Service Date: February 12, 2004

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

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IN THE MATTER OF	)	UTILITY DIVISION
Tariff Transmittal QLDC02-01	)	
by Qwest LD Corp. d/b/a Qwest Long Distance	)	DOCKET NO. D2002.12.153
Initial Tariff and Price List for Qwest Long	)	
Distance	)	ORDER NO. 6479d

FINAL ORDER ON TARIFF FILING

I. Introduction

A. Background and History of the Case

1. On December 9, 2002 Qwest Long Distance Corporation ("QLD"), the long distance affiliate of Qwest Corporation ("Qwest" or "QC"), filed initial tariff and price list pages pursuant to which it would offer service in Montana.

2. On December 23, 2002, the Commission authorized QLD to use existing IntraLATA tariff and price lists on file for QC in the InterLATA market, contingent upon the Federal Communication Commission's ("FCC") approval of Qwest's application under 47 U.S.C. Section 271 to offer service in the InterLATA market.

3. On December 26, 2002, QLD filed a motion for reconsideration of the December 23, 2003 NCA; the Commission denied the request.

4. On January 22, 2003 QLD filed a Motion for Interim Relief. On February 5, 2003 the Commission authorized Qwest to implement on an interim basis the December 9, 2002 filing with certain modifications.

5. On February 14, 2003, the Commission approved the price list and tariff pursuant to which QLD was authorized to do business in Montana. QLD began offering service on an interim basis in Montana on February 11, 2003.

6. On April 23, 2003, Qwest filed Tariff Transmittal QLDC03-02, requesting revision to the interim tariff. On May 7, 2003 the Commission rejected tariff transmittal QLDC03-02 but added it to Qwest's opening round of testimony for consideration in this docket.

7. On June 3, 2003, Qwest filed tariff transmittal QLDC03-03, requesting revision of the interim tariff. On June 16, 2003, the Commission rejected tariff transmittal QLDC03-03 but added it to Qwest's opening round of testimony for consideration in this docket.

8. On July 16, 2003 the Commission identified additional issues in this docket, and required Qwest to file additional initial testimony on the identified issues by August 18, 2003.

9. On July 23, 2003, Qwest filed a "Motion for Reconsideration of the Commission's Decision to Extend the Schedule in this Proceeding to Address Additional Issues."
The Commission granted the motion for reconsideration and eliminated the additional issues from the proceeding.

10. QLD is a reseller of long distance toll service in Montana.

11. On October 21, 2003, Qwest, through its long distance affiliate Qwest Services Corporation ("QCC") filed its tariff transmittal QCC03-01 pursuant to which QCC wished to offer service in Montana. Qwest stated that the "entry of QCC into the Montana market allows Qwest to complete the offerings of long distance service allowed by the 271 approval of the FCC in December 2002. With this tariff, Qwest will offer long distance service to the full market in Montana through its 272 subsidiaries."

12. This order addresses the tariff submitted to the Commission by QLD, and the terms and conditions upon which QLD is authorized to do business in Montana.

B. Evidentiary Rulings

13. At hearing, Qwest objected to the admission of certain data requests propounded by the Commission to the Montana Consumer Counsel. (TR 107-111.) As directed by the presiding officer at the hearing, Qwest filed its objections in writing on November 19, 2003.

14. The Commission sustained Qwest's objection to PSC-037; all other objections were over-ruled and data requests PSC-038 through PSC-049, along with all of the other data

requests admitted at hearing, are a part of the record on which the final decision in this matter rests.

15. PSC-037 was excluded from the record based on Qwest's hearsay objection. PSC-037 contained testimony of Dr. Greer from a prior docket, and the hearsay objection to the admission of that testimony was sustained. However, the Commission noted that Dr. Greer's prior testimony was a matter of public record and that the Commission may take administrative notice of public information as necessary. (NCA, December 17, 2003.) In addition, the Commission may rely on economic theories in issuing a final decision without admitting them formally into evidence in a given docket. Economic theories are within the Commission's experience, technical competence, and specialized knowledge used to evaluate evidence and reason to a conclusion. MCA § 2-4-612(7); see also Order No. 5354e in PSC Docket Nos. 88.1.2, 88.9.33, 88.8.44, paragraph 24. Consequently, although the Greer testimony attached to PSC-037 was excluded from the record, the Commission may rely on the theories put forth by Dr. Greer in reaching its final decision in this docket.

II. Summary of Testimony Filed

A. Initial Testimony

16. On June 12, 2003 MCC filed the testimony of Allen G. Buckalew, which addressed three issues: tying; costing/pricing; and service limitation (to voice only). Each issue is reviewed in turn.[1]

17. By tying its services to QC's local services Buckalew asserts that QLD denies customers choice: they cannot choose alternative local exchange providers if they otherwise would want QLD's long distance ("LD" or "toll" hereafter) service. QLD should not be allowed to tie QC's local exchange products through billing arrangements and discounts. If the reason for such tying – billing problems – might change, QLD's tariff continues to tie services by offering customers discounts for toll services if they use additional services. Buckalew emphasizes that he

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[1] Attached is MCC's response to data request PSC-037.

is not against "joint marketing," that is allowed, but adds that joint marketing and tying are different.[2] He also asserts that QC has a virtual monopoly in its service territory and that very little local exchange or intrastate toll competition has developed in Montana.[3] Combined, this creates a potential anticompetitive effect. Tying unfairly increases Qwest's local and toll market share.

18. Although not an antitrust proceeding, Buckalew advises the PSC to use antitrust laws as a guide, specifically Section 1 of the Sherman Act and Section 3 of the Clayton Act. These laws prohibit this type of tying arrangement if the impact is to lessen competition in an attempt to create a monopoly. To determine if the tying violates these laws, four rules-of-reason[4] are usually applied: (1) are two products (or services) involved? (2) does the seller possess sufficient economic power in the market of the tying product? (3) is there substantial commerce in the tied goods? and (4) are defenses of reasonableness absent?

19. Buckalew responds to the above four questions as follows. He concludes that there are two services involved. Second, although QLD has little market power in the interLATA market, QC has significant, virtual monopoly, market power in the local exchange market. Local exchange is the tying product and QC has market power. QCI is using its market power in the local exchange "…to enter the toll market faster than it could on its own." Buckalew doubts

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[2] QLD ties its services to QC's services under the rationale that it (QLD) cannot do its own billing. Assuming that QLD or QCC does its own billing, the customers still have a strong incentive to stay with QLD/QC due to package pricing. In addition, the tying was to end in March, 2003. (PSC -038(b))

[3] Citing FCC Report, "Statistics of the Long Distance Telecommunications Industry," May 2003, Table 16. (PSC -039)

[4] Dr. Greer recommended a per se ban on tying. That is, any tying under the corporate umbrella should be stopped. The courts are not so clear. Some use the rule of reason. Some apply the per se ban. For example, Section 1 of the Sherman Act was interpreted by the Supreme Court in the Standard Oil case as follows: "tying agreements serve hardly any purpose beyond the suppression of competition." According to Buckalew, the per se ban that Dr. Greer recommended in 1991 could and should be applied today in this case. (PSC -040) Tying should be stopped in any case and the advantage with tying is even more anticompetitive due to the fact that it is combined with below cost pricing. PSC -041(c). Buckalew was also asked about the relevance of Dr. Greer's D90.12.86 and Buckalew's own D94.2.8 testimony that held that the degree of and the type of regulation should have a relation to a firm's dominance as measured by its market share. Buckalew's response is the testimony in this case reflects the degree of regulation based on a company's market share and adds that the same theory is the common thread of all of the proposals and that his recommendation is similar to that of Dr. Greer's. (PSC -037)

most customers will know the difference between the local and the toll company and there is no difference on the Qwest Internet website. Third, although the toll market is not "workably competitive," there are competitors and substantial commerce. If QLD entered the toll market in a fair and non-anticompetitive way there would be an improvement in the competitive alternatives in the InterLATA toll market. Fourth, Buckalew does not view QLD's defense to use QC's billing system as reasonable especially given tying and that the tied toll product is priced below cost.[5] Many carriers do not have their own billing systems.

20. Buckalew also testifies that it is clear that QCI supports QLD's entry into the toll market with QC profits. This he asserts can be viewed as using monopoly profits to support competitive operations – clearly not permitted by federal law. Although QLD's toll rates do not cover the cost to provide service in Montana QCI can provide service at less than cost and make up the loss with QC profits. He notes that the Commission has reports that QC earns more than a reasonable rate of return. QLD should not be allowed to tie QC's local exchange products through billing arrangements and discounts or to give discounts based on whether a customer is a QC customer that buys more QC services to subsidize QLD's services.[6] QLD should be allowed to use OSS as needed and if available to other carriers.[7]

21. Buckalew finds that QLD's rates are not compensatory. Such rates should be based on QLD's actual costs for (1) toll services and (2) its actual access charges in Montana.[8]

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[5] As evidenced by the fact that there are stand-alone toll companies it is unnecessary to offer both toll and local together from a technical or operational standpoint. PSC -041(b)

[6] In response to PSC -002(a) QLD asserts that QC will do QLD's billing and Qwest will be involved in any bill corrections (PSC -002(e)). QLD may offer promotions such as paying the PIC switch charge. (PSC -001(b))

[7] Buckalew is concerned that QLD uses but does not pay for OSS, which he considers both a costing and a subsidy issue. (PSC -042(b))

[8] QLD initially asserted that it pays the access charges to originate and terminate toll traffic for their customers, that WorldCom does not pay such charges, and that QCC will pay access charges when it becomes the entity providing LD service. (PSC -017(a)) QLD supplemented its response correcting the initial response to state: "WorldCom pays the access charges. To clarify: QLD is a 'switchless reseller' and WorldCom is the underlying facility-based IXC." (see PSC 01-017S1). Buckalew asserts that both embedded and long-run incremental costs should be provided by QLD. (PSC -042(a)) Buckalew holds that even if WorldCom pays access charges QLD's cost studies must impute Montana access charges. (PSC -047(a)) Buckalew also finds the charges

None of the cost studies QLD produced have anything to do with QLD's actual or expected costs.[9] QLD basically provides toll services combining the facilities of others with its own. QLD needs local services from LECs like QC and toll facilities from carriers like MCI WorldCom. QLD provides no evidence of what it costs to provide the services it provides in Montana today. By QC's own estimate access charges are almost $.08/minute whereas QLD only includes (PROPRIETARY) costs per minute.[10] This result is wrong. QLD's study is proprietary, and although this is a "Montana intrastate filing," QLD's cost study weights access expenses by the number of lines in each state. As a result, Montana access charges are "virtually ignored." The study also is "heavily weighted to interstate" even though this is an "intrastate rate filing." QLD's study bears "no relationship to Montana access costs." As the study uses an average minute of use that combines originating and terminating access rate (PROPRIETARY) for Montana, QLD should explain why the rate used is almost (PROPRIETARY) the actual Montana charges that its affiliate QC claims. He concludes that QLD's study should be rejected.

22. Buckalew concludes that QLD's study has other problems that arise because it does not develop QLD's own costs. QLD's study is a hypothetical futuristic cost study.[11] The study has nothing to do with whether the rate that QLD charges is compensatory. It does not

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(PROPRIETARY) provided by QLD (in response to PSC -035 and 036) to be relevant to QLD's costs. (PSC -047(e))

9 In response to PSC -021 QLD states to not have studied the volume of traffic that will terminate on the other ILECs' systems in the state of Montana; the traffic that QLD terminates to an ILEC would be considered "transit" traffic if it passes through a tandem. The carrier access charges incurred to terminate intrastate calls at other ILEC switches are included in the average access cost of $.0229365 cost (PSC -030(b)); this $.0229365 access rate is an estimate of the national composite switched access rate (PSC -034(c)). Although no studies have been performed, QLD assures that its rates cover costs, in part, because assumptions of traffic splits in the cost study are based on historical interstate and intrastate traffic patterns that were used to calculate a weighted per minute of use cost of long distance. (PSC -030(a))

10 MCC has advocated that the cost of providing toll service by any Qwest affiliate must impute access charges. QLD's prices for Montana services must recover access charges, which Qwest has estimated to be equal to about $.08 plus QLD interexchange, marketing, operations, and administrative costs. The $.08 is only access, and QLD should impute the access charges that are paid to other toll carriers in Montana in its rates. (PSC -043(a)) Buckalew does not recommend a threshold above costs to set price. Prices should be set above costs, including QLD's costs and the cost of access. (PSC -044)

11 The QLD cost study results are based solely on the forward-looking costs of an efficient IXC serving the entire long distance market served by QLD corporate entities. (PSC -034(b))

reflect the costs of QLD's operation in Montana. The studies are neither embedded nor historical and do not measure prior investment decisions. Instead, the studies estimate the long-run incremental costs that an efficient IXC (interexchange carrier) will incur, a least-cost scorched-node scenario of the cost to fully replace the network nodes Qwest uses to provide service. In addition, QLD should explain how it justifies its projected use of unlimited (PROPRIETARY) minutes per month (p.12).

23. Buckalew concludes that QLD has not demonstrated that its toll prices are above cost, adding that QLD has not even studied its costs. Even if the PSC uses the study and corrects for Montana specific access costs, the rates are not compensatory. For example, the rates for QLD's $.05 and $.07 plans and the preferred unlimited promotional plan are priced below costs using the costs in QLD's hypothetical least cost scenario, combined with the cost of Montana access. And, QLD's rates for unlimited and preferred unlimited are priced above costs only if QLD's average use forecast is correct. Buckalew recommends that the PSC require QLD to produce its cost of doing business in Montana and a better measure of usage.

24. Buckalew finds unreasonable QLD's proposal to limit calls to voice only calls under the unlimited long distance plans.[12] The limit violates universal service principles in Section 254 of the 1996 Act. Access, local or toll, to advanced telecommunication and information service should be provided in all regions. As the FCC stated that access to Internet and information services is provided using telecommunications services, it follows that access to the Internet or any other data provider is a telecommunications service even though the traffic is data, not voice. The limitation also violates Section 255 of the 1996 Act in that in excludes hearing impaired devices. Under 201(b) of the 1996 Act QLD cannot classify telecommunications services as data or voice and thereby limit traffic to voice. The PSC must reject tariff language that limits service to voice only.

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[12] QLD asserts that the way a customer must demonstrate to the Company that its use is not fraudulent is that, in part, the calls are voice calls. (PSC -006(b)) Buckalew asserts that telephone companies cannot dictate to consumers what type of traffic can go over their lines. The concern here is similar to the constraint Ronan attempted to include in D2000.1.14. (PSC -044(c))

25. In summary, Buckalew testifies that QLD's rates should remain interim approved until June 2004 and that the tying QLD's services with QC's should be terminated. QLD must provide toll services to any customer in its exchanges. Discounts for services should be based on QLD's cost structure, not the LEC's cost structure. By June 2004 QLD should justify its rates with its own costs.[13] On a monthly basis QLD should provide and report: (1) the customers for each service, (2) details on its actual costs and the costs allocated from QC and (3) the costs QLD pays to lease facilities and the amount of usage over those facilities. The PSC should open its own 272 proceeding to ensure QC is not subsidizing QLD or any other affiliate. He concludes that the Commission should eliminate tariff language limiting service to voice only service.[14]

B. Rebuttal Testimony

26. On July 18, 2003 QLD filed its rebuttal testimony. This section reviews in turn the rebuttal testimony of David Teitzel, Teresa Million, Dr. William Taylor and Larry Theis. Teitzel addresses market competition, Million addresses costs versus rates, Taylor addresses allegations of improper tying and pricing below costs and Theis addresses tying and antitrust law.

1. David Teitzel

27. Teitzel's testimony addresses the competitiveness of Montana's toll market and the voice only restriction issue raised by Buckalew. As for the competitiveness of the Montana toll market Teitzel reviews prior PSC findings, MCC testimony and provides evidence on the state of competition. First, he asserts that Buckalew wrongly asserts that the Montana toll market is not competitive. As contrary evidence, Teitzel notes the Commission's finding (D99.8.205) that the existence of 1+ presubscription was, among other factors, sufficient to fully detariff QC's business and to conditionally detariff QC's residential intraLATA toll services – actions taken over Buckalew's objections. Importantly, Teitzel adds that because QLD has no market share upon market entry that following Buckalew's standard the market can be considered "workably

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[13] If by June 2004 QLD has not satisfied the costing, tying and voice concerns that MCC raised, then QLD would cease to provide service with Commission approved rates. (PSC -046)

[14] The Montana Commission is allowed by 261(b, c) of the 1996 Act to impose requirements necessary to further competition as long as they are not inconsistent with the FCC's regulations. (PSC -045)

competitive" and QLD's services detariffed.[15] The standard he references is Buckalew's recommendation to use a 30% threshold on market share to determine whether a market is competitive.

28. As evidence of competition Teitzel states: (1) there are 479 registered toll carriers (480 with QLD's entry)[16] but adds that it is uncertain which carriers are active even though at least 100 different plans (inter- and intra-state) are apparent from a review of "ABTolls" website; (2) in its other common carrier (OCC) dockets (D88.11.49 and D94.2.8) the PSC relaxed its regulations (no rate of return, elimination of maximum allowable rates and no carrier access charge flow through) for certain IXCs and that the PSC determined (Order 5778h) that no further action pertaining to the interLATA market is required; and, (3) in the 1997 session the Montana legislature repealed the "equal regulation," followed by the PSC's waiver of tariff filing requirements for "reseller IXCs." Teitzel then lists IXC plans that he asserts are competitive with QLD's. Based on this comparison of rates he concludes that the toll market in Montana is robustly competitive.[17]

29. Teitzel next describes QLD's initial and revised tariff filings and then reviews the offerings of other IXCs. QLD's six initial residential offerings are "offered in conjunction" with interstate plans. With presubscription customers may select QLD as their interstate/intrastate/interLATA carrier or they may select QLD for these interLATA services and their intraLATA service provider. They may not choose QLD as their intraLATA service

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[15] Teitzel was asked whether the D88.11.49 and D94.2.8 policies should apply to how each of QLD and QCC are regulated. He replied that the "relaxed regulatory treatment" granted in D88.11.49 and D94.2.8 should be applicable to QLD at market entry as QLD is merely a new entrant with no market power. (PSC -059)

[16] Two requests seek revenue information for these carriers. Qwest has objected to these data requests on the grounds that they seek revenue information concerning Qwest Corporation that is not publicly available or accessible to QLD. (PSC -049 and PSC -051)

[17] As for the competitive nature of toll markets in Montana, QLD has responded that Section 272 of The 1996 Act requires regional bell operating companies like Qwest to offer in-region InterLATA services through a separate affiliate. QLD adds that "No other company that provides toll service in Montana has the same statutorily mandated 'corporate relation' that QLD has to Qwest. However, Section 272's separate affiliate requirements make clear that QLD is to operate separately from Qwest. In that sense, the requirements of 272 place QLD in the same position with respect to Qwest as all other toll carriers in Montana." (PSC -051(c)) (emphasis added)

provider, as QLD does not provide the service on a stand-alone basis. As an example, QLD's "Preferred Unlimited" plan allows residential customers "unlimited" domestic LD calling for $30/month. Revisions to QLD's initial filing, including a $10 month credit "promotion" for the "Preferred Unlimited" were not approved. Where QLD received 272 approval, 12 of 13 states have approved QLD's plans and promotions. Companies in other regions offer "unlimited" plans and other Commissions have not restricted these "unlimited" plans.[18] No other Commission has investigated RBOC pricing after 271 approval was granted.[19]

30. As for bundled services, Teitzel testifies that QSC does not require its customers to purchase QLD's plans. He adds that there are other providers of bundled services, such as MCI's Neighborhood Complete package that includes local and toll service for $69.95/month after the first invoice. He adds that J.D. Power's July 1, 2003 report finds that bundling is a reason for price reductions adding that customers find higher satisfaction with bundled services than those customers not taking bundled service. He adds that MidRivers competes, as a CLEC, with QC and does not offer its LD service to other company's local service customers. There is no difference in how QLD and MidRivers offer service.

31. Teitzel explains how other carriers profitably offer plans that are priced at or below Qwest's switched access rates by averaging the costs associated with all plans across all

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[18] As for the Commission's rejection of Qwest's 5,000 minutes of use, "Qwest" states its intent to add a footnote to the QLD rate schedules that reflects the "Montana required monitoring level of 1,250 minutes." PSC -003(e)) In a May 27 data response, QLD explained why it continued to advertise residential voice allowing: "…5000 minutes of state-to-state calling (and first 1250 monthly minutes of in-state calling in Montana)." QLD's response is, in part, that "…Qwest will <u>review</u> the advertising disclaimer for clarity on a forward going basis." (PSC -026(b)) (Emphasis added.) In response to what it meant by "review" Qwest states: "…the staff appears to be asserting that it is confused as to the meaning of the advertising disclaimer. The answer was meant to assure the staff that Qwest will review future advertising disclaimers with staff's concerns in mind to ensure that the disclaimers clearly indicate that if both intrastate and interstate usage exceeds 1,250 minutes the Fraud Detection group is triggered." (PSC -033); Qwest adds that it did not disregard the Commission's order and adds that if a customer's usage exceeds 1250 minutes, there will be a determination that the usage is consistent with the plan. In this regard, there is no per minute rate for "voice" usage in excess of 1,250 minutes (PSC -006(d, e)) and the 1,250 minute gauge applies only to intrastate traffic (PSC -007). As for other rates in QLD's interim approved price list, QLD asserts that the "monthly flat rates" apply to both interstate and intrastate service. (PSC -003(d))

[19] Qwest estimates to have spent over $3 billion dollars to open its markets to competition in compliance with the 1996 Act. (PSC -049, PSC -059)

states where the plans are available (he qualifies this testimony to note the exclusion of, for example, monthly fees or other tariff requirements at page 12). Carriers that provide an array of services in multiple states offset the high cost of service in some states with the high margins in other states.[20] He concludes that QLD's prices cover cost and that QLD does not operate any different from other multi-state providers.

32. Teitzel finds incorrect Buckalew's contention that the parameters in QLD's unlimited LD plan tariffs unlawfully impose use restrictions. First he restates that the plans are available to residential customers for voice communications adding that they contain a "usage parameter" to ensure the plans are used for the purpose intended. If, for example, a business customer made home use of such a plan for continuous Internet access, the user would drive up the level of average use and the price for all users: "…the 'voice only' parameter is to ensure that a small minority of data users do not drive up average usage of the unlimited plans to the point at which the price of plans would need to increase to unattractive levels." Thus, he asserts that "reasonable usage parameters" ensure that the plans serve the needs of customers who originate voluminous outbound toll calls. He adds that PSC tariffs have long distinguished between local service, business and residence, customer types. Such class distinctions are lawful and similar to the voice-type use restriction on the residential unlimited LD plans. He adds that MCI's "Neighborhood" service restricts residential use. A monthly fee will be assessed for "data usage" in excess of 5000 minutes/month.

33. Teitzel also finds incorrect Buckalew's suggestion that QLD's limiting of use on the unlimited LD plans would exclude hearing impaired services as the "voice only" limit does not apply to hearing impaired devices. Customers with impaired hearing will be allowed to connect devices to use the unlimited LD plans.

[20] Whereas Teitzel testifies that the Qwest 10 Cent Single Rate Plan "offers state-to-state and in-state calls…" the tariff states that the plan allows customers to complete calls between any two points within the state but is provided in conjunction with an interstate plan. Teitzel asserts there is no inconsistency as the state tariff states that the intrastate plan works in conjunction with the interstate plan and "in conjunction" means that the QLD offerings "<u>always include interstate calling capability</u>." (PSC -055) (emphasis added)

2. Teresa Million

34. The purpose of Million's testimony is to rebut Buckalew's contention that QLD's toll service is priced below cost. She explains that QLD's cost study calculates the costs of toll services and is a valid basis to determine that QLD's toll rates cover relevant incremental cost as required by the PSC's rules.

35. Million testifies that Buckalew incorrectly implies that QLD's rates are not compensatory. PSC rules (ARM 38.5.3720) state that "all interexchange carrier rates must be above relevant costs" while the law (MCA 69-3-811(2)) describes "relevant costs" as "…including the price for any components that are used by the telecommunications provider and that would be essential for alternative providers to use in providing the competitive services pursuant to Commission-approved methodology." She notes that the filing requirement for new services (ARM 38.5.2735(1)(f)) includes the relevant incremental cost of providing the service. She adds that the industry standard for cost is TSLRIC (total service long run incremental cost). QLD's TSLRIC models the "forwarding-looking, long-run incremental costs that an efficient IXC will incur for the components essential to providing long distance services." Such costs include switching, transport, network access channels, billing & collection, marketing and access charge expenses. She adds that Buckalew does not argue that the components QLD includes are an incorrect basis for toll rates. She concludes that QLD's toll rates are compensatory.

36. As for Buckalew's criticism that QLD's rates are not Montana specific, Million explains that QLD's toll rates and rate structures are designed to align with the marketing plans of the IXC industry and involve "common rates" and combined services. In PSC docket D90.12.86 AT&T, MCI and U S West stipulated to a method to compute long distance rates, that all parties agreed that the costs be established on a "service basis" and that the rates cover the "*aggregate*" cost of providing service, which QLD interprets to mean "all pricing plans" would be set above the relevant cost. She adds that the PSC approved the stipulation (Order 5535g). Million also notes that the services that are the subject of this docket are ones used by the customer for "either interstate or intrastate calls, similar to the services offered by QLD's long distance competitors in

Montana." As there is, "no Montana stand-alone intrastate service" Million asserts that basing costs solely on Montana inputs would not be a relevant cost basis.

37. Million asserts that the QLD cost study approximates the forward-looking costs of an efficient IXC that serves the entire long distance market and that realizes efficiencies in switching and transport of calls by using multiple transport rings. The modeled network includes seven levels of rings each of which serve multiple states. Customers served by this "unified network" use the rings regardless of the intrastate or interstate nature of their calls and therefore "share" the cost of the rings. She concludes that this "forward-looking architecture" cannot be modified to show a network that exclusively serves a single state because of the sharing of resources and costs in the model.

38. Other reasons that Million gave for calculating costs on an average basis stem from the 1996 Act. She asserts this section requires IXCs to use the same rates across urban and rural areas and across all states for interstate toll rates:

> *the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other state.* (254(g))

39. Million interprets this section to protect customers from, in part, fluctuating rates within states with varying cost characteristics. She adds that because the FCC's "rate integration rules" (Title 47, 64.1801(a) and (b)) adopt this requirement the long-distance carriers Teitzel lists develop national pricing structures like the ones QLD developed in this docket.[21] She concludes that the cost of providing service under such national price structures is a national measure. She adds that "If the service applies to both interstate and intrastate usage, then the cost study should

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[21] Buckalew asserts that there is nothing in the rules or the Act that says that intrastate rates have to equal interstate or vice versa. (PSC -048) In response to a question of how Qwest has proposed to change its intrastate rates to comply with the 1996 Act, QLD states that the referenced section of Million's testimony, to which the question refers, concerns the obligations of "interexchange carriers" pursuant to the 1996 Act and that <u>neither Qwest nor U S West has ever been an interexchange carrier</u>. (Emphasis added.) The response adds that the FCC's rate integration rules only apply to interstate rates. (PSC -054)

be developed on the same basis, just as QLD has done…" She finds that this practice is good for consumers.

40. Million concludes that QLD's toll prices exceed the incremental cost developed in its TSLRIC study. The study calculates the TSLRIC for toll at $.041660/mou based on 165 minutes (she notes Buckalew's questioning of the difference between the average minutes of use in the study versus in the unlimited toll plans). QLD uses the same approach to price its toll services as its IXC competitor's use. She adds that while they are irrelevant here that QLD's prices are in the aggregate higher than short run costs both from an IXC perspective and the perspective as an interim reseller of IXC services. QLD's toll prices exceed its short run Montana costs as reseller costs for a recent three month period resulted in short run costs considerably less than QLD's aggregate toll rate plans if Montana's interstate and intrastate usage are combined (PSC -036).

3. Dr. William Taylor

41. Taylor's testimony addresses allegations in Allen Buckalew's testimony that include (1) improper tying and (2) non-compensatory pricing.

42. Taylor explains why neither of Buckalew's allegations has any merit. He asserts that Buckalew's application of tying is incorrect as it fails to establish any evidence of improper tying. QLD and QC offer their services in a manner that is standard fare in the telecommunications industry. Second, he argues that Buckalew's view of QLD's LD offering in Qwest's 14-state service region is narrow and unrealistic. Buckalew ignores that QLD's pricing is uniform both within and outside its service region, like that of AT&T and MCI. He states that Buckalew's comparison of intrastate access charges to QLD's LD retail price in Montana is indefensible and unjustified.

43. Taylor restates certain of Buckalew's claims: (1) that QLD ties its LD services to QC's local services, thereby preventing the customers from choosing alternative local exchange providers if they want QLD's toll service; (2) that Buckalew takes exception to the current practice of bundling (QC's local service and QLD's LD); (3) that "QC has a virtual monopoly in its service territory"; (4) that due to the minimal competitive development in Montana, this type

of bundling constitutes a "potential anticompetitive effect" and (5) that "tying…will unfairly increase both its local and total market share."

44. Taylor restates the four criteria from the Sherman and Clayton Acts, which are the basis of Buckalew's testimony on the issue of tying. Taylor then restates Buckalew's findings adding his initial comments. (1) Buckalew identifies QC's local service and QLD's LD, (2) Buckalew alleges that QC has "significant market power (i.e., virtual monopoly)" in Montana, while conceding that QLD has "little market power" in the InterLATA long distance market, contending that offering of QLD's LD only in conjunction with QC's local service is evidence of use of local service as the "tying product," (3) Buckalew has conflicting opinions on the state of the market for LD – that there is substantial commerce in the toll market while the same market is not workably competitive and (4) Buckalew rejects any defense of reasonableness for the alleged improper tying of local and long distance services, especially when the tied toll product is priced below cost; Taylor adds that while Buckalew recognizes that "joint marketing" or bundling of QC and QLD's services should be permitted, that Buckalew takes exception to improper tying, which is how he characterizes QC's offering of local service together with QLD's long distance service.

45. Taylor argues that Buckalew's analysis of improper tying is fundamentally flawed, and thus, is no basis for reaching or accepting his conclusions. Taylor offers an explanation of improper tying (pp. 6, 7). An act of economic tying is where an entity leverages their market power for the tying good to force customers to take the competitively available tied good from them. He holds that Buckalew reversed the definition of tying.

46. A legitimate case of improper tying could be raised if QC's local service customers were required to also purchase a designated amount of QLD's LD (perhaps even at a price that is higher than that charged by other long distance providers). Taylor asserts this is not the case in Montana, nor is it the case to which Buckalew objects. Taylor further contends that Buckalew does not make the argument, nor does he have the grounds to do so, that QLD enjoys LD market power. The fact that a customer cannot take QLD's offering without first subscribing to QC's local service does not mean that a functionally similar service is unattainable within Montana, or

from elsewhere. Therefore, any charge of improper tying of QC's local service and QLD's LD is baseless.

47. Taylor further testifies that such bundling is commonplace throughout the telecommunications industry. IXCs acting as CLECs routinely bundle local and long distance services, as discussed in David Teitzel's testimony.[22] It is also common to see bundles of local exchange service with other competitive services like high-speed internet access or voicemail, without those latter services being provided on a stand-alone basis. The key is that those services are available competitively.

48. Taylor also testifies that the only economic advantage a firm could seek by implementing anti-competitive strategies, such as improper tying, is additional profits not otherwise available. The availability of "viable substitutes" prohibits additional profits being extracted from QLD's LD when bundled with QC's local service. The current bundled offering is the very opposite of improper tying. Any increase of the price of QLD's LD would cause customers to switch providers. Thus, without a monopoly position or market power in the supply of long distance service there can be no harm to competition or competitors in the markets for local and long distance services from the business decision not to supply QLD's LD on a stand-alone basis. Because QC's local rates are regulated QC could not charge a higher than market price even if QC's local customers were required to subscribe to QLD's LD.

49. Taylor has "great reservations" about Buckalew's contention that QC has significant market power. First, Buckalew does not identify the claimed market power domain and second he defines the "significant market power" as QC having a "virtual monopoly" in the provision of local service in Montana. Taylor testifies that it is unclear what a "virtual monopoly" is and how it translates into significant market power. The conventional definition of market power is the ability of a firm to raise the price of its service above the competitive level on a sustained basis, which cannot occur in competitive markets. It is not enough, and sometimes

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[22] Taylor has not undertaken a study of ILECs or CLECs in Montana that bundle their offerings of toll and local services. (PSC -056)

plainly incorrect, to equate market power with some arbitrarily defined high level of market share. Market share of unregulated firms is a frequent misleading indicator of market power.

50. Taylor testifies that the 1996 Act has further diluted whatever market clout ILECs may once have had. The 1996 Act considerably lowered entry barriers for CLECs and permits unhindered entry to the resale market. There is substantial evidence that CLECs have liberally used UNE-P to compete in the provision of local service to both residential and business customers.[23] He concludes that because of legal provisions that reduce the cost of entry, such markets are "contestable."

51. To demonstrate that there is no empirical evidence to support the contention that QC has significant market power Taylor rebuts Buckalew's testimony that QC has a virtual monopoly for local service. He testifies that this characterization suggests a concern with QC's market share. He adds that, although it provides no market share data from Montana Taylor infers from an FCC report that there is evidence that alternatives to QC's local service are being sought out by customers of the Montana market.[24] For example, the number of wireless lines in Montana increased to 315,000 in 2002 while the number of switched access lines that all ILECs serve in Montana fell by 20,000, from 1999 to 2002. In the face of the available empirical evidence, it is hard to sustain the inference that Buckalew makes about market conduct (the exercise of significant market power by QC) on the basis simply of current market structure (number of CLECs, market share of ILECs, etc.). Confusing one for the other does not advance Buckalew's analysis. Even if QC had market power, it gains nothing by requiring its LD customers to buy its local service. Customers are free to take QC's local service on a stand-alone basis. If QC had market power in the local market, it is possible that requiring its local subscribers to also subscribe to QLD's LD could conceivably be profitable and anti-competitive.

52. As for Buckalew's rejection of QLD's need to use QC's billing system as a reasonable defense for bundling, Taylor asserts that such bundling is not unusual or suspicious, is

[23] FCC, *Local Telephone Competition: Status as of December 31, 2002* ("*FCC Local Competition Report*"), Industry Analysis and Technology Division, Wireline Competition Bureau, June 2003.

[24] FCC Local Competition Report.

not surprising and is prevalent within the industry. Bundling allows for marketing and cost advantages. Economies of scope are a natural reason to provide services on a bundled basis. Customers benefit from discounted prices and absent any showing that the bundle is priced below the proper price floor, competitors cannot be harmed. Taylor notes that the FCC endorsed offering of service bundles at discounted prices, particularly those including local service as a component. The FCC views bundling as "offering of two or more products or services at a single price" and that "the local exchange market is not substantially competitive and because incumbent LECs have market power, we must balance the risk the incumbents can act anticompetitively with the public interest benefits associated with bundling." (pp. 13, 14)

53. Taylor finds it noteworthy that, apart from the benefits to consumers that accrue from service bundles offered at discounted prices, the FCC addressed the potential for anti-competitive conduct when more competitive services are bundled with less competitive services such as local exchange service. Taylor notes that a precaution advocated by the FCC, that "…the stand-alone offering, on non-discriminatory terms, of the less competitive service…" is clearly heeded in the present case by the fact that QC's local exchange service is available without any requirement that QC's customer must also purchase QLD's long distance service. Whether or not customers are aware of the difference between QC and QLD, the only unfair benefit that could arise would be from successfully pursuing an improper tying strategy as described earlier.

54. As for Buckalew's complaint of a strategy that the bundling of QC's local and QLD's long distance services unfairly exploits customer confusion over the differences between the local and the toll company, Taylor asserts that just as CLECs profit by offering bundled services, for consumers to have a full range of choices QC and QLD must be permitted to offer bundles of their services in the same manner. (p. 15)

55. Taylor next addressed Buckalew's allegations that (1) QLD's LD rates are not compensatory, (2) the cost study submitted by QC in response to MCC's data request does not develop QLD's own costs and (3) that even if the Commission corrected QLD's cost study for Montana specific access costs, QLD's LD rates remain non-compensatory.

56. Taylor testifies that alleged non-compensatory rates should be of concern to the Commission. In theory, the charging of non-compensatory rates can be potentially anti-competitive if it is part of a sustained and deliberate strategy to force equally-efficient competitors for the service to exit the market.

57. Taylor testifies that the Commission should be interested in two distinct, but related, issues. First, whether QLD's rates are non-compensatory in the circumstances in which QLD operates vis-à-vis AT&T and MCI. He adds that the relevant market for such IXCs is not uniquely intrastate long distance or interstate long distance, but rather "all distance long distance." He claims that intrastate long distance by itself is emphatically not the proper economic market. Thus, the Commission should expect any assertion of predatory pricing be made in the context of the correct market. Second, the Commission should determine that QLD's LD rates are non-compensatory using the same yardstick used for regional or national IXCs. Any comparison of rates and costs should be conducted in the properly defined market and account for whether the aggregate revenue from LD recovers the costs of those services. He finds that Buckalew's micro approach, that compares a toll rate with QC's intrastate switched access rate, fundamentally flawed because it fails to consider the correct product and market within which to conduct the test. It also fails to test whether the services in question as a whole recover their costs.

58. In addressing Buckalew's testimony that QLD's rates are not compensatory, Taylor analyzes his reasoning. He holds that Buckalew confuses QLD with QC, as QLD does not charge access charges: "Taking this as the implied view, Buckalew appears to argue that if QLD's rates do not equal or exceed QC's intrastate switched access charges in Montana, then those rates should be considered non-compensatory." Taylor also criticizes Buckalew for recommending the unclear "actual costs" concept (p. 17).

59. Taylor testifies that Buckalew fails to consider the situation in the relevant economic market implying this is significant for two reasons. First, as QLD is currently operating under an all long distance model, rather than specifically interstate or intrastate, as is standard industry practice and as a provider of regional or national long distance service QLD must be able

to charge customers everywhere averaged rates rather than state specific rates.[25] He adds that a hypothetical single supplier of intrastate-only long distance services could not successfully hold the market price above the competitive level if faced with competition from suppliers of both intrastate and interstate long distance services.

60. Taylor further argues that it is standard practice for regional or national providers to charge rates that are averaged across the nation. AT&T and MCI have a long-standing practice and legal requirement to offer averaged rates for interstate long distance service.[26] With averaging it is possible that AT&T's and MCI's rates appear "below cost" in any given state, including Montana. Buckalew neither investigates this possibility, nor brings charges of "non-compensatory rates" against either carrier or others that serve Montana customers alongside customers from several other states. For QLD, to not match this pricing practice or offer competitive rates would be both counter-intuitive and economically self-defeating.

61. Second, as a reseller of MCI's LD, QLD bases its short run cost on what it pays MCI for the service. By the "relevant costs" standard of §69-3-811(2) MCA,[27] QC's intrastate switched access charges in Montana, or any other state, are irrelevant. As long as QLD recovers in revenue (from its LD offerings) at least as much as it is paying MCI for the underlying wholesale long distance services and incurring in its own retail and other costs it cannot be pricing LD in a non-compensatory manner. Taylor notes that Million's testimony explains how QLD's rates are compensatory.

62. Taylor testifies that it is standard practice for regional or national providers to charge rates that are apparently below intrastate access charges in other states (e.g. QC's charges in Montana). Whether QLD's rates for intrastate long distance calls in Montana exceed its incremental costs is an improper test for predatory pricing or other anti-competitive behavior. QLD is a new entrant in a competitive long distance market, it has no market power in the

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[25] See the discussion of unlimited toll plans in Teitzel's rebuttal. These plans do not distinguish between intrastate or interstate long distance calls, nor do they charge separate rates for such calls.

[26] The 1996 Act, Section 254(g), and 47 CFR 64.180, (a) and (b).

[27] See Teresa Million's testimony.

market, it cannot drive other LD providers from the market by pricing below cost and it has no ability to recoup the profits lost due to predatory pricing. Pricing intrastate LD services below incremental cost—even if that were the case—would not be anti-competitive because intrastate long distance services are only part of the relevant economic market i.e., only part of the package of interstate and intrastate long distance calls that IXCs sell to customers.

63. Taylor also rebuts Buckalew's testimony that QLD's cost study does not "develop QLD's own costs." While the cost study may not pertain directly to QLD's current short-run cost, as a reseller, to provide such service, it also is not based on QC's intrastate access charges in Montana in isolation. The study constructs costs using a weighted average of imputed tariffed access charges from different states, varying by intrastate/IntraLATA, intrastate/InterLATA, interstate/IntraLATA, and interstate/InterLATA calls. Taylor testifies that this is the only sensible way to construct QLD's cost to provide regional and national long distance services. The intrastate access charges in Montana are only a small piece of this cost calculation. The study provides relevant costs, just not in the manner Buckalew seeks and which Taylor asserts is an inappropriate comparison of costs and rates.

64. Taylor concludes by addressing Buckalew's position that if the Commission were to "correct" the cost study for Montana-specific access charges, QLD's rates would remain non-compensatory. He claims that Buckalew's suggested correction is unnecessary and irrelevant. That access rates vary from state to state (including in each of the Qwest-served states) should have no bearing on the cost and rate comparison that Buckalew urges the Commission to perform. Taylor reiterates that any such comparison should look at the costs to resell MCI's service currently, and the nationally or regionally-weighted facilities-based cost to provide long distance service in the future.

4. Larry Theis[28]

65. Theis' testimony responds to that portion of Buckalew's testimony that questions QLD's requirement that in order to purchase QLD's long distance services in Montana, a consumer must also purchase QC's local exchange services. This is the so-called illegal tying arrangement. He finds Buckalew's opinion to reflect a fundamental misunderstanding of antitrust laws and adds that the QLD's proposal does not constitute a tying arrangement and is pro-competitive within the relevant market.[29] Buckalew's opinion is flawed as it fails to take into account the elements of illegal tying established long ago by the courts. The elements include first that there be two distinct products and that the seller must have market power in the market for the tying product sufficient to foreclose a "not insubstantial" amount of commerce in the "tied" product market (pp. 3, 4).[30] The Supreme Court held that only if patients were "forced" to purchase the contracting firm's services as a result of market power would the arrangement have anticompetitive consequences. The relevance of that case, the "Hyde" case, is to look at whether QC used its power in the local exchange market to "force" customers to purchase QLD's toll service. QC does not impose such a requirement. Therefore, and given the efficiencies inherent in "packaging," QLD's arrangement is pro-competitive. From an antitrust standpoint this is important to Theis because antitrust laws are intended principally to ensure the best products at the lowest prices and are not meant to protect individual competitors. Packaging serves this purpose. Another reason the arrangement QLD proposed "may not be a tying arrangement" is that the lines between the local and long distance markets have become blurred: because of the

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[28] As no curriculum vitae accompanied Theis' testimony he was asked to identify his regulatory and antitrust work experience that involved telecommunications. (PSC -057)

[29] Theis lists U S Supreme Court cases that affirmed the "black letter law" that a tying arrangement is illegal if the seller has some special ability generally "market power," in the tying product such that it can force a purchaser to do something that he would not do in the competitive market. (PSC -057)

[30] See the recent Supreme Court analysis of tying in the case that the defendant as alleged to have tied anesthesiological services to the use of the defendant's hospital rooms. The court held that the antitrust inquiry must focus on the hospital's sale of services to its patients and determine whether the hospital used its market power in the market for operating rooms (the tying product) to force patients to use the anesthesiological services (the tied product).

dramatic impact cellular phones have had on the local and long distance market e.g., the “call anywhere” packages, the lines between IntraLATA local and long distance calls suggests movement away from separate markets and that there no longer are two products.[31]

III. Regulation of Telecommunications Carriers in Montana

A. Resellers

66. Prior to 1997, the resale of telecommunications service in Montana was exempt from Commission jurisdiction. In 1997 the resale exemption was removed by the Montana legislature (§ 69-3-805, MCA), subjecting resellers to Commission jurisdiction.

67. In response to long distance resellers filing interconnection agreements that contained toll tariffs, which required Commission approval, the Commission exercised its statutory authority under § 69-3-805(2) to waive the requirements of § 69-3-805(1)(e). (Minute entry of April 11, 2000 work session.) On August 15, 2000, the Commission clarified that the waiver of § 69-3-805(1)(e) requirements included price lists on file prior to April 11, 2000, allowing CLECs to withdraw tariffs or price lists on file with the Commission. (NCA, August 17, 2000, In The Matter of the Waiver, In Part, of § 69-3-805(1)(e), MCA.)

68. As a result of those actions, resellers in Montana have not been required to file initial price lists or tariffs in order to do business in Montana. The Commission stated in its August 17, 2000 NCA that the waiver of filing price lists and tariffs did not apply to “entities providing telecommunications service in Montana who are required to file tariffs or price lists by Commission order, rule or other provision of Montana law.” (NCA, August 17, 2000, In The Matter of the Waiver, In Part, of § 69-3-805(1)(e), MCA.)

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[31] Theis did not document the dramatic effect cellular phones have had on the local market. Instead of providing “scientific” facts, he asserts that his statement referenced an obvious fact. He adds that wireless is almost universally sold as a combination of local and LD and adds that many of the non-RBOC LECs “bundle” long distance services as well. (PSC -057) He adds that his testimony is not that there were no longer separate markets for local and long distance but that it is “arguable” that there were no longer two products for purposes of a tying analysis
As for promotions, QC pays the cost of its promotions and QLD pays the cost of its promotions and discounts. (PSC -011) Qwest has no plans to bundle local and toll service in ILEC territory, nor does QCC. ((PSC -028(a), PSC -33(c))

69. QLD is a reseller of telecommunications services in Montana, and absent a requirement by Commission order, rule or other provision of Montana law, is not required to file an initial price list or tariff under Montana law.

B. Other Common Carriers

70. In the 1980s, AT&T applied to reduce the degree of regulation imposed on it by the Commission. [32] The Commission granted part of AT&T's application for reduced regulation. The Commission granted AT&T's petition to flow through access charge changes to maximum allowable rates, but denied AT&T's request to price index maximum allowable rates. Order No. 5274a, November 30, 1987, in Docket No. 86.12.76; see also Order No. 5548 in Docket No. 88.11.49, paragraph 4.

71. In 1985, the Montana legislature passed into law § 69-3-807(5), which required all providers of comparable regulated telecommunications services within a market area to be subject to the same standards of regulation. MCA § 69-3-807(5) (1985).

72. As a by-product of the AT&T dockets, the Commission initiated a proceeding in November of 1988 in which it investigated the regulatory status of common carriers other than AT&T. The Commission issued a show cause order directing American Sharecom, Intermountain Digital Network, MCI, Touch America, U.S. Sprint and WestMarc Communications, Inc., to provide information regarding their regulatory status. Those carriers were referred to as the Other Common Carriers, or "OCCs." PSC Docket No. 88.11.49.

73. In the Show Cause Docket (88.11.49), the Commission decided to apply "a type of regulation" to AT&T that was "somewhat different than the type of regulation imposed upon MCI, US Sprint, Touch America and American Sharecom." PSC Order No. 5548, Docket 88.11.49, paragraph 56. The Commission determined that statutes and rules governing regulation of public utilities must be "interpreted in light of their underlying policies, purposes and intent. A basic rationale for the regulation of public utilities lies in the need to control the market power of some companies due to the existence of natural monopoly or other market imperfections. However, if the traditional economic or public safeguard reasons for protective government

[32] Docket No. 83.11.80 (Order No. 5044d); Docket No. 86.12.67.

oversight are less compelling or not present, a reduced form of regulatory control may be more appropriate, even though a company's operations fall within the definition of "public utility" under Montana law." Order 5548, Docket No. 88.11.49, paragraph 58; § 69-3802, MCA.

74. The Commission concluded that § 69-3-807, MCA authorizes the Commission to impose varying regulatory structures upon telecommunications carriers, based upon the level of competition in the relevant market and the consequent market power exerted by any given firm. Order No. 5548a, Docket No. 88.11.49, paragraph 60. Therefore, the Commission imposed a different level of regulation on AT&T than it did on the other common carriers (OCCs). Id., paragraph 61. The Commission sought to balance regulating the carrier with dominant market share (AT&T) with allowing the emerging competitive marketplace to take over the role of traditional regulatory oversight. The Commission concluded that until November 1, 1994, the Commission would regulate all interexchange carriers (AT&T and the OCCs) under an alternative regulatory treatment, requiring the carriers to file price lists specifying the prices charged for intrastate services. Order 5548a, paragraphs 109, 114.

75. AT&T requested reconsideration of the Commission's decision to regulate AT&T differently than the other common carriers. The Commission granted that motion and on reconsideration, entered an order setting in place the initial alternative regulatory scheme as applied to interexchange carriers. That scheme was to begin on November 1, 1994 and run for a period of three years. Under that regulatory scheme, carriers were required to maintain tariffs on file setting forth Maximum Allowable Rates, and containing complete descriptions, terms and conditions of all services offered.

76. In March of 1994 the Commission initiated a follow up docket, PSC Docket No. 94.2.8, to investigate the regulatory status of the OCCs, and to establish policies on the best level of equal regulation for AT&T and the OCCs, the regulated IXCs. Order No. 5778d, Docket No. 94.2.8, paragraph 9. In Docket No. 94.2.8, the Commission continued the relaxed regulation experiment from January 1, 1995 through December 31, 1997, in which the following regulatory scheme was implemented for IXCs: price regulation was suspended, and price lists would be effective on seven days notice unless challenged; promotions would only be available as part of a

tariff filing; tariffs would not contain separate rate and prices sections; filing fees would not change; the Commission would continue to exercise jurisdiction over customer complaints; GAAP would be used as the method of accounting; and data reporting requirements would continue as specified by the Commission. Order No. 5778d, PSC Docket No. 94.2.8, paragraph 37; paragraphs 43 through 50.

77. In April of 1995 the Commission clarified that the following "entities" are subject to the relaxed regulation regime of the OCC Orders: AT&T; MCI; U.S. Sprint; TRI Touch America; American Sharecom; Econo Call; LDDS Communications, Inc (aka Dial-Net); Cable & Wireless, Inc.; One-2-One Communications; ITC Tele Services, Inc.; Wiltel, Inc. and West Coast Telecommunications. The Commission further clarified that introduction of new services by any of these entities would be subject to the same seven day filing requirement as price increases and decreases of existing services. Order No. 5788f, PSC. Docket No. 94.2.8, pages 2-3.

78. In 1997, the Montana legislature repealed the equal regulation requirement contained in MCA § 69-3-807(6), effective April 22, 1997.

79. Following the completion of the second three year experimental period of relaxed regulation for IXCs, in December of 1997, the Commission, through solicitation of comments from interested parties and workshops, addressed whether, and how, to continue the experiment of relaxed regulation. The Commission concluded that the relaxed regulation experiment should continue on a permanent basis. While this level of regulation was different than that applied to resellers, the Commission found that "the present regulation of other interexchange carriers has worked well since the experiment began and it is reasonable to continue that regulation at this time." Order No. 5778h, PSC Docket No. 94.2.8, page 2. The Commission concluded that the OCC docket needed no further action and that the Commission would continue to informally monitor market developments in the Montana intrastate long distance market. Order No. 5778h, PSC Docket No. 94.2.8, page 3.

IV. Findings of Fact: Commission Decision

A. Regulatory structure

80. The Commission finds that the OCC regime is most appropriate for the long term toll offering by the long distance affiliate of Qwest Corporation (in this docket, QLD). Although QLD is a reseller its affiliate status with QC and its transitional nature warrant regulating QLD within the OCC regulatory structure rather than the reseller regulatory structure. The Commission finds that QLD's entry into the long distance interexchange market will likely reduce market concentration and increase the competitive market in Montana. The Commission notes that should the competitive market conditions change as a result of QLD's entry, the Commission may exercise its regulatory authority over QLD in a comprehensive manner.[33] The Commission will require periodic reporting of QLD's market penetration as set forth below.

B. Relevant market.

81. QLD filed its tariffs for approval in the intrastate interLATA market in the State of Montana. At hearing, QLD argued that the relevant costs pertaining to these tariffs are those of the broader regional market in which QLD does business. MCC's witness concurred with the testimony of Qwest's witnesses that the intra and interstate markets are merging. See, transcript, page 54; page 96, lines 8-16. The Commission finds, although the intrastate and interstate telecommunications markets are legally distinct markets, this legal distinction does not delineate the relevant economic market. The Commission finds that regulation of QLD should be applied in light of the economically relevant market, which is the broader regional market in which QLD does business.

82. The Commission finds the degree of competition in the relevant economic market, which is the regional economic market, sufficiently robust to regulate QLD as it does the OCCs. The Commission finds persuasive the testimony presented by QLD that there are in fact no single suppliers of intrastate-only long distance and that such an entity could not compete with suppliers of both intra and inter state long distance service. See, paragraph 57 above.

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[33] In 1994, the Commission noted that while the "overwhelming evidence reveals an effectively competitive interLATA market today, that condition could be threatened by USWC's (Qwest's predecessor) entry" into the interexchange market (parenthetical added). See also Dissent of Commissioner Rowe in Order 5778d, noting that "underlying principles of universal service demonstrates that long distance phone service continues to be affected with significant public interests. These public interests confirm that the commission should not wholly abandon its

83. While QLD's testimony indicated that upon entry into the long distance market, other RBOCs captured on average about 25% of the long distance telecommunications market (TR 57), the Commission does not find this to be a significant impact on competition in the regional long distance market that would justify regulating QLD more stringently than other long distance carriers are regulated. Taylor and Buckalew agreed that initially, QLD's entry will reduce concentration, but tended to disagree about longer term effects.

C. Pricing and Costing

84. As evident from the above summary of testimony and the hearing record the MCC and QLD have opposing views on whether QLD's rates would cover cost. Mr. Buckalew's testimony asserts that QLD's rates are not compensatory as QLD's toll rates do not cover the cost of providing service in Montana and QLD, through its parent company QCII, can provide service at less than cost and QCII can make up the loss with QC profits. The MCC holds that the relevant costs includes QC's own access charges of about 8¢/minute plus 2¢ to 3¢/minute of additional costs for a total cost of around 10¢/minute. (TR 46, 75) Mr. Buckalew verified that the only direction that the interim rates could go to mitigate his concerns is "up." (TR 87-88)

85. QLD asserted that because QLD is a "switchless reseller" of MCI's wholesale service all of QLD's prices are above relevant cost. (TR 13) QLD's Ms. Million also testified that QLD's rates are compensatory because they include relevant incremental costs for services used by the customer for "either interstate or intrastate calls." Ms. Million adds that the cost study approximates a forward-looking cost model that cannot be modified for a state.

86. The Commission finds that while there is one relevant long distance telecommunications market in which IXCs compete the relevant costs include those identified in the MCC's testimony. At a minimum the cost for intrastate traffic is the roughly $.08 per minute carrier access charge cost in the MCC's testimony. This is a minimum as QLD must have some costs in addition to its out of pocket cost paid to just Qwest to originate and terminate calls on

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statutory responsibility to at least minimally ensure that rates for basic message toll long distance service are just and reasonable." (Dissent of Commissioner Rowe, Order 5778d, page 9.)

just Qwest's system. The MCC's Mr. Buckalew estimates that the additional costs range from $.02 to $.03 per minute.

87. However, because the Commission finds merit in similar regulations for QLD as for other common carriers, the Commission will not impose a specific cost-based price floor on QLD that would constrain the prices that QLD offers on an intrastate basis. The Commission's decision to not impose a specific floor critically depends on QLD's eliminating its exclusive offering of service to just Qwest basic exchange service customers. The reason for this condition is obvious: if QLD's rates cover costs, then QLD's rates should be equally available to all consumers, not just a subset of Montana consumers.

D. Interim Tariff Approval and Tying

88. This docket was not intended to address how best to regulate both QLD and QCC. However, the MCC's testimony raised a "tying" issue. The Commission's policy findings recognize concerns that emerged with and that are associated with the MCC's tying issue. The decisions here reflect a concern about QLD's exclusive offering of its services to Qwest basic exchange service customers. As the above earlier findings summarized the prefiled testimony of the MCC and of QLD, the following adds evidence from the hearing.

89. While Mr. Buckalew advised the PSC to use an antitrust framework to analyze MCC's tying concerns, in response to cross examination Mr. Buckalew agreed with that he was 180 degrees off on the proper interpretation of tying and antitrust. Mr. Buckalew, however, added that this is not a traditional antitrust case and if it were, the MCC would be at the U. S. Department of Justice claiming tying arrangements and an antitrust violation. (TR 90-91) Mr. Buckalew also testified that with QCC's October 21, 2003 filing that the MCC's "tying" concern is eliminated. (TR 89)

90. The Commission is cognizant of both the goals of Congress and of the Montana Legislature to open markets to competition, when it is in the public interest to do so. And, although the tying allegation by the MCC reverses the standard antitrust view, there remains a broader policy concern about linking eligibility for QLD's long distance service to taking Qwest's basic exchange services.

91. The Commission is concerned with how Qwest has once again conditioned the offering of one product to the ratepayer's subscription to a Qwest basic exchange service.[34] The Commission finds persuasive the MCC's testimony that "…all tying should be stopped."[35] The Commission's findings and conclusions in this docket are intended to ensure the requirement of taking Qwest local service will be eliminated as quickly as possible. To achieve this objective the Commission approves QLD's tariffs and price lists filed with the Commission as of June of 2003; no revised or new rates in tariffs and price lists will be approved by the Commission until QLD submits evidence to the Commission that its service is available to anyone in Montana, and is not contingent on a customer's taking local service with Qwest through QC.

92. The record is ambiguous regarding Qwest's plans to merge QLD and QCC. The record is ambiguous in terms of if, when, and how QLD will be merged with QCC.[36] Given this ambiguity, and the Commission's desire to make QLD's service available to everyone in Montana regardless of status as a QC customer, the Commission will not approve any new or revised tariffs and price lists until QLD satisfies the Commission that the tying of QLD and QC services has ended.

93. The Commission's interest is that Qwest, through its long distance affiliate (QLD or QCC), offer a single set of tariffs to all consumers in Montana. When a single set of tariffs

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[34] In Qwest's 271 docket (2000.5.70), evidence on Qwest's tying its offering of Megabit (DSL) service to a customer's subscription to Qwest's basic exchange service emerged. Qwest disconnects Megabit service if a customer decides to change to a CLEC for local voice service over the same loop. See the Commission's January 11, 2002 Final Report On Qwest's Compliance With Two Emerging Service Items: Line Sharing and Subloop Unbundling (D2000.5.70, pp. 5-10). In its August 1, 2002 Evaluation of Qwest's 271 entry bid filed with the FCC the Commission agreed that such tying is an entry barrier and that it is not in the public interest to allow Qwest to tie its offering of Megabit service to its offering of voice service. The Commission conditioned its approval of Qwest's 271 entry bid on Qwest's providing reverse line sharing for each mode of entry.

[35] See MCC data response to the Commission PSC -041 (c).

[36] In response to PSC -001 QLD asserts that once the financial restatement issues involving QCI are resolved that the transition to replace QLD with QCC will occur. However, in response to PSC -030(d) QLD disagrees that QCC will replace QLD. In response to PSC -053 QLD asserts "...if QLD ceases to exist, QCC would offer the same calling plans as those offered by QLD and QCC prior to a merger of the two companies." (emphasis added). At present, QCC is the entity that may replace QLD when its WorldCom contract terminates (PSC -012). QCC intends to offer services to "all" customers regardless of their underlying local service provider (PSC -016(c)). The Commission notes, however, that QCC's October 2003 tariff filing does not offer services to "all" customers regardless of their underlying local service provider.

emerges, the Commission would agree with the MCC that the Qwest local requirement arrangement that presently exists would be eliminated. Once QLD's exclusive offering of services to just Qwest basic exchange service customers ceases, and either QCC or QLD offers the same long distance services to all Montana basic exchange service customers, the entry barrier CLECs now face should be eliminated. In turn, a CLEC's customers and other ILEC customers will then have access to the same low-priced long distance toll rates that QLD offers exclusively to Qwest's basic exchange customers. The Commission finds that QLD may not offer service under price lists or tariffs submitted after June of 2003 until the concern regarding tying is eliminated. QLD and its parent may resolve the issue in at least three different ways (the following list is non-exclusive and illustrative):

a. Freeze offering QLD service to new customers;

b. Revise the QLD tariffs to eliminate the Qwest local restriction and ensure that QLD services are made available neutrally to al Montana customers;

c. Fully merge QLD into QCC, based on the absence of a Qwest local requirement in the QCC filing.

It is up to QLD to decide how to comply. QLD shall submit to the Commission a compliance proposal addressing this and the other issues identified in this Order. Once a compliance proposal is approved by the Commission, QLD will have the full benefit of the regulatory flexibility provided in the OCC structure.

E. Voice Only Restriction

94. Qwest is not permitted to limit traffic on any plan to just voice traffic. In this regard the Commission generally agrees with the concerns that the MCC raised: in addition to voice traffic consumers may use QLD's plans for data purposes. The Commission rejects the voice only restriction in the QLD tariffs. Any QLD offering must not be restricted to voice only and must allow data usage. This issue also appears to be resolved in the QCC filing, which provides additional incentive for QLD service to be migrated to QCC.

F. Minutes of Use

95. The Commission finds that QLD may apply the minutes of use as proposed in its initial tariff submitted on December 9, 2002. With respect to the minute of use threshold that triggers a fraud investigation, QLD is allowed to implement in its Unlimited Plans the 5,000 minutes of use threshold in its initial December 2002 filing. The Commission approves the minutes of use threshold as proposed by QLD in its December 9, 2002 filing.

G. Filings To Amend its Interim approved Rates

96. QLD filed on three occasions in 2003 amendments to its interim approved tariff. First, on April 23, 2003 QLD revised its interim approved tariff to reduce the rates on the 5 Cent Saver and 7 Cent Preferred plans from the existing level of 10¢ to 05¢ and 07¢ respectively. Second, on June 4th QLD filed a new plan that provides for a 5¢ per minute rate for all interstate and intrastate calls with a monthly $5.00 fee. Third, on August 13, 2003 Qwest filed to introduce several new consumer long distance plans and a new business plan. The three consumer (residential) plans offer rates at 15¢, 7¢ and 5¢. The business plan is an unlimited plan for $25 per month.

97. Mr. Buckalew testified that the April 23 amendments would set rates below cost. He also testified that the June 4, 2003 rate should not be approved. Mr. Buckalew was uncertain about approving the August 13, 2003 amendments due apparently to the rate design proposal by QLD. (TR 76)

98. Consistent with the Commission's previous findings regarding the relevant market and the application of the OCC regulatory structure to QLD, the Commission approves of the April 2003 and the June 2003 amended filings, subject to QLD meeting the terms of this Order.

H. OSS and 272 Concerns

99. Buckalew explained his concern that QLD does not pay for OSS (operational support systems). (TR 74, and Testimony, p. 8) He held that before the long distance business is given a clean bill of health there must be a 272 proceeding. He was not fully aware of the Commission's work on Section 272 implementation and the MCC had not been involved in the

272 audit. (TR 101- 106) In response to further cross examination, Mr. Buckalew explained the need for a further 272 proceeding, and that now is the time to look at the implementation of 272.

100. The Commission finds the OSS issue is not critical to decisions in this docket. There is the larger concern of whether Qwest affiliates are advantaged vis-à-vis competitors of QSC's affiliates (QLD and QCC) even if a valid 272 process is in place. The Commission finds merit in initiating a Montana 272 proceeding, in part, because of the MCC's recommendation and concern that the 272 process does not prohibit subsidies from flowing from QCI to QLD.[37] Such a proceeding should allow others such as the MCC the opportunity to review the affiliate relationship between QSC and its affiliates QLD and QCC, and will likely be established after the pending regional 272 audit is completed (see Finding of Fact 105).

101. Section 272 of the Telecommunications Act of 1996 imposes substantial structural and nonstructural safeguards applicable to the provision of in-region InterLATA service by BOCs, such as Qwest.

102. The 272 requirements are of crucial importance, because the structural and nondiscrimination safeguards of section 272 seek to ensure that competitors of the BOCs will have nondiscriminatory access to essential inputs on terms that do not favor the BOC's affiliate. These safeguards further discourage, and facilitate detection of, improper cost allocation and cross-subsidization between the BOC and its section 272 affiliate. These safeguards, therefore, are designed to promote competition in all telecommunications markets, thereby fulfilling Congress' fundamental objective in the 1996 Act.

103. In the multi state proceeding Qwest was required to have a third party independent testing, covering the period from April through August of 2001 to determine: (a) whether there have been adequate actions to assure the accurate, complete, and timely recording in its books and records of all appropriate accounting and billing information associated with Qwest Corporation (QC)/ Qwest Communications Corporation (QCC) transactions, (b) whether the

[37] As noted earlier, Mr. Buckalew testified that QCI supports QLD's entry into the toll market with QC profits. Similarly, the Commission previously recognized that the 272 process, in and of itself, cannot mitigate against an

relationship between QC as a vendor or supplier of goods and services and QCC has been managed in an arm's length manner, including, but not necessarily limited to a consideration of what would be expected under normal business standards for similar contracts with an unaffiliated third party, and (c) whether there are reasonable assurances that a continuation of the practices and procedures examined will continue to provide the level of accuracy, completeness, timeliness and arm's length conduct found in examining the preceding two questions.

104. KPMG performed this testing. The PSC reviewed the testing by KPMG, which found instances where Qwest was not in compliance. Qwest corrected those discrepancies and addressed each of them by strengthening existing controls or implementing new controls in efforts to avoid them in the future. The Montana Public Service Commission found in its final report on Qwest's compliance with section 272, that Qwest has controls in place that are "reasonably designed to prevent, as well as detect and correct" such discrepancies and is in compliance with section 272.

105. After the FCC granted Qwest market entry under §271, Section 272(d), requires Qwest to obtain and pay for a joint Federal/State audit every two years. An independent auditor must determine whether the company has complied with the requirements of Section 272 and the regulations promulgated under Section 272. This audit will have to examine the much-expanded relationships between BOCs and their affiliates. These audits are intended to ensure that Qwest commitments under section 272 are kept on a going forward basis. Currently this audit is underway with a joint effort between the Federal Communications Commission ("FCC") and state commissions. The Montana Commission participates in that audit. The independent firm of Ernst &Young is performing the audit and anticipates a draft report due by March 31, 2004. Depending in part upon the Report, this Commission may open its own section 272 review, and will closely examine the results of the multistate audit.

I. Customer Disclosures

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anticompetitive price squeeze (see Commission's July 5, 2002 Final Report on Qwest's Compliance with the Public Interest Requirement, pages 20 through 29.)

106. The Commission finds that QLD must include a bill insert that diagrams the total bill to the consumer of each of the residential rate options. Each time a new residential offering occurs, the rate on an existing offering is changed, or a promotional offering is tendered, QLD must again include a bill insert that diagrams all options. Such information is intended to enable consumers to make informed judgments about which of the long distance tariff offerings will be least cost.

107. New or revised tariffs and price lists will not be approved prior to the Commission approving the required bill inserts in accordance with this Order.

J. Reporting Requirement

108. The Commission finds merit in requiring QLD to file certain information. For each tariff or price list under which QLD markets intrastate telecommunications services in Montana, QLD must provide the number of customers served and the overall minutes of use that it sells on each such Montana tariff or price list. QLD must also report the same data for each interstate tariff that QLD offers in conjunction with the Montana intrastate tariffs. An initial report shall be filed within ten days of this Order. Subsequent reports shall be filed ninety days from the date of this Order, six months from the date of this Order, and every six months thereafter, either until QLD ceases marketing service to new customers or until the requirement is terminated by the Commission.

K. Regulatory Requirements of QLD

109. Once QLD has demonstrated, and the Commission has approved QLD's compliance with this Order, it will be regulated under the OCC structure. At that time, QLD will be regulated as follows:

- price lists shall be filed with the Commission;
- any proposed promotions shall only be available as part of a tariff filing;
- QLD tariffs are not required to contain separate rate and price sections;
- the Commission will continue to exercise jurisdiction over customer complaints;
- GAAP shall be used as the method of accounting; and

- QLD shall comply with the data reporting requirements specified by the Commission.

V. Conclusions of Law

1. The Commission has authority to supervise, regulate and control public utilities. Section 69-3-102, MCA. QLD is a public utility offering regulated telecommunications services in the State of Montana. Sections 69-3-101, 803, MCA.

2. Every public utility shall file with the Commission tariffs (schedules) that are in force at the time any service is to be performed by it within the State of Montana. Section 69-3-301, MCA.

3. QLD is currently providing service in Montana on the basis of interim rates. (Order No. 6479a, entered in D2002.12.153; interim rates approved on February 14, 2003.)

4. The rates that QLD is entitled to charge for service in Montana must be just and reasonable, and QLD has the burden of showing that the rates it proposes charging in Montana are just and reasonable. MCA § 69-3-201.

5. The regulatory regime the Commission will apply to QLD is that set out by the Commission in the OCC Orders. QLD shall be regulated according to the terms of the OCC regulatory regime, as specifically adopted in this order as set forth above.

6. The Commission approves QLD's proposed tariff subject to the specific reservations and limitations set out in this order.

VI. Order

THEREFORE, based upon the foregoing, it is ORDERED that:

QLD's tariff filing is approved, subject to the specific limitations and reservations as set forth in this Order.

DONE AND DATED this 5th day of February, 2004, by a vote of 4 to 1.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ROWE, Chairman

THOMAS J. SCHNEIDER, Vice Chairman

MATT BRAINARD, Commissioner

GREG JERGESON, Commissioner, Voting to Dissent
(Dissent attached.)

JAY STOVALL, Commissioner

ATTEST:

Connie Jones
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.

Dissent of Commissioner Greg Jergeson

As I analyzed the considerable data, testimony and evidence presented in the case, I struggled with the apparent conflict between the requirement of Montana statute that prices charged for telecommunications services must be above relevant costs and the scenario suggested in the Qwest application. While Qwest proposes to offer a 5 cent per minute rate, the preponderance of evidence presented was that it costs from 8 cents to 11 cents per minute to deliver a long-distance telephone call from one location in Montana to another. That confirms the frequent observation of Senator Conrad Burns that “there’s a whole lot of dirt between those poles in Montana” causing costs to be higher here than where customers are concentrated in such as urban centers like Denver, Las Vegas, Los Angeles and Seattle.

Based on evidence presented to the Commission, it’s obvious that the 5 cents per minute rate will not cover the 8 to 11 cent per minute cost of a call originating and terminating in Montana. It’s also axiomatic that the costs will be paid, somewhere, somehow, by someone. Who will shoulder the burden of paying those costs not recovered in the Qwest long-distance rates are not identified, not by Qwest, not by the Montana Consumer Counsel, and I certainly cannot identify them. However, in the highly networked system that our telecommunications services are delivered, when all the accounts are settled, someone will pay the costs. That someone could be customers of other Qwest services or the customers of other telephone companies. But those customers won’t discover their obligation until after the deed has been done.

So then, how is the PSC to resolve the apparent contradiction between state law which demands that costs be recovered in rates charged by a regulated telecommunications carrier and a rate structure that doesn’t recover those costs? There is only one way and that is to deregulate rates for that carrier. Ah, yes, where have I heard before that utility deregulation will yield lower rates for consumers? Railroads, airlines, natural gas and the mother of all, Montana Power's deregulation scheme, all come to mind.

The inherent danger I see in the proposition that we deregulate Qwest long-distance rates to satisfy a yearning for lower rates will leave no one to guard the gates when the deregulated utility decides, at some later date, to increase rates. That will occur when the legitimate competitors, who must recover all of their costs as a matter of economics, are driven from the field by the below-cost marketing strategy employed by Qwest.

As a Public Service Commissioner, I believe I am obligated to look out for the interests of all telecommunications customers in Montana, not just those that have been identified by Qwest as the beneficiaries of their plans. I also believe I am obligated to consider the long-term consequences of any decision in this matter. Therefore, I am unable to approve the Qwest application at this time.

While I approve of some of the internal details of the decision, for example, the customer disclosure provision, I must dissent from the fundamental decision in this case.

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GREG JERGESON, Commissioner, Voting to Dissent
PSC District #1