result in a revenue shortfall which would be borne by the general body of ratepayers (USWC Exh. 2-R, p. 9).

Secondly, by emphasizing USWC's estimated 93.5 percent intraLATA toll market share, MCI fails to recognize that 23 percent of the surveyed large businesses said they used an alternative provider, while USWC requests price detariffing for precisely those types of customers. Mr. Cooper reiterates the Company's intention to compete proactively, in order to be able to enter into contracts

for MTS with large customers, and preserve "a greater contribution to its total costs from these customers" (Id. p. 10).

In response to MCI's criticism of the "Mountain Bell Survey of IntraLATA Competition: Montana," Mr. Cooper provides the following remarks. First, the use of the survey in his direct testimony was intended to demonstrate current and potential levels of competition in the intraLATA toll market in Montana. Second, that MCI criticizes the study without support from an alternative study. Third, Mr. Cooper addresses MCI's criticism regarding the memory issue with the following quotation from the study, which appears under the subtitle "Limitations":

The mean numbers of intraLATA calls and the mean bills were compared between those respondents who referred to their bill and those respondents who did not refer to their bills. In most cases, no differences were detected between the two groups in regard to the number of calls and size of bill. (USWC Exh. No. 2-R, p. 11)

Fourth, regarding the methodology of the study used in the Colorado case, Mr. Cooper notes this study was conducted in 1986 and the changes suggested in that case have been incorporated into the study used in the 1987 survey. Finally, in response to MCI's claim that its customers were not among those surveyed, Mr. Cooper cites page 9 of the survey, which shows MCI as a reported

carrier in all of the customer stratifications surveyed (Id. p. 11). Mr. Cooper fails to rebut MCI's assertion that other than incidence rates, the survey results are not statistically significant.

American Telephone and Telegraph

Mr. Michael Wood, testifying on behalf of AT&T, cites and discusses AT&T's position regarding four issues in this Docket:

- 1) USWC should be required to reduce its switched carrier access service prices by at least \$.01 per minute. This claim is supported by AT&T's criticism of USWC's misuse of market-based pricing in a noncompetitive market (AT&T Exh. No. 1, pp. 2 & 3-7).
- 2) In order to prohibit USWC from being able to price its interexchange toll services anticompetitively, AT&T recommends that USWC be required to impute access costs of about \$17,000,000 in aggregate, into its cost of providing interexchange toll services (Id. p. 2 & 7-17).
- 3) AT&T holds that USWC should first be required to disaggregate and separate the competitive from the non-competitive Centron service elements before it is allowed to

detariff the competitive service elements. Furthermore, AT&T suggests the noncompetitive elements be priced in such a way that disparities between PBX and Centron services are eliminated (Id. p. 2 & 17-23).

- 4) Finally, AT&T holds that USWC should not be allowed to increase its Private Line Access prices because those prices are currently well above incremental cost and the market-based pricing methods applied to this increase are both discriminatory and inappropriate for a monopoly provided service (Id. pp. 3, 23-26).

Carrier Access Service

Arguing that market-based pricing has its place in the more perfectly competitive markets to produce economically efficient prices, as opposed to a monopoly market, Mr. Wood holds the application of market-based pricing in a monopoly market is inappropriate. He cites USWC's local exchange as such a monopoly market through which interexchange carriers must pass to access their customers. Although the cost of bypass is a possible price ceiling for USWC's access charges, this application fails since providing bypass facilities to residential and business customers is largely unrealistic and uneconomical. AT&T holds that efficient monopoly pricing is best achieved in the regulatory arena when prices are more closely based on incremental cost. However, AT&T maintains that NTS costs should not be included in the incremental cost of providing toll or access services, since these costs are only incurred when a customer accesses the local switched network, as opposed to the toll network (AT&T Exh. No. 1, pp. 3-6).

AT&T holds that USWC's Montana carrier access prices are not properly priced and should be reduced based upon two criteria.

First, the Carrier Common Line Charge element of carrier access should be reduced, since it is an NTS cost. Second, the traffic sensitive service elements should be reduced to a mark-up equal to

USWC's authorized rate of return. Using data from Exh. LFC-1 in Docket No. 84.4.15, Mr. Wood's exhibit MVW-1 (AT&T Exh. No. 1) shows a mark-up range of 57 percent to 2040 percent over incremental cost for the various mileage bands of local transport.

An examination of Mr. Wood's exhibit shows a mark-up over incremental cost for the 50 and 100 + mileage bands (which AT&T uses most often) of 952 percent and 350 percent, respectively, with prices of roughly \$.03 to \$.04 per minute. AT&T suggests these prices be reduced by at least \$.01 per minute, to be reasonable.

Such a reduction would allow USWC a 100 percent mark-up over incremental cost and reduce AT&T's cost of providing toll service by about \$1.4 million.

USWC Rebuttal

In response to AT&T's suggestion to set Switched Access prices at, or slightly above LRIC, Mr. Hatzenbuehler states it is the Company's preference and policy to price Switched Carrier Access Service at a compensatory level above LRIC, which is "market-based" (USWC Exh. No. 25-R, p. 8). USWC holds that prices set at LRIC will not make a sufficient contribution to common costs and it is essential that all services not be set at LRIC in order for the Company to survive. Common cost contribution must be recovered in some prices. Likewise, USWC responds to AT&T's suggestion that carrier access prices be set at a mark-up equal to USWC's authorized rate of return by restating the Company's intention to set these prices at compensatory levels.

Finally, USWC responds to AT&T's claims "that USWC's local transport rates are 'market-based' and exceed the incremental cost of providing such transport by a range of 57% to 2040%" (USWC Exh. No. 25-R, p. 10), by first explaining how these prices are set in mileage band increments in relation to LRIC. Mr. Hatzenbuehler notes that "to price the seven bands of Local Transport strictly in line with the incremental costs of providing the service would not

provide the smooth continuum of rates USWC believes to be appropriate" (Id. pp. 10-11).

Imputation of Access Charges

Mr. Wood recommends the Commission require all LECs that also provide intraLATA toll service to impute carrier access costs into their toll rates. AT&T makes this recommendation on the grounds that it is necessary to avoid unreasonable discrimination and unfair competition (AT&T Exh. No. 1, p. 8). AT&T argues USWC is in a position to compete unfairly since it is both the monopoly provider of access to interexchange carriers as well as its own intraLATA toll service. AT&T holds that under conditions where LECs, such as USWC, are not required to treat access costs the same as interexchange carriers, even though the facilities and costs are the same, the LEC will have the capability to improperly use its local access as an advantage over interexchange carriers in toll markets. Mr. Wood cites the following achievable results, if USWC were required to impute carrier access costs:

- a. Minimize the potential for price discrimination against competitive suppliers of intraLATA services and against suppliers of substitutable interLATA toll services; and

- b. Ensure that competitive intraLATA inter-exchange service are not subsidized by other monopoly services of Mountain Bell, such as local exchange service. (AT&T Exh. No. 1, p. 9)

AT&T cites two instances where an LEC has been found to be discriminating against an interexchange carrier due to the omission of access cost in its toll rates. First, in the United States District Court for the District of Columbia |U.S. Court of Appeals for the District of Columbia, 846 F. 2d 1422 (D.C.C. 1988)-, Judge Greene found USWC to be discriminating against AT&T in the provision of access to the General Services Administration (AT&T Exh. No. 1, p. 11). Secondly, the Texas Third Court of Appeals found Southwestern Bell to be discriminating against AT&T, MCI, and other carriers by not paying access charges for its own provision of toll service and charging the same to these other carriers. |AT&T Communications of the Southwest v. P.U.C., 735 S.W.2d 866 (Tex. App. 1987)-. Mr. Wood maintains that these cases demonstrate the ability of local exchange companies to attract large customers unfairly, by pricing their access services in a discriminatory manner (AT&T Exh. No. 1, p. 12).

AT&T also cites the Minnesota Public Utilities Commission (Docket No. P-999/CI-85-582, Nov. 2, 1987), the Oregon Public Utility Commission (Order No. 88-665, OPUC Docket No. UT 47, June

30, 1988), and the Washington Utilities and Transportation Commission (WUTC Cause No. U-85-23 et al., 18th Supplemental Order, Dec. 30, 1986) which order Northwest Bell and Pacific Northwest Bell, respectively, to impute access charges into their toll rates.

AT&T also cites the Wyoming PUC's (Order, Oct. 23, 1987, Docket No. 9746, as consolidated, p. 38) intent to have toll service providers include, in their filings for toll rates in general rate cases, evidence of imputation of access charges (AT&T Exh. No. 1, p. 13).

AT&T recommends that USWC impute access charges into its toll prices by the same amount it charges interexchange carriers for access, including Carrier Common Line Charges. AT&T holds that this would be consistent with the carrier access charges independent LECs charge USWC for access to their exchanges in USWC's provision of toll service.

According to the data supplied by USWC in this Docket (USWC's proprietary response to MCI Data Request No. 12), AT&T estimates USWC should impute roughly \$17,000,000 in access charges into its cost of providing intraLATA toll and WATS prices on an aggregate basis. AT&T notes this figure may need to be adjusted due to any prior imputation USWC may have already made in its cost of service calculations. To arrive at the \$17 million figure, AT&T

converted USWC's conversation minutes and originating messages for MTS and WATS into access minutes of use (MOU). Switched access price elements, including Carrier Common Line, the LS2 Local Switching, Line Termination, Intercept, and the 0-1 mileage band for Local Transport, were then applied to the converted MOU. Because USWC collocates its local switch and Point of Presence (POP), AT&T felt the 0-1 Local Transport mileage band rate represented the fairest method of applying this element.

USWC Rebuttal

USWC witness Mr. Hatzenbuehler appears to have chosen to respond to both MCI and AT&T regarding the imputation of Carrier Access Charges into its toll costs, in general terms. A summary of USWC's position regarding this issue is found at the end of the review of intervenor testimony section.

USWC alleges that an imputation test, both as outlined above and as proposed by Mr. Wood, would be satisfied, given the present USWC toll prices in Montana (USWC Exh. 25-R, p. 8, cf. Exh. AT&T-1, pp. 7-17).

Centron Services

AT&T's concern regarding USWC's request for price flexibility for nonaccess portions of Centron is focused on what the Company considers "nonaccess." AT&T is concerned that monopoly-provided services such as local distribution facilities |i.e., local loops, station telephone number assignment, Touch Tone, and Direct Inward Dialing (DID) may be considered within the Company's definition of "nonaccess." Mr. Wood states that detariffing these services would create "the possibility of disparate treatment for customers of functionally equivalent services, such as PBX service, which make use of these items as well" (AT&T Exh. No. 1, p. 18). The crux of AT&T's position is that such detariffing will "seriously impede the ability of other telecommunications carriers to compete with Mountain Bell in the Montana market place" (Id. pp. 18-19).

AT&T argues that detariffing should only be granted, if USWC is first required to unbundle (disaggregate) the noncompetitive components of Centron Services which are used to provide the competitive services. These noncompetitive Centron services include local loops, station telephone number assignment, Touch Tone, and DID. Second, AT&T argues that the particular assignment of a local loop does not remove its status of being monopoly-

provided. Third, AT&T disagrees with USWC's comparison of Centron loops and PBX in-house wiring, that is, USWC holds the two are synonymous. Fourth, NARs are not the equivalent of a business access line and should, therefore, be unbundled from the Centron service and price tariffed separately.

Regarding NARs, AT&T holds that all other local exchange customers receive the local loop service element while only the Centron customer must purchase a NAR to obtain access to the CO or dial tone. It appears that AT&T's argument is in defense of its PBX market, since the Centron customer is not required to pay a tariffed rate for each and every physical connection to the central office (AT&T Exh. No. 1, p. 21). AT&T contends that USWC's Centron detariffing request should be denied. Mr. Wood states that otherwise, "discrimination in the pricing of monopoly-provided local loop facilities for use with Centron-competitive services could result" (Id. p. 22).

AT&T cites a recent decision by the Colorado Public Utilities Commission (CPUC) regarding deregulation of USWC telecommunication services. It was the CPUC's duty to consider the intent of the relevant Colorado legislation concerning deregulation of "Centron and Centron-like services." |See C.R.S. << 40-15-401(1)(f) and 40-15-102(4)~ The CPUC accepted USWC's offer of

compromise and held that "the local loop portion and NAR usage for a Centron system or a Centrex system are not exempt from regulation under part 4" of the legislation (Initial Commission Decision Declaratory Order, Jan. 6, 1988, Case No. 6645, < 36, p. 15, as clarified by Statement, Findings of Fact, Feb. 24, 1988, Case No. 6645, p. 4) (Id. p. 23).

USWC Rebuttal

Mr. Cooper filed a few brief statements on AT&T's direct testimony regarding Centron Service. These statements are made in regard to Mr. Wood's characterizations of services that differ in their physical provision and their function. Namely, he points out that NARs are functionally the same as business access lines even though NARs are not physically connected to the CO. Functionally, these two components provide network access. It is the station lines that provide the physical connection between the customers premises and the CO for centron service. It is noted the Company proposes to reduce current price disparities between PBX trunks and NARs by increasing the NAR prices (See USWC Exh. No. 27-R).

Secondly, in response to AT&T's concerns about USWC's position regarding station lines, USWC continues to maintain that the local loops, which connect the customer premises to the CO to provide Centron service, are still priced above cost. Furthermore,

Mr. Cooper notes the Company's proposal includes Commission oversight of flexible prices of station lines and other "ancillary" Centron services in order to compete with vendors of substitutable service components such as AT&T, who have no pricing constraints (USWC Exh. No. 2-R, pp. 8-9).

Centron Detariffing: AT&T-USWC Stipulation

In their proposed stipulation, at paragraph 9, USWC and AT&T agree on the following:

The parties agree that USWC's provision of Centron Network Access Registers, Centron Station Lines and the Common Equipment (which includes DID, Touch Tone and station number assignment) shall remain tariffed. Detariffing of the competitive elements of Centron Service, including all other features and enhancements of Centron Service, should be granted. (USWC Exh. No. 26)

Private Line Access Service

Applying the same argument against the use of market-based pricing, as developed under AT&T's argument opposing the current levels of Carrier Access Charges, Mr. Wood holds that USWC's proposal to increase Private Line Access prices is not sound and current prices are unreasonable (AT&T Exh. No. 1, pp. 23-25).

AT&T finds USWC's witness Kenneth Greenwalt's comparison of USWC's proposed prices to comparable prices in other states and the comparisons to interstate Private Line prices to be unreasonable, because they do not reflect the average special transport length found in Montana (Id. p. 25). AT&T holds that Private Line Access prices should be established using each state's own incremental cost of service.

Mr. Wood notes that USWC's proposed \$283,679 increase in Private Line Access prices will result in an increase in AT&T's costs of about \$162,300, or a 34 percent increase. AT&T supports its claim of misuse of market-based pricing by noting the USWC proposal is a mark-up of 77 percent to 1400 percent over its estimated incremental cost. Mr. Wood notes that the mark-up for the transport mileage band exceeding 50 miles (approximately 300%) has an especially aggravating impact on AT&T's access transport costs. AT&T holds the application of market-based pricing for this

monopoly service is "arbitrary." Mr. Wood also points out that AT&T's current Private Line Prices will not absorb USWC's proposed increase and AT&T's Private Line Prices will have to increase (Id. p. 24).

USWC Rebuttal

USWC's witness Kenneth L. Greenwalt rebuts AT&T's opposition to increases in Private Line prices on three points. First, USWC notes its proposed Private Line price increases will increase AT&T's prices by 34 percent per element, returning prices to their July, 1987 through mid-February, 1988 levels, which is nearly the same as the 1987-1988 price level for interstate access.

Mr. Greenwalt notes that AT&T purchased a significant amount (see appendix B) of these services at those prices (USWC Exh. No. 28-R, p. 1).

Secondly, USWC states it is valid to compare intrastate and interstate (by state) Private Line prices. Mr. Greenwalt also notes that pages 4, 8 and 12 of his Schedule 1 (Id. p. 2, USWC Exh. No. 28) compare circuits with transport mileages exceeding 50 miles, in order to address one of AT&T's concerns. USWC holds that it is necessary to make the interstate/intrastate comparison to avoid the possibility of tariff shopping (Id. p. 2). Using the "demand quantities" for all of the intrastate elements used to

develop Private Line recurring prices proposed in this Docket, Mr. Greenwalt found the recurring monthly revenues for the proposed Private Line prices and the current Montana interstate private Line revenues were \$75,405.12 and \$75,842.37.

Regarding AT&T's claim that Private Line services are monopoly provided, USWC states that although the proposed price changes sought in this Docket are not made in response to any competitive threat, USWC maintains that these services are indeed competitive. Mr. Greenwalt holds that the purpose of the proposed price increase is to merge its Private Line and Special Access services. Such a merger is designed to reduce possible price discrimination between the two services, since they provide similar service to different customer groups. USWC cites three cases in which AT&T has supported a merged Special and Private Line Access tariff.

USWC's Position Regarding

Imputation of Carrier Access Charges for IntraLATA Toll Service

During the course of these proceedings, the issue of whether or not and how USWC should be required to impute carrier access charges surfaced in light of USWC's request to be allowed pricing flexibility for IntraLATA MTS. Both MCI (MCI Exh. No. 3B)

and AT&T (ATT Exh. No. 1) address the issue in their direct testimonies. USWC responds to these concerns in the rebuttal testimonies of Messrs. Hatzenbuehler and Cooper (USWC Exh. Nos. 25-R and 2-R). The following is a summary of USWC's position regarding imputation of carrier access charges as a competitive test for detariffing intraLATA MTS (toll) per Mr. Hatzenbuehler's rebuttal testimony.

Mr. Hatzenbuehler begins his rebuttal by noting the method used by USWC to complete intraLATA, intrastate and interstate toll calls. Basically, it is the Company's integrated switched network. He goes on to state the three basic ways a carrier other than USWC can provide intraLATA toll service. Those methods are: 1) by purchasing switched access service between the points of origination/termination and POP; 2) by purchasing a combination of special and switched access service for service between points of origination/termination and POP; and 3) using a privately owned dedicated channel between the customer's premises and the carrier's POP.

USWC notes its intraLATA toll prices are regulated by the MPSC and implicitly by the Federal court, via the MFJ; and that it is prohibited from hauling interLATA traffic. Mr. Hatzenbuehler also notes that USWC's toll rates subsidize "overall costs of the

business" (USWC Exh. No. 25-R, p. 3) allowing residential basic exchange prices to be low. The subsidy originates from a combination of aggregate toll prices and per minute prices set well above costs. In order to gain maximum efficiency in its use of the public switched network, time-of-day and day-of-week discounts are offered. Also low prices at the low mileage bands are designed for customers with above average calling to nearby communities (Id. pp. 3-4), to reduce EAS pressures on USWC and the MPSC.

It appears that USWC contends that the appropriate imputation method will depend on the outcome of the MTS detariffing issue pending in this Docket (USWC Exh. No. 25-R, p. 4). This position is also taken in regard to the current market environment, which is essentially composed of regulated and/or unregulated competitive carriers. USWC feels that since it must compete as a regulated firm with nonregulated firms, it has a disadvantage and that the competition will not emerge until USWC is released of regulatory constraints to the extent currently experienced by its competitors (Id.). The Company holds that if it must serve as carrier of last resort, restricted by state-wide average toll prices, maintain low short-haul toll prices, and is restricted to toll service within LATAs, no imputation should be required. The

Company is, however, open to negotiating imputation methods should these constraints be released (Id. p. 5).

USWC recommends the following regarding the imputation issue:

Because USWC provides carrier access, local, and toll services, a rational method of ensuring a competitive environment would be to insure that all types of calls are charged for the use of essential facilities under equal terms and conditions. Until it is possible to implement this type of pricing structure, no competitive test, such as imputation, should be required. (USWC Exh. No. 25-R, p. 5)

Mr. Hatzenbuehler points out that USWC has taken the position in other imputation cases that imputation for the purposes of creating a competitive market must be done in relation to USWC serving as a public utility. In cases where USWC's public utility role has not been considered and imputation has been ordered (eg. in Minnesota, Oregon and Washington) the public pricing policies mentioned above (toll averaging, carrier of last resort, etc.), which constrain USWC from competing under regulation, are "in jeopardy" (USWC Exh. No. 25-R, p. 6).

USWC suggests that if the Commission orders imputation, as a competitive test, it should do so in a way that treats USWC according to the conditions faced by its competing carriers when they purchase these services. USWC states, however, that its

"competing carriers are under no obligation to price their service on a per minute per rate band basis in relation to the access charges which they pay." USWC suggests that imputation be done on an aggregate basis using "essential access elements." Those elements include: carrier common line charge, switching, intercept, line termination, and 0-1 mileage band of transport. Furthermore, USWC holds that nonessential elements should be included at LRIC, which would include all transport at distances greater than the 0-1 mileage band (Id. pp. 6-7).

Finally, the Company suggests it be allowed to provide toll service under conditions similar to those of other carriers.

That is, in cases of partial bypass (where a network is configured with a dedicated channel at one end and switched access at the other), or cases of total bypass (in which dedicated channels are used at both the originating and terminating ends) USWC holds that LRIC should be the basis for imputation (USWC Exh. No. 25-R, p. 7).

In the case of Bell-Independent and Independent-Independent traffic, the Company proposes that a separate aggregate imputation test should be conducted (Id. p. 7). The Company feels if this traffic is to be priced below "the proper imputation test," Bell-Bell toll should not bear the burden of short-falls. USWC

holds that exclusive subsidization of high cost Montana toll areas operated by independent telephone companies should not be USWC's sole responsibility, if it is the designated toll carrier for those areas.

Review of Rate Design Stipulations

During the course of these proceedings, three bilateral stipulations were entered into by the Applicant, with MCC, AT&T and Northwest Telephone Systems, Inc., respectively. The following is a summary of these stipulations in relation to the rate design issues in this Docket.

USWC/MCC Stipulation

In the revenue requirements stipulation between the MCC and USWC, the following rate design was proposed for a second Interim Order in Docket No. 88.1.2 and in conjunction with Docket No. 88.12.55:

Table 5
SUGGESTED RATE DESIGN: USWC/MCC STIPULATION

| <u>SERVICE CATEGORY</u> | <u>REVENUE</u> |
|---|------------------|
| 1. Directory Assistance (reduction to three free calls from present five call allowance and increase price to \$.40 for each call thereafter) | \$ 319,777 |
| 2. Listings (increase charge for non-published and non-listed service) | 177,518 |
| 3. New Number Referral | 79,000 |
| 4. Special Access | 283,579 |
| 5. Late Payment Charge | <u>1,359,000</u> |
| Total | \$2,218,874 |

Source: |Stipulation of U S West Communications and the Montana
Consumer Counsel, p. 4, Par. 7(b)-

AT&T and USWC Stipulation: IntraLATA Toll Detariffing and Imputation

The AT&T and USWC stipulation covered imputation, USWC's proposed Centron price detariffing, and the Switched and Special Access issues in this Docket (USWC Exh. No. 26). Regarding Imputation of CACs, USWC and AT&T agree, in principle, that CACs should be imputed into USWC's cost of providing intrastate intraLATA toll services in order "that all providers of intrastate intraLATA toll services in Montana ... have access to the switched network under equal rates, terms and conditions." Namely, the toll service prices USWC negotiates in or outside of individual contracts, should cover the access costs that other carriers incur in providing similar services.

The stipulation also recognizes that USWC is confronted with certain constraints which are not faced by other toll providers. First, USWC is restricted to providing toll service within LATA boundaries. Second, USWC is designated as the toll carrier of the independent LECs in Montana. Third, USWC offers low priced short-haul toll in recognition of the importance of toll for its rural customers, and to deter pressure for EAS. Fourth, USWC, unlike other providers, is fully regulated, thereby giving it less pricing flexibility.

The parties find that USWC's currently tariffed intraLATA toll prices are sufficient to recover, in aggregate, all access and related costs for the completion of both Bell-Bell (B-B) and Bell-Independent (B-I) traffic (USWC Exh. No. 26, p. 2). The interstate access elements included in the parties analysis include the following essential elements: carrier common line charge, local switching 2, intercept, line termination, and the 0-1 mileage band of local transport. Furthermore, the parties hold that "other cost elements incurred in the provision of intrastate intraLATA toll service, such as Billing and Collecting and transport beyond the 0-1 mile band should be included on a long-run incremental cost basis for 'B-B' traffic." All billing and access charges paid by USWC to Independent LECs for serving their customers ought to be imputed into USWC's toll rates.

The parties agree that the complex issue of imputation should be further examined in future regulatory proceedings before this Commission.

Although AT&T agrees to withdraw its opposition to USWC's application of market-based pricing to switched carrier access and Private Line service, AT&T retains the right to oppose market-based pricing of carrier access services in the future.

AT&T agrees to withdraw its opposition to USWC's proposal to increase its switched carrier access and Private Line/Special Access services. AT&T and USWC have agreed to discuss future price structures for customers who purchase significant volumes of Special Access service, if the Commission approves USWC's application to increase the prices for these services.

The parties' agreement regarding USWC's proposed price detariffing of its Centron service is stated under USWC's rebuttal to AT&T's position regarding USWC's initial application.

Northwest Telephone Systems, Inc.

In yet another stipulation between NWTS and USWC, NWTS agreed to withdraw its participation in Docket No. 88.1.2 based on the agreement that USWC will "provide HNPA 555 directory assistance service to NWTS customers by MST&T tariff Section A.6.2.4." (HNPA and MST&T are assumed to mean Home Number Planning Area and Mountain States Telephone and Telegraph, respectively.)

The parties agree that USWC will provide HNPA 555 DA at \$0.32 per DA message (USWC Exh. No. 2-NW). The key difference between this agreement and the cost structure underlying USWC's DA provision to independent LEC customers is that NWTS will be

responsible for billing and collection and access costs (cf. USWC Exh. No. 2-S p. 2 and No. 2-NW Pars. 5-6). The parties agree that future price changes will be subject to the consideration of the MPSC.

RATE DESIGN: COMMISSION DECISION

This section of the Order will be broken into five parts and will address the five general issues in the three Dockets before the Commission. These Dockets include 88.1.2, 88.9.33, 88.8.44. The five issues to be addressed include the following.

First, policy issues that have surfaced in Docket No. 88.1.2 will be discussed. These issues include 1) imputation of carrier access charges in USWC's MTS and WATS rates, 2) intraLATA equal access, 3) the merits of time-of-day carrier access pricing, and 4) USWC's shift from a product specific pricing policy to what it has called "market-based" pricing. Second, the Commission's decision regarding the cost of service analysis USWC proposed in these dockets will be reiterated in conjunction with the Commission's rate design decisions. The Commission's decision regarding USWC's proposed elasticity based revenue estimates will also be addressed.

Third, the Commission will address the two interim orders issued on September 19, 1988, Order No. 5354, and March 3, 1989,

Order No. 5354a, in Docket No. 88.1.2. The first of these two Orders addressed USWC's request for interim relief. The second came as a result of a stipulation between USWC and the MCC regarding the revenue requirement issue in Docket No. 88.1.2, and USWC's request for interim relief in the separations case, Docket No. 88.12.55.

Fourth, the three stipulations offered in these proceedings will be addressed. These stipulations involve the following: 1) USWC and AT&T regarding the imputation of Carrier Access Charges into USWC's cost of providing MTS and a definition of the nonaccess components of Centron Services; 2) USWC and NWTS regarding USWC's provision of Directory Assistance to NWTS service area; and 3) USWC and MCC regarding the suggested rate design portion of their stipulation.

The fifth and final portion of this section will address the remaining rate design issues to be decided in the three outstanding dockets listed above. The following issues will be addressed, in order, as follows: First, USWC's price detariffing proposals are examined generically and specifically. The specific proposals include 1) USWC's proposed price detariffing of Coin Telephone Message service, 2) Custom Calling services (excluding Call Waiting), 3) the nonaccess portions of Centron Services, and

4) price flexibility for USWC's 100 largest Message Telecommunications Service customers. Second, the Commission's decision regarding the Late Payment Charge, Base Rate Area revenue recovery, charges for installing auxiliary terminal equipment for Semi-Public telephone subscribers, Extended Area Service, Directory Assistance, per the proposals in Docket Nos. 88.1.2 and 88.8.44, proposed price increases for Network Access Registers, residence and business local exchange Usage Block Options, and OutWATS and 800 services.

Third, the remaining revenue generating rate design issues not covered in interim Order Nos. 5354 and 5354a, which include proposed changes in Message and Measured usage charges and various changes in nonrecurring charges will be addressed. Finally, the Commission's decision regarding USWC's request to terminate an 800 service circuit on a Centron 6 or 30 Service (Docket No. 88.9.33) will be addressed.

General Pricing and Other PoliciesImputation of Carrier Access Charges

The Commission finds the imputation of CACs into USWC's toll prices to have economic merit so that competition will be effective in maintaining just and reasonable toll rates in Montana, as this relates to nonfacility based resellers. Both MCI and AT&T maintained that USWC should be required to impute CACs into its toll rates (see MCI Exh. No. 3B, pp. 17-23 and AT&T Exh. No. 1, pp. 7-17). Per AT&T's suggestion that CACs should be imputed into toll service rates in general, the imputation methods both AT&T and MCI present, USWC's rebuttal and position regarding imputation (USWC Exh. No. 25-R, pp. 2-8), the several court and regulatory decisions both AT&T and MCI cite, and the stipulation between AT&T and USWC, the Commission suggests that the appropriate method for USWC to impute CACs must be addressed in much more depth, due to its complexity, when and if USWC proposes price detariffing of its toll services, including WATS and MTS in future rate cases.

It is obvious from Ms. Ferguson's comment regarding the stipulation between USWC and AT&T that MCI is not completely satisfied with the imputation methods AT&T and USWC have temporarily agreed upon (see USWC Exh. No. 26, paragraph 6). Assumably, the use of the 0-1 mileage band of transport. Ms. Ferguson states,

regarding the AT&T/USWC stipulation, the following advantages and disadvantages:

Probably the first and only advantage is that something is better than nothing. The disadvantages would be, is that the intraLATA toll calls that Mountain Bell carry are not limited to that one particular mileage band, so, therefore, they will carry calls from the central office through the tandem; and if they do that, which is similar to our calls or AT&T calls or Sprint or anyone else's, then basically they are paying a lower access charge than any of us, so that does give them a price advantage, because in effect, it reduces their costs. That's probably the single biggest disadvantage is the fact that in this instance while it's something, it still is not going to do very much to promote effective competition. (TR pp. 793-794)

Further comment of the Commission regarding its position on USWC's imputation of carrier access charges is stated under the part addressing USWC's proposal for MTS price detariffing.

IntraLATA Equal Access

The Commission finds that MCI's contention that the lack of complete equal access in Montana reduces potential competition in the Montana toll markets has merit (MCI Exh. No. 3B, pp. 10-16).

In the instant docket, the Commission finds four primary issues to be related to implementing statewide equal access. Those issues are: 1) the costs associated with implementing equal access, 2) the availability of essential technology for nonelectronic central office equal access, 3) the potential impacts on fostering competition in the Montana toll markets, and 4) the effects on universal service and basic exchange rates. The following is a brief summary of the record in this docket with respect to these four issues.

First, USWC witness, Mr. Frank Hatzenbeuler, maintained, in his rebuttal testimony (USWC Exh. No. 25-R, p. 12) that the costs associated with implementing statewide equal access would be significant and produce an undue burden on basic ratepayers. He also maintained that minimal value would result from such an action due to "USWC's carrier of last resort requirement, interLATA exclusion, statewide average toll rates, and need to address EAS concerns through low short-haul toll rates" (Id.). MCC witness,

Mr. Allen Buckalew, notes that the cost of programming digital switches to provide equal access must be examined on the premise that all of the digital switches capable of equal access programming must be used to develop costs (TR p. 764). This suggests to the Commission that equal access cost estimation applied in the past may need to be examined in greater detail in the future.

Second, the Commission finds Mr. Buckalew's information regarding the Texas based Company, SRX, which produces adjunct facilities for cross bar switches providing equal access capability in these offices enlightening (TR 764). The Commission can only recognize that there may be several technological considerations and alternatives available for implementing statewide equal access.

Finally, the Commission takes into consideration, for future proceedings addressing equal access, Mr. Buckalew's comment concerning potential effects of ordering statewide equal access.

Specifically, that ordering USWC to implement statewide equal access may jeopardize USWC's existence. Mr. Buckalew draws from the Minnesota example, in which that Commission ordered statewide equal access so that competition could be fully realized. The problem, according to Mr. Buckalew, is that, unlike its nonregulated counter parts, USWC is restrained from providing

interLATA toll service. Hence, it may be that competing IXCs will offer both inter and intraLATA services as a convenience to the customer, causing a reduction in USWC's traffic. The MCC maintains that such a situation "is not fair competition" (TR pp. 762-763).

The Commission is addressing the equal access question here only because of its relevance to the USWC MTS detariffing proposal. The Commission does not have before it in this Docket a formal request to implement equal access on a statewide basis.

Time-of-Day Priced Carrier Access Charges

Per the review of MCI witness, Ms. Ferguson's adopted direct testimony, as reviewed in paragraph 188, above, and USWC's witness, Mr. Hatzenbuehler's rebuttal (USWC Exh. No. 25-R, p. 11), the Commission finds the following with respect to time-of-day priced carrier access charges. During cross-examination Ms. Ferguson was asked to confirm whether or not she was suggesting that (MCI Exh. No. 3B, p. 19, ll. 3-13) USWC price its carrier access charges according to time-of-day. She appears to respond by stating that the intention of this part was to not necessarily suggest that time-of-day CACs be developed but that time-of-day toll rates need to be set at least equal to carrier access charge levels (TR pp. 791-792). In response to Mr. Hatzenbuehler's rebuttal to the same section of Ms. Ferguson's direct testimony, Ms. Ferguson appears to say that in order to reduce potential price squeezes for other common carriers, USWC toll rates need to be at least equal to CACs at all times, regardless of whether or not toll prices are discounted during evenings, nights, and weekends (TR p. 792).

Regarding Mr. Hatzenbuehler's rebuttal testimony with respect to time-of-day CACs, or "off-peak period discounts for access customers" (USWC Exh. No. 25-R, p. 11), the Commission

questions the economic logic underlying his position. That is, in the event that traffic is shifted away from the peak period, due to off-peak period discounts, costs for providing peak period service may decline, which may result in a decrease in necessary contribution which may result in a reduction in peak period CACs.

The Commission recognizes that it may be the case that off-peak period discounts of CACs may not cause a shift in traffic from peak periods to off-peak periods per Data Response No. STF02-MPSC-081 part i. However, these considerations must be examined empirically in order to provide the Commission conclusory evidence when and if the issue is addressed in future proceedings.

USWC's Application of Market-Based Pricing

USWC has proposed a shift from product-based to market-based pricing, which is summarized in Paragraph Nos. 66 and 67, above. Based on the Commission's review of this testimony, several data responses and the transcript, the following is a summary of the Commission's position regarding USWC's application of market-based pricing.

USWC defines market-based pricing as "pricing which takes into account the customer's perception of the value of the product or service and the cost of alternatives while making sure that it

at least covers the incremental cost" (DR No. STF02-MPSC-83, part ii). Also, USWC defines value-of-service pricing as "a pricing concept under which rates are set primarily on the basis of the PRESUMED value of the service to the user. As an example, it was under this concept that price differences between residence and business customers were developed" (Id. part i). Mr. Hatzenbuehler also stated that USWC uses alternative services or customer choices as a means to determine the presumed value customers hold for each of its services. This gives the customer the opportunity to purchase the services which best suit their needs. However, it appears that Mr. Hatzenbuehler maintains that determining presumed value for a particular product cannot be done by isolating products. That is, presumed value must be determined by examining the relative value of each of the services USWC offers (TR p. 711).

USWC also uses incremental cost in its pursuit of market-based pricing as a price floor (cf USWC Exh. No. 25, p. 4 and DR No. STF02-MPSC-84, part i).

The Commission notes USWC's proposed price change for Private Line Access Service as a possible example of the shift from a product-based pricing focus to a market-based focus. Specifically, Mr. Greenwalt responds, in his rebuttal testimony

(USWC Exh. No. 28-R, p. 3) to AT&T witness Mr. Wood's concern that market-based pricing is inappropriate for pricing monopoly provided services (AT&T Exh. No. 1, pp. 23-26). Mr. Greenwalt states that USWC maintains that there is competition in the Private Lines Access market. However, it has not priced Private Line Access in response to any competitive threat. USWC explains how it has priced its services under a product focus as thus:

The product focus is when the same product is priced at different rates for different customers based on who the customer is rather than the market value of the product. For example, if a regular business customer purchased a dedicated line it was called "private line" and billed at one rate, whereas if a carrier purchased a dedicated line it was called a "Special Access line" and billed at a different rate. (DR STF02-MPSC-079, part i).

However, in the current docket, USWC has proposed that Private Line Access Service and Private Line should have the same rates and structure (USWC Exh. No. 28, p. 7). The Commission finds this to be a possible example of USWC's application of market-based pricing which may result in reducing cross-elastic effects and tariff shopping. Yet the Commission is concerned that USWC appears to consider its own Private Line service competition for its Private Line Access service.

The Commission holds that USWC should only be applying market-based pricing principles if there is a competitive market for those products or services. Traditionally, telecommunications regulation has been based on a combination of cost-based and value-based pricing. As the competitive environment begins to emerge, the Commission will continue to consider the appropriate merits of value-based pricing. However, in this proceeding, the Commission will not commit itself to either value-based or cost-based pricing as the appropriate pricing method. Furthermore, the Commission reserves its privilege to consider the appropriate pricing method on a service-by-service basis in the future.

Cost of Service and Elastic Response Implications
on Rate Design Decisions

Cost of Service

As stated in the Cost of Service section of this Order, the Commission finds USWC's LRIC analysis unacceptable. Hence, none of the Commission decisions regarding rate design are based on LRICs. However, the general "market-based" pricing policy USWC has proposed should be addressed. Recall, USWC has proposed that its services be priced to cover LRICs, at a minimum, regardless of whether the service is tariffed. However, without having confidence in USWC's LRIC methodology, the Commission is unable to decide if this goal is being met.

Elasticity Based Revenue Estimates

Although the Commission generally embraces elastic responses, it denies USWC's proposed five elasticity adjusted revenue estimates proposed in this Docket. This includes the proposed adjustments for residence basic exchange services, Local Coin Telephone service, Directory Assistance and Toll operator surcharges. Due to the proprietary nature of the analysis USWC performed, the Commission limits its discussion concerning its basis for denying these proposals to Appendix A of this order.

Elasticity Based Revenue Estimates (Proprietary)

The Commission's decision regarding this issue is proprietary, and may therefore be found in Appendix A, which is attached hereto and incorporated herein by this reference.

Review of Interim Order Nos. 5354 and 5354a

The attached Table B1 is a review of the revenue impacts resulting from the two interim Orders issued in Docket Nos. 88.1.2 and 88.12.55. The following is a brief statement summarizing the results of the two interim orders.

In Order No. 5354, the Commission granted USWC interim revenue relief for a gross amount of \$6.366 million which was reduced to \$5.062 million due to depreciation adjustments in Docket No. 88.2.5. These revenues were spread over Local Coin Telephone Service (an increase in the price per local message from \$.10 to \$.25), an increase in the prices for the Busy Line features of Centron 6 and 30 services, Companion Line service, and Local and Toll Operator Surcharges. The remaining revenue requirement was spread over all local exchange access services resulting in an approximate equipcentage increase of 4.75 percent.

In the second interim, Order No. 5354a, issued in Docket No. 88.1.2, in conjunction with Docket No. 88.12.55, price increases were approved for Listings Services, Special Access, Directory Assistance, and all recurring charges for local exchange access services, including flat-rated, message, and message exchange services. The price increases in all recurring charges for local exchange access services were made according to a .798 percent equipcentage amount. The Commission also granted USWC authority to institute a Late Payment Charge and a charge for its previously tariffed New Number Referral service. The second interim order was suggested by MCC and USWC through their January 19, 1989 stipulation.

The Commission reaffirms the rate design granted to USWC in Interim Order Nos. 5354 and 5354a, except as otherwise modified herein.

Stipulations

AT&T/USWC. The Commission finds merit in the stipulated agreement between AT&T and USWC regarding the issues addressed therein and adopts their stipulation with the exception of paragraph 4 thereof (see FOF Nos. 233-239, above for a summary).

The Commission finds that imputation is reasonable, in principle, but holds that further examination of this issue should be made in conjunction with the LRICs used to establish Carrier access prices, and the MTS price structure.

Acceptance of this stipulation has no bearing on the Commission's decision regarding USWC's proposed pricing flexibility for its 100 largest MTS business customers. The Commission does, however, agree that imputation should be addressed in conjunction with price detariffing intraLATA MTS, if MTS detariffing is proposed again.

NWTS/USWC. The Commission decision and discussion of the NWTS/USWC stipulation regarding DA charges, is found in Paragraph No. 309.

MCC/USWC. The Commission approves and accepts the stipulation between USWC and MCC regarding the suggested rate design stated on pages 3-4, paragraphs 7 a.-c. thereof, with the

amendments stated in Order Nos. 5354a, 5354b, 5354c and as otherwise modified herein.

In accepting and approving the three stipulations (only a portion of the AT&T/USWC Stipulation was accepted) submitted in this Docket, the Commission reminds the parties that all stipulated issues will be subject to full examination in USWC's next general rate filing (or other appropriate docket). In their stipulation, USWC and MCC agreed that neither party shall be deemed to have accepted, agreed to or conceded any particular ratemaking or legal principle underlying the agreed to revenue requirement. The Commission's acceptance of the three stipulations herein will have no bearing on its decisions in any future proceedings.

Detariffing

Following consideration of USWC's price detariffing proposals the Commission finds that the four detariffing criteria proposed by MCC are worthy of careful consideration. Those criteria are:

If the service is detariffed, the public should be protected from monopoly pricing; the detariffed service should not be essential to the public; the detariffed services' cost should be separable from the cost of providing monopoly service; if the service were detariffed, MB should not impose the

detariffed service costs onto local exchange ratepayers if the service proves to be a loss. (MCC Exh. No. 14, p. 53)

The Commission finds merit in these criteria, to the extent they are consistent with the decision making criteria set forth in the Montana Telecommunications Act. See < 69-3-801 et seq., MCA. The Commission expressly holds that the costs of a detariffed service should be paid by the subscribers of that service in its price. See < 69-3-807(2)(d) and (e), MCA. However, since USWC's LRIC methodology has been found unacceptable, the Commission is unable to set a price floor based on LRIC at this time. The Commission notes that a thorough and acceptable short or long run marginal or incremental cost analysis may be appropriate for determination of price floors for detariffed services. Further comments on these criteria and USWC's burden of proof of competition, per the Montana Telecommunications Act, are reviewed under each detariffing proposal below.

The Commission grants USWC's price detariffing proposals for the message portion of local Public and Semi-Public Coin Telephone Service, the recurring and nonrecurring charges for the installation, change in service configuration and recurring monthly charges for Speed Calling, Call Forwarding, and Three-Way Calling

features of Custom Calling, and the recurring and nonrecurring charges for the nonaccess portions of Centron services.

For reporting and tracking purposes, the Commission orders USWC to adhere to the following requirements regarding price detariffing of the message portion of public and semi-public Coin Telephone Service, Call Forwarding, Three-Way Calling, and Speed Calling. With respect to the custom calling services, USWC is required to provide the Commission and subscribers 40 day's written notice of intended price changes. With respect to the message portion of public and semi-public coin telephone service, USWC is required to provide notice to the Commission (and notice to the public through advertising) of price changes on or before the effective date. The Commission's purpose for these notices is so customers will be able to make rational purchasing decisions based on timely information.

All currently tariffed regulations, descriptions, and service quality standards will remain in effect. USWC shall also be required to comply with all applicable Administrative Rules in its provision of these detariffed services. Upon Commission acceptance of an adequate cost study, USWC shall maintain cost study results on file, with the Commission, for each and every

detariffed service. The MPSC approves the principle expressed by MCC (and accepted by USWC) that LRIC should be the price floor for detariffed services. The Commission requires USWC to address these issues further in its next case.

USWC is ordered to file with the Commission its marketing analysis for the detariffed services in this Docket. These reports must be updated and filed on an annual basis, on or before March 15 of each year, and must include market demand analysis, including own, cross and substitute price elasticities.

In the case of the nonaccess portions of Centron Service, USWC shall file with the Commission all contracts reflecting the outcome of price negotiations, and price changes on or before their effective date.

Local Public and Semi-Public Coin Telephone Message Service

The Commission finds USWC's proposed pricing flexibility for the message portion of local public and semi-public Coin Telephone Services has merit, and grants USWC pricing flexibility for these services. The Commission finds USWC's testimony is sufficient to justify detariffing under the factors set forth in Section 69-3-807(3) of the Montana Code Annotated.

The record in this case established that competition does exist in the coin phone market. However, the competition is not uniform throughout the state. Mr. Cooper testified "It is apparent from this that COCT vendors are directing their efforts to the more lucrative locations while Mountain Bell serves all areas which necessarily include many low revenue locations" (USWC Exh. 2, p. 4). In order to alleviate this concern, Mr. Cooper suggested that USWC be granted price detariffing for coin telephone service only "in those exchanges where there are customer-owned coin telephone use" (TR p. 961). USWC is not suggesting statewide detariffing, but to be allowed price flexibility only in those exchanges where there is at least one COCT (TR pp. 961-962). Mr. Cooper's proposal does not adequately address the problem of uneven competition in the state. A COCT could be placed in an exchange and later removed leaving the exchange without competition. Further, competition is not uniform throughout an exchange. For instance, downtown Missoula undoubtedly has COCTs. Florence, inside the Missoula exchange boundary, is a small town that probably does not have any COCTs. Isolated locations within an exchange with low coin volumes, such as small airports or rest areas, are rarely if ever served by COCTs. Rather than attempting to address the competitive nature of each possible coin phone location, the Commission finds

that a statewide uniform public and semi-public coin message rate will protect the public interest by precluding unjustifiably high coin rates in areas without competition. This appears consistent with one of USWC's goals in its proposed pricing policy (see TR p. 965, l. 20 - p. 966, l. 3)

Custom Calling Services

The Commission approves USWC's proposal to price detariff Three-Way Calling, Call Forwarding, and Speed Calling. The Commission finds USWC's Schedules 3, 4, 5, and 9 (USWC Exh. No. 2) to show a sufficient number of alternative providers of functionally equivalent customer premises equipment (CPE) and sufficiently support its position regarding Section 69-3-807(3), MCA. Furthermore, the Commission finds these CPE to be readily available from alternative providers as listed in Schedules 3 and 4.

Even though USWC may be able to provide the three Custom Calling features listed above at market-based prices, the Commission finds that revenues earned in excess of its revenue requirement may provide beneficial subsidies for basic residential services.

The detariffing granted herein, however, does not extend to "packages" of telecommunications services such as TeleChoice and packaged custom calling features. The Commission finds it is in the best interests of the public to retain full tariffs and regulatory authority for such packages.

Nonaccess Portions of Centron Services

The Commission finds merit in USWC's proposal to price detariff the nonaccess portions of Centron Services and notes, per Mr. Cooper's direct testimony (USWC Exh. No. 2, p. 9), that USWC has 11 percent of the Centron PBX/KTS/terminal equipment market.

Furthermore, the Commission finds merit in paragraph 9 of the stipulation between USWC and AT&T (USWC Exh. No. 26) in regards to USWC's proposed price detariffing of the nonaccess portions of its Centron Services. The Commission adopts this portion of the stipulation (USWC Exh. No. 26, Par. 9) and specifically states that certain portions of Centron Services will remain fully tariffed.

Those portions are Centron Network Access Registers, Centron Station Lines and common equipment including Direct inward Dialing, Touch Tone, and station number assignment.

The Commission finds that USWC has met its burden of proof regarding this issue under < 69-3-807(3), MCA, on pages 7 -

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11 of Mr. Cooper's direct testimony and his Schedule 9 (USWC Exh.
No. 2).

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IntraLATA MTS

The Commission finds USWC's application for price flexibility of intraLATA Message Telecommunications Service, as presented on page 24 of Mr. Cooper's direct testimony (USWC Exh. No. 2) and on pages 934 - 937 of the transcript, to be inadequate, and therefore denies this proposal. The Commission bases this decision on the factors listed in Section 69-3-807(3)(c) and (3)(d), MCA. Specifically, MCI maintains that since none of USWC's exchanges are equipped to provide intraLATA equal access, USWC carries all intraLATA calls initiated in an equal access Montana USWC exchange by customers who have subscribed to a nonfacility based carrier such as MCI, if the call is initiated with one-plus dialing rather than a 10XXX code (MCI Exh. No. 3B, p. 11). MCI maintains that since equal access or one-plus dialing parity has not been achieved across USWC Montana exchanges, there is no effective competition in Montana (Id. p. 10). USWC maintains that it has met its equal access obligation in Montana (USWC Exh. No. 2-R, p. 12). USWC further rebuts MCI (USWC Exh. No. 25-R, p. 12) by maintaining that a MPSC order requiring USWC to make intraLATA equal access available to other IXCs in Montana would place undue costs on general ratepayers and contribute little value toward creating a competitive marketplace. The Commission does not dispute USWC's assertions but finds them irrelevant. USWC's equal

access obligation under Judge Greene's Modified Final Judgment applies only to interLATA MTS. Neither of these arguments address MCI's concern regarding the lack of equal access in the intraLATA market. The Commission holds that USWC did not rebut MCI's position that the lack of equal access in Montana precludes effective competition, per se. Therefore, based on the IntraLATA equal access argument, the Commission holds that toll services provided by nonfacility based resellers in Montana are not functionally equivalent competition for USWC.

Secondly, the Commission holds that, in accordance with Section 69-3-807(3)(d), MCA, there is insufficient evidence in the record that supports a sound conclusion that just and reasonable rates will result in its granting USWC pricing flexibility for its 100 largest business customers. The Commission bases its conclusion on the following three premises:

First, the Commission finds USWC's MTS LRIC analysis (USWC Exh. No. 32-P, tab 4) to be unreliable, hence the Commission has no sound basis upon which to set a reasonable price floor. Second, even though USWC and AT&T stipulated imputation of carrier access charges in principle is proper and MCI states that some sort of imputation agreement is better than none at all (TR pp. 793-974), the Commission finds the record to be insufficient to make a

well founded decision regarding a proper imputation method.

Further investigation of an appropriate imputation methodology through the complete cycle of a general rate case will prove more meritorious. The AT&T/USWC stipulation (Paragraph 6) concedes a further proceeding is needed. Such a proceeding will allow the Commission to be able to examine more of the facets of this issue.

Third, the issue of time-of-day carrier access charges surfaced in this docket and the Commission finds merit in examining the benefits such rate designs would have on detariffed MTS prices in terms of maintaining just and reasonable rates. This includes the resulting price structures of all toll carriers.

As a tangential issue, the Commission finds that the data collected for the "Mountain Bell Survey of IntraLATA Competition: Montana" (DR STF02-MPSC-111A) may or may not have been collected randomly across LATAs (see TR p. 939). Hence, the Commission finds that it cannot base its decision on the results of this study, nor can it accept the revenue loss analysis presented in Mr. Cooper's Schedule 8 (USWC Exh. No. 2). Moreover, MCI contends that the survey results are not statistically significant, with the exception of the incidence rates (MCI Exh. No. 3B, p. 7). USWC did not rebut this claim. The Commission is also concerned that USWC

has not specifically identified its various customer subclasses within its largest 100 MTS business customers.

Late Payment Charge

The Commission finds the LPC proposed in this Docket has economic merit in encouraging customers to pay their bills on time. However, based on two broad premises, the Commission does not agree that 1.5 percent per month is an economically efficient rate. The first of these premises is from a marginal cost point of view and is summarized in Finding Nos. 289-291. The second premise is shaped by some of the more practical considerations necessary to achieve sound ratemaking objectives. This premise is summarized in Finding Nos. 292-296.

Two economic or marginal cost perspectives were reviewed before arriving at a 1 percent monthly rate: 1) the Company's avoidable cost associated with late payments, and 2) the consumers' marginal or "credit card" cost associated with late payments. First, the Company's economic or marginal cost rate would be set according to the interest cost USWC would avoid if all customers paid their bills on time. This rate is synonymous to the Company's cost of short term debt. According to USWC witness Mr. Brian

Johnson, this rate is currently 8.2 percent per annum or .68 percent per month with a 10 year historical range of 6 to 12 percent (TR pp. 238-239).

The "credit card" cost rate is summarized by Mr. Johnson (TR p. 240). This cost would be based on the rate a consumer would incur to borrow funds. Mr. Johnson states that this should be the rate "if the intent of the late payment charge is to get ... customers to pay their bill earlier." Mr. Johnson suggests that this rate should be the customer's cost of debt of about 18 percent.

According to Mr. Lane's direct testimony, the intent of the LPC is to "help offset expenses incurred as a result of carrying these (unpaid) balances each month" (USWC Exh. No. 31, p. 4). On an annual basis according to Mr. Lane's exhibit Schedule 1, page 1, the initial year's cost to implement the charge will be about \$81,000. Furthermore, the Commission finds that according to the Late Payment Charge Cost Study (Tab 17, Cost Filing Package, December, 1987, USWC Exh. No. 32-P) a 1.5 per cent per month charge would more than offset administrative and capital costs. Moreover, based on USWC's cost study, Mr. Lane's Schedule 1, Data Request No. MCC 11-017, and the testimonial record, a 1 percent per month LPC would also be compensatory.

The Commission has some concerns regarding the practical equity and consumer-oriented aspects of the LPC. The Commission is concerned that an 18 percent annual rate would result in confusion and resistance by ratepayers, due to its inconsistency with other Commission-approved LPCs. In addition, the Company's proposal to apply the LPC to all disputed bills which are not resolved in the customer's favor also invites ratepayer confusion and dissatisfaction. Many disputes are settled by some form of compromise without any clear "winner" or "loser."

Furthermore, the Commission finds that the ratemaking goal of price stability may not be fostered by imposition of the LPC. The Company states that its intent in requesting the LPC is partly to encourage timely bill payment practices by its customers.

General economic theory indicates that such may indeed be one result of the LPC. However, if customers do in fact change their payment practices, a revenue shortfall could result, which could then lead to additional rate increase requests from the Company.

Fairness in apportioning total cost of service among different consumers is another rate design principle that causes the Commission concern with respect to the LPC. Specifically, those customers who are having difficulty paying present tele phone

rates due to their financial limitations may pay a disproportionate share of the total LPC revenues.

The Commission also has concerns regarding application of the LPC to "alternative" or "deferred" payment agreements which are entered into by USWC and its customers. See Finding of Fact No. 16, Order No. 5354c.

The Commission also considered the advantages of only applying the LPC to late bills exceeding \$35 (or other alternative minimums); however, due to an absence of sufficient data in the record to calculate the revenue effect of such a change, the Commission will regretfully approve the LPC for late bills exceeding \$25, as requested by the Company.

Based upon the above premises, but with many of its concerns left unresolved, the Commission finds that a 1 percent per month LPC (compounded monthly) is a reasonable rate to meet the intent of the charge and is consistent with other LPC's approved by this Commission. Furthermore, the Commission holds that the LPC shall not apply to:

- a. Any balance of \$25 or less,
- b. Bills rendered more than 10 days after the bill date,
- c. Disputed bills during the period of the dispute, (regardless of whether it is resolved in the customer's

favor). However, the LPC shall apply to that portion of a bill not under dispute.

- d. Preferred payment date arrangements,
- e. Written contracts with payment schedules for construction of facilities to provide service, and
- f. Installment payment arrangements -- for installation charges, deposits, service and equipment charges, and any other pertinent charges for initiation or installation of service. See Order No. 5354a (Finding of Fact No. 36), Order No. 5354b and Order No. 5354c (Finding of Fact No. 18).

The charge shall apply to all other bills and charges, including what USWC terms "deferred" payment arrangements entered into between customers and the company -- ie, those situations in which disconnection for nonpayment is avoided following negotiation of a payment schedule with a customer. The total revenue impact of this LPC plan is estimated to be \$883,093.

The Commission requires USWC to address the Commission's concerns regarding the LPC in testimony it files in its next case before this body. USWC must track LPC revenues in sufficient

detail to quantify all information required in a. through f. below, and file the impacts of each item in its next case:

- a. The elasticity (repression/stimulation) effects of the LPC, based upon Montana experience.
- b. The LPC revenues from the various customer classes in Montana.
- c. The interrelationship between the LPC and the Company's termination policies, practices and experience.
- d. Revenue impacts of various minimum thresholds - including \$35 or graduated scales based upon Base Rate Areas.
- e. The Company's policies and practices regarding "alternative" and "deferred" payment arrangement agreements.
- f. Both technical information and Company policy with respect to the other public policy, equity and consumer-oriented aspects of the LPC. See Order No. 5354a (Finding of Fact Nos. 33-36) and Order No. 5354c (Finding of Fact No. 16).

The Commission is concerned about the legality of applying the LPC to certain parts of a bill -- namely, the Federal Excise Tax, the Customer Access Line Charge (CALC) imposed by the

FCC, the State \$.25 911 Fee, and the State Low Income Assistance Fee. The Company is also directed to address these concerns in its next rate case before the Commission.

The Commission finds it reasonable and appropriate to require USWC to provide adequate notification to its customers of the terms and conditions of the LPC. USWC shall provide said notice through the use of "bill stuffers," the content and format of which must be submitted to the Commission for review and approval. The LPC shall not be imposed upon any customer prior to the receipt of the bill stuffers.

Base Rate Area Changes

USWC filed tariff maps requesting changes to several base rate, locality rate, and suburban rate area boundaries in November, 1987 and January, 1988. The changes eliminated or decreased the zone increment charges paid by customers who were effected by the boundary changes. These boundary changes were approved by the Commission in December, 1987 and February, 1988 and have been in effect for over one year. USWC is seeking to recover its lost revenues from these changes in this Docket. No parties objected to USWC's proposal and the Commission will grant USWC's request. However, the Commission finds this kind of proposal to be inappropriate in the rate design section of a case. The rate design portion of a case is intended to address proposals to increase or decrease specific rates to recover a revenue deficiency or excess revenues set forth in the revenue requirement portion of an order. In this case, the rate changes have already been approved by the Commission and implemented by the Company. In this regard, the boundary changes approved by the Commission are similar to a Commission order changing rates during or after the test year.

These types of revenue changes are traditionally included in a rate case as a pro forma adjustment in the revenue requirement calculation (for instance, see Exh. USWC 9-R, Sch. 6, p. 7). In future cases, the Commission will resist requests to recover lost

revenues if they are not properly presented in the revenue requirement calculation.

Coin Telephone Service

USWC proposes restructuring the nonrecurring charges for the auxiliary terminal equipment offered to subscribers of Semi-Public Coin telephone services. This equipment consists of booths, shelves, and volume control handsets, which require installation at the customer premises. The current tariff requires an installation charge of \$50.20 for booths or \$36.95 for shelves. USWC proposes to remove these flat charges from the tariff and charge the time and materials rates set forth in section A3 of the tariff for this type of installation. No party to this proceeding objected to this change. The Commission finds that the change is reasonable and will have the effect of bringing the charges to individual customers more in line with the actual costs of each specific installation. Because this change will simply deaverage the installation costs for this auxiliary terminal equipment, there is no anticipated revenue impact.

As a means of reporting, USWC is ordered to file, with the MPSC, a summary of billing invoices for semi-public coin telephone auxiliary equipment installations, once every six months.

Such summaries must include the number of installations and the number of hours (and man hours) worked under the three different rate schedules listed in section A.3.1.2, subsection C.1, disaggregated by the structural materials encountered at each job site.

Extended Area Service

USWC is proposing to charge customers who currently have EAS an additional \$.25 fee per accessible exchange per month (see Finding of Fact No. 100). MCC recommends the Commission reject this proposal (see Finding of Fact Nos. 142-144). The Commission finds this proposal is contrary to sound public policy and therefore rejects the adoption of EAS increments. The LRIC study used by USWC to base this proposal has the same flaws as are outlined by the Commission in Appendix A to this Order. The Commission is also concerned about the universal service impacts of this proposal. The Company is proposing to implement the EAS charge on a nonoptional basis. The increment will range from \$.25 to \$1.25 per month depending upon the exchange in which the customer resides. USWC projects some repression will result from the implementation of this charge. This indicates that if this charge is implemented, some customers will leave the network. Since all of these EAS arrangements have been in existence for many years, the Commission finds it would be contrary to public policy and the goal of universal service to begin charging for this service based on flawed LRIC studies and a likely result of some customers discontinuing telephone service.

Directory Assistance

USWC is proposing to charge \$.40 per direct dialed DA call (currently priced at \$.37) and reduce the current free call allowance for these calls from five calls to one call (see Finding of Fact No. 86). MCC did not object to the increase in the DA rate per call. However, MCC proposes that the free call allowance only be reduced from five free calls to three free calls (see Finding of Fact No. 148). Pursuant to the USWC/MCC stipulation, Order No. 5354b in this Docket increased the rates for DA to \$.40 per call and reduced the free call allowance to three free calls. No other parties objected to these changes and the Commission finds that the rate increase and free call allowance reduction to three calls are reasonable and should remain in place on a permanent basis. The Commission agrees with MCC that a change to three free calls is more appropriate and less drastic than a change to one free call. The Commission finds that maintaining three free DA calls will also minimize customer confusion and frustration from this rate change.

USWC also proposes to discontinue the DA charge exemption for hotels, motels, Outwats, hospitals, coin phones and mobile phones. The requested charge for coin phones is \$.25 per DA call.

MCC agreed with this proposal. The Company also proposed to

increase the charge for operator assisted DA calls from \$.74 to \$1.35 to align this charge with the operator handled station to station rate. MCC did not object to this change. The Commission will not act on these proposals at this time. USWC failed to submit the impact on annual revenues that these changes would produce. If the Commission granted these changes, USWC would obviously generate additional revenues. Because the record does not contain evidence of the additional annual revenues which would be generated by this proposal, the stipulated revenue requirement has been included in the price changes for other services. The Commission would be granting additional revenues over and above the stipulated amount if these changes were approved. USWC may calculate the impact these changes would have on annual revenues and refile this proposal in its next case.

USWC and NWTS stipulated to a USWC charge of \$.32 per DA call provided by USWC (see Finding of Fact No. 239). NWTS will not charge USWC for carrier access charges or billing and collection services on these messages. The Commission finds this stipulation to be reasonable and approves the charges and conditions set forth in the stipulation. In so doing, however, the Commission is not indicating an acceptance of USWC's LRIC study for DA. Rather, the

Commission is willing to accept the \$.32 charge because it is the result of voluntary negotiations between the two parties.

USWC proposes a charge of \$.50 per DA call with no free call allowance to customers residing in the service territories of independent telephone companies (see Finding of Fact No. 132). MTA opposes a charging scheme for customers residing in member companies' exchanges that differs from the charges to customers residing in USWC's exchanges (see Finding of Fact No. 179). The Commission will not approve USWC's proposal at this time. In arriving at this decision, the Commission finds that the underlying DA LRIC study cannot be relied upon for the reasons set forth in this Order (see Appendix A, paragraph Nos. 42-43). USWC uses this study as a starting point for its calculation of the \$.50 DA charge. The Commission will not deaverage DA rates without accurate cost studies. However, the Commission finds some merit to USWC's argument that it costs more to serve customers residing in independent companies' exchanges. The Commission will consider implementing a different DA rate for these customers in future cases if USWC files LRIC studies as specified in this Order. The Commission is particularly concerned about the additional billing and collection costs incurred in the provision of DA to customers residing in independent areas. This charge was a significant

factor in USWC's request for a \$.50 charge. Billing and collection services provided to other carriers are not regulated. Therefore, independent companies could charge USWC an amount that greatly exceeds the billing and collection costs incurred in serving customers that USWC bills directly. If this is not reflected in the DA charge to those customers residing in the independent company exchanges, USWC will be recovering these costs from customers who clearly do not cause the costs.

Network Access Registers

Two price increases occurred in the two Interim Orders for the recurring charge for NARs. The Commission finds these increases to be sufficient in lieu of USWC's \$57,163 proposed increase in this Docket. The Commission also finds USWC LRIC studies unacceptable and, therefore, is reluctant to grant USWC any further increases in NAR prices until the Commission approves USWC's LRIC methodology and results. The Commission bases its denial of USWC's proposal to increase the nonrecurring charges for NARs on the same reasons.

OutWATS and 800 Service

The Commission denies USWC's proposed price restructuring of OutWATS and 800 services submitted in Ms. Round's testimony (USWC Exh. No. 27, pp. 7-9). The Commission bases its decision on its concerns regarding USWC's LRIC studies. The Commission is also concerned about reducing revenues and restructuring prices for OutWATS and 800 services in light of AT&T's concern regarding the imputation of CACs into toll service rates (see AT&T Exh. No. 1, pp. 7-17). The Commission's conclusions regarding these problem areas is elaborated in Appendix A of this order.

Block Usage Rates: Residence and Business

The Commission finds the Business and Residential Block usage options proposed by USWC (USWC Exh. Nos. 27 & 30) inappropriately priced, per the revenue requirement stipulation between USWC and MCC and the final rates for flat-rate basic residential and business services. That is, the 9- and 12-hour optional blocks for business and residential customers are priced higher than unlimited flat-rate services. Furthermore, the Commission finds that there is insufficient evidence on the record for the Commission to reprice these services in relation to the billing determinants for flat-rate service and local measured and message usage. Finally, the Commission finds the LRIC studies submitted in this Docket (USWC Exh. No. 32-P) to be unreliable. (See also Appendix A.) Based on the foregoing, the MPSC denies USWC's proposed block usage services. The Commission finds some merit in USWC's block usage proposals and will consider similar proposals in future rate cases, if requested.

Remaining Revenue Generating Rate Design

The following two subsections address the Commission's decision regarding the remaining revenue generating rate design in Docket No. 88.1.2.

Usage Charges

The Commission approves the proposed price changes for Business Message Usage services as proposed by Ms. Rounds (USWC Exh. No. 27, pp. 5-6). These price changes include an increase from \$.062 to \$.08 per message, for business, PBX trunk service, and Public Access Lines. MCC does not object to these proposals.

The Commission also approves the proposed price changes for Business LMS and the restructure of LMS mileage bands per Ms. Rounds direct testimony (Id. Sch. 3). The revenue increase associated with these changes is expected to be \$46,004.

The Commission also approves USWC's proposed residential LMS price changes, per Ms. Wilcox's direct testimony (USWC Exh. No. 30, p. 11, ll. 11-13). These changes consist of not only price changes, but mileage band compressions identical to those proposed for business LMS. MCC does not object to these changes. The expected revenue increase associated with these changes is \$14,579.

Nonrecurring Charges

The Commission approves USWC's proposed nonrecurring price changes as follows: First, an increase in the residential Company-initiated termination and restoral of service charges (per line), from \$14.95 to \$20.00, and a decrease of the same charge for business customers from \$61.40 to \$28.50. Second, an increase in the price to establish or change billing name responsibility from \$4.45 and \$11.05 for residence and business customers, respectively, to \$7.50 for both. Third, an increase for Measured Service Detail billing from \$4.45 to \$7.50 for residence service.

Fourth, an increase in the installation charge for Local Service Options (TeenLink) from \$35.30 to \$51.50. Fifth, a decrease the price for Centrex station number changes, for the first four numbers on the same order, from \$8.25 to \$7.50. Sixth, to reprice the remaining nonrecurring charges for the remaining price tariffed Centron 300 services, except NARs, including the station lines (see USWC Exh. No. 27, Sch. 4).

Seventh, the Commission grants USWC the authority to reduce the nonrecurring charge associated with installing or changing specific configurations of features for the remaining tariffed portions of Custom Calling, from \$17.75 to \$11.25. The Commission holds that these prices will remain tariffed and will

apply to installations of price tariffed features and combination packages which include tariffed features, for example, the Call Waiting feature (see Paragraph Nos. 279-281 above for the Commissions decision regarding price flexibility sought for Custom Calling features). The Commission also holds that these prices will apply, as tariffed, for feature configuration changes from a price tariffed to a price tariffed configuration, a price tariffed to a price detariffed configuration, and a price detariffed to a price tariffed configuration. Per USWC's request, the Commission approves USWC's request to reduce its installation charge for IntraCall from \$17.75 to \$11.25 (USWC Exh. No. 30, p. 7). Parties to this proceeding do not object to the above changes and the Commission finds them to be reasonable.

The anticipated revenue changes associated with the above listed nonrecurring price changes are listed in Table 1B, under the column labeled "Final Order Annual Revenues."

800 Service Circuit Termination on a Centron 6 or 30 Service -
Docket No. 88.9.33

The Commission approves USWC's proposal to terminate an 800 service circuit on a Centron 6 or 30 service (Docket No. 88.9.33) on a final basis. However, the Commission questions USWC's costing methodology in this case. Namely, that the cost for terminating an 800 circuit, as presented by USWC's witness Mr. Heberly (USWC Exh. No. 34), are based on company-wide estimates (TR pp. 901-903). The Commission questions whether or not these costs are homogeneous across the USWC 14 state service region.

CONCLUSIONS OF LAW

1. USWC is a public utility offering regulated telecommunications services in the State of Montana. < 69-3-101, MCA. The Commission has authority to supervise, regulate and control public utilities. < 69-3-102, MCA.

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

3. The MPSC has provided adequate public notice of all proceedings herein and an opportunity to be heard, to all interested parties in this Docket. < 69-3-303, MCA and the Montana Administrative Procedure Act, Title 2, Chapter 4, MCA.

4. The revenue requirement, rate design and rate levels approved herein are just, reasonable and nondiscriminatory. << 69-3-201 and 69-3-330, MCA.

5. USWC's applications to detariff certain custom calling services (Speed-Calling, Call Forwarding and Three-Way Calling), certain portions of Centron, Coin Telephone (local message charge) and a certain portion of the intraLATA MTS market, were complete; and adequate notice was given to interested parties. ARM 38.5.2711(3).

6. The MPSC deems it necessary and appropriate for a more complete public understanding of this order, that USWC provide a written summary of the proprietary information provided in this Docket which is discussed in this order (including Appendix A), for inclusion in the public record.

7. The MPSC may detariff regulated telecommunications services under such terms and conditions as may best serve the declared policy of the State of Montana, and pursuant to statutory authority, << 69-3-807 and 69-3-802, MCA.

ORDER

1. The USWC interim annual revenue increase of \$5,500,000 approved in Order No. 5354a (See also Order No. 5354) is hereby affirmed and approved as final.

2. The rate design and rate structure approved in Interim Order No. 5354a is hereby approved as final, except as modified in Paragraph Nos. 271, 276-286, 296, 300-301, 303-310, 312-317 of the Findings of Fact herein.

3. The January 19, 1989 stipulation between USWC the MCC, with respect to revenue requirement, is accepted and approved. The rate design suggested in the stipulation, however, has been modified herein.

4. The December 12, 1988 stipulation between USWC and AT&T regarding imputation of access rates and detariffing of certain elements of Centron, is accepted; except with respect to paragraph 4 of said stipulation. In view of the Commission's Findings and Decision with respect to USWC's cost studies, the Commission expresses no opinion regarding paragraph 4 at this time.

5. The December 13, 1988 stipulation between USWC and NWTS regarding HNPA555 directory assistance service, is hereby accepted and approved.

6. USWC's application for price detariffing of three Custom Calling services -- Speed Calling, Call Forwarding and Three-Way Calling -- is partially GRANTED. USWC must maintain a statewide uniform rate for these services, however, USWC may establish different prices for different customer classes (as such classes are defined by tariff). The MPSC retains tariffs for service standards and requirements for these services. USWC shall be required to provide subscribers and the Commission 40 day's written notice of price changes for these services.

7. The USWC application to detariff IntraLATA MTS (toll) for its largest business customers is DENIED.

8. The USWC application to detariff Coin Telephone (local message charge) is partially GRANTED. USWC shall be permitted to vary price for the coin telephone local message charge on a statewide uniform basis only. MPSC retains tariffs for service standards and requirements for this service. USWC shall be required to provide the Commission (and the public through advertising) notice of price changes on or before their effective date.

9. The USWC application for price detariffing of the non-access portions of Centron is GRANTED, as provided in the USWC/AT&T Stipulation. Specifically, Centron Network Access Registers,

Centron Station lines and Common equipment (which includes DID, Touch Tone and station number assignment) shall remain fully tariffed. The MPSC retains tariffs for service standards and requirements of all Centron services. USWC shall be required to provide notice of price changes to the Commission on or before their effective date including contract specific rates.

10. The Commission retains full authority and jurisdiction over both rates and service standards for "packages" of telecommunications services (such as TeleChoice and packaged custom calling features), which USWC may offer, even though such packages include detariffed services.

11. USWC is hereby ordered to prepare a written summary for the public record, of the proprietary information discussed in Appendix "A," and submit it to the Commission for review and approval on or before May 20, 1989. Said summary shall be placed on the public record pursuant to Paragraph 5(b) of the Protective Order issued herein on January 20, 1988.

12. USWC is hereby ordered to comply with all findings, directions and requirements of the Commission set forth in the foregoing Findings of Fact, including but not limited to Rate

Design: the Commission Decision (Paragraphs 241-317), Finding of Fact Nos. 22, 24-25, 29-30, 34-41 and 57, and Appendix A and B.

13. Docket Nos. 88.9.33 and 88.8.44 are hereby closed. Docket No. 88.1.2 remains open only with respect to the affiliated interests issues discussed in Finding of Fact Nos. 26-30. A Final Order on those issues may be issued at a later date.

14. USWC shall file rate schedules that reflect the revenue requirement and rate structure approved herein. The rates granted herein shall be effective upon filing and approval by the Commission.

15. All proposals, motions and objections not ruled upon are denied.

Done and Dated this 3rd day of May, 1989 by a vote of 5 - 0 .

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Vice Chairman

JOHN B. DRISCOLL, Commissioner

WALLACE W. "WALLY" MERCER, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Ann Purcell
Acting Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.

ACRONYMS

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| 31 | MTS/Toll | Message Telecommunications Services |
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| 4 | NWTS | Northwest Telephone Systems, Inc. |
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