(Decision No. C91-1128)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

INVESTIGATION AND SUSPENSION OF PROPOSED CHANGES IN TARIFFS - COLORADO PUC NO. 5 -- TELEPHONE, THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, D/B/A U S WEST COMMUNICATIONS, INC., DENVER, COLORADO.	)	DOCKET NO. 90S-544T
INVESTIGATION AND SUSPENSION OF PROPOSED CHANGES IN TARIFFS FILED BY THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, D/B/A U S WEST COMMUNICATIONS, INC., ADVICE LETTER NO. 2173-AMENDED.	)	DOCKET NO. 91M-119T
INVESTIGATION OF TARIFFS FILED BY U S WEST COMMUNICATIONS, INC., DENVER, COLORADO PURSUANT TO ADVICE LETTER NO. 2119.	)	DOCKET NO. 89I-597T
RE: TARIFFS FILED BY U S WEST COMMUNICATIONS, INC., IN ADVICE LETTER NO. 2201.	)	DOCKET NO. 91S-366T

INITIAL COMMISSION DECISION ON PHASE II ESTABLISHING
RATES AND CERTAIN PRICING AND COSTING POLICIES

- - - - - - - - - - - - - - - - - -

Mailed Date: August 23, 1991
Adopted Date: August 19, 1991

- - - - - - - - - - - - - - - - - -

Appearances: Robert L. Connelly, Jr., Esq., and Laurie J. Bennett, Esq., Denver, Colorado, for The Mountain States Telephone and Telegraph Company, d/b/a U S WEST Communications, Inc., Respondent;

Dudley P. Spiller, Jr., Esq., Denver, Colorado, for The Colorado Municipal League and The Colorado Cable Television Association;

Tucker K. Trautman, Esq., George D. Rosenberg, Esq., and Rebecca B. DeCook, Esq., Denver, Colorado, for Colorado Ski Country U.S.A. and Metropolitan Fiber Systems, Inc.;

Robert W. Nichols, Esq., Denver, Colorado, for Colorado Payphone Association;

T. Larry Barnes, Esq., Denver, Colorado, for AT&T Communications of the Mountain States, Inc.;

Michael M. McGloin, Esq., Gary Davenport, Esq., and Eric Beltzer, Esq., Denver, Colorado, for US Sprint Communications Company Limited Partnership;

Sue E. Weiske, Esq., Denver, Colorado, for MCI Telecommunications Corporation;

Thomas D. Smart, Jr., Esq., Denver, Colorado, for Intelesys, Inc.;

Ann E. Hopfenbeck, Esq., Denver, Colorado, for Integrated Network Services, Inc.;

Terry Parrish, Longmont, Colorado, pro se.;

Stephanie K. Walsh, Esq., Arlington, Virginia, for Department of Defense and Other Federal Executive Agencies;

Deborah S. Waldbaum, Esq., Denver, Colorado, for Office of Consumer Counsel;

Mana L. Jennings-Fader, Esq., and Michael Williams, Esq., Denver, Colorado, for the Staff of the Commission.

STATEMENT, FINDINGS OF FACT, AND CONCLUSIONS

BY THE COMMISSION:

PROCEDURAL HISTORY OF PHASE II

This decision deals with Phase II of the general rate case filed by The Mountain States Telephone and Telegraph Company d/b/a U S WEST

Communications, Inc. ("U S WEST"), when it filed its Advice Letter No. 2173 on September 14, 1990, requesting an increase in total intrastate revenues of $70.2 million. On September 19, 1990, the Commission suspended the proposed rate increases. On November 9, 1990, in Decision No. C90-1499, it bifurcated the case into two phases.[1] Phase I would deal with issues of overall revenue requirements and Phase II would address issues of rate design and rate structure. Phase I was settled through a Stipulation between U S WEST, the Office of Consumer Counsel ("OCC"), and the Staff of the Public Utilities Commission ("Staff") which was approved in Decision No. C91-497 on April 11, 1991. That Stipulation called for an increase in test year revenues of $32.7 million. The initial collection of this additional revenue, pending resolution of Phase II, was allowed through an across-the-board surcharge which went into effect on May 1, 1991, by Decision No. C91-497. A copy of that decision was admitted into evidence in this proceeding as Exhibit No. 63. That decision sets forth the procedural history of Phase I. As noted in that procedural history, Decision No. C90-1499 consolidated Docket No. 89I-597T with the Phase II issues in this proceeding. As also noted in that decision, Decision No. R91-155 was issued February 11, 1991, which established two dockets, Docket No. 91M-118T for the purpose of issuing a final decision on Phase I, and Docket No. 91M-119T for the purpose of issuing a final decision on Phase II. That decision was

[1] Rate proceedings can be heard in phases, with Phase I being used to determine revenue requirements and Phase II being used to determine rate design or spread of the rates.

entered in Docket No. 90S-544T and several other dockets that are not consolidated with this proceeding. It also established a procedural schedule for Phase II which set forth: filing dates for some testimony; a date for a prehearing conference; and dates for the hearing commencing on July 8, 1991, and continuing on July 9, 10, 11, 12, 15, 16, 17, 18, 19, 22, 23, and 24, 1991; the requirement for the filing of statements of position on August 2, 1991; that an initial decision would be issued either by August 16 or August 23, 1991; that applications for rehearing, reargument or reconsideration would be due on September 5 or 12, 1991; and that a final decision would be issued by September 20, 1991.

On September 14, 1990, U S WEST submitted prefiled testimony of eight witnesses on rate design, service costing and rate structure (Phase II issues). On April 19, 1991, U S West filed revised direct testimony and exhibits relating to Phase II. The revised testimony took into account the rate increase of $32.7 million stipulated to by the parties, and authorized by the Commission in Decision No. C91-497.

Decision No. R91-529-I was issued on April 22, 1991. It revised the previously established procedural schedule, and authorized the filing of the U S WEST Phase II revised testimony which was filed on April 19, 1991. It also ordered that: intervenor and staff Phase II testimony would be due on May 20, 1991; U S WEST rebuttal testimony would be due on June 21, 1991; and, made clear that the issues in Docket No. 89I-597T would be considered in the Phase II proceedings.

On May 20, 1991, the Staff filed testimony that set forth an entirely separate set of proposed rates to recover the $32.7 million. The Staff also submitted a fully distributed cost study in its filing. The Office of Consumer Counsel filed testimony on that date which also contained recommendations for another alternative set of rates to recover the $32.7 million.

A prehearing conference in Phase II was held on May 17, 1991, and as a result Decision No. R91-715-I was issued on May 28, 1991. That decision established a schedule for filing testimony concerning the issues in Docket No. 89I-597T which is consolidated in this proceeding. It also consolidated Docket No. 91S-366T into this proceeding and established a procedural schedule for filing testimony in regard to the issues in that docket. Finally, it set a further prehearing conference to be held on June 28, 1991, at 9:00 a.m.. That prehearing conference was held, and as a result Decision No. R91-877-I was issued on July 3, 1991. That decision: vacated the hearing dates of July 8, 9, 10, and 12, 1991; established a further prehearing conference to be held on July 11, 1991, at 2:00 p.m.; and added the dates of July 25, and 26, 1991 as reserved hearing dates. These changes were made as a result of the motion to approve stipulation and the stipulation filed by U S WEST, Staff, and the OCC on June 27, 1991. U S WEST, the Staff, and the OCC signed on that date a Stipulation with yet another set of proposed rates for the recovery of the $32.7 million increase. Thus, there are at least four full rate proposals in the record which are designed to recover the $32.7 million. Decision No. R91-877-I also denied the motion of Staff to add certain additional issues to this proceeding.

Objections to the motion to approve stipulation were filed by Intelesys, Inc. (Intelesys); MCI Telecommunications, Inc. (MCI); The Colorado Municipal League and the Colorado Cable and Television Association (CML); Colorado Ski Country USA and Metropolitan Fiber Systems, Inc. (Ski Country); Integrated Network Services (INS); Terry Parrish (Parrish); Department of Defense and all other Executive Agencies (DOD); the Colorado Payphone Association (Payphone); and US Sprint Communications Company Limited Partnership (Sprint).

The final prehearing conference in this proceeding was held on July 11, 1991, as established by Decision No. R91-877-I. A written order was not issued as a result of that prehearing conference, but the Administrative Law Judge ruled on the following motions:

- Staff's July 1, 1991 motion for leave to file supplemental testimony of Staff witness Warren L. Wendling and for an order shortening response time;
- Staff's June 28, 1991, motion for leave to file corrected and revised testimony of Staff witness Wendell D. Winger and for an order shortening response time.

The motion to approve stipulation was taken under advisement. All parties were given leave to present live testimony during the hearing concerning the stipulation. A procedural schedule was discussed and it was determined that the issues relating to 89I-597T would be heard on the July 24, 1991. A motion in limine filed by U S WEST on July 3, 1991 was denied during the hearing.

The hearing commenced on Monday, July 15, 1991 and continued on July 16, 17, 18, 19, 23, 24, 25, and 29, 1991. At the conclusion of the hearing the matter was taken under advisement. At the parties' request, the previously scheduled date for the filing of briefs was changed from August 2, 1991, to the close of business on August 7, 1991.

During the course of the hearing, Exhibits 1 through 111 were marked for identification and all were admitted into evidence. Prefiled testimony for witnesses was marked as an exhibit, and the exhibits attached to the testimony were not separately marked. Exhibits to testimony are identified as indicated in the prefiled testimony.

Payphone, on July 11, 1991, filed its motion for order requiring accounting and refund. A similar motion was filed by CML on July 15, 1991. U S WEST filed a motion for extension of time, until August 2, 1991, to file a response to the motions. On August 2, 1991, U S WEST filed a further motion for extension of time asking to be allowed to file a response on August 7, 1991. On August 7, 1991, U S WEST filed another motion for extension of time, asking that it be granted until August 13, 1991, to file its response. U S WEST filed its response on that date. These motions for extension of time are granted. The issues raised in the motions for accounting are more properly matters to be considered in Docket No. 91M-118T, the docket created for Phase I. They will be considered in that docket, and not in this Decision, as they relate to the implementation of the rate increase granted in Phase I.

On July 31, 1991, Payphone filed a motion to take administrative notice. U S WEST filed its response in opposition to the motion on August 6, 1991. The opposition is based on the fact that the motion is untimely, being filed two days after the close of the hearing and involving documents most of which are dated approximately one year prior to the hearing and all of which were in existence prior to the hearing, that the material may be irrelevant, and that some of the documents are not proper subjects for administrative notice. The grounds stated in the opposition are sufficient and the motion to take administrative notice is denied.

Briefs or statements of position were filed by the parties as follows:

PARTY	DATE
DOD	August 6, 1991
OCC	August 7, 1991
Parrish	August 7, 1991
INS	August 7, 1991
Intelesys	August 7, 1991
MCI	August 7, 1991
AT&T	August 7, 1991
Ski Country	August 7, 1991
CML	August 7, 1991
U S WEST	August 7, 1991
Payphone	August 8, 1991
Staff	August 9, 1991

On August 7, 1991, Payphone and Staff each filed a motion for enlargement of time to file their statements of position. Payphone requested that it be allowed to file on August 8, 1991, and Staff requested to file on August 9, 1991. Adequate grounds were shown, and the motions for enlargement of time are granted.

INITIAL DECISION OF THE COMMISSION

The hearing for Phase II was conducted by Administrative Law Judge Robert E. Temmer. The suspension period and schedule does not provide sufficient time for the issuance of a Recommended Decision. The Commission finds that due and timely execution of its functions unavoidably requires the elimination of the recommended decision of the administrative law judge, and that this decision should be the initial decision of the Commission. A daily transcript of the hearing was prepared and filed.

THE STIPULATION AND THE MOTION TO APPROVE

As noted above, on June 27, 1991, U S WEST filed its motion to approve stipulation stating that U S West, the OCC and the Staff had entered into a stipulation resolving numerous issues in this Phase II proceeding, and requesting that the Commission approve the stipulation pursuant to Rule 83(a) of the Commission's Rules of Practice and Procedure (4 CCR 723-1). A copy of that motion, a document entitled Submission Of Additional Signature Page To Stipulation, showing that AT&T is a signatory to the stipulation concerning paragraph 30 only and that AT&T does not oppose the remainder of the stipulation, the Stipulation (consisting of 27 pages and its separate substituted confidential Exhibit B) were all marked as Exhibit No. 4 and admitted into evidence. Additionally the document entitled Amended Stipulation was marked as Exhibit No. 5 along with its attached Exhibit B, B1 and C, and admitted into evidence. A document entitled Supplemental Stipulation was marked as Exhibit No. 6 and admitted into evidence. Exhibit No. 6 was filed pursuant to the terms of paragraphs 32 and 33 of Exhibit No. 4. Exhibits No. 4, 5 and 6 (collectively referred to as the Stipulation) contain the terms of a stipulation or agreement signed by U S WEST, Staff, OCC and AT&T, which, if approved, resolves numerous issues in this U S WEST Phase II proceeding. Because all parties to the proceeding did not sign the Stipulation and because it was objected to and because all issues were not resolved among the parties who did sign the Stipulation, a full hearing was held on all issues.

AT&T agrees to paragraph 30 of the Stipulation and does not oppose the remainder of the Stipulation. Written objections or comments concerning the Stipulation were filed prior to hearing by Intelesys, MCI, CML, Ski Country, INS, Parrish, DOD, Payphone and Sprint. At the beginning of the hearing, U S WEST, Staff and OCC sponsored witnesses that testified about the settlement process that was followed in arriving at the Stipulation, and provided evidence that in their opinion the Stipulation was fair, reasonable and in the public interest. Certain parties also offered oral testimony during the hearing concerning objections to the Stipulation and the procedure used to arrive at the Stipulation. The parties also discussed the Stipulation in their briefs or statements of position.

The written comments and objections that were filed raised various procedural and substantive objections. The procedural objections were that:

* the Stipulation should not be adopted as a finding or ruling of the Commission;
* not all parties were consulted or asked to participate in the negotiations that led up to the Stipulation;
* AT&T was involved in the negotiations and that AT&T is a competitor of some of the parties in this proceeding;
* the Stipulation was arrived at behind closed doors;
* some parties to the proceeding were not informed about the Stipulation until after it was signed; that stipulating to rates is inappropriate; and
* the interests of all ratepayers were not represented by the stipulating parties.

Additionally, several of the parties suggested that the Stipulation should not in any way effect their right to a full and fair hearing, and that the parties to the Stipulation should be required to produce all of their evidence and have all of their witnesses be subject to cross examination. All of the signatories to the Stipulation, (U S WEST, the Staff, OCC, and AT&T) were required to present their witnesses and evidence, and all of their witnesses were subject to cross-examination by all of the parties to the proceeding. Every piece of prefiled testimony and every exhibit, with the exceptions of the testimony and exhibits of Mr. Dunkel, was received into evidence and forms a part of the record in this case. The focus of the hearings, as required by the law, was on determining what are just and reasonable rates for all interested, not simply adjudicating the propriety of the merged positions of U S WEST, the Staff and the OCC as embodied in the Stipulation.

The evidence establishes that the signatories to the stipulation did not invite other parties to this proceeding to engage in the negotiations that led up to the Stipulation. However, it also shows that the signatories did not intend to exclude any other parties from consideration. In fact, several parties were given information that negotiations were ongoing. The signatories intended to see if they could arrive at an initial solution and then receive input from other parties whose concerns could be accommodated. The evidence establishes that the other parties did not contact the signatories with proposals to negotiate or proposals for resolution of the issues in this proceeding.

The substantive objections raised by the parties both in their written objections to the Stipulation and their testimony, deal with specific rates or proposals in the Stipulation. Those objections will be discussed in other sections of this decision dealing with the particular rates or areas to which they are related.

Rule 83(a) of the PUC's Rules of Practice and Procedure, (4 CCR 723-1), provides that: "Any two or more parties may offer into evidence as an exhibit, a written stipulation as to any fact or matter in issue of substance or procedure. The Commission shall enter an order approving or disapproving any stipulation offered into evidence as an exhibit, or may recommend modification as a condition of approval." Thus, under the rule, we are required to analyze the Stipulation and either approve or disapprove it. The rule contemplates that fewer than all parties to an action may enter into a written stipulation. Furthermore, on a number of prior occasions, the Commission has accepted into evidence stipulations among some, but not all, parties to an action and has ruled on the stipulations. Indeed, in the last general rate case of U S WEST, I & S Docket No. 1720, U S WEST, the Staff and AT&T entered into a stipulation prior to hearing, which was approved after a full evidentiary hearing. The contention that there is some mandated burden on the stipulating parties to include others in negotiations is without merit. The record is clear that all stipulating parties were open to settlement overtures by other parties, even though they were not obligated to do so. Certain parties also argued that it is improper, from a public policy standpoint, to approve the type of negotiations involved here. We find nothing in this record that would allow us to draw that conclusion. We further find that there was nothing improper about the manner in which the negotiations were conducted. However, we do encourage parties to Commission proceedings to include and consider all interests in their negotiations.

We will start our analysis from the standpoint that the parties to the stipulation have presented evidence in this proceeding in support of their stipulation; and that the procedure they used was not inappropriate. The evidence presented would allow the Commission to adopt the Stipulation as a resolution of the issues it purports to resolve in this proceeding. However, it is our duty to analyze the Stipulation in the context of the entire proceeding, and will start from the position that the Stipulation merely evidences the position of its signatories as to what the resolution of the proceeding should be, for the issues covered.

Since all of the parties to this proceeding were not signatories to the stipulation, no issue in this proceeding is considered to have been removed from the hearing process or settled, and whether or not the stipulation should be approved, as a resolution of this proceeding is one of the issues to be resolved by this Decision. However, the stipulation does address some issues that were not addressed in this proceeding by non-stipulating parties. As to those issues, the Stipulation may be deemed to have resolved the dispute between all of the parties involved in those issues, and thus they may not be the subject of extensive discussion in this decision.

In the following sections of this Decision we will examine the contested issues in this proceeding as they were presented by various parties.

BUSINESS SERVICES ISSUES INCLUDING BASIC EXCHANGE RATES

DIRECT INWARD DIALING AND HUNTING

BUSINESS BASIC EXCHANGE RATES (IFB)

The DOD contends that there is an imbalance in the present rate structure, as residential rates are too low and business rates are too high. The contention is based on the cost studies submitted by U S WEST which, it is contended, show that residential subscribers are charged at rates substantially less than the cost to provide residential service and that business customers are charged rates substantially in excess of the cost required to provide business service. It is also contended that the Staff cost study is biased against business, and that if any of the proposals submitted, either in the Stipulation or otherwise, are accepted, the imbalance will continue.

DOD then states:

> If there is a justification for maintaining subsidized residential rates, it lies in the concept of 'universal service.' The theory of universal service is that the telephone system is only as valuable as the total number of connections to it. If there are substantial segments of the population that do not have telephones and cannot be reached by the telephone system, then the value of telephone service to <u>all</u> subscribers is severely diluted. Thus, it is to the benefit of all of society, not just nonsubscribers, that every household at least have access to telephone service. In the past, this objective has been cited as a justification for maintaining severely depressed residential telephone rates. (DOD statement of Position, p.10)

DOD then argues that universal service has been essentially achieved, that lowering installation charges is a better way to achieve universal service than keeping the rate for the service low, and that there are other programs designed to help the residential ratepayer, all of which leads to their conclusion that there should be a 24 percent increase in residential rates, and that business exchange rates should not be increased.

There is a proposal in this proceeding to reduce the installation charges to $35.00, from the previous rate of $53.00 for residential service (non-recurring charges), which the evidence shows is an effective means in the effort to achieve universal service. No party has objected to that proposal, and the only question became whether or not the proposed price in the stipulation covered costs. The evidence establishes that the cost of installation has declined, and the current costs are likely covered by the $35 charge. The proposal is just and reasonable, and should be accepted. This does not mean, however, that the Commission accepts the argument that residential basic exchange service should be increased by 24 percent as proposed by DOD. There are other reasons for maintaining a differential between residential and business rates in addition to the concept of universal service, including the fact that the usage characteristics of the two categories of service are different, and that this difference has an impact on costs. Further, the cost evidence in this proceeding does not support the contention that residential service is provided at substantially less than cost. In fact, the Staff cost study shows that costs are covered, and that the rate of return from residential service provides a substantial contribution to the overall revenue requirement.

We note that Staff originally proposed an increase to $13.94 for residential basic exchange, which would include the charge for Touchtone in accordance with a Staff proposal. This proposal, the inclusion of Touchtone for all types of service, was not objected to, and the evidence supports its adoption so that in the future there will not be separate charges for Touchtone service. The rate proposal of Staff was modified by the Stipulation which proposes that the rate for residential service be between $13.46 and $13.63. This proposal and the previous position of Staff are far from the 24 percent increase recommended by DOD. In fact, the initial proposal by Staff is somewhat less than half of the DOD proposal.

The Commission finds that the principles of rate continuity and rate shock require that the proposal of DOD for an immediate and drastic increase to residential rates be rejected. While we believe that residential rates should be adjusted to reflect increases in costs, the Commission cannot accept the drastic solution advocated by DOD. We note, however, that the residential rates suggested in the Stipulation are adjusted toward the original Staff proposal as a result of the decisions made on other issues in this docket. We find that the residential rate (IFR) should be $13.95 per month, and that rate is just and reasonable.

The position of DOD that business basic exchange rates should not be increased, must also be rejected. U S WEST originally proposed certain increases. The Stipulation proposes increases to the basic business (IFB) rate, and reductions to the measured or message rate business services and to the business installation charges. The proposed rates in the Stipulation are cost related, and they move the rates in the direction indicated by the cost evidence. The main thrust of the DOD argument is that the residential rates should be increased in order to support the maintenance of the rates for business services at status quo. As discussed above, the argument is unsound. The proposal for basic business exchange service, as set forth in paragraphs 8 and 16, of Exhibit 4, and the proposal for Measured Business and Message Business Access Lines as set forth in paragraph 13 of Exhibit 4 should be adopted and approved, as those rates are just and reasonable, except that the rate for each rate group for IFB lines in paragraph 8 shall be increased by 2 cents because of the Commission's decision regarding directory assistance for payphones which is discussed in another section of this decision. The two-cent adjustment is just and reasonable.

DIRECT INWARD DIALING (DID)

DID service allows the stations on a private branch exchange (PBX) to receive local and long distance calls without handling by an attendant or operator. Each station is given its own seven-digit number which can be dialed from the public switched network. DID service is limited to customers who employ PBX equipment.

The stipulating parties recommend an increase in the monthly rate for DID from its current level of $37.20 to $40.00. This increase of approximately 7 percent is less than the percentage increase in the proposed residential rate. Yet DOD opposes even this increase and proposes instead to roll the rate back to $26.70, the rate charged in Arizona. This proposal, if accepted, would have a net negative revenue impact of approximately $2.3 million which translates into an increase in the residential rate of approximately 16 cents per month.

DOD suggests that the existing rate is not justified, nor is the increase, and that it represents an abuse. This contention is only based on the U S WEST cost study, and does not mention the cost study presented by Staff. The existing rate was approved in I&S Docket No. 1720. DID service is discretionary, and thus constitutes an expense which may be avoided by a business which chooses available alternatives. The Commission finds that the discretionary nature of the service, coupled with the relatively small burden which this rate increase imposes on those consumers who choose it, balanced against the contribution which those rates provide, make it reasonable for the Commission to conclude that the rate proposal of the parties, as viewed as part of the entire rate design, is just and reasonable, when it was not convincingly shown that the existing rate is improper. The DOD showed that the rate in Arizona is lower. But, there is also testimony demonstrating that rates in other states are higher. Rates set in other states are set on conditions in those states. The rates we shall approve are based on conditions in Colorado. The proposal for DID in paragraph 31 of Exhibit 4 is approved and adopted.

HUNTING

Hunting allows incoming calls to seek out non-busy lines. Without hunting, if the line or number called is in use, a busy signal will be obtained. With hunting, if there are any lines or numbers not being used, the call will be completed even if the number dialed is in use. This service is important to a user concerned with incoming calls. If, however, a user is concerned only with outgoing calls, then this service is not necessarily important.

The stipulation adopts the recommendation that hunting be unbundled[2] from the PBX trunk line. Unbundling hunting is appropriate, as it gives the customer the flexibility to select services that they believe satisfy their telephone usage requirements. This would result in a new rate for a newly unbundled service, and it must be evaluated from that perspective.

The proposed monthly rate for unbundled hunting of $5.25, which is almost the differential in the tariffs for trunks with and without hunting previous to this proceeding, was opposed on the basis of its relationship to cost. The parties to the stipulation argued that the stipulation merely split the trunk rate into components, that the cost of

2 "Bundled" services have components that could be offered separately with separate prices. If a service is "unbundled," it is offered and priced separately.

service is covered and that it should be accepted. As pointed out by those in opposition, the relationship between the cost figures submitted by U S WEST and this rate is quite high. For those users interested in incoming calls, this service is essential. We conclude that a rate for the service of $3.65 would have a better relationship to the fully distributed cost of the service, would move the rate towards cost, and would still provide a needed contribution. We find that this would establish a rate that would be just and reasonable, and that the rate in paragraph 5 of Exhibit 4, should not be accepted. We further find that the reduction in revenue as a result of the change to the rate for hunting should be offset by a corresponding increase to the basic residential exchange rate (IFR), which is accounted for in the $13.95 IFR rate we have found to be just and reasonable.

PUBLIC ACCESS LINES (PAY PHONE ISSUES)

A number of issues were raised in this proceeding relating to pay phones, both as to those pay phone services completely provided by U S WEST and to the ways service is provided by U S WEST for public access lines ("PAL") to Customer Owned Coin Operated Telephones, provided to the public by entities other than U S WEST. The Stipulation addresses a number of these issues. Payphone, the only party to this proceeding which raised payphone issues, and which is not a party to the Stipulation does not oppose the provisions in paragraphs 13, 14, 15, 18, and 21 of Exhibit No. 4. Those paragraphs set the PAL rate equal to the Measured

Business and Message Business Access Lines, set the rate at 25 cents for U S WEST Public Coin Telephones and Shared Payphones and 10 cents for U S West Public Coin Telephones without dial tone first, and the rate for directory assistance for payphones at 25 cents. These proposed changes represent a significant step in the direction of correcting certain disparities. These changes include the reduction in the PAL rate to conform with other measured and message business access lines, uniform rates for all measured and message usage, and the application of time of day and day of week discounts to PAL measured usage. The stipulation would also address an inequity in the directory assistance charges that existed, by reducing the cost of directory assistance to private payphone providers from the present 32 cents to 25 cents and by establishing that same rate for U S WEST pay telephones. The proposal for directory assistance charges contained in paragraphs 18 and 21 will not be accepted or approved. We believe that there may be problems with the availability of directories at many payphone locations so that a call to directory assistance is not discretionary; that there might thus be a disparity between payphones and the Stipulation's provision for one free call for directory assistance for all other categories, and that users of regulated payphones would experience rate shock as a result of this proposal. We are concerned about the provision of directories at payphone locations, and want U S WEST to report to us the steps it takes to assure that directories are available. We consider evidence on the availability of directories at payphone locations essential in any decision to impose directory assistance charges on payphone users, and such evidence is not in this record. For this reason, and the others here discussed, we will not authorize a directory assistance charge for U S WEST payphones. To maintain the parity proposed in the Stipulation, we will eliminate directory assistance charges for PAL service.[3] The result will be that there will be no directory assistance charges for any regulated payphone service. We find that this will be just and reasonable, but will result in a reduction of revenue. We further find that both residential and business basic exchange services will benefit from having users of payphones being able to use directory assistance as an aid to contact them, and that both IFR and IFB rates should be increased approximately 2 cents to offset this revenue reduction.

The provisions of paragraphs 13, 14, 15, and 18 except for directory assistance charges, are supported by the evidence submitted, are in the public interest and are just and reasonable. They are approved and adopted.

Payphone contends that several other changes need to be made both as to provisions in the Stipulation and in the way U S WEST does business in relation to payphones. Those contentions will be discussed in the following subsections.

---

3 It is clearly not our intention to create a windfall for private payphone providers by this decision, and suggest that they should not charge payphone users for calls to directory assistance. U S WEST should submit the report regarding directories at payphone locations to the Commission by October 30, 1991.

FLAT RATE OPTION FOR PAL

Pursuant to the Stipulation, the rate structure for PAL service would continue in much the same form as it has, with some rate reductions. PAL service may only be purchased at a measured or a message rate, except in those areas served by U S WEST central offices without measuring capability. Payphone contends that PAL service should be obtainable at the flat business rate (IFB). The reasons stated for keeping mandatory measured PAL service were that average monthly usage on a PAL line is significantly higher than the average monthly usage on a IFB business line, and that PAL service is used to resell basic telephone service.

The argument that PAL usage is higher than the average monthly usage on a IFB business line is not supported by the record. The studies of PAL usage submitted by U S WEST are not reliable, and cannot be used for a finding of fact about PAL usage. There is some evidence to suggest that there is wide variation in usage levels for some IFB business lines. An examination of these comparisons does not reveal inequity in the price for PAL service, but does suggest that there may be a need to examine those other uses to determine whether separate rates, which account for greater usage, should be charged to those customers.

The second reason, that PAL is a resale service, has merit, and the Commission has determined that there should be some differential in rates based on the nature of the service. The proposals in the

Stipulation that have been approved above are a step in the direction requested by both U S WEST and Payphone. The proposal provides reductions for the PAL users so that their rates are more in line with other business users, but keeps the rate as a required measured rate as an appropriate differential which recognizes that it is resale service, and that it may have different usage characteristics. We would be disposed to accept the suggestion of Payphone to establish a flat rate for PAL equal to the flat rate business trunk rate, in order to eliminate the disparity shown in the record to exist between certain resellers, i.e., between hotels and motels, and private payphone providers. However we are concerned that the correction would possibly create two inappropriate rate situations rather than simply eliminating the disparity. U S WEST may be providing service to that kind of customer pursuant to the trunk rates, when it could be more appropriate to treat them as, or like, Shared Tenant Service Providers. We will discuss this further in a subsequent section of this decision. In connection with high business uses, as suggested above, U S WEST should consider whether some other rate might be more appropriate, or whether such uses are classified appropriately. In the meantime, it is not in the public interest to set a flat rate for PAL. In the past, we have been hesitant to order mandatory measured rates on the basis that end users have a strong desire for a flat rate option. That reason is not applicable in the situation we are discussing here. We therefor conclude that measured rates should remain.

COMMISSION PAYMENTS ON PUBLIC PHONE SERVICE

Paragraph 40 of Exhibit No. 4, provides a method for Commission oversight of the commissions that U S WEST pays to space providers for its public coin telephone service. Payphone argues that the proposed method is inappropriate, and that these commission payments should be made pursuant to tariff. While Payphone concedes that specific levels or rates need not be in the tariff, it does argue that the tariff should contain a provision stating that commissions are paid pursuant to a Commission-approved schedule and policy. This area is subject to competition, and while the commissions in question may be calculated by reference to the revenue generated, the commissions do not change the rates charged by U S WEST to the public. PUC oversight of commissions is certainly appropriate, but that does not mean that commission rates must be included in the tariff. The proposal in the Stipulation incorporates provisions for PUC approval of the commissions paid and of the method used to determine the commissions. The stipulation provides, for the first time, a method by which this can be accomplished, and thus, through PUC oversight, the public interest is protected. The balance in paragraph 40 of the Stipulation is entirely appropriate, and will be accepted and adopted by the Commission, because it is just and reasonable. Finally, although the provisions were criticized as vague, they were understandable to the PUC and Staff, and thus constitute a workable framework for administrative oversight. We find the provisions are sufficiently clear as to be capable of enforcement, and that the provisions should not be rejected because of vagueness.

COIN LINES

Payphone also contends that U S WEST should be required to offer coin lines by tariff for private payphone providers. This would make services available to private payphones to verify coin deposit, allow coin return for uncompleted calls, and would not require "smart" terminal equipment. It is clear from the record that there is a demand for these services, and also that U S WEST is investigating ways that these services may be made available. There is nothing more, save a weak argument that failure to provide coin lines is discriminatory. U S WEST shall continue with its investigation to determine the manner in which it desires to provide these services, and submit its findings and proposal no later than January 30, 1992. In the meantime, the Payphone proposal that U S WEST be required to provide coin lines is rejected.

SHARED PAYPHONE SERVICE

Payphone objects to the proposal in Paragraph 29 of Exhibit No. 4 to accept the U S WEST proposal to establish Shared Payphone Service and to set its rate at $40.00. The basis of the objection is that the rate does not cover the cost of the service. Payphone criticized the cost data submitted, as well as some evidence which was based on data that was six or seven years old. The contention that the proposal should not be approved is rejected. The rate proposed in the Stipulation would not provide a negative rate of return. And according to the cost study of Staff, while the rate would not earn the average rate of return, it would recover cost and make a substantial contribution. The rate is adequately related to the cost, and the proposal in the Stipulation is just and reasonable. It is approved and adopted.

STRUCTURAL SAFEGUARDS

Payphone has also contended that U S WEST should be required to place either its retail or wholesale payphone operations into a separate subsidiary, in order to inhibit the sharing of private payphone vendors' confidential or proprietary information with the retail coin operation of U S WEST. The record does not substantiate that this has happened. The record does show steps taken by U S WEST to prevent the sharing of proprietary information from occurring. U S WEST has moved the sales, maintenance, and installation functions for public access line services out of the public services marketing unit and into its carrier and network organization. U S WEST also has a policy that it is inappropriate to share customer information from one portion of the public organization to the other. A violation of this policy can result in disciplinary action. We find that, in the absence of evidence to show that abuses have happened, these measures are sufficient. The proposal by Payphone that structural safeguards be imposed is rejected.

SHARED TENANT SERVICES

AND

NETWORK ACCESS REGISTERS

SHARED TENANT SERVICES (STS)

Several of the parties argued that the rate for a STS trunk should be the same as the rate for a flat business trunk. The Stipulation proposes that the STS monthly rate be $80.71, and that the monthly flat business trunk charge should be $40.28 for Rate Group I, and $42.28 for Rate Group II. The parties opposing the Stipulation proposal contend that the costs to provide the two services are the same, and that since the services are functionally equivalent there is no justification for a price differential. There is evidence in the record to support the idea that the services are functionally equivalent, and that the costs of providing both services are the same. But, there also is evidence that STS usage may not be the same as the usage for flat business trunks. STS providers are, in effect, much like small Local Exchange Providers since they can carry both business and residential traffic. In addition, STS providers displace residential and business lines (IFR and IFB) and therefor displace revenues that would be received by U S WEST in the provision of basic local exchange service.

Staff has suggested that the mixed use characteristics that may be involved with STS, might warrant the introduction of mandatory measured service, and that a price differential from the flat trunk rate is justified. STS service is different from service for flat business trunks. It involves the aggregation of many users who would generally take other types of service, rather than one user that would not generally have used multiple units of another service. Functional equivalency, and similar costs are reasons for similar prices, but here the different usage, the facts that we are not dealing with end users and the loss of the provision of the other types of service to those who subscribe to the service of the STS provider justify a difference in treatment, but we believe that difference should result in the same kind of treatment as we are approving for PAL service, i.e., mandatory measured service. The proposed rate for an STS trunk in Paragraph 20 of Exhibit No. 4 will not be adopted and approved. We will order that STS providers be provided service at the measured business trunk rate,[4] or be based on it for STS Network Access Registers, and that U S WEST, on or before October 30, 1991, report on users such as hotels and motels, and whether they have been classified as STS providers. Providing service to STS providers at the measured trunk rate may have a revenue impact, but it cannot now be determined. It may provide more or less revenue than the current rate. Therefore, no offset will be ordered.

---

4 If the Central Office cannot provide measured service, then message service will be substituted. If neither can be provided, then the flat trunk rate is to be used.

NETWORK ACCESS REGISTERS (NARs)

U S WEST proposed an increase in the NAR rate under the Centron Custom and the Shared Use Tariffs, so that NARs would be priced comparably with functionally equivalent network access elements of competing services. In this proceeding the competing services at issue are the Centron Custom Service on one hand and Private Branch Exchange ("PBX") Systems on the other. Both provide intercom-type features out of a switch, as well as access between these stations and the public switched network. The two services, overall, offer the same functions and are basically substitutable for each other. Since the PBX features are provided entirely on the premises of the user, and are thus unregulated, the only regulated element of PBX service is the PBX trunk, which provides access to the public switched network. In Custom Centron Service, the element that is functionally equivalent to the PBX trunk is the NAR. Although the NAR and the trunk are in no way technically similar, since a NAR is a software function in the switch and the PBX trunk is a physical line, they perform the same functions of providing access to the public switched network at any given time. The proposal in this proceeding is to price the PBX trunk and the functionally equivalent NAR in a comparable fashion, by using a formula based on the appropriate trunk rate.

INS contends that for some Centron configurations, the functional equivalence is more like a flat business line. The same sort of argument might be made for a PBX with a high ratio of stations to trunks. In either event, both are used to gain network access in a system with switching capabilities not available on a flat business line. The contention of INS is rejected.

INS also contends that the formula used to arrive at the rate for NARs double counts the Touchtone element, and the rate, therefore, should be reduced by $4.27. The evidence establishes that double counting did not occur, and the suggested rate reduction is rejected.

The formula proposed in the Stipulation includes the proposed $5.25 for hunting charge, which we have previously rejected. The rate for all NARs, including STS NARs, should be adjusted to reflect $3.65 for hunting, rather than $5.25. With that adjustment the rates for NARs are just and reasonable, and will be adopted. This adjustment is accounted for in the offset set forth above for hunting, as well as in the increase to the IFR rate.

SWITCHED ACCESS SERVICE ISSUES

Several issues generally related to switched access service were presented in this proceeding. The Stipulation deals with most of these issues at paragraph 30 of Exhibit No. 4. The parties to the proceeding did not resolve or agree to some proposals for imputation requirements, the elimination of the difference between the LS1 and LS2 rates, and the proposal for audit and review of reports concerning percentage of interstate usage (PIU). These three issues will be discussed in the following subsections.

IMPUTATION REQUIREMENTS

The unresolved issues regarding imputation are between U S WEST, AT&T, and MCI. This issue first arose in Docket No. 89I-082T which involved U S WEST intraLATA toll services. A stipulation was entered into in Docket No. 89I-082T (Exhibit 80 in this proceeding) that established a process and formula to impute access and billing costs into U S WEST intraLATA toll services. In this proceeding, AT&T sought three modifications to that Stipulation: (1) to include in the calculation the access and billing costs associated with toll calls originating in Independent Local Exchange Company ("ILEC") territory; (2) to impute costs associated with the Colorado Universal Service Fund; and, (3) to impute tariff rates when monopoly services were used by U S WEST to make competitive services offerings. U S WEST agreed in the Stipulation in this proceeding to impute costs for the Colorado Universal Service Fund; and no party has objected to that provision. It is just, reasonable, and will be approved and accepted. The other two imputation issues were not resolved. AT&T and MCI contend that the ILEC related access and billing costs are a part of the costs to U S WEST to provide intraLATA toll service originating in ILEC territory, and that they must be included in the relevant costs of the service when testing to determine if price covers cost. U S WEST argued that to include these costs would place it at a competitive disadvantage because it is the carrier of last resort. The Commission finds that U S WEST's argument is without merit. These expenses are a direct part of U S WEST costs to provide intraLATA toll services. U S WEST should include these costs when testing the relationship of prices to costs of service. The parties have called this an "imputation" issue. It is in reality a matter of recognizing the actual costs that are incurred, rather than imputing some surrogate, as may have been done in the past.

The last unresolved imputation issue involves imputation of the tariff price for monopoly services when U S WEST uses monopoly services to make competitive offerings. AT&T requests this Commission to make a policy statement on this issue in order to promote and assure fairness in competitive situations. The position of U S WEST is that no statement of policy is required because it is moving in this direction, is fully aware of its legal and regulatory responsibilities in this regard, and because the services that would be involved are, in fact, deregulated. At this juncture the Commission accepts the arguments and assurances of U S WEST on this issue.

ELIMINATION OF LS1-LS2 DIFFERENTIAL

The Stipulation in paragraph 30(b) of Exhibit No. 4 proposes to eliminate the differential between the LS1 and LS2 rates. MCI suggests that the Federal Communications Commission's Schedule for the phase out should be followed, rather than requiring elimination now. The LS1-LS2 differential was originally put in place to reflect the transition to equal access in the State of Colorado, and the rates were designed to be transitional. That transition is virtually complete, with 94.1 percent of the access lines in Colorado being serviced by equal access offices by the end of 1991. The reason for having transitional rates has likewise virtually disappeared as a result. It is just and reasonable to eliminate the differential at this time. The provisions of paragraph 30(b) of Exhibit No. 4 are approved and adopted, as the proposal in the Stipulation is just and reasonable.

PERCENTAGE OF INTERSTATE USE (PIU)

Paragraph 30(e) of Exhibit No. 4 sets up a procedure that would require interexchange carriers (IXC) and resellers to provide data supporting their reports of PIU. This data would go to Staff, which in turn could require an audit by a third party, for which the IXC or reseller would pay reasonable expenses. Thus, under this provision, while U S WEST takes on much of the administrative burden, it is the Staff of the Commission which decides whether or not an audit is to be performed.

MCI and Sprint object to this proposal. The stated bases for objection are that there has not been sufficient showing of a problem, that U S WEST should not decide whether an audit is required, that these IXCs already have audits done that they will supply, and that an independent third party should do the audit if one is required.

The report of PIU is used to allocate minutes of use and revenues for carrier access services between the interstate and intrastate jurisdictions. The primary objection to this provision went to the procedure for selecting an auditor. Paragraph 30(e) of Exhibit 4 requires Staff, not U S WEST, to determine whether an audit is needed, and, if so, Staff would then instruct U S WEST to retain a "qualified third party" to perform the audit. We interpret this to mean that Staff is to select the auditor to be retained by U S WEST. Sprint argued that an audit requirement was needed, but there was convincing evidence presented that misreporting was occurring in other states and that this is an industry-wide problem. The Commission concludes that there is sufficient evidence to cause concern and that the problem must be addressed. The Commission finds that the objections do not warrant any change to Paragraph 30. However, any problems, procedural or substantive, encountered in the future with the PIU audit process required in Paragraph 30(e) may be presented to the Commission in a complaint proceeding. The solution in the Stipulation paragraph 30(e) is a reasonable remedy. The Commission finds that all of paragraph 30 is fair, reasonable and in the public interest, and is approved and adopted.

PRIVATE LINE ISSUES

The parties to the Stipulation resolved their differences regarding Private Line Services in Paragraphs 26, 27, and 28 of Exhibit No. 4. The original proposals of U S WEST relating to private line were three-fold. First, it proposed restructuring the private line tariff to make it more understandable and useful for customers. Second, it proposed elimination of Outside The Base Rate Area ("OBRA") charges. Finally, it proposed to increase certain private line rates.

Ultimately, the parties to Exhibit No. 4 stipulated to additional private line increases, the maintenance of OBRA charges and the restructure of private line tariffs, as modified slightly by the recommendations of Staff. Objections to the proposal have been raised on the basis that the Staff proposal for differential depreciation is flawed, that OBRA charges should not be imposed, that the tariff should not be restructured, and that any increase should be spread differently. These objections will be discussed in the following subsections.

DIFFERENTIAL DEPRECIATION

Staff presented a theory of differential depreciation to redistribute depreciation expenses over the full range of products to recognize that increasing depreciation rates are being allowed because of increased technology in the services other than basic residential telephone service. The differential depreciation method used depreciation rates applicable before the advent of the growth of state-of-the-art technology, for residential basic service, and redistributed the remaining depreciation expense to all of the other product categories. The Staff rationale for differential depreciation is based on the assumption that higher depreciation rates are being driven by newer technologies, such as digital technology, that are not used by residential services. The concept in general was endorsed by several parties, but the application was criticized because some services were impacted when they should not have been. For instance, by its very nature, analog private line neither needs nor uses digital technology, but was assigned an increased amount of depreciation under Staff's theory.

There is merit to the concept of making the services that are driving investment in new technology pay the associated costs. There is also merit to the concept that all beneficiaries of an investment in new technology should pay a fair share of the associated costs. However, it appears difficult, if not impossible, to know in advance who the long term beneficiaries of a given investment will be. Staff is encouraged to study all sides of this concept in the future. Insofar as the method used here assigned more costs to analog private lines, it was flawed. If Staff, after study, decides to propose this concept again, refinements should be made to correct the problems shown. However, there is not a showing that the amount of depreciation assigned to the entire private line class was inappropriate.

OUTSIDE THE BASE RATE AREA (OBRA) CHARGES

As noted above, U S WEST originally proposed the elimination of these charges, but according to the Stipulation they will remain. As such, the proposal is the continuance of an existing charge. There was a contention that this would allow a double recovery of a cost. The Commission was not convinced by the evidence, which was insufficient to support elimination of the OBRA charges. The OBRA charges are just and reasonable. Maintaining them will result in these types of services being subject to zone charges, as are other types of services pursuant to Exhibit No. 6, so that all of these services will be treated alike.

RESTRUCTURE AND INCREASES

U S WEST proposed to separate the private line tariff from the access tariff. It appears this would make sense, and should be approved.

The rate structure proposed in the Stipulation is based largely upon the Cost Of Service Study submitted by the Staff, and it is a restructure of the tariff. The private line tariff was restructured in 1987 in I&S Docket No. 1720, and the rates established therein were found to be just and reasonable. The proposal here is criticized on the basis that certain categories of private line will receive large percentage increases and suffer rate shock, that the Staff cost of Service Study does not fully justify the structure proposed, and that the tariff should not be restructured again so quickly. As found above, there are deficiencies in the Staff Cost of Service Study, and its use to completely restructure the tariff may not be justified because of its limited categories. For that reason, and because the rate structure in existence has previously been found to be just and reasonable, the total amount of the rate increase proposed in the Stipulation for the private line class should be spread on an even percentage basis, rather than as proposed in the rate restructure. This would apply to the recurring rates. Such rates will be just and reasonable, and adopted by the Commission. The proposal for the reduction of non-recurring charges associated with Private Line Services as proposed in Paragraph No. 27 of Exhibit 4, is just and reasonable and will be approved and adopted. Certain parties have suggested that a lesser percentage increase than as implicitly proposed in the Stipulation should be imposed. Those suggestions are rejected. The Staff Cost of Service Study and the record supports the percentage found above to be just and reasonable.

MISCELLANEOUS ISSUES

Two issues of a miscellaneous nature were presented, that were not part of the Stipulation. They were the proposal of Staff for a second line quantity adjustment, and the proposal of the OCC for a residential message service tariff. They will be discussed in the following subjections.

SECOND LINE ADJUSTMENT

Staff in this proceeding recommends an increase in the quantity of certain second telephone lines to balance the advertising expense permitted by the Commission in Phase I of the rate case. Recognizing a change in the number of telephone lines would be novel. The Staff contends that the approval of the advertising expense concerning second lines was unprecedented. It was agreed to by the Staff in Phase I and approved by the Commission.

The proposal will be rejected. It is a selective update of test year quantities. The proposed justification that the advertisements in Certain parties have suggested that a lesser percentage increase than as implicitly proposed in the Stipulation should be imposed. Those suggestions are rejected. The Staff Cost of Service Study and the record supports the percentage found above to be just and reasonable.

MISCELLANEOUS ISSUES

Two issues of a miscellaneous nature were presented, that were not part of the Stipulation. They were the proposal of Staff for a second line quantity adjustment, and the proposal of the OCC for a residential message service tariff. They will be discussed in the following subjections.

SECOND LINE ADJUSTMENT

Staff in this proceeding recommends an increase in the quantity of certain second telephone lines to balance the advertising expense permitted by the Commission in Phase I of the rate case. Recognizing a change in the number of telephone lines would be novel. The Staff contends that the approval of the advertising expense concerning second lines was unprecedented. It was agreed to by the Staff in Phase I and approved by the Commission.

The proposal will be rejected. It is a selective update of test year quantities. The proposed justification that the advertisements in question would have an impact beyond the test year is not convincing or supported by the record.

RESIDENTIAL MESSAGE SERVICE

U S WEST originally proposed to grandfather two-party message service ("2MR"). As an alternative to this procedure the OCC recommended that the Commission adopt a new one-party residential message service ("IMR"). U S WEST objects to this proposal.

The reasons stated by U S WEST for the objection are the low subscription to message service, combined with the increased possibility of abuse of this service and the availability of measured service as an alternative to flat rate service. With the proliferation of home personal computers, telecommuting, computer bulletin boards and the like, U S WEST contends the risk of camping onto the network for prolonged periods of time has increased. There are two factors that make the present message service unattractive to consumers. First, the message service offering is two party service, eliminating the flexibility and privacy afforded by a single party line. Second, the only residential message service presently offered does not provide a sufficient economic advantage to consumers over the IFR rate. The argument that individuals will "camp-on" to lines with computers is speculative and unfounded, given the practical considerations of computer use and individuals' needs for other access to the telecommunications network.

The proposal of the OCC for the establishment of a one-party residential message service to replace the two party service is approved and adopted. Such rate will be just and reasonable.[5]

COSTING AND PRICING

In regard to costing and pricing issues, there are two dockets in this proceeding, each of which presents distinct issues. In the general rate case (Docket No. 90S-544T), the issues concern the appropriate cost methodology and the appropriate pricing methodology and philosophy for determination of the rates for existing services. In the related open network architecture docket (Docket No. 89I-597T), the issue presented is the pricing philosophy for new services. Although there is overlap in these two areas, it is essential to keep the issues separate, as they require different treatment. We will discuss these issues in the following subsections.

---

5 U S WEST shall file a Report on the response, sign up or usage of this service by January 30, 1992.

COST DEVELOPMENT

Two theories of costing have been advanced in this proceeding. Long Run Incremental Cost (LRIC) and Fully Distributed Cost (FDC). This is not the first proceeding in which these two theories have been examined. As pointed out by the parties, they were discussed in I&S 1720, Decision No. C87-364, a copy of which is in this record as Exhibit No. 83, and Case No. 6633. All parties agree that both LRIC and FDC studies require the application of judgment and can contain inaccuracies.

The Commission concludes that the existing LRIC studies done by U S WEST should not be relied upon in this proceeding because they contain a substantial number of conceptual and empirical flaws and inconsistencies.

Staff prepared and presented a FDC study, in accordance with the principles developed and accepted in Docket No. I&S 1720. That is the study and method that should be relied on in this proceeding for costing existing services.

COST UTILIZATION FOR PRICING

All of the parties agree that FDC studies are useful for historical analysis and, in particular, for the assessment of past profitability of individual services, and that all prices cannot be set equal to LRIC for all services because joint and common costs will not be covered, and the firm will go "broke."

U S WEST contends that:

1. FDC studies can be used to evaluate the need for rate adjustments to broad categories of service.

2. FDC studies are inappropriate for use in the pricing of individual services. This is because such studies:
   a. are too formulistic,
   b. rely upon historical data,
   c. contain arbitrary allocations of joint and common costs, and
   d. might preclude U S WEST from earning its allowed rate of return.

3. LRIC studies are the only cost studies appropriate for use in the pricing of individual services.

4. LRIC is used only as a price floor in this process, not as a sole determination of price.

5. Case No. 6633 set a precedent for using LRIC as a price floor in Colorado.

6. LRIC can also be used as a test for predatory pricing and cross subsidization.

7. A price may be set below LRIC if justified by public policy concerns, network externalities, or service complementarities.

8. The majority of prices will be set above LRIC. The amount by which they exceed LRIC should depend upon competitive alternatives, customers' willingness to pay, and public policy goals.

9. Any price above LRIC is a fair, just, and reasonable rate.

10. If a service is priced such that less than maximum contribution to joint and common costs is generated, this lost contribution must be made up in the pricing of other services.

11. Price ceilings for monopoly services should be determined by the stand-alone costs for those services. As an alternative to price ceilings for these services, the markets could be opened up to competition.

12. Price ceilings are unnecessary for competitive services.

13. Competitive pressures in the future will require the de-averaging of rates.

14. Pricing based in part upon LRIC is more apt to result in the utility being able to earn its revenue requirement than is pricing based upon FDC because LRIC pricing takes competition and demand elasticities into account.

The Staff contends that:

1. Even in Case No. 6633, the Commission did not give a precise definition of LRIC nor did it endorse a particular LRIC computation.

2. LRIC should not be used for setting price floors, for setting actual prices, as a test for cross subsidization, or as a test for predatory pricing.

3. Static economic efficiency occurs when price is set <u>equal</u> to long run marginal cost. Since U S WEST generally sets price <u>above</u> LRIC (which is not equivalent to long run marginal cost), it cannot claim to have achieved this efficiency.

4. Through the rate-setting process, we can try to improve productivity or cost effectiveness but we cannot justify our rates by an appeal to static economic efficiency unless its conditions are met.

5. The prices proposed by U S WEST bear little relationship to LRIC.

6. In the last general U S WEST rate case (Docket No. 1720), the Commission chose to use FDC, not LRIC. It also found that U S WEST did not demonstrate substantial competition in its markets.

7. LRIC pricing essentially assigns a disproportionate percentage of the benefits flowing from the presence of economies of scale and scope to the incremental services.

8. Since LRIC studies are inappropriate as a basis for pricing and since U S WEST uses them for no other purpose, the costs of conducting such studies should not be included as an allowable expense.

MCI contends that:

1. Forward-looking LRIC should be used for pricing purposes.

2. Public policy concerns may very well dictate that basic residential services be exempt from the general rule that prices should exceed LRIC's.

AT&T contends that:

1. Forward-looking LRIC should be used as price floors.

2. Price ceilings should be determined by stand-alone costs, which include some proportion of joint and common costs, plus 5% for pricing flexibility.

3. The Commission should state explicitly in its order in this case that all matters related to the establishment of price floors and price ceilings be discussed again in the AFOR case (Docket No. 90A-665T).

CML contends that:

1. U S WEST LRIC studies are too flawed to be used for pricing purposes.

2. Most "competition" to a particular U S WEST service comes from other U S WEST services.

3. U S WEST is basically proposing value-of-service pricing whereas the Commission has been, and should continue to be increasingly interested in cost-of-service pricing, as necessitated by increased competition.

The Commission finds the U S WEST pricing methodology should not be adopted. In addition to the inadequacies of the LRIC studies used to generate price floors, U S WEST has offered no adequate description of the process by which actual prices are set. It suggests that further cost considerations are irrelevant but that prices should depend upon competitive alternatives, customers' willingness to pay, and public policy goals. Nevertheless, U S WEST provides no studies to document competition in any markets and no studies to measure customers' willingness to pay. It furthermore fails to describe in any detail the process by which these factors are incorporated. Consequently, adopting the U S WEST methodology would be equivalent to endorsing an unknown procedure for rate determination.

In Docket No. 1720 the Commission found no convincing evidence of sufficient competition in U S WEST markets, and ruled that FDC, not LRIC, be used for pricing purposes. There is no indication in the current proceeding that there has been any substantial change in the degree of competition since Docket No. 1720. Moreover, in the last two years, U S WEST has not taken any advantage of the mechanisms put in place by HB 1336 to respond to increased competition by moving a service from part 2 to part 3, within part 3 to achieve relaxed regulation, or from part 3 to part 4. Since the passage of HB 1336, such movement has been requested only for private line services (Case No. 6633) and the request was granted. Therefore, at this time and with the evidence presented, there is no reason for the Commission to adopt a pricing methodology different from that in Docket No. 1720.

The discussion of the theoretical and empirical issues related to the setting of price floors and price ceilings presented in this docket forms an inadequate basis for resolving these issues. With respect to price floors, the appropriateness of using any measure of LRIC is challenged by the Staff. Even among the parties which endorse LRIC for this purpose, there is much criticism of the particular methodologies used by U S WEST to compute such cost figures. Turning to price ceilings, the discussion is even less substantial. AT&T alone proposed a methodology for actually setting price ceilings. U S WEST agrees that they may be necessary for monopoly services but not for competitive ones. The other parties remain silent on the issue.

In addition to the inadequacy of the discussion, there is also no compelling reason to resolve the debates here. Price floors and price ceilings come into play only as one possible way of determining whether cross-subsidization is occurring. The Commission can proceed as it has in the past, without reference to price floors and ceilings, and simply set rates which it deems just and reasonable and in the public interest. Therefore, the discussion of the theoretical and empirical issues related to the establishment of price floors and price ceilings should be deferred to the AFOR case (Docket NO. 90A-665T). In that case, whether U S WEST should be given pricing flexibility within some range for a greater number of its services may be a crucial question, in which case the setting of price floors and ceilings will become of central importance. It is in this context that all interested parties should be encouraged to offer testimony on these matters so that the record will develop sufficient evidence upon which to base decisions.

COSTING AND PRICING FOR NEW SERVICES

In regard to new services, the parties also differed as to the appropriate method and philosophy that should be used.

U S WEST contended that:

1. LRIC studies should be done the same way for both new and existing services.

2. LRIC should be used as a price floor for both new and existing services.

3. U S WEST is moving, but only gradually, toward similar pricing for services of similar functionality.

4. If an essentially identical service appears in two different places in the U S WEST tariffs, it should be priced essentially the same in both places in order to avoid tariff shopping.

5. In may be the case, however, that proposed rates for similar services differ because of different customer needs, different market characteristics, and public policy goals.

6. ONA services are regulated but they are used in the provision of deregulated enhanced services. These ONA services cannot be priced close to LRIC because this would make it impossible to maintain high prices on the deregulated enhanced services in the face of competition and would thus result in a loss of contribution from these enhanced services to covering joint and common costs.

7. The Staff proposed pricing scheme for new services has not been advocated or used anywhere else and does not appear in either the theoretical or the applied pricing literature.

The Staff contends that:

1. FDC studies, as normally conceived, cannot be done for truly new services.

2. U S WEST does LRIC studies for new services but they fail to contain any allocation of joint costs as they should.

3. The proposed prices for new services generally have little relationship to LRIC.

4. New services should be priced as follows: LRIC with some joint costs allocated according to the peak responsibility method should be calculated for the service in question. Next, the ratio of FDC to the sum of LRICs for the broader service category in which this service will fall should be computed and then used to scale up the LRIC for the new service. The result of this scaling process should be used as a benchmark for pricing.

5. In order to justify a price which falls outside some reasonable range around the benchmark price, U S WEST must provide additional studies concerning, for example, markets, demand, or cross-elastic effects. Otherwise, the price should not be allowed.

6. If the ratio of FDC to the sum of LRICs mentioned above seems unreasonably large due to the inappropriate computation of LRIC, then

this ratio should not be used for pricing purposes. Instead, a price ceiling should be set at twice LRIC.

MCI contends that:

1. U S WEST is in a position to use its bottleneck facilities to impede competition through price squeezing, cross subsidization, differential quality, and bundling of bottleneck with non-bottleneck services. These practices should not be allowed.

2. U S WEST should impute the same prices to itself that it charges its competitors for a given ONA service.

3. ONA services should be priced according to building blocks, not tariffed services.

4. The Commission should immediately adjust some rates which are clearly anticompetitive and then mandate the formation of a workshop designed to revamp costing and pricing methodologies along the lines of the building-block approach. This workshop should make recommendations to the Commission within one year.

CML contends that:

1. U S WEST LRIC studies inappropriately use the same annual expense factors for new and existing services when the costs of new services are higher.

2. New services are responsible for a disproportionate amount of R & D expenditures; nevertheless, these expenditures are incorrectly assigned to common costs and arbitrarily spread to all services.

The Commission concludes that in pricing ONA services, the price imputed to U S WEST should be equal to the price charged its competitors. Also in this pricing effort, there should be a careful delineation between new services and reconfigurations of existing services. For the existing services, the U S WEST costing and pricing methodologies are no more valid here than elsewhere; FDC pricing methodology should be applied. For new ONA services, at least two of the possible approaches are of interest, and deserve further study: (1) the Staff methodology, and (2) a study of ways to develop costing and pricing methodologies for new services which are not equivalent to U S WEST procedures, but which would include consideration of a proper application of LRIC, or other theories.

The workshops currently going on in Oregon, Iowa, and Florida to develop costing and pricing methodologies based upon building blocks instead of tariffed services should be monitored. Progress reports and ultimate results should be obtained and analyzed for the desirability of their application to Colorado. Letting other states be first to embark upon this process might streamline the process and save valuable resources here if the choice was made to go ahead with it in the future.

Rulemaking may be necessary in the future to resolve the method that will finally be adopted. This might present a further opportunity to refine the proposals presented in this proceeding that seem to be the most appropriate. In any event, we are not convinced that we should now adopt any of the methods advanced. We are convinced that the method proposed by U S WEST, as applied, is inappropriate and should not be adopted.

SUMMARY AND CONCLUSION

We have discussed the main issues raised by the parties in the sections above. To the extent we have not discussed all of the points or positions raised, we find that those points or positions did not have merit and are rejected. To the extent that there were requests to initiate other actions, such as the Staff suggestion concerning a show cause concerning line extension charges, we find those should be separately pursued and will not be a part of our Order.

The Stipulation covers a number of matters that have not been the subject of discussion in the decision, because they were not contested. An example of this is the matter of rate areas and zone charges set out in Exhibit No. 6. The implementation of that part of the Stipulation would result in many changes. The provisions of that part of the Stipulation also change the way line extension charges have been imposed. We will attach to this decision as an appendix the parts of Exhibit Nos. 4, 5, and 6 that are not proprietary. We find that the provisions of the Stipulation are just and reasonable and supported by the evidence, except for those provisions discussed above where a contrary finding is made. We approve and adopt the Stipulation with the modifications noted above in other sections of this decision as our resolution of the proceeding. We conclude that the following Order should be entered.

O R D E R

THEREFORE THE COMMISSION ORDER THAT:

1. The Stipulation entered into by certain parties in this proceeding (Exhibit Nos. 4, 5, and 6 admitted into evidence) are approved and adopted with the modifications set forth above.

2. U S WEST Communications, Inc., is authorized to file tariff sheets, to reflect the provisions of this Order which will produce, on an annual basis, incremental revenues in the approximate amount of $32.7 million, as previously authorized in Decision No. C91-497, and which incorporate and are consistent with the matters discussed above. Said tariff sheets shall have an effective date of September 24, 1991, shall be filed on not less than one day's notice, shall refer to this decision number, and shall by their terms replace the tariffs authorized by Decision No. C91-497, which are to, by their terms, expire on September 24, 1991.

3. The tariff sheets filed with Advice Letter No. 2173 and as revised by Advice Letter No. 2173-Amended are hereby permanently suspended and cancelled.

4. The tariff sheets filed with Advice Letter No. 2201 are hereby permanently suspended and cancelled.

5. U S WEST Communications, Inc., shall comply with the provisions of this decision, including the provisions concerning the submission of reports by October 30, 1991, and January 30, 1992.

6. This Decision is the initial Decision of the Commission and is a final Decision subject to the procedural provisions of the §§ 40-6-114 and 40-6-115, C.R.S.

7. The 20-day time period provided for by § 40-6-114(1), C.R.S., to file an application for rehearing, reargument, or reconsideration begins on the first day after the mailing or serving of this Decision and Order. The Commission encourges that any such filings be made as early as possible.

This Order is effective on the date it is mailed.

DONE IN OPEN MEETING August 19, 1991.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

ARNOLD H. COOK

CHAIRMAN ARNOLD H. COOK CONCURRING
IN PART, AND DISSENTING IN PART.

GARY L. NAKARADO

COMMISSIONER GARY L. NAKARADO
SPECIALLY CONCURRING.

CHRISTINE E. M. ALVAREZ

COMMISSIONER CHRISTINE E. M. ALVAREZ

CHAIRMAN ARNOLD H. COOK CONCURRING IN PART, AND DISSENTING IN PART:

I join in the majority's conclusions in all matters, except for the residential rate approved in this Decision. I dissent because I believe the residential basic flat monthly rate of $13.95 set by the majority in this Decision is too high. While I am willing to go towards the goal of reducing the hunting charge (because it is above costs), I would not have reduced the hunting charge from $5.25 to $3.65 a month as the majority decided. I would have reduced the hunting charge by a more moderate amount, to $5.03, in order to reduce rate shock to residential customers. If the hunting charge was set as I propose at $5.03 a month, then residential rates would be $13.70 a month, instead of the $13.95 rate decided by the majority. The rate chosen by the majority represents a 13.2 percent rate increase over the present $12.32 monthly charge paid by residential customers. In my opinion, the 13.2 percent rate increase is too high. The residential rate I proposed, $13.70, would constitute an 11.2 percent increase over current rates. I feel that residential rates of $13.70 and a charge of $5.03 for hunting would be a better balancing of the need to set prices of services in relation to their costs, and the need to gradually effect rate changes. I feel a longer transition period, and a lower present residential rate, would have been a better course, particularly in light of other charges residential ratepayers will have to pay (such as High Cost Fund charges and dual party relay charges) in the near future. Accordingly, I dissent from that part of the Decision which set a residential rate of $13.95 a month.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

ARNOLD H. COOK

COMMISSIONER GARY L. NAKARADO SPECIALLY CONCURRING:

Commissioner Gary L. Nakarado's special concurrence concerning the Costing and Pricing section of the decision to follow.

(S E A L)

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

ATTEST: A TRUE COPY

Suzanne A. Fasing

Suzanne A. Fasing
Director

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

GARY L. NAKARADO

RET:jkm:1008A