(Decision No. C87-364)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

RE: INVESTIGATION AND SUSPENSION OF PROPOSED CHANGES IN TARIFF - COLORADO PUC NO. 6 - TELEPHONE, THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, DENVER, COLORADO 80202.	INVESTIGATION AND SUSPENSION DOCKET NO. 1720 DECISION AND ORDER OF THE COMMISSION

March 20, 1987

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The Bijou Telephone Cooperative Association, Inc.,
Columbine Telephone Company,
Delta County Cooperative Telephone Company,
Eastern Slope Rural Telephone Company, Inc.,
Farmers Mutual Telephone Company
Sunflower Telephone Company, Inc.,
Wiggins Telephone Association,
Nucla-Naturita Telephone Company,
Pine Drive Telephone Company, doing
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The S&T Telephone Cooperative Association, Inc.,
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STATEMENT, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

BY THE COMMISSION:

I.

HISTORY OF THE PROCEEDINGS

Investigation and Suspension Docket No. 1720 (I&S 1720) involves a rate restructure filing made by The Mountain States Telephone and Telegraph Company (Mountain Bell) on July 25, 1986. On that date, Mountain Bell filed Advice Letter No. 2041 accompanied by 420 tariff sheets. In Advice Letter No. 2041, Mountain Bell seeks to restructure and to reprice its intrastate services in Colorado.

In its Advice Letter No. 2041, Mountain Bell stated that the purpose of its filing was to restructure and reprice the rates and charges for most of its products and services, which would result in the net recovery of $21,113,000, the revenue increase authorized by this Commission in Decisions No. C85-1465 and No. C86-646 in I&S 1700. To calculate its proposed rates, Mountain Bell used inventory from 1985 in determining the revenue effect of its proposals and the rates that were in effect in 1985, rather than including the 1986 across-the-board percentage increases which were applied as a result of decisions in I&S 1700.

The major changes proposed by Mountain Bell are grouped in 11 categories as follows:

1. Exchange Services
2. Long Distance Message Telecommunications Service (LDMTS)
3. Wide-Area Telecommunications Service (WATS)
4. Service Charges
5. Directory Assistance Service
6. Operator and Information Services
7. Direct Inward Dialing (DID) and Identified Outward Dialing (IOD)

8. Custom Calling Services
9. Customized Services
10. Private Line Services
11. Switched Carrier Access

A brief description of the proposed changes in each of these 11 categories was discussed in Advice Letter No. 2041.

In accordance with the provisions of § 40-6-111(1), C.R.S., as amended, the Commission is authorized to set tariffs for hearing if it believes that the proposed rates may be improper. Section 40-6-111(1), C.R.S., as amended, also provides that the Commission, in its discretion, may suspend the effective date of filed tariffs for 120 days, and, if necessary, by separate order, may suspend the effective date of filed tariffs for an additional 90 days. Thus, the power and authority of the Commission to suspend the effective date of the tariffs filed by Mountain Bell extends for a maximum period of 210 days or, in this docket, until March 22, 1987. If no new rates are established by final decision of the Commission before March 22, 1987, the tariffs filed by Mountain Bell will become effective by operation of law on that date.

On August 14, 1986, the Commission issued Decision No. C86-1051 which suspended the effective date of the tariffs filed by Mountain Bell, gave notice of a hearing, and established certain procedural directives in I&S 1720. I&S 1720 is a procedural departure from mechanisms used in the past by the Commission and Mountain Bell in general rate cases. In past proceedings, a general rate case was divided into two phases: Phase I determined the revenue requirement, and Phase II determined how the revenue requirement would be spread among the utility's various ratepayers. In the recent I&S 1700, the Commission determined that Mountain Bell was entitled to an increase in revenues of $21,113,000. Rather than enter upon a Phase II in I&S 1700 to determine the appropriate spread of rates, I&S 1700 was closed except for certain ancillary matters. Mountain Bell filed Advice Letter No. 2041 accompanied by tariffs to restructure or spread the $21,113,000 rate increase. A separate docket, namely, I&S 1720, was established to consider Mountain Bell's proposed restructuring of rates.[1]

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[1]The following parties moved to intervene in I&S 1720 and were granted intervenor status either by rulings of the Commission or by Executive Rulings by the Commission's Executive Secretary:

September 8, 1986	Agate Mutual Telephone Exchange, <u>et al</u>. (Agate)

September 11, 1986	Denver Burglar and Fire Alarm Company American District Telephone Company
August 20, 1986	Office of Consumer Counsel (OCC)
August 22, 1986	Colorado Municipal League (CML)
August 25, 1986	Colorado Ski Country U.S.A. (CSCUSA)
August 28, 1986	U S Sprint Communications Corporation (Sprint)
August 28, 1986	MCI Telecommunications Corporation (MCI)
August 28, 1986	Secretary of Defense on behalf of U.S. Department of Defense and all other Executive Agencies of the Federal Government (DOD)
August 29, 1986	Competitive Telecommunications Association of Colorado and Wyoming (Comptel)
August 29, 1986	Colorado Association of Radio Common Carriers
August 29, 1986	AT&T Communications of the Mountain States, Inc. (AT&T Comm)

Decision No. C86-1051 established detailed procedural provisions relating to the filing of direct testimony and exhibits, rebuttal, cross-rebuttal, and surrebuttal testimony, discovery and protective provisions, the audit of Mountain Bell's books and records, the disposition of various procedural matters by a Hearings Examiner of the Commission, the prehearing conference, the settlement of issues, hearing dates, and statements of position.

Post-hearing statements of position were filed on or before February 20, 1987, by Mountain Bell, AT&T Comm, Agate, CML, Comptel, OCC, MCI, Sprint, and the Commission Staff. Reply statements of position were filed on or before March 2, 1987, by each of the parties that filed initial statements of position, with the exception of Agate.

Hearings for the reception into evidence of prefiled testimony and exhibits and the cross-examination of witnesses were held on January 14, 15, 16, 21, 22, 23, 28, 29, 30, and February 4, 5, and 6, 1987. A listing of the various witnesses and the exhibits introduced into evidence while each witness was on the stand is attached to this decision and order as Appendix A.

Hearings for the reception of public testimony were held on December 30, 1986, January 7 and 9, 1987, and on February 12 and 13, 1987.[2]

On page 6 of Decision No. C86-1051, the Commission indicated that settlement of issues among parties was encouraged and that parties could begin settlement negotiations at any time. However, no settlement agreement among the parties would be final unless it was accepted by the Commission. On December 29, 1986, Mountain Bell, AT&T Comm, and the Staff of the Commission (Staff) submitted a contested settlement agreement to the Commission. Since all parties were not signatories to the settlement agreement, no issue arising in I&S 1720 was considered by the Commission to have been removed from the hearing process or settled.

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[2]A substantial number of the public witnesses are or were Mountain Bell employees. We learned, through these witnesses' sworn testimony:

A. Many believe, through comments from Mountain Bell, that their jobs and the jobs of their colleagues will be lost without the restructure proposed by Mountain Bell. This is in spite of the fact that this case will bring no new revenue to Mountain Bell.

B. Some believe, again from information they received from Mountain Bell, that Mountain Bell Colorado is being subsidized by other states in Mountain Bell territory, in spite of the company's 10.55 percent rate of return earned on equity.

C. They support an increase in local charges, which they said current and past employees do not pay, and a decrease in toll rates, which they do pay.

Motions to strike, directed to the Staff reply statement of position, were filed by CML on March 4, 1987, and by the OCC on March 6, 1987. On March 9, 1987, Mountain Bell filed a motion to strike directed to the OCC's reply statement and attachment 1 to the reply statement. Due to the time constraints imposed upon the Commission in order to have a final decision issued prior to the end of the statutory suspension period, the Commission finds that it should waive response time to the three motions to strike and deny these motions, making any response moot. The Commission notes that post-hearing statements of position and reply statements of position embody legal and factual arguments. To the extent these statements contain information which cannot be sustained by the record in the docket, there is no harm in our receiving that information so long as the Commission does not rely upon it in making its decision.

Submission

The spread-of-the-rates issues in this matter have been submitted to the Commission for decision. In accordance with the provisions of the Colorado Sunshine Act of 1986, § 24-6-401, et seq., C.R.S., and Rule 10 of the Commission's Rules of Practice and Procedure, the subject matter of this proceeding was discussed at open meetings on March 11 and 13, 1987, and has been placed on the agenda for an open meeting of the Commission for discussion and decision. In the open meeting on March 20, 1987, this decision was entered by the Commission. The effective date of this decision is March 20, 1987.

II.

GENERAL REMARKS

A. The New Telecommunications Environment.

The last significant restructure of rates assessed by Mountain Bell occurred in I&S 1108, which was adjudicated by this Commission in 1977. In 1977, the American Telephone and Telegraph Company (AT&T) and its 22 subsidiary operating companies, known collectively as the Bell System, ubiquitously provided both long distance and local telephone service throughout the United States. The Bell System, with its various components and affiliates, was the largest corporation in the world. The Bell System's total operating revenues in 1979 were over $45 billion, and, in 1980, they exceeded $50 billion. These sums represented almost 2 percent of the gross national product of the United States in each of those two years. The Bell System's net income for 1979 and 1980 was $5.6 billion and $6 billion, respectively. During 1979, the Bell System's net assets devoted to telephone service were valued at approximately $99.3 billion. By the end of 1979, the Bell System employed over one million people, and it was the largest employer in the United States with the exception of the federal government.

On October 24, 1982, United States District Court Judge Harold H. Greene entered what has come to be known as the Modification of Final Judgment (MFJ) in probably what was the largest antitrust case in the history of the United States, denominated as <u>United States of America v. Western Electric Company and American Telephone and Telegraph Company</u>. The MFJ ordered a structural reorganization of the Bell System, which purported to achieve what were then the antitrust objectives sought by the United States Department of Justice in over three decades of antitrust litigation involving the Bell System. Throughout the 20th Century, the Bell System had provided integrated end-to-end telephone service. The Bell System's wholly owned Bell operating companies (BOCs) had franchise monopolies that provided local exchange telecommunications services for approximately 80 percent of the nation's telephone subscribers under state public utility regulation. The BOCs local exchange facilities also originated and terminated both local and intrastate toll regulated by the states and interstate toll calls regulated by the Federal Communications Commission (FCC) under the Communications Act of 1934, 47 USC 151, <u>et seq</u>. The BOCs also owned interexchange facilities that provided transmission for both intrastate and interstate calls, whereas AT&T's Long Lines Department owned portions of the network used exclusively for interstate transmissions.

The Bell System technologically was integrated. However, as a result of the MFJ, the 22 BOCs, former subsidiaries of AT&T, were regrouped into seven regional holding companies, which legally were separated from AT&T. Judge Greene retains continuing jurisdiction over the Bell System divestiture, and proposed changes to the MFJ have been submitted by the United States Department of Justice and the BOCs.

Mountain Bell is one of three operating companies which are subsidiaries of the 14-state regional holding company, U S WEST. The other two operating companies are Northwestern Bell and Pacific Northwest Bell. The divestiture of the 22 BOCs from AT&T have had legal and economic effects in Colorado.

A new term in telephone parlance is local access and transport area which has been given the acronym LATA. On April 20, 1983, Judge Greene entered a 162-page order approving, with some modifications, the LATAs that had been proposed by the Department of Justice and AT&T in response to the MFJ. On page 140 of his April 20, 1983, opinion, Judge Greene approved the two LATAs submitted by Mountain Bell for Colorado. Roughly speaking, the Colorado Springs LATA includes Colorado Springs, Pueblo, and the southeastern portion of Colorado. The Denver LATA includes Denver, northeastern Colorado in general, and virtually all of western Colorado, including Grand Junction and Durango.

In 1984, the Colorado General Assembly passed House Bill 1264 which deals with the provision of intrastate telecommunications services. House Bill 1264 was signed into law on April 2, 1984, by Governor Richard D. Lamm, and has been codified as Article 15 of Title 40, C.R.S. (§§ 40-15-10 through 40-15-110, C.R.S.). House Bill 1264 provides that intrastate, interLATA telecommunications services shall be governed under the doctrine of regulated competition, whereas intraLATA telephone service is to be governed by the doctrine of regulated monopoly. Accordingly, Mountain Bell can provide local and toll service within each of the two Colorado LATAs under the doctrine of regulated monopoly. The MFJ prohibited BOCs from providing long distance or toll service between LATAs; therefore, Mountain Bell is not authorized to provide long distance or toll service between the two LATAs in Colorado. At the present time, AT&T Comm, MCI, Western Union, Telephone Electronics Corporation WEST (TEC WEST) and U S Sprint are authorized to provide interLATA long distance or toll service in Colorado.

House Bill 1264 set forth a legislative declaration that it is the policy of the state to permit access to, and use by, the public of rapid advancements in telecommunications technology and to allow the competitive entry of providers of telecommunications service in the intrastate market as soon as practicable, consistent with continued availability of universal telephone service to the people of the state and the efficient transition from regulated monopoly to a competitive telecommunications environment.

A more detailed discussion of the changes at the federal level and in Colorado is set forth in Appendix B.

B. Mountain Bell Rate Restructure.

The last time the Commission considered the restructure of Mountain Bell's rates was in Phase II of I&S 1575. On December 7, 1982, the Commission entered a Phase I, revenue-requirements order which authorized Mountain Bell an overall revenue increase of $38,510,000. In Phase II of I&S 1575, Mountain Bell had proposed a significant restructure of its rates. On August 5, 1983, the Commission entered Decision No. C83-1248 of Phase II. On page 14 of that decision, the Commission said:

> The Commission, in this proceeding, must establish rates which are just and reasonable. CRS 1973, 40-6-111; see Public Utilities Commission v. Northwest Water Corp., 168 Colo. 154, 451 P.2d 266 (1969). When the Commission suspends a rate filing and holds hearings, as in this case, the burden is on the public utility to establish that the proposed rates comply with law; that is, that the proposed rates are "just and reasonable." Public Utilities Commission v. District Court, 186 Colo. 278, 527 P.2d 233 (1974); Utah Department of Business Regulation v. Public Service Commission, 614 P.2d 1242, 1245 (Utah 1980). The Commission's findings on whether rates are just and reasonable must be

> supported by substantial evidence in the record. See Morey v. Public Utilities Commission ___ Colo. ___, 629 P.2d 1061 (1981); Caldwell v. Public Utilities Commission, 200 Colo. 134, 613 P.2d 328 (1980). Indeed, Mountain Bell must support its proposed increase in rates and charges by way of substantial evidence, and the mere filing of schedules and testimony in support of a rate increase is insufficient to sustain the company's burden of proof. Utah Dept. of Business Regulation v. P.S.C., supra, 614 P.2d at 1245-1246.

In Decision No. C83-1248, the Commission found that Mountain Bell had not sustained its burden of proof in its price restructure proposals. Accordingly, the Commission (with some exceptions) authorized across-the-board increases for virtually all of Mountain Bell's telephone services.

I&S 1720 is Mountain Bell's first restructured docket since the January 1, 1984, divestiture of the Bell System. It is also true that I&S 1575, which authorized across-the-board increases, basically did not alter the structure of Mountain Bell's prices for its services and products. Thus, in reality, the last de facto restructure of Mountain Bell's rates occurred in I&S 1108 which was adjudicated by this Commission in 1977. In I&S 1720, Mountain Bell has proposed price restructuring in five general areas: (1) basic exchange service, (2) intraLATA toll, (3) interLATA access, (4) private line and special access, and (5) ancillary services. Mountain Bell has contended vigorously in this docket that the divestiture of the BOCs from AT&T, the advances of telecommunications technology, the loss of control over telecommunications technology by one ubiquitous provider, and the introduction of significant competition into Mountain Bell's market mandates the restructure of rates which it has proposed by the filing of tariffs accompanying its Advice Letter No. 2041. The various price restructure proposals are discussed later in this decision.

C. Competition.

It is almost universally agreed that when the Bell System was a ubiquitous telephone network, it was a monopoly. In the absence of legal constraints which are external to the monopoly provider, such as regulation, the monopoly provider has economic power to charge prices for goods and services either on the basis of cost or on the basis of value or by some combination of the two. In simple terms, cost-based pricing means that the consumer pays a price which reflects the costs which go into the production of goods or services, including capital, labor, and material costs. Value-based pricing, on the other hand, reflects not what it costs the provider to produce goods or services, but rather what is the value of the goods or services to the consumer. When the Bell System was a practical monopoly, the hallmark of its pricing scheme generally was value-of-service pricing. Residential telephone rates were lower than business telephone rates because, among other reasons, it generally was assumed that the telephone was more valuable to a business subscriber than it was to a residential subscriber. It also was believed that lower telephone rates for residential subscribers enabled more people to have telephones, thus advancing the social goal of universal telephone service.

One of the principal thrusts of Mountain Bell's case in I&S 1720 is that rapid technological change, as exemplified in fiber optics, digital switching, cellular radio, and new uses of microwave technology, has been a driving force in the increase in competition; that when competition exists, prices must be set on a long-run incremental basis; that to avert bypass of the Mountain Bell network, prices must be driven to costs; and that subsidy flows from such services as intraLATA toll and interLATA access must be reduced. The Commission generally agrees with the Staff that there have been changes in regulatory and antitrust policy at the federal level, detailed above, that have been most responsible for what competition exists in telephone markets rather than the technological changes themselves. We agree, of course, that the legal changes which initially opened equipment markets to competition, followed by the Bell System divestiture, have expanded significantly opportunities for technological change and their application in diverse markets.

Mountain Bell, in its initial statement of position correctly observes that I&S 1720 is not a deregulation case, and that there is, accordingly, no legal standard which Mountain Bell is required to meet in discussing the amount and type of competition which must exist to influence its price proposals. This contention by Mountain Bell is untenable, and the Commission has discussed the legal standard of just and reasonable rates and the fact that the burden of proof rests with the proponent utility. Because Mountain Bell chose to justify its repricing proposal upon the presence of competition, Mountain Bell assumed the burden of proving sufficient competition to require repricing of its service. Although we acknowledge, as have all parties in this docket, that certain measurable competition exists in some of Mountain Bell's telecommunications markets, we find that Mountain Bell has not met its burden of proof to establish that sufficient competition exists in its major markets to justify its pricing proposals. Mountain Bell apparently takes the position that the mere existence or potential existence of another provider, however small or large, and irrespective of whether the additional provider is legally or illegally positioned in the market, establishes the existence of competition. We also reject that notion of competition.

A traditional economic view of competition, to which this Commission subscribes, was discussed in Staff Witness Hunt's testimony. It is not the same as perfect competition, which would describe a theoretical situation in which each firm faces a perfectly elastic demand curve for its product at the prevaling price. In the perfectly competitive market, each firm can sell as much as it pleases at the market price, except that the amount of output produced by the firm always will be limited by rising marginal costs. Thus, no one firm can gain more than an infinitesimal portion of the market.

The Commission is interested in what is termed a workably competitive market. This market would exist when five criteria are met:

1. The number of firms in the market must be large enough so that no one firm can affect the market price, and all firms will act independently with little likelihood of collusion.

2. The number of firms should be at least as large as economies of scale permit, which will insure that any economies of scale and production will be realized by all firms, and no one firm or group of firms will have a distinct cost advantage.

3. Artificial barriers to entry or exit will not be present. Firms will be induced to enter the market when existing firms are earning an above-normal rate of return, and exit when profits are below this level. Consequently, profits will be maintained at a level just sufficient to attract capital investors needed for production, research, and development. Free entry also pressures existing firms to minimize waste, produce efficiently, and maintain quality standards that satisfy consumers. Thus, firms that hope to be successful under workable competition must satisfy the consumer at a minimal cost to society.

4. The differences in the quality of the product produced by firms in the market will be minor, and those differences will be reflected in price. A high degree of product homogeneity serves to keep prices relatively equal, and the products easily substitutable. Because quality differences are price-sensitive, advertising will tend to stress any quality differences, keeping less informative promotional expenses to a minimum.

5. The absolute size difference between firms should not be excessive.

Mountain Bell's failure to use traditional economic definitions of competition, as well as other market structures, results in there being little basis of understanding between divergent parties to this proceeding. If competition to one party is a tightly controlled oligopoly, but is a perfectly or workably competitive market to another of the parties, the discussion as to firm behavior, price, conditions of sale, and market structure inevitably will be confused to the point that rational decision-making is jeopardized. In addition, Mountain Bell's failure to use the traditional economic definition of workable competition could result in the inability of the Commission to determine whether market failures have occurred.

The significance of a determination whether market failures occur is that the Commission must be in a position to determine whether the benefits of competition alleged by a party will be forthcoming or whether firm behavior in a market will tend toward that of a monopolist. This is important from the standpoints of marginal-cost pricing and the altering of price for competitive needs by a firm.

An additional advantage derived from the use of the more traditional economic definition of competition is that common economic methods and techniques can be used to examine the market structure and firm conduct. These economic methods and techniques are well-known, well-established, and can be applied to the telecommunications market if the traditional economic definition of competition is used. Failure to rely on a traditional economic definition of competition, however, results in a hodge-podge of theories, techniques and methods used to examine the market structure and firm conduct. No useful purpose is served by the Commission's review of various methods and techniques advanced by parties without the common economic foundation provided by the use of a more traditional definition of competition.

As an example of competition, Mountain Bell in I&S 1720 pointed to intraLATA toll. We find its contentions in this regard unconvincing. First of all, pursuant to § 40-15-104(2), C.R.S. (1984), Mountain Bell holds a statutory monopoly for the provision of intrastate intraLATA telecommunications service for most of the State of Colorado. Under § 40-15-104(1), C.R.S. (1984), the provision of intrastate interLATA telecommunications services is provided pursuant to the doctrine of regulated competition. In fact, a number of interLATA telecommunications services providers have been granted certificates of public convenience and necessity to provide telecommunications services on an interLATA basis within the State of Colorado. These providers of interLATA telecommunications services include, as indicated above, AT&T Comm, MCI, Sprint, Western Union, and TEC WEST. In accordance with the terms of the Commission decision granting certificates of public convenience and necessity to MCI, Sprint, and Western Union, these three interLATA telecommunications services providers are required to compensate Mountain Bell for any incidental, intraLATA traffic which they may have inadvertently handled over their systems (see Commission Decision No. C85-226).

As evidence of the existence of alleged intraLATA competition, Mountain Bell submitted the testimony and study of Dr. Alessio. Dr. Alessio's testimony provided a worst-case scenario regarding potential diversion of revenues from Mountain Bell in the intraLATA toll market, rather than a probable outcome. Dr. Alessio ignored actual market conditions in suggesting that Mountain Bell is subject to revenue losses because a number of large users are located in the same geographical vicinity. He fails to delineate the economic and physical ability or even the probability of any competing technologies actually to secure those Mountain Bell revenues allegedly at risk.

The only actual example of intraLATA bypass of Mountain Bell's network which Dr. Alessio was able to provide was the system of University of Denver between its two campuses. Neither Dr. Alessio nor any other Mountain Bell witness could quantify the penetration of cable or other technologies into Mountain Bell's intraLATA markets. Cable television in the Denver area cannot provide substantial two-way services, at present, nor can it provide large-scale, point-to-multi-point services. Cable television does not reach the downtown Denver area. We find that it has not been shown in Colorado or nationally that cable is an economically viable alternative to traditional, switched telephone service. Dr. Alessio's testimony did not provide substantive information regarding alleged intraLATA toll competition, and his conclusions are entitled to little or no weight.

Mountain Bell also sponsored the testimony and exhibits of Mr. Gordon Blankenship who provided three studies which purported to show intraLATA competition. Two of Mr. Blankenship's studies pertained to intraLATA toll, and the third study pertained to private microwave systems allegedly used by their owners for substantial bypass of Mountain Bell's network. We find that each of the studies was riddled with extensive flaws and does not show what it purported to demonstrate.

With respect to Mr. Blankenship's intraLATA toll studies, two general comments should be made. First, these studies were not based upon actual traffic data even though this data was available to Mountain Bell. Second, for Feature Groups A and B, and the traffic carried by MCI and Sprint using those feature groups, any intraLATA calls are transmitted by those companies to Mountain Bell for transport. Neither MCI nor Sprint has the facilities to carry such intraLATA calls in Colorado and, therefore, there can be no traffic loss to Mountain Bell on this basis.

Turning now to Mr. Blankenship's intraLATA toll competition study, which used survey information gathered by Mountain Bell, we find that the survey instrument was flawed in many respects, and the results were misrepresented by Mr. Blankenship. First, the survey instrument used to gather the subscriber information was so complicated that only the most sophisticated user could understand and adequately respond to the questions contained in the survey. One example of the inaccurate results of the survey is that it indicated that some customers believed some interLATA carriers have rates 26 percent below Mountain Bell's intraLATA rates. Mr. Blankenship admitted that this great a disparity in intraLATA rates between Mountain Bell and its alleged competitors was not likely.

Second, Mr. Blankenship misrepresented the validity of the survey results in his testimony. Under cross-examination, Mr. Blankenship revealed that the data used for many categories in the study statistically were not reliable. It also appears that the intraLATA revenues allegedly lost to MCI and Sprint, as estimated by Mr. Blankenship, are greater than the total revenues of MCI and Sprint in the State of Colorado.

Last, Mr. Blankenship's study includes resellers from which Mountain Bell presently receives compensation pursuant to the tariffs it has on file with the Commission. Clearly, the revenues generated by resellers should not be included in a study purportedly demonstrating alleged intraLATA revenue lost to Mountain Bell since Mountain Bell already receives revenues for the traffic it carries on behalf of the resellers.

Mr. Blankenship's second study entitled, "Colorado 1986 IntraLATA MTS Competition Analysis," allegedly attempted to estimate the impact of intraLATA toll competition on Mountain Bell's revenues. Staff Witness Hunt, in his testimony, specifically refuted the conclusions of Mr. Blankenship's second study and made the following points which were uncontroverted in this proceeding:

1. The primary culprits in intraLATA leakage are Feature Group A lines which were greatly overstated by Mr. Blankenship's study.

2. The study concluded that resellers should not be included in the study results, a finding not relayed by Mr. Blankenship.

3. Had the adjustments set forth above been made, they would have resulted in a reduction of the intraLATA loss to zero. However, by subtracting out the amount attributable to resellers, the remaining loss of revenue allegedly attributable to MCI and Sprint would be more than their total intrastate operations.

Mr. Blankenship also admitted under cross-examination that the proposed rates of Mountain Bell for its intraLATA toll service are likely to decrease by 10 to 20 percent, thereby reducing the alleged revenue loss. Mr. Blankenship used the old rates in conducting his study even though Mountain Bell is touting the benefits of forward-looking methodologies. Clearly, Mountain Bell should have used its new proposed rates in demonstrating the alleged impact of intraLATA toll competition on its operations. At the very least, Mountain Bell could have indicated the change in the revenue loss due to its proposed rate decrease.

InterLATA access charges are those charges which are assessed by Mountain Bell to interLATA carriers such as AT&T Comm, MCI, and Sprint for the privilege of gaining access to Mountain Bell's network and customers. Mountain Bell has proposed that access charges be reduced, and has alleged that the threat of bypass of Mountain Bell's system (which is a species of competition in that the customer, instead of purchasing from another provider, provides the service to himself) justifies the lowering of access charges. We agree, for reasons stated below, that access charges should be lowered, but not because of the competitive threat of bypass as alleged by Mountain Bell.

We find that Mountain Bell Witness Blankenship's microwave study failed to demonstrate the existence of significant bypass of Mountain Bell's system. It should be pointed out that Mr. Blankenship's study far overstates the alleged inroads into Mountain Bell's customer base made by private microwave systems. This study also overstates the potential inroads of bypass into Mountain Bell's customer base. We find Mr. Blankenship's microwave study contains the following errors or misrepresentations:

1. The study does not make a distinction between economic and uneconomic bypass. Mountain Bell has stated that its only concern is economic bypass.

2. Public utilities, railroads, state and local governments, and oil companies make up 97 percent of the reported revenue losses. Each of these entities has particular quality and security requirements which Mountain Bell has difficulty fulfilling. In addition, these entities (except oil companies) have right-of-way paths unavailable to the general public which will tend to place them in the category of economic bypassers.

3. Most of the private microwave capacity was installed prior to 1980. The largest users of private microwave systems, such as Public Service Company, the State of Colorado, K N Energy, Inc., and Colorado-Ute Electric Association, Inc., began construction of their private microwave systems in 1953, 1953, 1957, and 1977, respectively.

4. The largest users of private microwave systems also tend to be the largest users of Mountain Bell switched services. This conclusion was contained in Mr. Blankenship's study, but was not presented by him in either his direct or rebuttal testimony, and did not come out until he was cross-examined.

5. Reliability was a major concern for the largest private microwave system users. This was brought out in the study presented by Mr. Blankenship as well as in other studies on the subject of bypass.

6. Eight of the private microwave systems make up 82 percent of the alleged revenue loss, of which two of the systems make up 41 percent of the alleged revenue loss.

The conclusions which can be drawn from Mountain Bell's microwave study are that only a few users have the vast majority of the private microwave system-capacity in place in Colorado. These few users primarily install their own microwave systems for specific, specialized reasons. These were detailed and corroborated by the study offered by Mr. Blankenship. In addition, these few users tend also to be among Mountain Bell's largest customers. Rather than demonstrating the existence of a significant amount of bypass of the Mountain Bell network, the study actually shows that private microwave networks are a complementary good to Mountain Bell services and not a substitute for those services. Many of the larger private microwave systems were built prior to the time that bypass and intraLATA competition were even an issue. The study sponsored by Mr. Blankenship also states that resale of unused capacity is not considered to be a problem and should not be a concern to Mountain Bell. Finally, Mr. Dunkel testified that he had computed intraLATA traffic carried by carriers other than Mountain Bell from Mountain Bell's own data and found that Mountain Bell carries over 99 percent of intraLATA traffic. We find this testimony to be the most firmly grounded statement of intraLATA competition in the record.

Although the Commission is not persuaded that competition forms an adequate basis upon which to base the pricing of Mountain Bell's services, the Commission would be remiss if it did not acknowledge that there are telecommunications markets which are either competitive or are tending toward it. As already indicated above, there are several providers in the intrastate interLATA long distance telephone market. We recognize the intrastate, interLATA market as a market in transition toward competition. Each of the markets where we recognize the potential for competition has its own set of unique issues. The transition in each market must be crafted around the issues in that market. As to the intrastate, interLATA market, the precise issues of market share measurement, the extension of equal access in central offices where it is requested but not provided, the problems with subscription of customers, the measurements of traffic, and the billing problems, as well as the Commission's compensation order and its impact on Mountain Bell revenues are well known. What is not clear is the priority of these various issues and their resolution along a logical time frame.

Likewise, the Commission recognizes that the private line market where it involves high speed data transfer (sometimes called the high end of the private line market) is a market which is becoming more competitive. We believe there are aspects of this market in which the Commission should encourage competition pursuant to § 40-15-110, C.R.S. This market has its own special issues and its transition toward competition should be tailored to those issues. The task of carefully defining this market, by service and technology, remains. Cost and price, separation of assets, definition of measurable progress toward defined goals and a time frame for transition need to be addressed as well. In the tracking of technological and competitive development in this market, the relative market shares and identities of the various providers (as well as the issue of the development of the State's own telecommunications system), are questions which are familiar but not precisely defined enough so that all parties are aware of the speed and direction in which this market and its regulation should be moving.

Certain central office services are also candidates for transition treatment, particularly where they face competition from increasingly sophisticated on-premise equipment which is available in the unregulated market to many customers. The issues unique to this market include the development of technology, market definition, demand studies, and federal and state regulatory treatment.

We find that the intrastate, interLATA toll, the high speed data private line, and the central office services markets (where services compete with a PBX) are markets where the Commission now recognizes the potential for competition. These markets are targeted for transitional status, and eventual relaxed regulatory treatment, should the Commission find that the trends in these markets are leading consistently to more, rather than less, competition.

We believe that competition will provide protections for customers, where it exists, and lessen the need for regulation. The transition we have in mind for these markets involves:

1. Recognition that certain markets are in transition toward more competition.

2. Establishing a goal that each of these markets should eventually be workably competitive, so that customers and competitors are protected by the competitive market, with little or no regulatory oversight.

3. Development of an explicit transition strategy tailored to each market. The elements of such a strategy should include:

a. Requirements for studies and information development appropriate to the twin goals of customer protection and competition in each market.

b. Reporting requirements with time frames which will track progress (or lack of it) along the path to a competitive result.

c. Minimum, efficient regulation which corresponds to and encourages the developing competition in each market.

By recognizing the potential, through the process outlined in our order on refraining from regulation in Case No. 5323, for competition in certain markets, establishing a goal of workable competition in these markets, and developing a transition strategy, the Commission can balance both protection of universal service and encouragement of competition. How rapid the transition can be accomplished will depend not only on economic factors such as demand and supply in each market, clear and logical policy, careful planning and study, but also on the goodwill and cooperation of all parties in the process. The Commission is willing to do its part and, for the process to work to the benefit of us all, so must the telecommunications providers and the representatives of consumers. We would also urge Mountain Bell to provide actual data, rather than worst-case hypotheticals in future filings where competition is an issue.

Almost simultaneously with the entry of this decision, the Commission will enter a decision in Case No. 5323 which deals with the procedural issues of refraining from regulation for competitive need. Our regulatory responses in both I&S 1720 and Case No. 5323 are complementary, and we trust that the decisions in both these dockets will be informative to the telecommunications industry in this State and to the members of the general consuming public.

D. Cost-Based Pricing

While the Commission favors cost-based pricing, we recognize that at times externalities will require some deviation from a strictly cost-based pricing method in order that the rates are just and reasonable. There is no absolute or scientific formula that will yield the accurate pricing of telecommunications services that can replace the application of informed judgment by the Commission. The level of judgment is not decreased with the use of a particular method of costing and pricing. In this docket, Mountain Bell identified a marginal cost method presented as a long-run incremental cost study (LRIC). The Staff presented a fully distributed cost (FDC) study. Some discussion of these studies is in order.

In Decision No. C83-1248 dated August 5, 1983, in I&S 1575 (p. 40), the Commission indicated that:

a. A FDC study should be the centerpiece of Mountain Bell's pricing proposal in the next rate restructure case;

b. For those services or portions of services which use embedded plant, embedded costs should be used including previously authorized rates of return;

c. To the extent possible, plant and expenses should be allocated directly to the services to which they pertain;

d. The next cost-of-service study should allocate non-traffic sensitive cost on a one-third, one-third, one-third approach based on detailed engineering and traffic data; and

e. Reconstruction cost studies are appropriate only for services which involve <u>new</u> investment.

FDC methods allocate all costs, both variable and fixed. FDC methods have the advantage of distributing all costs and allowing the company to meet its revenue requirement without the necessity of making additional adjustments. FDC has what some consider to be a disadvantage of requiring allocation of joint and common costs and use of judgment in the application of that allocation. It is the allocation of the $573.7 million in joint and common costs that will be a primary factor in determining the rates paid by various classes of customers. Even though the disadvantage of the use of FDC is the difficulty of choosing an appropriate method to allocate joint and common costs, as indicated above, all cost methods require judgment, including LRIC. The level of judgment is not decreased with the use of a particular method. FDC has the advantage of making that decision overt, rather than hidden in residual pricing.

The second cost-allocation method proposed in this case is the LRIC, or marginal cost method advanced by Mountain Bell. Marginal cost methods may take the form of short-run or long-run marginal cost. Both short-run and long-run marginal cost methods place primary emphasis on the limited but important function of price, which is the optimal use of plant capacity for economic efficiency. The major disadvantage of marginal cost pricing methods, whether short-run or long-run, is that they must be adjusted by some method so that the firm can cover all costs. Thus, price and the marginal cost are not equal. Consequently, economic efficiency through prices cannot be obtained. It is only in the theoretical, perfectly competitive model that prices are equal to marginal cost. It is also interesting to note that in the perfectly competitive model, price is also equal to <u>average</u> cost. This is significant because, in other market structures and under regulation, prices will not equal marginal costs, but must cover average costs. Consequently, apart from a perfectly or workably competitive market, relative economic efficiency may dictate that prices may be based on (but not equal to) marginal cost but that average cost must be covered.

An additional problem presented by long-run marginal cost methods is that they require knowledge of future events, such as projections of population, personal income, labor force, technological development, interest rates, domestic and international business activity, inflation, unemployment, and specific cost and demand conditions of the firm. To state that accurate long-run projections of these and other events is possible is clearly an act of heroism. Few, if any, claim the ability to establish an actual set of accurate long-run prices.

Finally, an adjunct to LRIC is so-called Ramsey pricing or inverse-elasticity pricing. What this means is that prices diverge from costs to a greater extent for goods and services with the fewest substitutes than for goods and services with many substitutes. That is, the group of customers with an inelastic demand pay a relatively higher price. Inelastic customers are those who continue to buy a product or service notwithstanding higher prices for the product or service. Stated another way, if a customer does not have the practical alternative to consumption of a product or service and cannot choose to switch to a functionally equivalent product or service, the customer is compelled to pay the monopoly provider charges. We reject the concept of Ramsey or inverse-elasticity pricing because it places economic burdens on those inelastic customers, typically residential basic exchange customers, who have the fewest options, if any at all. In addition, Ramsey pricing results in the subsidization of those customers whose demand is more elastic because the goods or services are less essential. Thus, they can choose whether to remain on the system or switch to other products or services offered by other vendors or provided by themselves. In other words, those with the fewest options subsidize those with the most.

Contrary to the OCC's assertion that the Staff's allocation of traffic-sensitive costs by minutes of use did not give weight to the more expensive first minute of use, the Staff did use dial-equipment minutes of use for traffic-sensitive costs which inherently gives weight to the first minute and we find that was appropriate.

There are no generally preferred methods of allocating these costs as well as no scientific formulae. Two basic arguments exist in determining the cost allocation method to be used in allocating joint and common costs. The first argument is that the cost-causer should be the cost-payer, which says that the end-use customer requires the line to be built and, consequently, it is the end-use customer that should pay the access costs for use of that line. The second argument defines the local loop as a system. This system has many different users demanding service, including residential customers; small, medium, and large businesses; governmental bodies; resellers; long distance companies; and others. A local loop is required and used by all of these users. Consequently, it has value to all of these users, and all should pay a portion of customer access.

In determining the allocation of customer access, the Staff has suggested the use of the Subscriber Plant Factor (SPF) as an interim measure. SPF has been used traditionally in the jurisdictional separations process in telecommunications at the federal level and is a commonly recognized and accepted method of allocation. While other methods may be used, it is important that they be based in some way on the configuration of the network and that they are uniformly applied. The Staff believes that SPF constitutes such an allocation methodology and recommends that it be adopted for the purposes of allocating customer access costs in this proceeding. We find that the Staff's recommendation is reasonable and should be adopted.

Mountain Bell, as indicated above, generally (but not exclusively) advocated the use of an LRIC cost method to establish prices for its services. However, in order to be in compliance with the letter, if not the spirit of the Commission's order in I&S 1575, Mountain Bell also presented an FDC study which was denominated as a revenue cost analysis system (RCAS). Although Mountain Bell's RCAS and Staff's cost-of-service study were both generically based upon an FDC method, there were a number of important differences between them.

The first significant difference is in the treatment of the costs associated with the subscriber loop investment and those investments in the local central office which are made on a per-subscriber-loop basis. Mountain Bell's RCAS assigns all of these costs to the access categories, thereby placing the full burden of recovery on the individual subscriber. This results in misleadingly low revenue-to-cost ratios for access and high ratios for State toll and the interLATA carriers. The Staff perceived these costs as joint investment in subscriber loops and allocated the costs using the interstate, interLATA SPF (as prescribed by part 67 of the FCC Rules); the interstate, intraLATA SPF; the intrastate, interLATA SPF; and the intrastate, intraLATA SPF. This resulted in costs being assigned to those services using the local loop and thereby matching the revenues being generated.

Thus, we disagree with the oft-repeated contention of Mountain Bell and AT&T Comm that toll rates subsidize basic exchange rates. In essence, Mountain Bell and AT&T Comm are arguing for the proposition that toll should not have to make any payment for joint and common costs which is a proposition this Commission categorically rejects.

Second, Mountain Bell's RCAS does not use the same data as the test year from I&S 1700. It uses plant investment balances, depreciation reserves, etc., from a June mid-point of the test year rather than average plant balances. Staff first jurisdictionally separated intrastate values and then used the I&S 1700 test year average plant investment balances, which more accurately represents actual values than does the use of mid-point data.

Third, the cost used by Staff RCAS includes common overhead costs, whereas Mountain Bell's version uses only direct costs. Thus, the Staff used a more detailed allocation procedure to distribute these common costs than Mountain Bell's net investment base.

Finally, Staff used a rate base to calculate rate-of-return by category of service as suggested in Decision No. C83-1248 in I&S 1575. The rate base used by Staff is derived by the same method as recommended by Staff in I&S 1700 and includes cash working capital.

As a result, the Staff has submitted a more detailed cost-of-service study than has been presented previously to this Commission. To the extent possible, it was based on engineering and traffic data, and has been tested on a per book as well as a pro forma basis. The pro forma basis is particularly important because it takes into account future known and measurable events.

Although the OCC alleged that by assigning loop maintenance costs on the basis of relative investment, there is an overassignment of those loop maintenance costs to residential users, the fact is that loop maintenance costs were subdivided by the Staff and were allocated in some cases on primarily the basis of investment, and in certain other minor cases on the basis of the number of loops. We would note, in any event, that the allocation of loop maintenance costs on the basis of investment is a long standing and sound principle of cost allocation.

As indicated above, Mountain Bell advocated the use of an LRIC methodology in order to price its services. LRIC costs are based on forward-looking studies which allegedly accommodate the provisioning needs and technologies now being used or about to be used within the telecommunications industry. Long-run incremental costs are the costs of adding one more unit of a given service. Mountain Bell contended that LRIC costing is the appropriate method to use for most pricing decisions since it follows the principles of cost causation and, thus, gives a more accurate indication of what costs will be incurred in the provisions of a specific service. Mountain Bell also contended that cost-based pricing promotes economic fairness and equitable rates by insuring that no customer groups unnecessarily or unfairly pay more than the cost of serving them, and that LRIC pricing also protects against cross-subsidies which arise from the arbitrary allocation of joint and common costs.

Although touted as a forward-looking and accurate cost method, the Commission finds that LRIC costing is fraught with a number of difficulties. LRIC costing leaves the indirect (that is, joint and common) costs still to be collected from some source. If competitive products and services are priced at the margin, we agree with Staff that the basic exchange (which is a basically inelastic market) becomes a sump into which all the joint and common costs are thrown. In other words, competitive services (priced at the margin) get the advantage of a free ride in that the joint and common costs attributable to their production are not collected from the consumer of the competitive service or product, but rather from the consumers of those services and products, such as basic exchange, to which all the joint and common costs have been allocated. Since the basic exchange telephone ratepayers have nowhere else to go (that being the definition of an inelastic market), the joint and common costs are dumped on them.

Under an FDC method, the allocation and apportionment of joint and common costs is done in the open, rather than being hidden in the sump of residual pricing. Finally, we note Mountain Bell Witness Miner admitted that many of Mountain Bell's studies were a mixture of forward-looking LRIC cost studies and embedded FDC cost studies. Although the use of differing cost study methods may be justified in certain circumstances, Mountain Bell did not use consistent assumptions in its use of differing cost methods. As Staff pointed out in its statement and reply statement of position: not all of Mountain Bell's studies used the most current technology; the studies used varying costs of capital; they were performed in various years and did not accurately reflect investment or expense for any one service or total investment expense. Accordingly, we find that the overall use of Mountain Bell's cost method in this docket is entitled to little or no weight.

As a result of the Staff's detailed and refined cost-of-service study, we find that the costs and attendant contributions to rate of return supplied by Mountain Bell's various services, as set forth in Staff Witness Wendling's Exhibit 4, are reasonable and should form the basis of appropriate pricing of Mountain Bell's goods and services in this docket.

E. The December 1986 Settlement

Mountain Bell, AT&T Comm, and the Staff submitted a document entitled "Settlement Agreement" to the Commission on December 29, 1986. The operative provisions of that document are stated as follows:

1. Recognizing the substantial progress that has been made through the extensive efforts of the costing methodology task force, this task force should continue to address such issues as service category disaggregation, differential depreciation, use of peak responsibility data, etc.

2. As a part of the costing methodology task force activity, the NRRI trial study underway in Texas will be evaluated for its potential use in Colorado as the 3 to 5 year pricing plan. This evaluation will include the analysis of the results of the Texas study and provide a report to the Commission suggesting possible implementation in Colorado.

3. Total revenues from Access Services will be reduced by $11,733,128 as effected by reductions proposed in the testimony of Dr. Parkins and Mr.

Hatzenbuehler, the effects of which are summarized in Dr. Parkins's proprietary Exhibit 1.

4. AT&T Comm will reduce its rates for telecommunications services in Colorado to reflect AT&T Comm's share of the reduction in Mountain Bell's intrastate access charges. AT&T Comm will reduce its rates on the date Mountain Bell reduces access charges, or as soon thereafter as the rate reduction can be implemented for billing purposes. It is AT&T Comm's intent to reduce its rates as a result of this case, and to do so as quickly as possible. AT&T Comm's agreement to reduce its rates is limited to this case. In addition, AT&T Comm expressly reserved the right to argue for alternative cost methods to be used in the future.

5. Mountain Bell's estimated decrease in volume of Billing and Collections in the amount of $1,465,455 will not be calculated in the rate spread in this proceeding.

6. All restructure repricing proposals submitted by witnesses Hatzenbuehler, Heinze and Mansell will be approved, with the following exceptions:

   The resultant revenue effects of the provisions of this agreement are based upon average test year quantities and are contained in Attachment A to the Agreement, entitled, "Summary of Annual Revenue Effects" and do not reflect any hypothetical shifts in service-classifications.

   The tariff rider percent surcharges will be rolled into the specific rates with footnote identification as to the applicability of the surcharge. The wording on the tariff rider pages at the front of the tariff book will reflect that treatment and will contain the dates for review or termination, where appropriate.

   The call allowance for Directory Assistance service will be reduced from 5 calls per month per residence or business customer line per month to 2 such calls. For calls made above the allowance the charge per call will be 32¢.

7. It must be pointed out that the Summary of Revenue Effects Attachment A [attached to this decision as Appendix C] reflects Mountain Bell's proposal to reduce the charge for installation of a residence basic exchange service line to $30, even though Mountain Bell's cost for this work activity is calculated to be $53.08. By dividing the number of residence basic exchange access lines into the revenues foregone by applying the $30 installation charge, the PUC Staff has calculated this to have the monthly revenue effect of $9,817,300, resulting in an increase of 70¢ per residence line. The PUC Staff is concerned over the extent of this revenue effect. So this remains unresolved.

Although denominated a Settlement Agreement, the document submitted to the Commission by Mountain Bell, AT&T Comm, and the Staff on December 29, 1986, is more in the nature of a stipulation. The centerpiece of that stipulation is the recognition of the fact that the Staff's cost-of-service study yielded prices which were in accord with the tariffed prices submitted by Mountain Bell pursuant to Advice Letter No. 2041. Because we find that the Staff's cost-of-service study is reasonable and that the tariffs filed by Mountain Bell are reflective of the Staff's cost-of-service study, we conclude that the settlement agreement is reasonable and should be accepted.

The primary impact of the settlement agreement is that intraLATA toll rates and interLATA access charges will come down and basic exchange rates and private line rates will go up. The largest increase in residential basic exchange will be $2.75 per month, which includes the 44¢ surcharge already in effect since I&S 1700. Thus, the highest rate increase from April to May when the tariffs will go into effect, as a result of this docket, is $2.31. The vast majority of basic exchange rates will go up $2 per month, or $24 per year. Although some of the percentage increases in basic exchange appear to be large, the dollar amount of the increase is modest. As Mountain Bell Witness Unruh testified, the rate for residential flat rate service in New Mexico nearly doubled ($8.80 to $16.39) in seven years. The penetration rate in 1984 however, was virtually the same as it was in 1977. We, therefore, have every hope that the penetration rate will not significantly change as a result of this rate increase.

In addition, the Commission has considered the possibility of a phased-in approach to the new rates which we approved today and has determined that, on balance, a phased-in approach appears to us to create more problems than it solves. It is important to remember that thousands of components comprise a general telephone rate restructure. Telephone service today is provided by many discrete, complex elements. When we order a repricing, Mountain Bell must recompute, tabulate, and bill each element to each customer, action that is not without cost to the ratepayer. A phased-in approach would, necessarily, require this activity by Mountain Bell to be repeated and the costs to be increased.

The OCC contends, and in our view correctly, that rate stability and rate continuity are important regulatory goals that should not be jettisoned when significant rate shifts are brought about as a result of a major rate case. The OCC correctly points out that in I&S 1640, involving gas and electric rates charged by Public Service Company of Colorado, the Commission invoked the concepts of rate stability and rate continuity in capping rate increases at 15 percent, even though cost-of-service considerations would have justified a larger increase to certain customers. Phasing-in rate increases over a period of time is the embodiment of gradualism in ratemaking and is designed to avoid what has come to be known in utility parlance as rate shock. In our conception, however, rate shock is a concept which embodies not only large percentage increases but more importantly, significant dollar amount increases. Obviously, if a particular rate increases from $1 to $2, there is an increase of 100 percent, even though the absolute dollar amount is only $1. Such an increase, in our view, would not qualify for the appellation of rate shock. It also should be noted that in the Public Service case (I&S 1640), the Commission was dealing with the consumption of gas and electricity, which are a much more significant element of the average consumer's budget than is telephone service. For the vast majority of telephone consumers in Colorado, it strains credibility to declare that a $2 rise in basic exchange is going to create widespread hardship. Two dollars is half the price of a movie ticket, the approximate price of two gallons of gas, or two packs of cigarettes. Nevertheless, the Commission is aware of the fact that there are individuals and families on the margin for whom a rise in basic exchange telephone rates will be a hardship. These are individuals or families who cannot, and should not, be forgotten.

To cast a blind eye toward the economic reality of the overwhelming majority of Colorado consumers in order to help individuals or families at the economic margin is not sound public policy. A more responsible and economically sound approach is to target economic help where it is truly needed, rather than ignoring well-grounded cost-of-service studies.

The Colorado General Assembly has taken a first step in targeting aid to consumers who need financial help. The Emergency Telephone Access Act, enacted in 1986, and codified at § 40-3.4-101, _et seq_., provides for a 25 percent discount for single, local, dial-tone line, and the flat usage charge in the principal residence of eligible subscribers. Eligible subscribers are those persons certified by the Department of Social Services as qualified to receive financial assistance payments administered by the Department under programs for Old Age Pension, Aid to the Blind, Aid to the Needy Disabled, or low-income disabled persons who qualify to receive Supplemental Security Income under the Federal Social Security Act, as amended. We believe that this is a first good step in targeting assistance to those who have need and is a far better solution than keeping basic exchange rates artificially low for all consumers, most of whom do not need economic help in paying their telephone bills.

This Commission believes that there are individuals or families who need help in paying their telephone bills who do not fall in the categories of eligibility as defined by the Emergency Telephone Assistance Act. The Commission would also note, with some apprehension, that the Emergency Telephone Assistance Act has an automatic sunset date of February 15, 1989. The Commission is of the opinion that the Emergency Telephone Assistance Act should be continued on a permanent basis, and that the eligibility list should be expanded beyond those presently eligible.

It should also be recognized that two low-cost alternatives are available to families and individuals on the margin. We are referring, of course, to message and measured services which are options to flat rate service for those whose use of the telephone is limited. Although Mountain Bell has recommended that a $25 charge be made for changing to measured service, we find that the charge for obtaining measured service should remain at $10.10 in order to enable the measured service option to be more readily available to low-income individuals and families. We find that the $25 charge is likely to be a barrier to entry to obtain this service. We also believe that the $10.10 charge should be payable over a reasonable period, such as six months. Although the low-cost option of measured service has already been available for some time, the penetration rate for this service has been quite negligible, less than 1 percent according to Mountain Bell Witness Unruh. We attribute this in part, at least, to the fact that Mountain Bell has failed to advise residential customers of this low-cost option.

The Commission learned through public witness testimony by Mountain Bell telephone service representatives that the company does not require consistency in the information the public receives about low-cost option alternatives to flat-rate service. Telephone service representatives are not required by Mountain Bell to inform all customers who call for new service or changes in service about low-cost message or measured service rates, or to offer to everyone the option of paying installation and deposit charges in monthly installments.

We conclude that the settlement presented to the Commission on December 29, 1986, is reasonable and that it should be implemented without delay. A phased-in approach to the implementation of the settlement, though superficially appealing in terms of easing the burden at the present time, may intensify the burden down the road when the subsequent phase-in of the settled rates coincides with increases mandated by the FCC in January of 1988.

A phased-in approach to implementing the settlement agreement rates (in the event these rates were approved by the Commission) was not proposed by any party in the hearing. Accordingly, there is no quantification of the likely administrative costs and burdens which would occur if a phased-in approach was adopted. Even without such quantification, however, common sense would dictate that certain legal and administrative costs of administering a phased-in approach to the settled rates would be a significant cost to the general consuming public of Colorado.

III.

BASIC EXCHANGE SERVICES

A. Revenue Change

Mountain Bell proposed a revenue increase of $50,748,000 for basic exchange services, and a reduction in service charges and construction charges, etc., of $10,650,000. The Staff's position based upon its cost-of-service study was that basic exchange services should yield an overall revenue increase of $40,941,000 and that the reduction of service charges and construction charges should be $843,000, rather than $10,650,000 as proposed by Mountain Bell. The OCC, based upon its stand-alone cost studies for basic exchange and intraLATA toll, recommended a $5.9 million increase for basic exchange. The stand-alone cost study was interesting and helpful. While it is not the basis for our decision, it does suggest that neither local access nor long distance prices is subsidizing the other. The CML recommended an increase of $6.77 million to basic exchange predicated upon its contention that there was no showing of competition in the intraLATA toll market and, accordingly, that no intraLATA toll rate reduction was required.

In our discussion above concerning cost-based pricing, we found that the Staff's cost-of-service study was reasonable and should be adopted. The Staff's cost-of-service study correctly, in our view, indicates that a revenue increase of $40,941,000 is reasonable for basic exchange recurring services, and that a reduction of $843,000 for nonrecurring charges is reasonable.

B. Nonrecurring Service Charges

Mountain Bell proposed to replace the existing service order in central office, line-service-charge elements with a product-related service and equipment charge. This proposal is a general restructure from the current multi-element method to a single charge per specific service. This charge generally would apply to all services being offered by Mountain Bell. It is intended to recover the costs associated with service ordering, central office line connection, or rearrangement of, as well as certain other non-recurring costs applicable to each service. Mountain Bell proposes that these costs be combined and recovered up front in a service and equipment charge.

Although the Commission has accepted the stipulation among Mountain Bell, the Staff, and AT&T Comm filed on December 29, 1986, one of the issues that was not resolved by that stipulation concerns the rates to be charged for installation of residential service. Mountain Bell acknowledged that the cost to initiate service is approximately $53, but requested that the Commission approve a below-cost rate of $30. The Staff's position was that a below-cost charge of $30 deviated too far from the actual cost of approximately $53, and would require a 70¢ per-line, per-month, subsidy from other residential ratepayers to those who desire to initiate service.

The Commission recognizes, as the OCC contends, that a high service and equipment charge can be a deterrent to low-income individuals in subscribing to residential service. Once again, the Commission must balance its general support of cost-tracking pricing with certain externalities which may dictate tempering a strictly cost-based proposal. We agree with the Staff that the divergence between cost (approximately $53) and Mountain Bell's proposed price for service and equipment charge of $30 is too large. The Commission finds that the more appropriate way to recognize the externality of the hardship of a $53 installation charge is to provide that this charge is payable in six equal monthly installments, interest free. Public witness testimony from telephone representatives shows that in certain circumstances, generally involving low income households, Mountain Bell extends the period of time to pay installation charges over a 12-month period, interest free. Mountain Bell should continue this practice and should offer the six-month installment option to all who request installation.

C. Monthly-Dial Tone Line and Usage Rates

Mountain Bell proposed certain increases in its monthly rates for dial-tone line and local usage elements of its basic exchange services. As noted above in our discussion regarding the residential dial-tone line service and equipment charge, the Commission has found that the usage element was overpriced because of the inclusion of non-recurring elements in the monthly usage element of approximately 70¢ per month per line. We find that the residential usage elements should be reduced to reflect the fact that the service and equipment charge should bear its actual cost incidence of $53, rather than being subsidized by the usage element in basic exchange.

Mountain Bell has proposed to introduce optional amplified voice-grade circuit service to meet increasing customer requests for conditioned facilities. We find that this proposal is reasonable and should be adopted.

Mountain Bell has also proposed to realign the usage rate elements of business line and trunk to the same monthly rate and for the inclusion of a rotary hunt element. The OCC argued that such a rate realignment was not proper. However, Mountain Bell did demonstrate during the hearings the developments in CPE made it technologically impractical to monitor whether or not a particular line customer (due to his own sophisticated equipment) was actually using his line as a *de facto* trunk. In other words, because of technological advances, the distinctions between line charges and trunk charges have become practically obsolete, and we find that Mountain Bell's proposal to realign these two rate elements is proper, at this time.

D. Measured Service

Mountain Bell also requests that business customers have available to them a new, optional, three-element, measured service plan with the same local usage rates as proposed for residential customers and we agree. It is contended that this plan is appropriate to provide an alternative to the single-element, message-rate service. It is argued that long holding time customers currently subscribe to Mountain Bell's message rate services for computer linkage, data transmission, and related activities thereby abusing this service, and that this use is subsidized substantially by other customers on the network. Mountain Bell has proposed eliminating future offering of message rate service for business and residential lines. We find that business message rate, as Mountain Bell contends, does have the potential for abuse through extensive data transmission, but that this abuse is much less likely among residential customers. Therefore, we accept Mountain Bell's proposal for business customers and reject it for residential customers. In addition, to our belief that great numbers of residential customers are not likely to misuse message service, we also believe message service is an important low-cost option which Mountain Bell should continue to make available to residential customers.

Mountain Bell also proposed to reduce the message unit allowance and to raise the charge for each additional unit for grandfathered business message usage customers. The Commission finds this proposal to be reasonable and will authorize the requested rates. Further, Mountain Bell proposed to reduce the first-minute charge and raise the each-additional-minute charge for the usage charges for measured usage service. The Commission finds these proposals to be reasonable and will authorize these rates.

IV.

INTRALATA TOLL

A. Competition

Mountain Bell has a statutory monopoly in the geographic areas it provides intraLATA toll service. The Commission has protected that monopoly and has ordered interLATA carriers to reimburse Mountain Bell for incidental intraLATA traffic carried by interLATA carriers. That decision is on appeal to the Colorado Supreme Court. Mountain Bell argued that the Commission should abandon interLATA carrier reimbursement because it is allegedly inaccurate and has never been paid. This argument must be rejected because the Commission considers this incidental traffic illegal. Failure to order reimbursement would only hurt other Mountain Bell ratepayers who would have to make up the lost revenue and would not be consistent with protecting Mountain Bell's monopoly status required in § 40-15-104(2), C.R.S. In addition, as we have already found, Mountain Bell's share of this market exceeds 99 percent and we find Mountain Bell's estimate of its market share is less reliable.

B. Rate Restructuring and Revenue Reduction

In this proceeding, Mountain Bell is proposing a number of modifications to its intraLATA toll tariffs. These include a reduction in revenue from intraLATA toll service together with a restructuring to reduce the taper in the mileage bands, a reduction in the Rate Savers Plan to match the reduction in toll rates, the introduction of an optional, volume discount plan, a reduction in revenue from OUTWATS service together with a restructuring of the rates to make the service more attractive to the medium-sized user and, finally, a small increase in the revenues from 800 service. Mountain Bell has proposed a reduction of $26,853,656 in intraLATA toll revenues, a reduction of $4,245,236 in OUTWATS revenues, and an increase of $316,756 in 800 service revenues. The effects of the rate restructurings are included in these figures. Staff modified the reduction in intraLATA toll revenues to $26,457,656 to account for the decrease of $396,000 of anticipated revenue underrecovery due to the offering of the optional, volume discount plan.

Mr. Van Ruler proposed in his testimony that Mountain Bell be required to unbundle their Exchange and Network Services Tariff. The record in this proceeding does not make clear all the implications of this change, and for this reason, the Commission finds that it cannot proceed with this change at this time. It would be interested, however, in hearing further arguments on this point in future proceedings.

Staff's cost-of-service study shows that with the restructuring of rates and the changes in revenues proposed for intraLATA service, the service is still earning above the overall rate of return approved for Mountain Bell as a whole. The Commission finds, therefore, that the benefits of these changes should be made available to the Colorado ratepayer. In order to account for the $396,000 in revenue that was left unaccounted for in the Settlement, the Commission will accept Staff's proposal to reduce intraLATA toll revenues by $26,457,656 instead of Mountain Bell's original proposal of $26,853,656.

C. Volume Discounts

Mountain Bell has proposed a new, optional, volume discount plan to meet the need of volume toll users who do not have high enough usage levels to warrant the purchase of WATS services. This plan would include a non-recurring presubscription charge to establish or change the service and a discount scale which is based upon a presubscribed amount of minimum monthly usage. Mountain Bell also proposed a tapered schedule of OUTWATS which will result in a reduction in those rates to provide a lower-priced alternative to long distance message telephone service for high-volume users who might seriously consider bypassing the Mountain Bell system. Mountain Bell's Witness Heinze testified that the volume discount plan would be useful to customers using more than $200 per month in intraLATA toll while the restructured OUTWATS tariff would be beneficial to customers using more than $300 per month in intraLATA toll. The Rate Savers Plan would be attractive to the lower volume user.

The optional, volume discount plan was supported by Staff and by Mr. Larry Van Ruler, witness for the Independent Telephone Companies. He showed in his direct testimony that this plan is an effective cap on the customer-related access line cost charge for originating traffic, and as such reduces the incentives for bypass by the large customer. The volume discount assures that the large user will pay the customer-related costs of their access line, but prevents the overrecovery that a linear customer-related access line cost charge would produce. In order to assure that the customer-related access line costs are recovered, however, the customer must presubscribe to the plan. If this is not required, then in those months when the $200 minimum is not achieved, the customer-related costs are underrecovered while in those months when the $200 minimum is exceeded, the recovery of customer-related costs is capped. The result is an overall underrecovery. For this reason, the Commission finds that presubscription should be required to the optional volume discount plan.

D. Closed End of WATS

Mountain Bell has proposed that the Carrier Common Line Charge (CCLC) be removed from the closed end of WATS lines and that these lines be billed under Special Access rates. This is consistent with the treatment of these lines ordered by the FCC in CC Docket No. 86-1. The closed end of a WATS line is the originating end of an OUTWATS line or the terminating end of an 800 service. In either case, the lines are point-to-point service dedicated to the use of a given customer. The remainder of the WATS service is not billed under the Switched Access tariff, but under the applicable WATS tariff. Use of either OUTWATS or of 800 service is typically by the high volume toll user. The imposition of a CCLC on these lines is a strong incentive for these customers to bypass the Mountain Bell network and has no cost basis since payment for the use of the local network by the WATS subscriber is made in the WATS usage rates. Removing the CCLC from these access lines is a highly targeted and cost-justified move to significantly reduce an unnecessary bypass incentive presently existing in Mountain Bell's rate structure. The Commission finds that this proposal is in the public interest and will approve the requested change.

V.

INTERLATA ACCESS

A. Bypass and Revenue Reduction

Our general discussion of competition and cost-based pricing in this Decision above applies with particular force to interLATA access which is the charge that a carrier pays to Mountain Bell for access to Mountain Bell's system. InterLATA toll, to be distinguished from intraLATA toll in Colorado, is one of the more competitive telecommunications service markets. We have already indicated that there are five entities authorized under the doctrine of regulated competition to provide interLATA toll service in Colorado, namely AT&T Comm (which has grandfathered authority to provide the service), MCI, Sprint, and Western Union who were certificated by this Commission in 1985, and Telephone Electronics Corporation West who was certificated in 1986. A carrier such as AT&T Comm faces the competitive forces of bypass. As is typical in the telecommunications industry, AT&T Comm's largest customers account for a disproportionately high percentage of total revenues. These customers are sophisticated not only in their needs, but also in their ability to analyze and act upon alternatives. They are aware that their charges are increased by the present access charges paid by AT&T Comm to Mountain Bell. These large customers can reduce their telecommunications costs, either through direct links to the interLATA carrier, or through the creation of private systems. Bypass potential is a factor that even OCC Witness Johnson considers should be taken into consideration by this Commission in reaching our spread-of-the-rates decision.

A portion of the access charge paid by an interLATA carrier to Mountain Bell goes to pay for non-traffic sensitive (NTS) costs. These costs, which by definition do not vary with usage, are today supported by interLATA carriers and their customers through the CCLC of 5.24¢ per originating and terminating access minute. The FCC recently ordered a further reduction in the CCLC rate for originating traffic to 1.55¢ per minute effective January 1, 1987. The Staff cost-of-service study indicated that the state carrier access category showed a rate of return of 22.43 percent. OCC Witness Johnson indicated that intrastate switched access service produced a relative contribution of 248 percent over cost. Thus, both on a rate-of-return basis and a contribution-over-cost basis, it is clear that interLATA access at the present time is significantly overpriced and the prices need to be lowered in order to bring them more in line with its cost.

In its initial Advice Letter No. 2041 filing, Mountain Bell requested an overall revenue reduction of $12,817,084 in interLATA access charges. This figure consisted of a reduction of $11,351,629 in the CCLC, local switching, and local transport revenues, plus a reduction of $1,465,455 in billing and collection revenue. In the course of the

Staff's audit, an error was discovered in the calculation of the local transport revenue which enlarged the overall decrease from $11,351,629 to $11,733,128. In its audit, the Staff also found that the decrease of $1,465,455 in billing and collection revenues was due to a projected decrease in the volume usage of this service and was not due to a reduction in rates. In the hearings, the Staff contended that this reduction more properly was a Phase I (revenue requirements) issue and should not be considered in this spread-of-the-rates docket. In the settlement agreement, Mountain Bell agreed to withdraw its request for this revenue, and the Commission concurs in this decision.

Mountain Bell has proposed to reduce the access revenues in the following manner: first, the CCLC will be set equal to the interstate CCLC charges in effect prior to the FCC's modification in January 1987, or $.0304¢ per minute for originating access and 04.33¢ per minute for terminating access. Second, all originating WATS minutes and terminating 800 access minutes will be exempted from the CCLC charges. Third, the local transport charge element of access will be adjusted downward to flatten the mileage taper presently in effect. Fourth, the intercept element of the access charge will be increased slightly. Finally, prices for local switching and line termination elements of access will remain unchanged.

Mountain Bell justifies its interLATA access charges again on the basis of business and market-related reasons. We agree that the present CCLC rate of 5.24¢ per minute is over three times higher than that presently assessed at the interstate level for originating traffic (01.55¢ per minute). We recognize that this discrepancy may well create incentives for carriers and resellers to misreport their percentages of interstate usage and generally shop from the interstate tariffs rather than from the intrastate tariffs. However, our principal reason for agreeing with Mountain Bell's proposal in interLATA access is that it is sustained by Staff's cost-of-service study, which indicates that, even at reduced levels, interLATA access charges will more than recover their cost of service and provide a substantial contribution to NTS cost recovery.

B. Non-Premium Access

MCI and Sprint have requested the Commission to order a 55 percent access charge discount in nonconforming (that is, non-Feature Group D or "non-equal access") end offices in Colorado. They contend that access in such offices using Feature Groups A (FGA) and B (FGB) places them at a competitive disadvantage compared to AT&T Comm. The dollar impact of this premium differential was not quantified during the hearings, and it is assumed that the total amount of money in question is relatively insignificant. MCI and Sprint have said that for them it is a matter of principle that they should not have to pay the same access charges as AT&T Comm which, on an overall basis, has the advantages of superior interconnection with Mountain Bell.

In 1984 Mountain Bell had proposed that a 55 percent differential be adopted for interLATA traffic-sensitive and NTS rate elements charged to other common carriers, who are interexchange carriers, other than AT&T Comm. However, before the 55 percent differential could be adopted, Mountain Bell withdrew the tariff pages which recommended the differential in a revised tariff filed in July 1984, which was implemented that month without a hearing. The revised tariff did not provide for a differential.

The FCC and 9 of the 14 states served by U S WEST subsidiary operating telephone companies provide other common carriers, such as MCI and Sprint, with a differential. The FCC has provided a 55 percent differential for FGA and FGB since 1984 for both traffic-sensitive and NTS interstate access rate elements in non-equal access offices. Once an end office is converted to equal access, the differential is removed even if a carrier continues to use FGA or FGB out of that office, or chooses not to offer equal access. The differential, therefore, is not structured to reward other common carriers who do not offer equal access. Instead, it actually encourages a operating telephone company, such as Mountain Bell, to convert end offices to equal access as soon as possible in order to collect the same rates from other common carriers as from AT&T Comm.

In the hearings in this docket, the testimony of Timothy J. Gates on behalf of MCI; Carolyn Ratti and Ronald Havens for Sprint; and Robert Hirsch for AT&T Comm, outlines the differences among the various feature groups. All four witnesses recognize that FGA is the most inferior of the feature groups. The biggest problems of FGA include the fact that a rotary phone cannot be used, a customer has to dial up to 22 numbers to complete a call, they have no automatic number identification (ANI), no call supervision, no guarantee of transmission quality, and noise and echo suppression are needed. To complete a call using FGA, a customer must use a touch-tone telephone and dial a local, seven-digit number, which is different in every city. After receiving a second dial tone, the customer dials a five-number personal identification number (PIN) plus the ten-digit number of the person to be called (which includes the area code).

FGB Access also is inferior to both FGC and FGD. Unlike FGA, which can only be accessed without a toll call in those local calling areas in which a seven-digit access number is available, a call can be made using FGB Access from anywhere Mountain Bell serves. The trunk side switching allows a call to be made from any BOC end office in a LATA by dialing a universal access number, 950-1/0XXX. Still, an FGB tandem call suffers many of the same problems as FGA. Using FGB, it is necessary to dial either 32 or 36 numbers to complete a call. The customer must dial the universal 7-digit or 11-digit access number, plus 11 numbers to reach the person called, plus a 14-number PIN. This is between 10 and 14 more numbers than are necessary using FGA. In addition, rotary dial station signaling and ANI are provided on an optional basis only. Moreover, transmission quality is not guaranteed from end-to-end of the call.

FGC and FGD have all of the qualities that FGA and FGB tandem lack. They can be accessed using both touch-tone and rotary dial telephones. Approximately 24 percent of Colorado customers have rotary dial phones. Intrastate toll calls can be completed by dialing only eight digits. Only 11 digits need to be dialed to complete interstate calls. ANI is provided, and transmission quality is guaranteed. Calls can be originated anywhere in Colorado.

Approximately 2 percent of the lines in the State are served by independent companies. Their customers, and those of Mountain Bell in non-electronic switching offices, may never be converted to equal access. While 81 percent of the lines in the State now provide equal access, the percentage is expected to increase by only 1 or 2 percent in the next few years. As a result, other common carriers will be able to provide only inferior access to 17 or 18 percent of the lines in the state for the foreseeable future. A differential is a small price to pay to encourage Mountain Bell to convert more end offices to equal access.

Finally, MCI has made a bona fide request to Mountain Bell, in accordance with the MFJ that non-conforming end offices be converted to equal access. In response to MCI's concerns, Mountain Bell submitted during the hearing an answer concerning conversion which the company entitled "MCI Data Request No. 1." The response indicated that Mountain Bell is working with the Department of Justice to convert more end offices. So long as unequal access remains, the 55 percent differential is fair and reasonable.

Some concern was expressed that granting other common carriers, such as MCI and Sprint, a differential would require that the loss in revenue to Mountain Bell be made up in higher rates somewhere else. As indicated above, the differential revenue loss was not quantified by Mountain Bell, MCI, or Sprint in the event a differential were to be ordered, but Staff Witness Parkins did submit a confidential exhibit that indicated that the level of FGA and FGB traffic in the state is small. Much of that traffic would not be subject to the differential, since FGA and FGB tandem are also available in equal access offices where the differential would not be available to MCI and Sprint. The Commission finds that it is appropriate to order Mountain Bell to follow the FCC's practice of making up the differential revenue from all rate elements of the switched access tariff, rather than spreading the recovery of this revenue deficiency over the general body of ratepayers.

C. Time-of-Day Differential Access Charge

CML and Comptel presented testimony in this docket arguing for a time-of-day (TOD) discount on switched access that tracks both Mountain Bell's intraLATA toll TOD rating periods and Mountain Bell's intraLATA TOD discounts. Mountain Bell argued against this proposal for a variety of reasons, including that the proposal would lead to non-economic use of facilities. Mountain Bell did admit in cross-examination that its intraLATA toll TOD rates are designed both to stimulate off-peak usage of otherwise idle plant and to track costs. CML and Comptel argue that since the same facilities of Mountain Bell are used for delivering switched access service and for delivery of intraLATA toll service, the rationale for TOD toll discounts is equally applicable for TOD switched access discounts. Nevertheless, CML and Comptel conceded that more information should be presented on this issue before Mountain Bell is ordered to implement specific TOD switched access rates.

CML and Comptel did encourage the Commission in this docket to embrace the concept of TOD switched access rates and to order Mountain Bell, in its next spread-of-the-rates filing, to present sufficient information about TOD switched access rates so that the Commission can judge the advisability of ordering discounts that track Mountain Bell's intraLATA toll TOD discounts. Such information would include, but would not be limited to, stimulation and repression studies. The Commission acknowledges that conceptually the TOD access discount is an interesting one, but by saying this we neither endorse the concept nor necessarily oppose it. Obviously, CML and Comptel like the concept and urge the Commission in this docket to embrace it. The Commission is not persuaded that embracing a theoretical and abstract concept, in the absence of any evidence as to how such a concept practically would be implemented, is of much value. Perhaps the most that can be said is that the concept is out on the table and the parties can proceed with it in future rate cases in whatever manner they see fit. In the meantime, the TOD access rate concept might be one which merits study by the Cost Methodology Task Force. At this time, however, we are not prepared to order Mountain Bell to perform special studies with regard to this concept. Of course, CML and Comptel are welcome to pursue whatever studies they believe are appropriate.

D. Access Charge for Mountain Bell

MCI and Sprint contend that Mountain Bell has proposed intraLATA toll rates that are lower than access charges alone for some calls in some mileage bands at certain times of day, and that, thus, Mountain Bell does not make the same contribution to local loop costs as other toll carriers such as MCI and Sprint, to the detriment of local ratepayers. MCI and Sprint contend that all intraLATA toll reductions proposed by Mountain Bell are suspect without the imputation of access charges to itself. The Commission believes that this is a non-issue at this time inasmuch as intraLATA competition is not legally permitted in Colorado and was found by the Commission to be miniscule. Mountain Bell has suggested that the only reason that imputation of such charges would be appropriate would be if the Commission failed to recognize the distinction between interLATA and intraLATA markets and openly acknowledged and allowed intraLATA competition with no restrictions. In that case, and in only that case, Mountain Bell says, would the issue of pricing advantage even be material. The Commission agrees with Mountain Bell except for the obvious and mistaken assumption that this Commission has the authority to allow intraLATA competition with no restrictions. Until such time as the General Assembly changes the law, if it chooses to do so, the provision of intrastate intraLATA telecommunications services is to be governed by the doctrine of regulated monopoly [see § 40-15-104(2)], C.R.S. In any event, if access charges were to be imputed to Mountain Bell, the charges computed for interLATA service would not be the appropriate levels. New rates would have to be computed using appropriate intraLATA revenue requirements and usage data.

E. Universal Local Access Tariff

OCC Witness Ben Johnson proposed a flat rate, universal local access service (ULAS) tariff to recover NTS costs for interexchange carriers in lieu of the CCLC. The ULAS tariff is an attempt to collect a flat or set amount from facilities-based interexchange carriers based either upon their relative channel capacities or upon their minutes of use. The total amount to be collected would be the same each month, or quarter, or year depending upon the selected time frame. The monies owed by any one interexchange carrier to Mountain Bell would be based on its percentage of the total channel capacity or minutes of use. The ostensible motivation for ULAS is that since NTS costs are recovered by the CCLC (which is usage-sensitive) there is a motivation for uneconomic bypass. However, Dr. Johnson admitted that bypass presently is not that much of a problem in Colorado. Still, he recommended that ULAS be adopted to prevent potential bypass.

Staff Witness Parkins stated that only 5.7 percent of the total NTS revenue requirement for intrastate and interstate long distance calling in Colorado is intrastate interLATA. Even if Dr. Johnson's contention concerning the effects of bypass on the rates of end users were true, we agree that implementing ULAS for interLATA access would have little effect.

To the extent that bypass incentives exist, they more clearly relate to interstate calling. The FCC has attacked this problem by reducing the CCLC on both the originating and terminating ends and by eliminating the charge on the closed end of WATS.

Staff Witness Parkins explained the reasons why ULAS would be administratively unworkable. Dr. Parkins testified that there have been a number of disputes concerning how interexchange carriers report channels and how these reports are verified. He was referring to the state of Kentucky where disputes have involved not only the interexchange carriers and the local BOC, but also the staff of the Kentucky commission. Whether the ULAS plan is predicated upon a channel capacity method or a minutes-of-use method, the reporting by each interexchange carrier would directly affect the payments by every other carrier. As a result, the interexchange carriers would have a direct interest in auditing the records of each other. Practically, the only ostensible entity that could mediate disputes among a large number of conflicting parties would be the Commission Staff. Adoption of ULAS may also involve the Commission itself in additional hearings to determine whether the ULAS plan is working properly.

A further difficulty with ULAS is that ULAS would discriminate against small interexchange carriers. Dr. Parkins testified that AT&T Comm's large trunk groups allow it to carry more calls per channel than those of small interexchange carriers. Dr. Parkins testified that the Erlang-B tables show that larger trunk groups are more efficient than a normal arithmetic progression would anticipate. As a result, comparing the relative channel capacity of AT&T Comm, which has a ubiquitous network in place in Colorado, with those of smaller interexchange carriers such as MCI and Sprint would be discriminatory. No evidence was presented to dispute the fact that larger AT&T Comm channels are more efficient. Therefore, relying on channel capacity to assess interexchange carriers for NTS costs would result in AT&T Comm being assessed a lesser amount per equivalent call than MCI or Sprint. We do not believe that such a result would be fair.

In response to these complaints, Dr. Johnson offered the minutes-of-use plan because he believes that it is fair to smaller carriers. He admitted, however, that it could result in a higher incremental cost for smaller interexchange carriers than a dominant carrier such as AT&T Comm. Dr. Pelcovits testified for MCI and Sprint that they would incur incremental costs which could be as much as five and one-half times higher than AT&T Comm for additional minutes of use. The reason is that the larger its market share, the less it costs an interexchange carrier to increase its minutes of use under a flat rate recovery plan such as ULAS. The converse is true for smaller interexchange carriers. Dr. Johnson also noted that the minutes-of-use proposal is more administratively burdensome than the channel capacity plan.

Dr. Johnson attempted to negate the foregoing problem by arguing that the average cost for all interexchange carriers would be the same no matter who stimulated traffic. What he refused to acknowledge is that interexchange carriers are more concerned with the incremental costs of each additional minute in determining whether to stimulate traffic, and that his proposal would place a greater burden on smaller interexchange carriers than it would on AT&T Comm for making that decision.

We find that special access and direct interexchange carrier connections should not be assessed a cost for the public switched network because they are not part of that network. Any such charge that would be assessed under ULAS would be an uneconomic cost which would make private network bypass more attractive as an alternative. Contrary to its proponents, ULAS is likely to encourage rather than discourage bypass. Because a customer's decision to bypass results in a long-term commitment due to the initial investment cost of constructing facilities, even a short-term adoption of ULAS could have unfortunate effects of driving large customers from the public switched network.

We find that lowering the intraLATA CCLC will do more to blunt whatever little bypass threat exists than the adoption of ULAS. The reduction in the CCLC would make the public switched network more economical for large users and will likely result in an increase in the minutes of use through a stimulated demand for which interexchange carriers pay a usage-sensitive rate. ULAS may well be a problem-creator rather than a problem-solver since it would encourage harmful price discrimination against lower volume interLATA toll users as well as resulting in a number of the administrative problems alluded to above. Although ULAS has been proposed in a number of states, it appears that it has only been adopted in the state of Idaho (where AT&T Comm is the only interexchange carrier) and in the state of Kentucky (where it has encountered a number of administrative problems).

For all of the reasons articulated above, we find that ULAS should not be adopted in Colorado.

VI.

PRIVATE LINE AND SPECIAL ACCESS

A. Revenue Increase

Mountain Bell proposes to reprice private line and special access services based upon LIRC costs studies. Mountain Bell also proposes to merge the special access and private line tariffs. As a result of these proposals, the total annual revenue effect of all recurring rate charges for private line and special access services is an increase of $10,281,685. Mountain Bell is also proposing to place the existing non-recurring charge structure for private line and special access with a product-related service and equipment charge, the total annual effect of which would be an annual increase of $3,560,540. CML has opposed the increases as excessive and has proposed to limit the increase to $5,878,000.

Although Mountain Bell justifies its pricing proposals for special access and private line on the basis of LRIC, for the reasons which we have stated above about the pricing of other services, the Commission finds that Mountain Bell's justification on that basis is unwarranted. We do agree, however, that the pricing proposals are just and reasonable since they do reflect the Staff's cost-of-service study which, as indicated above, we have found to be proper. The Commission acknowledges that CML is correct in its contention that Mountain Bell and Staff did not allocate loop circuit investments to residential users. However, the fact that these circuits were not so allocated did not materially affect the validity of the Staff cost-of-service study and certainly forms no basis for disregarding the study altogether.

If absolute perfection were the indispensable factor determinative of whether a particular cost study could be used, it is doubtful that any cost study could ever be used. Of the various cost studies introduced in I&S 1720, we find that the Staff cost-of-service study was the best one presented and most reasonable. Accordingly, we find that a combined revenue increase for private line and special access in the amount of $13,842,225 is just and reasonable.

The Staff's study shows that, even with the full increases, the combined service will be earning slightly below the rate of return authorized for Mountain Bell as a whole. It should be noted that according to Mountain Bell, private line has been earning significantly under its cost for some time. While the increases in certain specific individual elements of private line are significant, and at the same time other elements receive decreases, no evidence was presented to quantify the overall impact of Mountain Bell's proposal on individual customers who subscribe to multiple private line service offerings.

B. Merger of Private Line and Special Access

Prior to January 1, 1984, a single tariff governed all private line services offered in Colorado and all private line services were provided by Mountain Bell pursuant to this tariff. At that time, there was, of course, no distinction between interLATA and intraLATA private line because there were no LATAs. As of January 1, 1984, the private line circuit which happened to cross a LATA boundary was denoted an interLATA circuit, and the ownership of the interLATA portion of these facilities was transferred to AT&T Comm. The remaining intraLATA portion of that same circuit was renamed and rerated as special access provided to interexchange carriers by Mountain Bell. Mountain Bell Witness Mansell testified that not a single circuit was changed as a result of divestiture. However, with divestiture, two tariffs and two different sets of rates were put into place for these services. It is the existence of these two tariffs and the two differing sets of rates for virtually identical services which gives rise to the rate discrimination that exists today between private line and special access. It is this rate discrimination that prompted Mountain Bell to propose the merger of the two tariffs.

CML and Comptel were the only intervenors opposed to the merger of private line and special access. OCC, through Witness Johnson, accepted the concept of the merger proposal, but resisted immediate merger on the ground that the resulting private line increases would be excessive. Accordingly, OCC supported the notion of moving the rates of private line and special access closer together with the eventual objective of merging those rates.

CML Witness Dunkel listed several reported distinctions between private line and special access which formed the basis for CML's opposition to tariff merger. CML contends that private line service is not interconnected with another service and that the very nature of special access services is that it is merely one piece of a larger, interconnected service. CML also contends that the coordination problems that have existed in the past relating to special access are such that far too many problems and too many unknowns exist to justify the combining special access service with private line service. In our judgment, these are very thin arguments upon which to reject the proposed merger of these two tariffs. The fact that private line services are provided to the general public and special access services are provided primarily to carriers is nothing more than a truism; it does not justify rate discrimination in functionally equivalent services. Similarly, simply because a private line service is an end-to-end service, while special access service is a part of a larger service, is not in and of itself persuasive that the corresponding portions of these services should not be provided at the same rate.

CML Witness Dunkel also opposed the merger of the private line special access tariffs on the ground that the resulting merged tariff would be too complicated for customers to use easily. The Commission is not persuaded that this will be the case. Private line customers are typically sophisticated users who are quite familiar with the use of Mountain Bell's tariffs. Small users, who may not be as familiar with these tariffs as large users, will have available Mountain Bell's business office to advise them on services and rates. The critical issue is whether the services functionally are equivalent, and, on that score, there can be no dispute that they are. Accordingly, we find that the merger of the private line special access tariffs, as proposed by Mountain Bell, should be approved.

C. <u>Non-continuous Property</u>

CML Witness Dunkel criticized Mountain Bell's treatment of noncontinuous property extensions (NCP) in the new tariff. Mr. Dunkel points out that Mountain Bell calculated the costs for only the "central office provided" NCP extensions, and based its rates on this cost. It did not compute costs for direct-connected NCP extensions. Mountain Bell's Witness Elder testified that in doing its cost studies, Mountain Bell advertently erred by including the cost of only one loop, and in fact, may have significantly underestimated the cost. Mr. Elder also testified that he had performed his RCAS study without including any NCP loops, and that the increase was still indicated.

The Commission finds that Mountain Bell should correct its cost studies as quickly as possible to comply with I&S 1575 and submit the results to the Commission within 90 days together with any changes in the rate treatment of NCP extensions that are indicated by the studies. In the meantime, the Commission notes that, except for the one example cited in the testimony of Mr. Dunkel, there was no evidence of any significant harm to NCP customers, notwithstanding the fact that Mountain Bell did not strictly follow our directives in I&S 1575 to use engineering and traffic data in assigning costs due to the relative cost to compile the data now, versus the small benefit derived. As a consequence, the

Commission finds Mountain Bell's proposal is rational and that the problems indicated with NCP extensions are not significant enough to convince it to disallow the restructure or the merger of the private line and special access tariffs.

D. Alternate Pricing Arrangement

Mountain Bell's Private Line Access Service tariff, Page 15, 7.2.2., Rate Regulations, provides as follows:

> F. ALTERNATE PRICING ARRANGEMENT
>
> Where circumstances warrant, a customer subscribing to Private Line Access Service may request, on an individual case basis, an alternate pricing arrangement. The terms and conditions of such an arrangement will be determined by the Telephone Company at the time the request is made.

The Commission finds that this provision in the Private Line Access Service tariff and any similar language that may be found elsewhere in the tariff is improper and contrary to the intent of this decision. The Commission will not approve a provision such as this, which allows Mountain Bell unfettered discretion to circumvent all other tariff provisions found in the Private Line Access Service tariff.

VII.

ANCILLARY SERVICES

As a result of the settlement agreement, Mountain Bell now has proposed that, instead of eliminating the directory allowance altogether and charging 30 cents a call for directory assistance, directory assistance be reduced from five free calls a month to two free calls a month, with calls after the second call costing 32 cents each. Mountain Bell also has proposed that call-waiting be priced at a uniform statewide rate of $9 per month for business and $4.50 per month for residential. Mountain Bell also has proposed a 50¢ discount per feature on multiple subscriptions to custom calling services. The OCC generally agreed, but would not favor a 50¢ discount for the first custom feature obtained by the customer in a multiple subscription. The OCC also argued that the business rate for call-waiting should be $12.75 per month rather than $9. Finally, Mountain Bell has proposed a $2 charge per month for non-published service in which the identity of a Mountain Bell customer is not disclosed either in the telephone directory or by a call to directory assistance and a $1 charge for non-listed service whereby the Mountain Bell customer's name is not listed in the directory, but is available from directory assistance. We were convinced by Mountain Bell that contribution from recurring charges will more than offset the lower revenues from the non-recurring charges. We find all of the foregoing proposals of Mountain Bell to be reasonable, and they should be implemented.

VIII

OTHER ISSUES

A. Costing Methodology Task Force

Following the conclusion of I&S 1575, a costing methodology task force was established for the purpose of having Mountain Bell, the Staff, and other interested parties interact about ongoing costing method problems. The settlement agreement proposes that the Costing Methodology Task Force be continued to study such issues as service category disaggregation, differential depreciation, use of peak responsibility data, and the evaluation of the National Regulatory Research Institute trial study under way in the state of Texas for the potential appropriateness in Colorado as part of the three-to-five-year pricing plan, etc.

CML argues that the Costing Methodology Task Force should be discontinued since, in the past, it largely has been confined to a dialogue between Mountain Bell and the Staff because the cost of participation by other interested parties would be prohibitive. Meetings of the Cost Methodology Task Force and participation in it are and were open to all. The Commission most emphatically encourages an open dialogue, but recognizes the obvious fact that this Commission has no authority either to conscript other participants into the process or to provide funding for them.

We are not persuaded that non-participation by others due to financial considerations should derail this ongoing project. The Commission also would welcome additional participation and will consider seriously any other topics which may deserve new or additional study. The Costing Methodology Task Force itself, of course, is limited in terms of time and resources that can be channeled to it. A prioritizing of matters to be studied will have to be made by the task force. Periodic public meetings of the task force and the Commission will be held to advise all interested persons of the status of its work.

B. Tariff Riders

We agree with Mountain Bell that various tariff riders appearing in its exchange and network services tariffs should be replaced with actual rates for ease of use. Rates affected by riders, that have a specific termination point however, should be designated by appropriate language describing the embedded amount due to the rider and the termination date.

IX

CONCLUSIONS

I&S 1720 has been a very complex and difficult docket since this is the first major restructuring of Mountain Bell's prices for its goods and services since 1977, and the first since the divestiture of the Bell System on January 1, 1984. We have not discussed each and every issue that has been raised either in the pleadings or in the hearing room. However, we specifically find that all of the rates and charges which result from implementing this decision are just and reasonable, and not unduly discriminatory. In addition, any additional services approved in this order and services which have been modified or deleted are reasonable. A summary of the annual revenue effects is attached as Appendix D.

We have discussed the major relevant issues which we believe merit our specific attention and response. Except as indicated in the body of this Decision, we agree that Mountain Bell's tariff proposals, which accompany its Advice Letter No. 2041, dated July 25, 1986, should become effective on May 1, 1987. Although technical provisions of the Public Utilities Law would allow this Commission to suspend permanently some of Mountain Bell's filed tariffs before the March 21, 1987, expiration of the statutory suspension period, and allow others to go into effect at the end of the statutory suspension period, for purposes of administrative efficiency and to avoid confusion, we have decided to suspend permanently all of Mountain Bell's Advice Letter No. 2041 tariff filing today before the end of the statutory suspension period, and order Mountain Bell to make a new filing with an effective date of May 1, 1987, that is consistent with the directives contained in this Decision. In this way, Mountain Bell's entire rate restructure will take place simultaneously and confusion to its customers hopefully will be avoided.

To the extent that Mountain Bell or any other party has made a proposal which was not embodied in the original Advice Letter No. 2041 tariff filing and which has not been discussed specifically in this decision, the Commission finds that the treatment advanced does not merit adoption by the Commission in this docket.

<u>THEREFORE THE COMMISSION ORDERS THAT</u>:

1. The collective tariff filing filed by The Mountain States Telephone and Telegraph Company with this Commission on July 25, 1986, in Advice Letter No. 2041 is suspended permanently.

2. The Mountain States Telephone and Telegraph Company shall file new tariffs in accordance with the directives made in this decision on or before April 17, 1987, with an effective date of May 1, 1987.

3. The tariff riders filed by The Mountain States Telephone and Telegraph Company in accordance with Ordering Paragraph 1, Decision No. C86-646, dated May 23, 1986, shall continue in effect until the effective date of the tariffs filed in accordance with Ordering Paragraph 2 above, subject, however, to further order of the Commission.

4. The Mountain States Telephone and Telegraph Company shall implement the tariff changes ordered by Ordering Paragraphs 2 and 3, by filing an appropriate advice letter, accompanied by the tariffs. The tariffs shall state the decision number of this decision and the effective date of May 1, 1987. The tariffs shall be filed without further notice or order and shall be self-executing in all respects.

5. The Mountain States Telephone and Telegraph Company shall comply with all directives of the Commission as set forth in this decision in the portion designated "Statement, Findings of Fact, and Conclusions," as well as those otherwise set forth in the Ordering Paragraphs of this decision.

6. The motions to strike filed by the Colorado Municipal League on March 4, 1987, the Office of Consumer Counsel on March 6, 1987; and The Mountain States Telephone and Telegraph Company on March 9, 1987; are denied.

7. Any other pending motions, or other requests made pursuant to other pleadings, including, but not limited to, statements of position or reply statements of position which are not otherwise disposed of by this decision and order, are denied.

8. Any party who intends to file a motion for reimbursement of attorney fees or expert witness fees, or both, in this docket shall do so on or before May 15, 1987. Any motion filed shall describe in specific detail, by subject matter, areas for which reimbursement is sought, the amount of time and expense associated therewith, and how reimbursement meets the established criteria of the Commission. The motions also shall be supported by affidavits.

9. For purpose of acting upon motions for reimbursement which may be filed in accordance with Ordering Paragraph 8 above, the Commission shall retain jurisdiction and enter further orders as may be necessary.

10. Further, The Mountain States Telephone and Telegraph Company is ordered specifically to train its service representatives to inform all present and potential residential telephone subscribers about the options of message service and measured service and what the rate impact would be compared to the flat rate service. The Mountain States Telephone and Telegraph Company also is ordered to make these services much more widely understood through inserts in its monthly billings and through other means of advertising.

11. This decision shall be considered a final decision, subject to the provisions §§ 40-6-114 and 40-6-115, C.R.S.

12. The 20-day time period provided pursuant to § 40-6-114(1) within which to file an application for rehearing, reargument, or reconsideration shall begin to run on the first day after the mailing or service by the Commission of this decision.

13. This Decision is effective immediately.

DONE IN OPEN MEETING the 20th day of March 1987.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Arnold H. Cook

Andra Schmidt

Commissioners

COMMISSIONER RONALD L. LEHR DISSENTING

COMMISSIONER RONALD L. LEHR DISSENTING:

In its decision, the majority accepts a rate restructure settlement which was reached between the PUC Staff and Mountain Bell to which AT&T Comm. has also agreed. The settlement can be characterized as shifting major amounts of revenue from the long distance toll market into the local market. It also raises most private line service rates and lowers access rates paid by long distance carriers to Mountain Bell for their use of the local telephone system. Two different justifications for these massive shifts are put forward by the parties. Mountain Bell bases its support for these shifts of revenue on the case they made for competition in their markets. The company's case, based on incremental cost studies, is grounded in the philosophy that competition requires toll customers to pay less and local exchange customers to pay more. While the Commission majority rejects this notion of competition on which the company's support for the settlement is based, it nevertheless accepts the settlement's terms.

It should be noted that the settlement increases Mountain Bell's rates in several markets the company argues are competitive. The CML's response to this anomalous situation bears repeating here:

> The irony of Mountain Bell's presentation is that in the private line market for large customers with multiple lines (the single market in which Mountain Bell has shown the existence of some alternative facilities), Mountain Bell is proposing huge price increases! Clearly, this pricing approach is anathema to the Company's articulated concern of pricing its services low enough to meet the competition. The Company's pricing approach in the private line categories is, however, compatible with monopoly pricing. Mountain Bell seems determined to price private line at such a level as to drive private line customers to use alternative suppliers and alternative technologies, thus fulfilling a "death wish" and unhappily terminating a self-fulfilling prophecy that began with the Company's decision to eliminate Telpak several years ago--a decision that clearly signalled the beginning of a proliferation of privately owned microwave systems. Nor has the Company even attempted to address the issue of why alternative private line service providers can provide private line and private line-like service for a lesser price than Mountain Bell can offer when the same technologies are available to all suppliers and Mountain Bell enjoys the advantages of scale economies. (CML position statement, p. 3)

The Staff supports the rate restructure settlement for entirely different reasons. The Staff's case, based on fully distributed costs, is founded on historical accounting for costs and certain allocation assumptions that the majority finds to be acceptable. Just as the company's long-run incremental studies are riddled with assumptions about the future of markets, competition, and the costs which are related to the transition toward competition, so the Staff's case, based on accounting costs, is riddled with assumptions about the underlying economics in the federal separations procedures, the allocation of NTS costs on four SPF factors, as well as assuming a relationship between the cost history and future costs.

While I do agree that the set of assumptions made by the Staff are more acceptable than those made by the company in this case, I do not believe that the majority opinion in this case is sufficiently cognizant of all the many assumptions made in the Staff's study nor sufficiently aware of the impacts of the large-scale rate increases they accept when they endorse the rate restructure settlement between the Staff and Mountain Bell.

The Office of Consumer Counsel estimated that about 20,000 Colorado households would lose their telephones if the settlement were accepted. This number of households is based on the best study of price elasticity of demand which is available to the Commission (the so called Perl study which indicates a price elasticity of -.04). It represents one end of a spectrum of opinion, the other end of which is the company's assertion that these price increases will not effect anyone's access to a telephone. I find the latter extreme of the range of argument simply outrageous. In the case of other essential goods, such as natural gas, electricity, and gasoline, price elasticities of demand were consistently underestimated even where total price was low. The majorities' reliance on the assertion that the majority of customers' rates will only be raised $2 per month or $24 per year ignores the velocity or rate at which telephone rate increases are eating into residential customers' discretionary income and the profit margins of business telephone customers.

This Commission has recognized in many prior cases the important rate principles of stability and continuity. For example, in I&S 1640, the Commission ordered a cap of 15 percent on any rate increase to any customer class. The OCC dealt with this concern in the following terms:

> As for the principle of rate continuity, the Commission has itself acknowledged the validity of this standard in a recent case. In I&S 1640, Public Service Company's last rate design proceeding, the Commission explicitly stated its belief that "rate stability and the policy of gradualism must be recognized." (Citation omitted)
>
> Realizing that the setting of all class revenues to meet a uniform rate of return will result in rate shock for certain groups, the PUC adopted <u>a Staff proposal to limit class rate increases to 15%</u> consistent with its "policy of gradualism and rate stability." (OCC opening statement of position, at 20, citing Decision No. C85-1032, at 25.)

The OCC argues that rate continuity applies both to rate increases and decreases, and that the existence of externalities in the telecommunications market lends even more weight to the argument for rate continuity in telephone rate design. The outcome in I&S 1640 was recognized by the Commission as a way to balance the concern for economic efficiency and cost based rates with the rate impact on certain classes of electric customers.

In its decision, the majority argues:

> A phased-in approach to the implementation of the settlement, though superficially appealing in terms of easing the burden at the present time, may intensify the burden down the road when the subsequent phase-in of the settled rates coincides with increases mandated by the FCC in January of 1988.
>
> A phased-in approach to implementing the settlement agreement rates (in the event these rates were approved by the Commission) was not proposed by any party in the hearing. Accordingly, there is no quantification of the likely administrative costs and burdens which would occur if a phased-in approach was adopted. Even without such quantification, however, common sense would dictate that certain legal and administrative costs of administering a phased-in approach to the settled rates would be a significant cost to the general consuming public of Colorado.

There is no doubt that the FCC has moved to shift costs from those who make extensive use of long distance calling to those whose use is mainly local in nature. The FCC's justification for these shifts in costs to local consumers is the same as the majority's in this case, namely, that strict economics requires users of mainly local service to pay for a larger portion of the joint and common costs of the system. The threat of bypass, to which the majority does not give much credence, is the FCC's reason for shifting the costs of the long distance market to local users.

The FCC has been overturned by the U.S. Supreme Court in a recent decision on its preemptive requirement of depreciation methods which shifted costs from long distance to the local market. (See, Louisiana PSC v. FCC, 106 Sp.Ct.Rptr.1890 (1986).) The Colorado PUC played a role in preventing that shift of costs by joining in the appeal of the FCC's decision. Rather than passively accept the FCC's cost shifts, I believe the Colorado Commission should re-dedicate itself to administrative, legal, and other advocacy to prevent the increases mandated by the FCC in January of 1988 from taking place. It does not follow, moreover, that increasing local rates in Colorado now in any way lessens the burden of FCC mandated rate increase in January, 1988.

While no one proposed a phased-in approach to the settlement agreement rates, as the majority argues, it is certainly within the power of this Commission to require a phased-in approach to the massive rate shifts it adopts in its decision. (See, for example, § 40-3-102, C.R.S.) To argue otherwise is to ignore both the Commission's broad discretion in setting rates and its previous practices in adjusting rate increases to take into account the important principles of rate stability and rate continuity.

While there is no quantification of the likely administrative costs and burdens of a phased-in approach, neither is there any quantification of the burdens imposed on most ratepayers by the majority's unwarranted increase to local subscribers. Yet the majority does not argue that in the absence of quantification of impact on ratepayers such a shift should not be undertaken, while they do argue that the administrative costs of a phased-in approach ". . . would be more trouble than its worth in terms of its cost benefit to the general consuming public of Colorado."

I would certainly agree that it would be more expensive and troublesome to phase in the majority's economic cost theory over a period of three to five years. The cost to the rate administrators at Mountain Bell and the Commission Staff needs to be weighed, not against the simplicity of the precipitous approach taken by the majority, but rather against the impact of the rate shock that they have created for most Colorado telephone subscribers by their order. On this basis, I believe that common sense would indicate that a phased-in approach to such a shift in philosophy and costs would have a great deal more benefit than costs.

In this case, the majority opinion does not deal constructively with the problem of rate shock. By moving precipitously to an economic cost basis without considering the need for residential, business, or governmental telephone customers to make adjustments in their budgets over time to absorb the massive shifts mandated by the majority, the majority not only creates a problem for low-income customers who will have to drop off the system but also creates a rate shock of tremendous magnitude for most of the telephone consumers in Colorado.

Mr. Robert J. Hix of the Office of Consumer Counsel in his prefiled direct testimony of December 1, 1986, showed the winners and losers in this rate restructuring. Mr. Hix's conclusions, to which I subscribe, are that the vast majority of residential consumers will pay more for telephone service under Mountain Bell's rate restructuring proposal. Mr. Hix notes that the vast majority of residential customers make few, if any, intraLATA toll calls in a given month, which minimizes any beneficial impact of a reduction in toll rates. Generally, residential flat rate local exchange service increases from 31 percent to 131 percent across the various rate classifications, and even residential customers with average toll use will see increases ranging from 16 to 37 percent, according to Mr. Hix.

Mr. Hix's analysis shows that a typical customer must spend at least $34.87 in monthly toll charges to avoid a $2.85 local service rate increase, as proposed by Mountain Bell. Since the average number of local toll calls for residential customers is less than 4, not nearly 30 as would be required to offset the local rate increases with toll savings, residential customers would have to make almost ten times the average monthly toll calls in the zero to ten mile band to offset the local rate increase. Mr. Hix notes, not without irony, that a residential customer who made no residential toll calls prior to the changes accepted by the majority in this case would not be likely to make nearly 30 per month just to make up a $2.85 local rate increase. It should be noted that over 40 percent of Mountain Bell's residential customers make no toll calls each month, on the average. In summary, the losers under this rate restructure are most residential and business customers, while the winners are those who use large amounts of Mountain Bell's toll calling services. Most private line customers are big losers while interexchange carriers such as AT&T Comm., MCI, and Sprint are winners since their access charges paid to Mountain Bell for use of the local network are decreased under the majority's decision.

The decision by the majority will have massively untoward and immediate affects which I believe are a very poor example of the Commission's execution of its responsibility to balance the need for rates based mainly on economic theories and assumptions with the necessity to make major shifts in policy (which cause major shifts in dollars) in a way that gives adequate notice to people and allows people to respond gradually over time.

The substantive results of the decision are bad enough in my opinion but when the process by which they were reached is considered, they become intolerable. Two procedural aspects of the settlement concern me greatly. First, the task force which worked on the Revenue Cost Accounting System (RCAS), while it was open to all, only involved participation by members of the PUC Staff and Mountain Bell. In my opinion, it is not enough simply to open the door to a process which by its nature excludes broad participation. The Commission needs to take an active role in ensuring broad public participation with consistent regularity in its informal processes. Processes which are too expensive or are too difficult for broad public participation produce results which, in my view, should be viewed with a great deal of skepticism. Rather than viewing the results of the task force with any sort of skepticism, the majority in their opinion simply buys the results of the task force as represented in the settlement.

My second procedural concern is focused on the contested nature of the rate restructure settlement. Whenever a settlement is reached between parties to which other parties object, I believe the Commission should look with a great deal of interest at the objecting parties' concerns. In this case, both the Office of Consumer Counsel and the Colorado Municipal League raised major substantive concerns about the settlement agreement which were ignored or discounted by the majority. Unless the Commission is willing to look with a very skeptical eye at settlement agreements which are made only by certain parties to a case, then objecting parties are essentially frozen out of any real role in the proceedings by the agreement of the settling parties.

In light of these procedural concerns, I believe my substantive concerns about the massive revenue shifts accepted by the majority in this case are magnified. Where the Commission's judgment is brought to bear in so many ways about the assumptions that are built into all the parties' positions on rate structure issues, I believe that at the very least some cushioning by a phase in of the massive revenue shifts would be greatly preferred over the majority's insistence that the economic principles are so clear cut and the case so compelling as to require a decision which creates real potential for massive rate shock.

For these reasons, I respectfully dissent.[1]

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Ronald L. Lehr

Commissioner

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[1] I also agree with the differential charge for inferior access provided to long distance carriers other than AT&T Comm. by Mountain Bell. I support majority's treatment of the CCLC on the closed end of WATS as an appropriate, targeted response to the threat of bypass. Insofar as the majority opinion recognizes the potential for competition in the interLATA, interstate toll, private line, and central office markets, and sets forth a process of transition to competition for these markets, I agree with this approach. It is consistent with the decision in Case No. 5323 regarding procedures for refraining from regulation. It represents a logical response to our responsibility to encourage an efficient transition to competitive telecommunications markets while preserving universal service (See § 40-15-110, C.R.S.).

LIST OF WITNESSES AND EXHIBITS

JANUARY 14, 1987

Mountain Bell

Orville Unruh	Direct Testimony Exhibit A
H. Craig Petersen	Direct Testimony Rebuttal Exhibit 2 Exhibit 3 (Proprietary) Exhibit 4 (Proprietary)

JANUARY 15, 1987

Mountain Bell

Frank Alessio	Direct Direct Exhibits Supplement to Direct Supplement to Exhibits
Gordon Blankenship	Direct Rebuttal Exhibit 2 Exhibit 3 Exhibit 4 Replacement Exhibit 5a Exhibit 5b Exhibit 6

JANUARY 16, 1987

Mountain Bell

Dallas Elder	Direct Exhibits Rebuttal Testimony Rebuttal Exhibits Exhibit 2

Christopher Zamora	Direct Exhibits
Frank Hatzenbuehler	Direct Rebuttal Exhibit 1

JANUARY 21, 1987

Mountain Bell

Robert Miner	Direct Exhibits Rebuttal Exhibit 2 (Proprietary) Exhibit 3 (Proprietary) Exhibit 4 (Proprietary) Exhibit 5 (Proprietary)

JANUARY 22, 1987

Mountain Bell

Susanne J. Mansell	Direct Exhibits Rebuttal Exhibit 2 Exhibit 3 Exhibit 4
James A. Heinze	Direct Exhibits Rebuttal Rebuttal Exhibits Exhibit 2 Exhibit 3 Exhibit 4 Exhibit 5 (Proprietary)
Stanford Levin	Direct Exhibit Rebuttal Exhibit 2

JANUARY 23, 1987

Mountain Bell

Stanford Levin	Exhibit 3

Office of Consumer Counsel

Ronald Binz	Direct Exhibits

JANUARY 28, 1987

Colorado Municipal League

William Dunkel	Direct (Exhibit 1) Direct (Proprietary) Cross Rebuttal (Exhibit 2) Cross Rebuttal (Proprietary) Surrebuttal (Exhibit 3) Surrebuttal (Proprietary) Supplement to Surrebuttal Exhibit 4 Exhibit 5 (Proprietary) Exhibit 7 Exhibit 8 Exhibit 8 (Remarked) Exhibit 9 Exhibit 10 Exhibit 11

JANUARY 29, 1987

Office of Consumer Counsel

Ben Johnson	Direct Proprietary Portions of Testimony Surrebuttal Testimony Exhibit Errata Sheet Exhibit 2 Exhibit 3 Exhibit 4 Exhibit 5 Exhibit 6
Thomas Catlin	Direct Direct (Proprietary) Exhibit 1 Exhibit 2 Exhibit 3 Exhibit 4 (Amended) Exhibit 5 Exhibit 6 Notice of Correction

JANUARY 30, 1987

Office of Consumer Counsel

Mark Correll	Direct Exhibit 1 Exhibit 2 Exhibit 3 Surrebuttal Testimony Surrebuttal Exhibits
Robert Hix	Direct Direct Proprietary Exhibit 1 (Proprietary) Exhibit 2 (Proprietary) Exhibit 3 (Proprietary Exhibit 4 (Proprietary) Exhibit 5 (Proprietary) Exhibit 6 (Proprietary) Exhibit 7 (Proprietary) Exhibit 8 (Proprietary) Exhibit 9 (Proprietary) Exhibit 10 (Proprietary) Exhibit 11 (Proprietary) Exhibit 12 (Proprietary) Exhibit 13 (Proprietary) Exhibit 14 Exhibit 15 Exhibit 16 (Proprietary) Exhibit 17 (Proprietary) Exhibit 18 Exhibit 19 Exhibit 20 (Proprietary)
Marvin Kahn	Direct Exhibit 1 Exhibit 2 Exhibit 3 Cross Rebuttal Notice of Correction Errata Direct (Proprietary) Cross Rebuttal (Proprietary) Notice of Correction (Proprietary) Exhibit 4

FEBRUARY 4, 1987

MCI

Mr. Gates	Direct Exhibit 3 (3a, 3b, 3c) Exhibit 5
Michael Pelcovits	Cross Rebuttal Exhibit 1 Exhibit 2
John Wenders	

Staff of Commission

George Parkins	Direct Cross Rebuttal Proprietary Exhibits
Mr. Van Ruler	Direct

FEBRUARY 5, 1987

Mountain Bell

Frank Hatzenbuehler	Direct Exhibits Rebuttal Exhibit 2 Exhibit 3 Exhibit 4 Exhibit 5

AT&T-Comm

Robert Hirsch	Cross Rebuttal

Sprint

Ronald Havens	Surrebuttal Exhibit 1 Exhibit 2

FEBRUARY 6, 1987

AT&T-Comm

Rhonda Marshall	Direct Cross Rebuttal Exhibit 1 (Proprietary) Exhibit 2 Exhibit 3

Staff of The Commission

Carl Hunt	Direct Proprietary Exhibit 2 Exhibit 4
Warren Wendling	Direct Proprietary

Sprint

Carolyn J. Ratti	Direct

Administrative Notice Taken Of:

1. Advice Letter No. 2041
2. Decision C86-586 (Dated May 13, 1986)
3. Article 10, Section 18, Colorado Constitution

Data Requests Admitted:

1. Chairman Ronald L. Lehr - Data Request 1
2. Chairman Ronald L. Lehr - Data Request 2
3. Commissioner Andra Schmidt - Data Request 1
4. MCI - Data Request 1
5. Office of Consumer Counsel - Data Request 1
6. Public Utilities Commission - Data Request 1
7. Public Utilities Commission - Data Request 2
8. Public Utilities Commission - Data Request 3

CHANGES AT THE FEDERAL LEVEL

Undoubtedly the most significant event concerning the legal and economic structure of the telecommunications industry in the United States was the federal antitrust case which resulted in the divestiture of The American Telephone and Telegraph Company (AT&T) and its 22 subsidiary Bell operating companies (BOCs), known collectively as the Bell System. A decade ago, the Bell System ubiquitously provided both long distance and local telephone service throughout the United States. AT&T, with its various components and affiliates, was the largest corporation in the world.

The Bell System's total operating revenues in 1979 were over $45 billion, and in 1980, they exceeded $50 billion. These sums represented almost two percent of the gross national product of the United States in each of those two years. The Bell System's net income for 1979 and 1980 was $5.6 billion and $6 billion, respectively. During 1979, the Bell System's net assets devoted to telephone service were valued at approximately $99.3 billion. By the end of 1979, the Bell System employed over one million people, and it was thus the largest employer in the United States with the exception of the federal government.

The United States Department of Justice (Justice Department), on two occasions, in 1949 and 1974, filed civil antitrust actions under the Sherman Antitrust Act that sought a major structural reorganization of the Bell System. In each case, the Justice Department alleged that the structure of the Bell System provided it with both the incentive and the ability to leverage its power in the regulated monopoly markets, and to foreclose or impair competition in related competitive markets. The first antitrust action was begun in 1949 in the United States District Court for the District of New Jersey. Because state and federal regulatory authorities then required certificated telephone carriers to maintain end-to-end responsibility for telecommunications service, the only area of Bell System operations in which competition was feasible was equipment manufacture. The Justice Department's complaint alleged that the Bell System had monopolized the equipment manufacturing market, and therefore, it sought both the divestiture of Western Electric and the compulsory common, nondiscriminatory licensing of all Bell System patents for reasonable royalties.

In January of 1956, the parties stipulated to an entry of a final judgment but did <u>not</u> require the divestiture of any major part of the Bell System. However, in allowing the Bell System to preserve its integrated character, the final judgment entered by the United States District Court for the District of New Jersey on January 24, 1956, essentially limited the Bell System to providing regulated communication services and manufacturing the equipment used for such services and compelled the licensing of all Bell System patents under reasonable terms.

Sections II(i) and V of the 1956 Final Judgment limited AT&T and the BOCs, with some exceptions, to the provision of "communication services . . . the charges for which are subject to public regulation under the Communications Act of 1934 (or state laws)". Section IV of the 1956 Final Judgment limited Western Electric to manufacturing equipment of the type used by AT&T and the BOCs in providing communication services subject to public regulation.

In the ensuing two decades, technological developments and changes in regulatory policies introduced competition into major new areas of telecommunications.

In a series of decisions in the late 1960's and 1970's, the Federal Communications Commission (FCC) authorized telephone subscribers both to attach customer-provided equipment to telephone company terminals and, more importantly, to substitute their own equipment for the carrier provided equipment that is located on a customer's premises and that provides access to the telephone network ("customer-premises equipment" or "CPE").[1] Various states opposed these FCC decisions, claiming that the competitive provision of CPE would drive the prices of the equipment down to cost and thereby jeopardize the states' abilities to establish above-cost rates that could subsidize basic services and promote their traditional universal service objectives.[2] The states further argued that because they regulated intrastate telephone service, they had plenary authority under the Communications Act of 1934 (47 U.S.C. §§ 152(b)(1), 221(b)) to prevent the use of customer-provided CPE for any intrastate telecommunications service, notwithstanding that CPE was also used in common for interstate service.

The Bell System supported the states' claims, but they were rejected. The FCC was held to have paramount regulatory authority over facilities jointly used for intrastate and interstate communications. The states' plenary regulatory authority, in contrast, was held to be limited to those facilities "separable from and . . . not substantially affect[ing] the conduct or development of interstate communications." North Carolina Utilities Comm'n v. FCC, 537 F.2d 787,793 (4th Cir.), cert. denied, 429 U.S. 1027 (1976); accord, North Carolina Utilities Commission v. FCC, 552 F.2d 1036, 1045-46 (4th Cir.), cert. denied, 434 U.S. 874 (1977). These decisions gave rise to an intensely competitive industry (interconnect industry) in which hundreds of firms such as IT&T,

Rolm, Exxon, Northern Telecom, Tandy, and others began furnishing equipment to telephone subscribers for interconnection to the telephone network.

Another series of decisions under the Communications Act introduced competition into the provisions of intercity services. These decisions authorized specialized common carriers to provide specific intercity services[3] and required franchised local exchange carriers to provide the new entrants with interconnections to their local distribution networks and to originate and terminate intercity calls for them. These decisions were opposed by the Bell System and by some states as well.[4] Each contended that, by allowing specialized common carriers selectively to serve high density routes, the decisions would disrupt the nationwide-averaged rate structure, weaken the ability of interstate services to support local rates through the jurisdictional cost separations processes, and thereby jeopardize the ability of regulatory commissions to set rates to achieve universal service goals. Nonetheless, by the late 1970's and early 1980's, the authority of these competing carriers had been expanded to the point that they could participate in the transmission of any interstate call, either through their own facilities or through resale of the services of Bell System companies.[5]

Finally, technological developments during the 25 years after entry of the 1956 Judgment substantially eliminated the earlier distinctions between regulated telecommunications service and unregulated data processing. These developments created actual and potential competition between telecommunications carriers and data processing vendors in the provision of CPE, enhancement of basic telecommunication services, and information services.[6]

Despite the technological developments that characterized this period generally, local exchange functions have largely retained their natural monopoly characteristics. Providers of CPE, intercity services, and information services continued to require access to local exchange facilities to compete in these markets.

In 1974, the Justice Department, on behalf of the United States, brought a second civil antitrust action under the Sherman Antitrust Act against the Bell System, United States v. AT&T, et al., No. 74-1698 (D.D.C.). The Government alleged that intervening events demonstrated that the 1956 Judgment did not prevent the Bell System from monopolizing telecommunications equipment markets and that the Bell System had further, through control of its franchised local exchange monopolies, unreasonably restrained competition in the intercity service and CPE markets in which the FCC had introduced competition. The Justice Department again sought the structural separation of the Bell System's monopoly activities from its other businesses, seeking the divestiture of the BOCs and the divestiture and dissolution of Western Electric. The Justice Department thereafter modified its request for relief to seek divestiture only of those parts of the Bell System that provide local exchange functions.

AT&T moved to dismiss this suit on the basis that, although it had no blanket antitrust immunity, the specific conduct at issue was subject to pervasive federal regulation and complementary state regulation and thus was impliedly immune from the Sherman Antitrust Act.[7] The United States District Court for the District of Columbia twice denied this motion, holding that neither federal nor state regulation immunized AT&T from this suit for structural relief, and the United States Court of Appeals and the Supreme Court of the United States denied AT&T's petitions to have this ruling reviewed. United States v. AT&T, 461 F.Supp. 1314, 1320-21 (D.D.C. 1978); United States v AT&T, 427 F.Supp. 57 (D.D.C. 1976), cert. denied, 429 U.S. 1071 (1977), cert. denied, No. 77-1009 (D.C. Cir. May 27, 1977), cert. denied, 434 U.S. 966 (1977).

After the Bell System's threshold defenses were rejected, the United States District Court for the District of Columbia established innovative procedures to expedite its pretrial proceedings and trial. United States v. AT&T, 461 F.Supp. at 1343-49. These procedures enabled the completion of discovery, the narrowing of the issues, and the commencement and substantial completion of the trial within the next three and a half years.

Trial of the case began in March 1981. In each of the three major areas of the case, CPE, intercity services, and telecommunications equipment, the Government's proof consisted of evidence, vigorously disputed by AT&T, that the Bell System intentionally had abused its control over its franchised local exchange monopolies to discriminate against competitors and to cross-subsidize its prices in competitive markets. At the close of the Government's case, the United States District Court held that there had been sufficient evidence to put AT&T to its proof and denied AT&T's motion to dismiss. United States v. AT&T, 524 F.Supp. 1336 (D.D.C.1981).

Throughout the period of the 1974 case, the FCC and Congress extensively debated a number of issues raised by the case and the 1956 Judgment. Both forums considered the adoption of regulatory or legislative measures to prevent or reduce the possibility that AT&T would abuse its local franchise monopoly to obtain advantages in related competitive markets.[8] A focal point of the debate was whether and to what extent the 1956 Judgment would and should foreclose AT&T from participating in markets in which computer technologies had merged with the technologies that provide telecommunications services and in which traditional rate-of-return regulation had ceased to be appropriate.[9] The FCC's decision in one proceeding that raised this issue--the Second Computer Inquiry--led AT&T and the United States on March 4, 1981, to litigate the questions of the proper interpretation and scope of the 1956 Judgment.[10]

AT&T had vigorously contended, in all of these forums, that it had not abused its control of its local exchange monopolies and that the public interest would best be served by maintaining the end-to-end integration of the Bell System. Nevertheless, in opposition it was maintained that continuing the Bell System's present ownership of local exchange monopolies along with competitive operations would be a source of increasing controversy and uncertainty, and that even if it won United States v AT&T, the Bell System's common control over franchised local monopolies and competitive businesses would unavoidably expose it to future antitrust challenges and to onerous legislative and regulatory restrictions. Moreover it was perceived that if the 1956 Judgment were held to foreclose Bell System participation in computer and other markets that had merged with traditional telecommunicatons, the Bell System's ability to continue to innovate and enhance its services would be severely impaired.

Against this background, AT&T apparently concluded that it was in its interest to end the uncertainty and to obtain freedom from the constraints of the 1956 Judgment and from continuing antitrust exposure by agreeing to the precise structural reorganization that the Justice Department was seeking in the 1974 case: the divestiture and complete separation of the Bell System's local exchange functions from its intercity, CPE, and manufacturing businesses. On January 8, 1982, AT&T and the United States stipulated to the entry of a modification of the 1956 Judgment.[11]

The proposed modification required that, within eighteen months of its entry, the Bell System be split between its local exchange functions and other functions, through a number of discrete steps. Exchange boundaries [local access and transport areas (LATAs)] were established to determine which facilities were to be considered intraexchange facilities to be divested and which were interexchange facilities that AT&T would retain.[12] See §IV(G), J.A. 178-79. AT&T then transferred to the BOCs, or to a BOC-owned central staff organization, resources to enable them to provide local exchange functions independently of AT&T after divestiture. §I(A)(1); J.A. 174. The BOCs' facilities and resources relating to local exchange functions were then separated by transferring the CPE and interexchange facilities to newly created entities. §I(A)(2); J.A. 174. The License Contracts and other contracts that integrate the BOCs with the rest of the Bell System were terminated §I(A)(3); J.A. 174. Finally, the local exchange carriers (divested BOCs) were spun off.[13] §I(A)(4) J.A. 174-75. Because this structural reorganization eliminated the whole basis for the 1956 Judgment, the proposed modification vacated the injunctive provisions of that judgment in their entirety.

The proposed modification also imposed restrictions on the divested BOCs. It required that they provide exchange access to all interexchange carriers that was equal in type and quality to that provided to AT&T and prohibited discrimination in favor of AT&T and its affiliates in procuring equipment. In an attempt to assure that the BOCs did not, themselves, obtain competitive advantages through abuse of control of their local exchange facilities, the proposed modification prohibited the BOCs from providing interexchange services, information services, CPE, and any services other than exchange and exchange access services or natural monopoly services actually regulated by tariff. §II(D).

It was contemplated that no services would be discontinued as a result of the MFJ. All the facilities and personnel providing telephone service before divestiture would continue to provide telephone service after divestiture. The difference was that new AT&T affiliates would retain the Bell System's CPE and interexchange facilities and functions in each state while the separately owned BOCs would provide local exchange service.

After the modification was proposed, the 1956 case was transferred to the United States District Court for the District of Columbia. That District Court surmised that any significant delays in the decision to enter the proposed modification would threaten a vital national industry. However, because of the proposed modification's significance, the District Court, with the parties' consent, ordered procedures that gave the general public rights of participation that went beyond those prescribed by the Antitrust Procedures and Penalties Act of 1974, 15 U.S.C. §§16(b)-(h) (Tunney Act). After over 600 individual comments on the proposed modification were received, the District Court ordered additional briefing on eight broad sets of issues, conducted a two-day nonevidentiary hearing on June 29 and June 30, 1982, and afforded all commentors an opportunity to indicate, through explicit offers of proof, whether a further evidentiary hearing would be necessary to resolve any issues related to its public interest determination.

Many commentors challenged the effectiveness or appropriateness of specific provisions of the proposed modification. For example, a number of states and state commissions, directly or through their national association, filed comments that also challenged the proposed modification's effectiveness on far more fundamental grounds. It was contended that splitting the Bell System would require a number of one-time transactions that, under the literal terms of the applicable state statutes, could not occur without explicit prior state regulatory approval. It was also argued that the states, which generally opposed the split, had "unassailable authority to veto" the divestiture and to cause a "balkanized scheme of telephone service".[14] Because these claims went to the question whether the Decree could be effective, it was agreed that the issue should be resolved as part of the District Court's public interest determination.

On August 11, 1982, the District Court issued a 178-page opinion concluding that the basic split of the Bell System was an appropriate antitrust remedy and obviously in the public interest. The Court's opinion rejected nearly all the challenges to specific provisions of the proposed modification. The Court rejected the states' claims that they could block or undo the implementation of the Decree, holding that prior approval requirements were effectively preempted, but only to the limited extent they might be invoked to block the one-shot transactions. The District Court did conclude that several changes would have to be made in the proposed modification before it would be approved, including a provision that the divested BOCs be permitted to provide, but not manufacture, CPE. The District Court stated that it would promptly approve a modification that adopted its proposed revisions.

On August 19, 1982, the Justice Department filed a memorandum stating that it was prepared to agree to all the District Court's proposed revisions because "the alternatives available would pose unacceptable costs to the public interest." However, the Justice Department urged the District Court to reconsider its position on CPE in one respect. In the Department's view, the divested BOCs could be allowed to market "simple CPE" immediately. In contrast, it stated that their provision of "complex CPE" could pose greater competitive dangers and that a decision on BOC entry into these markets should be postponed until a hearing could explore the competitive costs and benefits of BOC participation. On August 23, 1982, the District Court rejected the Department's proposal. On August 24, 1982, the parties stipulated to the entry of an order that contained all the District Court's proposed revisions, and it was entered later that same day (MFJ). The divestiture of AT&T's 22 operating subsidiaries took place on January 1, 1984. As indicated above, the Bell System was technologically integrated. However, as a result of the MFJ, the 22 BOCs have been regrouped into seven regional holding companies which have been legally separated from AT&T since January 1, 1984.

One of the seven regional holding companies is U.S. West which is the parent company of three BOCs, one of which is Mountain Bell. The other two BOCs which are subsidiaries of U.S. West are Northwestern Bell and Pacific Northwest Bell.

It should be noted that the changed telecommunications environment at the federal level has not come to an end. Judge Greene, as of this date, retains jurisdiction to monitor the effects of the MFJ. Presently pending before the District Court are proposals to permit the BOCs to enter into information services, manufacturing, and out of territory long distance services. A number of proposals have been made at the federal congressional level involving telecommunications services during the past several years, and it can be anticipated that the telecommunications environment at the federal level will continue to be dynamic in the foreseeable future.

CHANGES IN COLORADO

As a result of the January 1, 1984 divestiture, Colorado was split into two LATAs. The Colorado Springs LATA includes Colorado Springs, Pueblo, and Southeastern Colorado in general. The Denver LATA includes everything else in Colorado, which is basically the Denver metropolitan area and most of western and northern Colorado. Judge Greene agreed that it was not necessary to make a third LATA centered in the Fort Collins and Greeley areas, and accordingly, those areas were consolidated with the Denver LATA.

In 1984, the Colorado General Assembly passed House Bill 1264 which deals with the provision of intrastate telecommunications services. House Bill 1264 was signed into law on April 2, 1984, by Governor Lamm, and has been codified as Article 15 of Title 40, C.R.S. (§ 40-15-10 through 40-15-110, C.R.S.). House Bill 1264 provides that intrastate interLATA telecommunications services shall be governed under the doctrine of regulated competition, whereas intraLATA telephone service is to be governed by the doctrine of regulated monopoly. Accordingly, Mountain Bell can provide local and toll service within each of the two Colorado LATAs; but, Mountain Bell is not authorized to provide long-distance or toll service between the two LATAs in Colorado. At the present time, AT&T, MCI, Western Union, Sprint, and TEC WEST are authorized to provide interLATA long-distance or toll service in Colorado.

House Bill 1264 contains a legislative declaration that it is the policy of the state to permit access to and use by the public of rapid advancements in telecommunications technology and to allow the competitive entry of providers of telecommunications service in the intrastate market as soon as practicable, consistent with continued availability of universal telephone service to the people of the state and the efficient transaction from regulated monopoly to a competitive telecommunications environment.

In February of 1987, Representative Patrick Grant introduced House Bill No. 1336 which, may result in deregulation of telecommunications, in Colorado, except for basic local exchange service. At this time, the ultimate disposition of House Bill No. 1336 is uncertain.

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[1]Carterfone, 13 F.C.C.2d 420, reconsid. denied, 14 F.C.C.2d 571 (1968); AT&T "Foreign Attachment" Tariff Revisions, 15 F.C.C.2d 605 (1968), reconsid. denied, 18 F.C.C.2d 871 (1969); Interstate and Foreign MTS and WATS, First Report and Order, 56 F.C.C.2d 593 (1975); Telerent Leasing Co., 45 F.C.C.2d 204 (1974), aff'd sub nom. North Carolina Utilities Comm'n v. FCC 537 F.2d 787 (4th Cir.), cert. denied, 429 U.S. 1027 (1976); Interstate and Foreign MTS and WATS, Second Report and Order, 58 F.C.C.2d 736 (1976), aff'd sub nom. North Carolina Utilities Comm'n v. FCC522 F.2d 1036 (4th Cir.), cert. denied, 434 U.S. 874 (1977); Interstate and Foreign MTS and WATS, Third Report and Order, 67 F.C.C.2d 1255 (1978).

[2]See, e.g., North Carolina Utilities Comm'nv. FCC, 522 F.2d 1036, 1048 (4th Cir.), cert. denied, 434 U.S. 874 (1977; see generally United States v AT&T, No. 74-1698 (D.D.C).

[3]Allocation of Frequencies in the Bands Above 890 mc, 27 F.C.C. 359 (1959), reconsid. denied, 29 F.C.C. 825 (1960); Microwave Communications, Inc., 18 F.C.C.2d 953 (1969), reconsid. denied, 21 F.C.C.2d 190 (1970); Establishment of Domestic Communications--Satelite Facilities by Non-Governmental Entities, 22 F.C.C.2d 86 (1970); Specialized Common Carrier Services, 29 F.C.C.2d 870 (1971), aff'd sub nom. Washington Utilities & Transportation Comm'n v. FCC, 513 F.2d 1142 (9th Cir.), cert. denied, 423 U.S. 836 (1975).

[4]See, e.g., Washington Utilities & Transportation Comm'n v. FCC, 513 F.2d 1142 (9th Cir.), cert. denied, 423 U.S. 836 (1975).

[5]See Bell System Tariff Offerings of Local Distribution Facilities For Use By Other Common Carriers, 46 F.C.C.2d 413 (1974), aff'd sub nom. Bell Tel. Co. of Pennsylvania v. FCC, 503 F.2d 1250 (3d Cir. 1974), cert. denied, 422 U.S. 1026 (1975); American Tel. & Tel. Co., Restrictions on Interconnection of Private Line Services, 60 F.C.C.2d 939 (1976); MCI Telecommunications Corp., Investigation into the Lawfulness of Tariff F.C.C. No. 1 Insofar as it Purports to Offer Execunet Service, 60 F.C.C.2d 25 (976), rev'd, MCI Telecommunications Corp. v. FCC, 561 F.2d 365 (D.C. Cir. 1977) cert. denied, 434 U.S. 1040 (1978); Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities, 60 F.C.C.2d 261 (1976), amended on reconsid., 62 F.C.C.2d 588 (1977), aff'd sub nom. AT&T v. FCC, 572 F.2d 17 (2d Cir.), cert. denied, 439 U.S. 875 (1978); Regulatory Plicies Concerning Resale and Shared Use of Common Carrier Domestic Public Switched Network Services, 83 F.C.C.2d 167 (1980), reconsid, denied, 86 F.C.C.2d 820 (1981).

[6]See, E.g., First Computer Inquiry, 28 F.C.C.2d 267 (1971), aff'd in part and rev'd in part sub nom. GTE Service Corp. v. FCC, 474 F.2d 724 (2d Cir. 1973); American Telephone & Telegraph Co. (Data Speed 40/4), 62 F.C.C.2d 21 (1977), aff'd sub nom. IBM v. FCC, 570 F.23d 452 (2d Cir. 1978); Second Computer Inquiry, 77 F.C.C.2d 384 (1980), aff'd sub nom. Computer & Communications Industry Ass'n v. FCC, No. 80-1471 (and consolidated cases) (D.C.Cir. November 12, 1982).

[7]AT&T also sought to dismiss claims in the case on the grounds that the 1956 Judgment was res judicata, but these claims were also rejected by the District Court. United States v. AT&T, 1976-2 Trade Cas. §61,097 (D.D.C. 1976).

[8]See, e.g., FCC CC Docket No. 78-72 (exchange access); Second Computer Inquiry, 77 F.C.C.2d 384 (1980); FCC CC Docket No. 80-742 (License Contracts); FCC CC Docket No. 80-53 and No. 19129 (Phase II) (Bell System Procurement Practices); H.R. 12323, 94th Cong., 2d Sess. (1976); H.R. 13015, 95th Cong., 2d Sess. (1978); H.R. 3333, 96th Cong., 1st Sess. ((1979); S. 611, 96th Cong., 1st Sess. (1979); S 622, 96th Cong., 1st Sess. (1979); H.R. 6121, 96th Cong., 1st Sess. (1979); S. 2827, 96th Cong., 2d Sess. (1980); S. 898, 97th Cong., 1st Sess. (1981); H.F. 5158, 97th Cong., 1st Sess. (1981).

[9]See, E.g., H.R. 6121, 96th Cong., 2d Sess. §218 (1980); S. 898, 97th Cong., 1st Sess. §229 (1981).

[10]In the Second Computer Inquiry, supra, 77 F.C.C.2d 384 (1980), the FCC established a new non-tariff form of regulation for the Bell System's CPE and its enhancements of basic telecommunications service. Because the Justice Department had taken the position that the 1956 Judgment would bar AT&T from continuing to provide these services once this new regulatory scheme was implemented, AT&T moved for construction of the Final Judgment on March 4, 1981. The Memorandum in Support of the Motion For Construction further stated (p.17) that the 1956 Judgment and become "obsolete and unjustifiable" and that the only "long term resolution" of the problems it raised was to vacate it or modify it to reflect the changed environment. In an order issued on September 23, 1981, the District Court held that, as written, the 1956 Judgment allowed the continued provision of CPE and enhanced services, despite the change in the form of public regulations. The United States' appeal from this order was subsequently dismissed on the ground that the proposed modification of the Final Judgment had eliminated any controversy between the parties. United States v. Western Electric Co., No. 81-1960 (3d Cir. February 2, 1982).

[11]Simultaneously with the filing of this stipulation, the parties voluntarily dismissed the 1974 Case pursuant to Fed. R. Civ. P.41(a)(1)(ii).

[12]Specifically, LATA boundaries define which traffic is interexchange traffic and which is intraexchange traffic. LATAs thus allow the preponderant use of facilities to be measured for the purpose of making ownership determinations at divestiture. See also §VIII(G); J.A. 184. The sole significance of LATAs after divestiture is that they distinguish between the areas in which the divested entities provide local exchange functions and areas in which service is defined as interexchange. See §§(A), (B) & (D); J.A. 1975-76.

[13]A series of corporate transactions were required to reconfigure the BOCs as local exchange companies and to spin them off from AT&T. To separate exchange and non-exchange assets, each BOC created two wholly owned subsidiaries, one to which the BOCs interexchange facilities was transferred and another to which the BOCs' customer premises equipment (CPE) was transferred. The BOCs then distributed the stock of these subsidiaries to AT&T which, as a result, held its ownership of the BOCs' exchange facilities separately from its ownership of the BOCs' interexchange and CPE assets. AT&T created seven new subsidiaries and transferred to these companies the stock of the BOCs that provided exchange service in each of seven regions of the country, as well as one-seventh ownership interests in the central staff organization. AT&T spun off the regional companies by distributing its stockholdings in those companies to existing AT&T stockholders. See Plan of Reorganization (filed in District Court December 16, 1982), pp. 440-71.

[14]Joint Comments of Alabama, 23 other states, et al. p.12; Arizona Comments, pp.7, 10, 13-15; see also Michigan P.S.C. Comments, p.6; Alabama P.S.C. Comments, pp. 4-5; Maryland P.S.C. Comments, pp.7-11; District of Columbia Comments, p. 12; National Association of Regulatory Utility Commissions ("NARUC") Comments, pp.30-42. In all, some 66 state and/or state utility commissions as well as NARUC filed comments.

Summary of Annual Revenue Effects

Category	Recurring	Nonrecurring	Total
Exchange Services	$ 47,066,342	$ 3,681,806	$ 50,748,148
Service Charges, Construction Charges, etc.	---	(10,650,164)	(10,650,164)
Long Distance Message Telecommunication Service (LDMTS)	(27,902,022)	1,048,366	(26,853,656)
Wide Area Telecommunications Service (WATS)			
-Outward WATS	(4,292,217)	46,981	(4,245,236)
-800 Service	223,190	93,566	316,756
Miscellaneous Services			
-Jacks, Wire & Airport Services	1,133,891	(612,747)	521,144
-Directory Assistance Service	4,896,727	---	4,896,727
-Nonpublished/Nonlisted Services	1,977,972	321,251	2,299,223
-Direct Inward Dial Service	(251,784)	31,583	(220,201)
-Identified Outward Dialing Svc.	686,785	---	686,785
-Custom Calling Services	(1,147,629)	1,632,962	485,333
-Central Office & Misc. Services	(16,406)	629,265	612,859
-Miscellaneous Common Carriers	---	22,854	22,854
-Customized Services	(15,907)	2,844	(13,063)
Private Line/Special Access Svcs	10,281,685	3,560,540	13,842,225
Switched Access Services	(11,733,128)	---	(11,733,128)
Total Revenue Effect	$ 20,907,499	$ (190,893)	$ 20,716,606
Revenue Deficiency			$ 21,113,000
Rate Treatment to be determined			$ 396,394

SUMMARY OF ANNUAL REVENUE EFFECTS
($000)

Category	
Exchange Services	$40,941
Service Charges, Construction Charges, etc.	(843)
Long Distance Message Telecommunication Service (LDMTS)	(26,457)
Wide Area Telecommunications Service (WATS)	
-Outward WATS	(4,245)
-800 Service	317
Miscellaneous Services	
-Jacks, Wire & Airport Services	521
-Directory Assistance Services	4,897
-Nonpublished/Nonlisted Services	2,299
-Direct Inward Dial Service	(220)
-Identified Ourward Dialing Svc.	687
-Custom Calling Services	485
-Central Office & Misc. Services	613
-Miscellaneous Common Carriers	23
-Customized Services	(13)
Private Line/Special Access	13,842
Switched Access	(11,733)
	$21,113

(Decision No. C87-364-E)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

RE: INVESTIGATION AND SUSPENSION OF PROPOSED CHANGES IN TARIFF - COLORADO PUC NO. 6 - TELEPHONE, THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, DENVER, COLORADO 80202.	)	INVESTIGATION AND SUSPENSION DOCKET NO. 1720 CORRECTED ERRATA NOTICE

May 15, 1987

Decision No. C87-364
(Issued March 20, 1987)

Substitute the attached Page 6 of 6 of Appendix A for the one in the Errata Notice, Decision No. C87-364-E, issued April 30, 1987.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

JAMES P. SPIERS
Executive Secretary

Dated at Denver, Colorado this
15th day of May, 1987.

JEAvc
6873c

Warren Wendling	Direct Proprietary
	AT&T-Comm
Rhonda Marshall	Direct Cross Rebuttal Exhibit 1 (Proprietary) Exhibit 2 Exhibit 3
John Wenders	Cross Rebuttal
	Sprint
Carolyn J. Ratti	Direct
Ronald Havens	Surrebuttal Exhibit 1 Exhibit 2

Administrative Notice Taken Of:

1. Advice Letter No. 2041
2. Decision No. C86-586 (Dated May 13, 1986)
3. Article 10, Section 18, Colorado Constitution

Data Requests Admitted:

1. Chairman Ronald L. Lehr - Data Request 1
2. Chairman Ronald L. Lehr - Data Request 2
3. Commissioner Andra Schmidt - Data Request 1
4. MCI - Data Request 1
5. Office of Consumer Counsel - Data Request 1
6. Public Utilities Commission - Data Request 1
7. Public Utilities Commission - Data Request 2
8. Public Utilities Commission - Data Request 3

(Decision No. C87-364-E)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

RE: INVESTIGATION AND SUSPENSION OF PROPOSED CHANGES IN TARIFF - COLORADO PUC NO. 6 - TELEPHONE, THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, DENVER, COLORADO 80202.	)	INVESTIGATION AND SUSPENSION DOCKET NO. 1720 ERRATA NOTICE

April 30, 1987

Decision No. C87-364
(Issued March 20, 1987)

Change the first set of Appearances to read as follows:

Appearances: Roy A. Adkins, Esq.,
David H. Stacy, Esq.,
Russell P. Rowe, Esq., and
Gary C. Tucker, Esq., Denver,
Colorado, for The Mountain States
Telephone and Telegraph Company.

Page 20, last paragraph, change to read as follows:

"Third, the cost used by Staff's cost-of-service study includes common overhead costs, whereas Mountain Bell's version uses only direct costs. Thus, the Staff used a more detailed allocation procedure to distribute these common costs than Mountain Bell's net investment base."

Change pages 5 and 6 of Appendix A to read as follows:

FEBRUARY 4, 1987

MCI AND SPRINT

Michael Pelcovits	Cross Rebuttal Exhibit 1 Exhibit 2

MCI

Timothy J. Gates	Direct Exhibit 3 (3a, 3b, 3c) Exhibit 5

Staff of Commission

George Parkins (concluded 2/5/87)	Direct Cross Rebuttal Proprietary Exhibits

Agate

Larry Van Ruler	Direct

FEBRUARY 5, 1987

Mountain Bell

Frank Hatzenbuehler	Direct Exhibits Rebuttal Exhibit 2 Exhibit 3 Exhibit 4 Exhibit 5

AT&T-Comm

Robert Hirsch	Cross Rebuttal

FEBRUARY 6, 1987

Staff of The Commission

Carl Hunt	Direct Proprietary Exhibit 2 Exhibit 4

Warren Wendling	Direct Proprietary

AT&T-Comm

Rhonda Marshall	Direct Cross Rebuttal Exhibit 1 (Proprietary) Exhibit 2 Exhibit 3

MCI

John Wenders

Sprint

Carolyn J. Ratti	Direct

Sprint

Ronald Havens	Surrebuttal Exhibit 1 Exhibit 2

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6. Public Utilities Commission - Data Request 1
7. Public Utilities Commission - Data Request 2
8. Public Utilities Commission - Data Request 3

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

JAMES P. SPIERS,
Executive Secretary

Dated at Denver, Colorado, this
30th day of April, 1987.

JEAvc
6835c