(Decision No. C88-1162)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

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IN THE MATTER OF THE RULES OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO PRESCRIBING COST ALLOCATION METHODS IN ACCORDANCE WITH TITLE 40, ARTICLE 15, SECTION 108, OF THE COLORADO REVISED STATUTES.	)	CASE NO. 6685 COMMISSION DECISION AND ORDER ADOPTING RULES

August 31, 1988

Appearances:

Roy A. Adkins, Esq., Denver, Colorado, for The Mountain States Telephone and Telegraph Company;

Steven H. Denman, Esq., for the El Paso County Telephone Company;

Craig Dingwall, Esq., Burlingame, California, for US Sprint Communications Company;

William Levis, Esq., Denver, Colorado, for MCI Telecommunications Corporation;

Michael L. Glaser, Esq., Denver, Colorado, for Eagle Telecommunications, Inc.;

Anthony Marquez, Esq., for the Office of Consumer Counsel;

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

Randall Alt, Esq., Denver, Colorado, for Agate Mutual Telephone Exchange, Bijou Telephone Cooperative Association, Inc., Delta County Telecommunications Incorporated, Farmers Telephone Company, Inc., Sunflower Telephone Company, Inc., Big Sandy Telecommunications, Inc., Columbine Telephone Company, Eastern Slope Rural Telephone Association, Inc., Nucla-Naturita Telephone Company, and Wiggins Telephone Association, and

Peter J. Stapp, Assistant Attorney General for the Commission.

BY THE COMMISSION:

STATEMENT

By Decision No. C88-664, issued June 1, 1988, the Commission established Case No. 6685 to consider adoption of rules prescribing cost allocation methods in accordance with § 40-15-108, C.R.S. On June 1, 1988, the Office of Regulatory Reform was provided with a copy of the proposed rules. By Decision No. C88-761, dated June 15, 1988, the Commission issued formal notice of rulemaking in this case. Those desiring to intervene were required to file that intent by July 1, 1988, and were authorized to file comments on the proposed rules attached to Decision No. C88-761 as Appendix A, by the same date.

Timely interventions were filed by The Mountain States Telephone and Telegraph Company (Mountain Bell), the El Paso County Telephone Company (El Paso), Haxtun Telephone Company (Haxtun), Agate Mutual Telephone Exchange (Agate), Bijou Telephone Cooperative Association, Inc. (Bijou), Delta County Telecommunications Incorporated (Delta), Farmers Telephone Company, Inc. (Farmers), Sunflower Telephone Company, Inc. (Sunflower), Big Sandy Telecommunications, Inc. (Big Sandy), Columbine Telephone Company (Columbine), Eastern Slope Rural Telephone Association, Inc. (Eastern Slope), Nucla-Naturita Telephone Company (Nucla-Naturita), Wiggins Telephone Association (Wiggins), Eagle Telecommunications, Inc. (Eagle), US SPRINT Communications Company (US Sprint), AT&T Communications of The Mountain States, Inc. (AT&T), MCI Telecommunications Corporation (MCI), and the Colorado Office of Consumer Counsel (OCC).

The hearing was held as scheduled on July 11 and 12, 1988, and at the conclusion of the hearing, this matter was taken under advisement. The proposed rules, which contained a statement of basis and purpose and statutory authority, were made available to any person at least five days before the scheduled hearing by being included in the rules proposed in Decision No. C88-761, and by being available at the Commission's office. Parties were given an opportunity to file further comments and statements of position. Comments or statements of position were filed by Mountain Bell, El Paso, AT&T, Eagle, Agate, Big Sandy, Bijou, Columbine, Delta, Eastern Slope, Farmers, Nucla-Naturita, Sunflower, Wiggins, MCI, US Sprint, and the OCC.

FINDINGS OF FACT AND CONCLUSIONS THEREON

Based upon all the evidence received, the record in this proceeding and the law of this case, the following facts are found and conclusions of law drawn.

1. In § 40-15-101, C.R.S., the General Assembly stated that:

> . . . it is the policy of the state of Colorado to promote a competitive telecommunications

marketplace while protecting and maintaining the wide availability of high-quality telecommunications services. Such goals are best achieved by legislation that brings telecommunications regulation into the modern era by guaranteeing the affordability of basic telephone service while fostering free market competition within the telecommunications industry. The general assembly further finds that technological advancements and increased customer choices for telecommunications services generated by such market competition will enhance Colorado's economic development and play a critical role in Colorado's economic future. However, the general assembly recognizes that the strength of competitive force varies widely between markets and products and services. Therefore, to foster, encourage, and accelerate the continuing emergence of a competitive telecommunications environment, the general assembly declares that flexible regulatory treatments are appropriate for different telecommunications services.

2. Under § 40-15-108, C.R.S., any provider of telecommunications products and services (provider) which offers both regulated and and deregulated telecommunications service is required to segregate its intrastate investments and expenses in accordance with allocation methods prescribed by the Commission to ensure that deregulated telecommunications services are not subsidized by regulated telecommunications services. In addition, any local exchange provider which provides facilities or equipment for use by interstate users or providers must separate all investments and expenses associated with the provision of the facilities or equipment for use by interstate users or providers according to applicable federal separations procedures and agreements.

3. Under § 40-15-106, C.R.S., the price of telecommunications services or products [1] which are not subject to the jurisdiction of the Commission shall not be priced below cost by use of subsidization from customers of services and products subject to the jurisdiction of the Commission, and cross-subsidization is deemed to be an illegal restraint of trade subject to the provisions of Article 4 of Title 6, C.R.S.

4. Under § 40-15-107, the Commission is required to administer and enforce all provisions of Article 15, Title 40, and has the right to inspect the books and documents of any local exchange provider as those books and documents pertain to any proceeding pending before the

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1. Throughout this order the use of the term services should be understood to include services and products.

Commission. Upon the request of the Commission, any local exchange provider must supply additional relevant and material information to the Commission as needed. The Commission has the right to inspect books and records of any affiliate of a local exchange provider which provides both regulated and deregulated telecommunications services, if, in the provision of those services, the affiliate uses plant or incurs costs which are joint and common to the provision of any basic local exchange service of a local exchange provider regulated by the Commission. Upon application, the Commission is authorized to enter protective orders for any confidential or proprietary information submitted to the Commission.

5. Article 15 of Title 40 is divided into four parts. Part 2 concerns regulated telecommunications services (Part 2 services). Part 3 concerns emerging competitive telecommunications services (Part 3 services) and part 4 concerns deregulated telecommunications services (Part 4 services). The Commission has jurisdiction over part 2 and part 3 services, but does not have jurisdiction over part 4 services. When regulating part 3 services, the Commission is precluded from considering traditional rate base or rate-of-return regulation as the sole factor for regulating these services. However, rate-of-return information shall be provided by local exchange providers for the regulation of part 3 services if requested by the Commission.

6. In Case No. 6636, the Commission issued rules concerning the regulation of emerging competitive telecommunications services as required by § 40-15-302, C.R.S.

7. Based primarily on the statutory sections cited above, and consistent with the rules issued in accordance with § 40-15-302, C.R.S., the Commission has proposed these rules to prescribe cost-allocation methods in order to encourage providers to provide both regulated and deregulated telecommunications services. In addition, these rules require providers to submit sufficient information to the Commission so it can reduce the likelihood of cross-subsidization and illegal restraint of trade, while guaranteeing the affordability of basic telephone service and fostering free market competition within the telecommunications industry. These rules establish the policies and requirements for segregating the intrastate investments and expenses of regulated telephone service from intrastate investments and expenses of non-regulated activities of telephone companies and their affiliates. These rules also establish the policies and requirements that must be incorporated in the cost-allocation manuals filed with the Commission by providers.

8. These rules apply to all telecommunications service providers subject to the jurisdiction of the Commission. We find that because of the size of the various providers, the number of access lines provided by them, or whether they provide any access lines, and the potential for cross-subsidization, the reporting requirements among the providers should vary. Therefore, Rule 1 establishes four classes of providers based on the number of access lines provided by a provider.

Mountain Bell is the only Class A provider in this state. It has the greatest opportunity to cross-subsidize the price of deregulated services by use of investments and expenses associated with the provision of regulated services without just compensation since it controls certain bottleneck facilities and the public switched network, as the Commission has found in several other proceedings and since it offers services under part 2, 3, and 4. The Federal Communications Commission (FCC) has recognized that AT&T and the Bell operating companies such as Mountain Bell, should be subject to greater scrutiny to ensure that cross-subsidization does not occur because of their prior monopoly status. These providers still enjoy substantial market shares, and some market dominance for certain services. As more competition evolves, the market shares may decline for these providers, and where a particular service becomes more competitive and the share of the market held by Mountain Bell or AT&T is reduced, more relaxed regulatory treatment may be appropriate which could reduce the reporting required under these rules.

On the other hand, due to the size of Class B providers, and in order to reduce the costs to comply with these rules, Class B providers are not required to file cost-allocation manuals with the Commission. Class B providers are generally small independent telephone companies. However, these providers are required to comply with the procedures described in these rules, particularly Rules 6, 7, 8, and 14, and if they seek a change in revenue requirements, they must demonstrate compliance with these rules through their work papers. The Commission Staff shall develop a model cost-allocation manual for small telephone company cost segregation that will be available to providers in the event they choose to maintain a cost-allocation manual even though they are not required to file that manual with the Commission.

Class C providers are larger independent telephone companies. Class D providers are interexchange carriers such AT&T, US Sprint, and MCI who provide no access lines and have less opportunities to cross-subsidize their services since they do not provide part 2 services.

9. Rule 2 provides certain definitions. We have defined cross-subsidization using the standard found in § 40-15-106, C.R.S. We also find cross-subsidization may occur when deregulated operations obtain benefits from intangible factors owned by the regulated entity, such as good will or the use of a corporate name, without just compensation. Therefore, we have clarified the definition of cross-subsidization by specifically identifying as cross-subsidization the use of good will or corporate names, for example, by the deregulated operations without providing the regulated operations with just compensation for the use of such intangible assets. This language is similar to that proposed by the OCC.

10. Primarily Mountain Bell and El Paso were concerned with the fact that the rules provide for segregation of investments and expenses between part 2, part 3, and part 4 of services and products. The Commission finds that this segregation is required only where the part 3

services and products have been granted relaxed regulatory treatment. When that treatment is allowed, the Commission anticipates that those services might become deregulated under part 4 upon appropriate application to the Commission. In addition, those services may not be subject to ratebase or rate-of-return regulation as other regulated services may be. However, when part 3 services are offered which have not been accorded relaxed regulatory treatment then the investments and expenses associated with providing those services need not be segregated from services regulated under part 2. Obviously, investments and expenses associated with services deregulated under part 4, or services which are deregulated by this Commission in accordance with part 4, must be segregated as required by § 40-15-108, C.R.S. Therefore, in Rule 3, each provider must identify part 2, 3 and 4 services and products in its manual; separation of part 2 investments and expenses from those of part 3 will be required only where relaxed regulation has been granted by the Commission.

11. Rule 4 recognizes that all telecommunications service providers are required by Rule 25(a) of the Rules of Practice and Procedure of the Commission to file an annual report by March 31 of each year. This rule also requires telephone and telegraph companies to maintain their books of account and records under the Uniform System of Accounts as described in § 40-4-111, C.R.S. In CC Docket No. 86-111 before the FCC, cost-allocation procedures were established for interstate providers of telecommunications services. Recognizing that many of the providers in this state must comply with those cost-allocation procedures, this Commission has adopted in Rule 4 the system of accounting prescribed by the FCC and cost-allocation procedures similar to those adopted by the FCC in Rule Nos. 6, 7, 8 and 14. We find that this should simplify the reporting process for providers so that they are not maintaining their system of accounts in different manners, one for the FCC and one for this Commission. Further, the system prescribed by the FCC and adopted by this Commission in these rules will provide this Commission with the information necessary to ensure that no cross-subsidization occurs between deregulated services and regulated services. Finally, the cost of compliance should be reduced substantially since providers should be providing information in one format for both agencies.

Any provider may seek a waiver of various provisions of these rules upon a showing that the FCC allows it to maintain its books of account and records in a manner different from the system prescribed by CC Docket No. 86-111, or where the FCC does not require a provider to comply with part 36 of the rules of the FCC concerning the filing of cost-allocation manuals. Providers also are allowed some flexibility when allocating investments and expenses where the allocation method employed by a provider reproduces results which are consistent with the principles described in these rules.

12. In devising cost-allocation procedures in CC Docket No. 86-111, the FCC also recognized that the size of various providers and their ability to control the market required different reporting

standards. This Commission finds that this further supports the need to divide providers in this state into the four classes described in Rule 1.

13. It is not necessary to comment on the remaining rules specifically, except to address concerns raised by the parties to this proceeding. The Commission has reviewed these concerns raised in either the evidence received or in the comments and position statements filed by those parties.

14. Mountain Bell was concerned with the fact that the Commission has applied these rules to Mountain Bell's affiliates. The Commission finds that in order to properly ensure that no cross-subsidization occurs, and to be consistent with § 40-15-107, C.R.S., it must monitor activities by affiliates of Mountain Bell or of any other local exchange provider. Finally, Mountain Bell believes that any information which is supplied to the Commission under these rules should, mandatorily, be treated as proprietary information. The Commission, throughout these rules, has declared that information provided to the Commission under these rules may be the subject of a protective order. Once again, this is consistent with the Commission's statutory authority found in § 40-15-107, C.R.S., which does not require protective orders, but merely authorizes them.

15. The OCC argues that the Commission's rules direct allocation of investments and expenses based on the actual use of services rather than on their forecasted use as endorsed by the FCC. However, the Commission finds that Rule 7.3.2.1 takes into account forecasted use of services since that rule recognizes that the amounts of use vary in intensity by time period and that when the engineering design criteria are sensitive to the peak-period usage, the segregation method will follow the engineering cost-causation. Therefore, the Commission is providing for forecasted use and is not relying solely on actual use to determine the allocation of investments and expenses.

16. Most of the independent providers requested that the Class B providers include local exchange providers who furnish fewer than 20,000 access lines rather than 2,000. El Paso suggested that the cutoff be 10,000 access lines. The Commission has adopted 2,000 access lines at this time on the basis that the vast majority of independent telephone service providers will be exempt from many of the filing requirements of these rules at this level. This should reduce the concerns about the costs of compliance raised by these parties. However, even where a provider exceeds the 2,000 access line cutoff, a variety of waiver provisions exist throughout these rules to allow a provider to demonstrate that the requirements of the rule will be burdensome or so expensive as to cause the cost of compliance to exceed the benefits expected. Moreover, the Staff of the Commission has been directed in these rules to provide a model manual for small providers which should reduce the cost of compliance.

17. The Commission finds that the proposed rules attached as Appendix A to this Decision will protect the public safety, health, and

welfare, are in the public interest and should be adopted. The Commission further finds that the record of the rulemaking proceeding demonstrates a need for the rules; that proper statutory authority exists for the rules; that the rules are clearly and simply stated to the extent practicable, so that their meaning will be understood by any party required to comply with the rules; that the rules do not conflict with other laws, and that the rules do not duplicate or overlap other rules. The Commission also finds that these rules are consistent with the statutory authority found in § 40-15-108, C.R.S., specifically, and other statutes generally found in Article 15, Title 40, C.R.S., and the adopted rules are consistent with the subject matter in the notice of proposed rulemaking.

THEREFORE THE COMMISSION ORDERS THAT:

1. The proposed rules under § 40-15-108, C.R.S., prescribing cost-allocation methods for segregation of investments and expenses of telecommunications providers, as modified and found in Appendix A, are adopted as the final rules. Appendix A is incorporated by reference into this Order as if set forth verbatim.

2. The rules adopted in ordering paragraph 1 shall be submitted by the Commission's Executive Secretary to the appropriate committee of reference of the Colorado General Assembly, if the General Assembly is in session at the time this Decision and Order becomes effective, or to the Committee on Legal Services, if the General Assembly is not in session, for its opinion as to whether the rules adopted conform with § 24-4-103, C.R.S.

3. An opinion of the Attorney General of the State of Colorado will be sought concerning the constitutionality and legality of the rules adopted in ordering paragraph 1.

4. The Commission's Executive Secretary shall file with the Office of the Secretary of State of Colorado a copy of the rules in Appendix A and a copy of the opinion of the Attorney General of the State of Colorado concerning the constitutionality and legality of these rules.

5. The Commission's Executive Secretary shall publish the rules adopted by ordering paragraph 1, in accordance with § 24-4-103(11)(k), C.R.S. These rules shall become effective on the 20th day after their publication in the Rules Register of the Secretary of State, in the event this Decision becomes a final Commission Decision.

6. The 20-day time period provided by § 40-6-114(1), C.R.S., to file an application for rehearing, reargument, or reconsideration begins on the first day after mailing or serving of this Decision and Order. Since these rules have been changed from those originally proposed, any party desiring to comment upon the rules, as modified, and as attached in Appendix A to this Decision should do so during this 20-day time period.

This Decision and Order shall be effective immediately.

DONE IN OPEN MEETING the 31st day of August 1988.

(S E A L)

ATTEST: A TRUE COPY

James P. Spiers
Executive Secretary

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

ARNOLD H. COOK

ANDRA SCHMIDT

Commissioners

COMMISSIONER RONALD L. LEHR ABSENT
BUT CONCURRING IN THE RESULT

TD:2117G:td:nrg

RULES UNDER §40-15-108, C.R.S. PRESCRIBING COST-ALLOCATION METHODS FOR SEGREGATION OF INVESTMENTS AND EXPENSES OF TELECOMMUNICATIONS PROVIDERS

BASIS, PURPOSE, AND STATUTORY AUTHORITY

The basis and purpose for these rules are to prescribe cost-allocation methods in order to allow intrastate telecommunications service providers to provide both regulated and deregulated telecommunications services as permitted by law, to provide for flexible regulatory treatments, and to prevent cross-subsidy and illegal restraint of trade, while guaranteeing the affordability of basic telephone service and fostering free-market competition within the telecommunications industry.

These rules will establish the policies and requirements for segregating the intrastate investments and expenses of regulated telephone service from the intrastate investments and expenses of non-regulated activities of telephone companies and their affiliates. Further, these rules will establish the policies and requirements to incorporate into the provider's cost-segregation manual, the accounting plans that segregate assets as adopted by the Commission according to Rule 1.3 of the Rules Under Section 40-15-302(1) C.R.S., Emerging Competitive Telecommunication Service, Decision No. C87-1654.

The specific statutory authority for these rules is §§ 24-4-103, 40-3-101, 40-4-111, 40-15-101, 40-15-106, 40-15-107, and 40-15-108 C.R.S.

RULE 1: APPLICABILITY

These rules are applicable to all intrastate telecommunications service providers who provide both regulated and deregulated telecommunications services as permitted by law.

There are four classes of telecommunications service providers.

1.1 Local exchange providers who furnish more than 20,000 access lines are Class A providers.

1.2 Local exchange providers who furnish no more than 2,000 access lines are Class B providers.

1.3 Local exchange providers who furnish no more than 20,000 access lines but more than 2,000 access lines are Class C providers.

1.4 Interexchange providers who furnish no access lines are Class D providers.

RULE 2: DEFINITIONS. As used in this rule, unless the context otherwise requires:

2.1 Product or service: When referencing product or service, one includes the other.

2.2 Provider: Provider means telecommunication service provider.

2.3 Cross-subsidization: Cross-subsidization occurs when telecommunications services or products which are not subject to the jurisdiction of the Commission (deregulated) are priced below cost by use of subsidization from customers of services or products subject to the jurisdiction of the Commission (regulated); or when a provider's deregulated services or products derive benefits from the regulated operations without receiving just and reasonable compensation from the deregulated operations for the benefits derived.

RULE 3: APPLICABILITY TO SPECIFIC TYPES OF ACTIVITIES

3.1 Each provider must file in its cost-segregation manual with the Commission a list of each product and service that it offers, providing a description of each product or service and the classification of that product or service as a Part 2, Part 3,or Part 4 product or service as those terms are used in Title 40, Article 15, C.R.S. and as determined by Commission decision. This list shall be updated as substantive changes occur.

3.2 Treatment of incidental activities. Providers will be permitted to continue accounting for nontariffed activities as regulated activities when they are offered incidental to tariffed services provided that:

3.2.1 The activities are outgrowths of regulated operations; and

3.2.2 The total revenue from all those activities does not exceed:

3.2.2.1 One percent of the provider's total annual Colorado operating revenue; or

3.2.2.2 The provider-specific revenue levels as ordered by the Commission; and

3.2.3 The activity is a non-line-of-business activity; and

3.2.4 The activity has traditionally been treated as an incidental service.

3.3 Providers shall specify in their initial cost-segregation manuals precisely which activities they propose to treat as incidental activities.

3.4 Providers shall update their cost-segregation manuals as changes occur to specify any new activity they propose to treat as incidental and will ensure that the activity proposed for treatment as an incidental activity complies with this rule, except for section 3.2.2.2.

3.5 Each cost-segregation manual filed with the Commission must include a showing that any activity proposed for treatment as an incidental activity complies with this rule.

RULE 4: UNIFORM SYSTEM OF ACCOUNTS

4.1 All providers who are subject to the jurisdiction of this Commission are required by Rule 25 (a) of the Rules of Practice and Procedure of the Commission to file an annual report by March 31 of each year. Rule 25(c)(1) of the Rules of Practice and Procedure of this Commission requires telephone and telegraph companies to maintain their books of account and records under the Uniform System of Accounts (USOA) prescribed by the Federal Communications Commission (FCC) or its successor regulatory agency. The system of accounts shall be further prescribed for the following classified types of providers:

4.1.1	Class A	FCC Part 32 USOA Class A
4.1.2	Class B	FCC Part 32 USOA Class A OR B
4.1.3	Class C	FCC Part 32 USOA Class A OR B
4.1.4	Class D	FCC Part 32 USOA Class A or in accordance with Commission Order.

4.2 Any provider may request a waiver from maintaining its books of account and records under the prescribed system, provided that the FCC does not require the provider to maintain its books according to the prescribed uniform system of accounts, as set forth in the FCC'S Part 32 Rules. Any system of accounts proposed to be used in lieu of the prescribed uniform system of accounts must be capable of providing sufficient information to the Commission to support compliance with these rules.

RULE 5: SEPARATION OF COSTS BETWEEN THE STATE AND INTERSTATE JURISDICTIONS

Any provider which provides facilities or equipment for use by interstate users or providers of telecommunications services must apply federal cost allocation and separations principles as described in Part 64 of the Rules of the FCC (the Cost Allocation Manual) and Part 36 of the Rules of the FCC (the Separations Manual). A provider which is not required by the FCC to apply the Part 36 rules may apply for a waiver of Rule 5 as it relates to Part 36. However, the provider requesting that waiver must implement a suitable alternate method of producing Colorado intrastate-specific information to the Commission.

RULE 6: COST SEGREGATION STANDARDS - GENERAL

The Commission adopts the use of a fully distributed cost study as the standard for the determination of whether there is cross-subsidization between regulated and deregulated services.

6.1 In performing a fully distributed cost study the following cost segregation principles (listed in descending order of preferred application) will be used by all providers:

6.1.1 Cost causation - Costs are assigned to all products and services that cause those costs to be incurred.

6.1.2 Traceability - Costs that are identified in their entirety with a specific product and service are directly assigned.

6.1.3 Variability - Costs that are not directly traceable to a particular product or service, but do vary to some degree with the volume of activity that is associated with products and services, are segregated according to the rate of of change of activity.

6.1.4 Capacity Required - Costs of capacity are assigned according to whether they are necessary for the performance of the service.

6.1.5 Beneficiality - A service is said to benefit from a cost if that cost is necessary to render that service.

6.2 Any investments or expenses that are used jointly by two or more different services or that are used in common by services must be segregated among all of those services using allocators that, to the maximum extent practicable, track how those costs are incurred.

6.3 Consistent with FCC Docket 86-111, Report and Order adopted September 23, 1986, ¶ 131, these rules do not require or suggest the sole use of Cost Accounting Standards Board (CASB) standards.

6.4 The method for segregating investments and associated expenses which are common or jointly used must ensure that all products and services that use those assets are allocated a portion of the joint investments and expenses. Incremental or marginal cost studies will not be accepted for the purposes of this rule.

RULE 7: COST SEGREGATION STANDARDS AND GUIDELINES - SPECIFIC

7.1 All investments and expenses attributable to the interstate jurisdiction are to be allocated using federal rules. Each cost-segregation procedure manual filed with this Commission must demonstrate that these federal procedures have been properly applied prior to the intrastate segregation process.

7.2 Each Part 2, Part 3, or Part 4 product and service found in Title 40, Article 15, Colorado Revised Statutes, must be treated specifically in the cost-segregation procedure. Each product or service must be identified in sufficient detail to determine the appropriate cost categories to be employed unless it qualifies for treatment as an incidental service in Rule 3.2.

7.3 In order to provide a consistent approach to segregating all costs, the Commission requires consideration in descending order of the following factors:

7.3.1 Costs must be directly assigned whenever possible. Directly assignable costs are defined as those costs that can be attributed only to the specific product or service. Clearly, where more than one product or service uses an investment or causes a cost to be incurred, direct assignment is inappropriate. (This employs the Traceability principle in Rule 6.1.2.)

7.3.2 The method of segregating common or jointly used investments and expenses, must use the provider's own engineering and service-provision design criteria as the primary assumption. (This employs the Variability principle in Rule 6.1.3.) The segregation method employed must, to the maximum extent possible, mirror the design criteria, including but not limited to the following:

7.3.2.1 If the amounts of use vary in intensity by time period, and the engineering design criteria are sensitive to the peak period usage, i.e., end office or toll switching, then the segregation method must also follow the engineering cost-causation.

7.3.2.2 Common or joint costs that vary in direct proportion to the relative amounts of use of a service shall be segregated based upon those relative amounts of use.

7.3.3 Common or joint costs that do not vary in direct proportion to the relevant amounts of use of the service shall be segregated by a surrogate measure that has a logical or observable correlation to the use of the product or service. (This employs the Capacity required principle in Rule 6.1.4.)

7.3.4 Common costs for which there is no direct or indirect measure of allocation shall be segregated using an appropriate general allocator that is based upon total expenses otherwise assigned. (This employs the Beneficiality principle in Rule 6.1.5.)

7.3.5 Residual common marketing expenses which cannot be directly assigned, or directly or indirectly attributed, will be allocated using a general marketing allocator. This allocation will be derived based upon the previously assigned or attributed marketing expenses between regulated and nonregulated operations.

7.4 Providers ordinarily shall segregate costs using the directly-attributable and cost-causative principles. General allocators shall be used only in exceptional cases and, then, only when the justification for their use is explained fully.

7.5 Providers will be required to provide the Commission with all the data necessary to verify the cost segregation.

7.6 As providers develop new products and services, investments will be used and expenses incurred in order to begin offering those products or services. It is not appropriate to allocate these investments or expenses exclusively to an existing service. As new products and services begin to use joint and common assets and expenses are incurred, the methods of segregation in the manuals must be modified to track the usage and expenses. The manual modifications are necessary when the use of facilities and expenses incurred become material.

RULE 8: COST SEGREGATION POINTS OF EMPHASIS

8.1 A time-reporting method of allocation rather than a general allocator must be used for labor-intensive items. For example, the allocation of costs associated with joint marketing of services should employ actual time-reporting methods for the allocation.

8.1.1 An allocation method which uses statistically valid samples based on time-reporting is permissible.

8.1.2 A method different from a strict time-reporting allocation method may be approved by the Commission if it can be verified that the surrogate method is reasonably related to the expense being allocated and that it fairly reproduces the results of a time-reporting method.

RULE 9: IMPLEMENTATION AND ENFORCEMENT

9.1 The Commission will enforce these cost-segregation methods and affiliate transaction rules by requiring providers to file cost-segregation manuals demonstrating, in detail, their application of the methods and affiliate transaction rules to their particular operations. These manuals must be approved by the Commission and must be kept current. These manuals shall be subject to public comment and review by the Commission and its staff. The results derived from the application of the allocation methods described in these manuals will be subject to audit review by this Commission and its staff.

9.2 Any provider desiring an exception to the cost-segregation standards in these rules must make that request by application, and may be granted an exception by Commission order.

RULE 10: COST SEGREGATION MANUALS

10.1 Classes of Utilities Required to File. All local exchange companies (LECs) that are classified as Class A or Class C providers are likely have services that fall into Part 2, Part 3, and Part 4, Title 40, Article 15, C.R.S. Each LEC must provide a manual that segregates its investments and expenses between each of these three categories. Class D Interexchange Carriers are likely to have services defined in Part 3 and Part 4 of Title 40, Article 15, C.R.S. Each of these interexchange carriers must provide a manual that segregates its investments and expenses between these two categories, or these carriers will perform specific cost segregations between categories on a case-by-case basis in accordance with Commission orders. Class B providers are not required to file a cost-segregation manual but will be afforded an opportunity to employ a model manual for small telephone company cost-segregation that will be developed and maintained by the Commission Staff.

Absent a Commission decision granting relaxed regulation of an emerging competitive service and adopting an appropriate accounting plan for segregation, Part 3 services may be aggregated with part 2 regulated services for manual and reporting purposes.

Where the Commission has issued a decision granting relaxed regulatory treatment under the rules under section 40-15-302(1) C.R.S., emerging competitive telecommunication service, the adopted accounting plan for segregation shall be incorporated into the provider's cost-segregation manual of this rule. Part 3 services granted flexible regulatory treatment may not be aggregated with part 2 regulated services for manual and reporting purposes.

10.2 Filing and Review Procedures. All providers described in these rules must use a cost-segregation manual, except Class B providers who are subject to Rule 10.4. The detailed manual will describe the manner in which each provider will implement these cost-segregation standards. Each manual will be reviewed by the Staff of the Commission for conformity with these rules and the public will be given an opportunity for comment. Each manual filing and subsequent change may be the subject of a hearing.

10.3 Exemption from the Manual-Filing Requirement. Any provider desiring a waiver from the manual-filing requirement must make that request by application, and may be granted a waiver by Commission order.

10.4 Applicability of Cost-Segregation Standards after Exemption from Manual Filing Requirement. The cost-segregation standards described in Rules 2, 3, 4, 5, 6, 7, 8, 11, 12, and 14, of these rules are applicable to all providers. Even though it may have been granted an exemption from filing a manual or was not required to file a manual, a provider must comply with these cost-segregation rules when: 1) it submits to the Commission a request for a change in revenue requirement, or 2) it files an Appendix B to its annual report (if required). Compliance with this rule shall be demonstrated by documentation of allocation methods and workpapers showing their application.

10.5 Manual Content. Each provider's cost-segregation manual shall contain the following information:

10.5.1 A description of each service (or service family) provided by provider comprehensive enough to provide sufficient information about the service to ascertain its cost treatment.

10.5.2 The category in which the service belongs, namely, Part 2, Part 3, or Part 4, Title 40, Article 15, C.R.S.

10.5.3 For each account and sub-account, a detailed specification of cost categories to which amounts in each account or sub-account will be assigned and the basis on which each cost category will be apportioned. Whenever a direct assignment is made, it must be specifically explained. Each provider must show in its manual the method it uses to segregate its costs between Part 2, Part 3, and Part 4 service grouping described in Title 40, Article 15, C.R.S. The manual must show how the segregation methods used conform to the prescribed standards in this rule.

10.5.4 A verification that the federally mandated Part 32, or the provider-specific FCC authorized accounting method, Part 64 and Part 36 (FCC) cost-allocation standards and separations procedures were used. A provider that is not required by the FCC to apply Part 36 or Part 64 will not have to make such a showing. However, the provider must implement a suitable alternative method of producing Colorado jurisdictional intrastate-specific information to the Commission.

10.5.5 A list of all activities to which the provider now accords incidental accounting treatment, and the justification for treating each as incidental.

10.5.6 A chart showing all of its corporate affiliates, as defined in Rule 14.

10.5.7 A statement identifying affiliates that engage in transactions with the providing entity and describing the nature, terms and frequency of those transactions.

RULE 11: REPORTING AND RECORDKEEPING

11.1 Each provider will be required to keep records and all supporting documentation for cost segregations two years following the close of the fiscal year to which the records relate.

11.2 Each provider shall, as an Appendix B to its annual report, provide to the Commission its segregated financial statements. The segregated financial statements in Appendix B need only display the aggregated totals for Part 2, 3 and 4 divisions.

11.3 Exemption from the Appendix B filing requirement. Class B providers are not required to file an Appendix B to their annual report. Any other provider desiring a waiver must make that request by application, and may be granted a waiver by Commission order.

11.4 The Appendix B to the Annual Report shall be accorded proprietary status by the Commission.

RULE 12: AUDITING

12.1 The providers will be required to submit certified reports of an independent auditor, attesting that the provider has designed and implemented its cost-segregation methods and procedures consistent with its approved cost-segregation manual. These audit reports also will be required as part of any formal request by the provider for a change in revenue requirements submitted to the Commission.

12.2 The independent auditor's certified report filed with the Commission shall include:

12.2.1 The scope of work conducted, specifying the items examined and the extent of examination.

12.2.2 The auditor's conclusion as to whether actual methods and procedures designed and implemented by the provider conform with the objectives, approach and procedures described in the cost-segregation manual.

12.2.3 Any material exceptions or qualifications that the auditor may have identifying the adequacy of the procedures.

12.2.4 Any limitations in the scope of review imposed upon the auditor by the provider.

12.2.5 A statement that the attestation standards have been fully met during the examination.

RULE 13: PROPRIETARY INFORMATION

13.1 The Auditor's Attestation Report shall be filed with the Commission and may be given proprietary status if requested and approved. Any workpapers used by the independent auditors must be made available for Commission staff review. The provider must make the proper authorization to release these workpapers to the Staff of the Commission.

13.2 The detailed specifications, documentation and supporting information implementing the provider's cost-allocation manual must be made available to the Commission and its Staff for review, and may be given proprietary status if requested and approved.

RULE 14: AFFILIATE TRANSACTIONS

All providers are subject to the following rule. This rule applies to transfers between regulated and nonregulated books of accounts and records within the company as well as between regulated and nonregulated affiliates.

14.1 Transfer of Assets

14.1.1 All assets transferred between regulated providers and nonregulated affiliates must be valued at the prevailing market price held out to the general public in the normal course of business or at the current effective tariff rate on file with the Commission.

14.1.2 If there is no prevailing company price or tariff rate, the asset transfer from the nonregulated affiliate to the regulated provider should be recorded at the lower of net-book cost or fair market value, while transfers from the regulated provider to the nonregulated affiliate should be recorded at the higher of net-book cost or fair market value.

14.2 Valuation of Services Provided to or by an Affiliate.

14.2.1 All services provided to or by an affiliate must be valued at the federally tariffed rate or the rate on file with the Colorado Commission.

14.2.2 If there is no tariffed rate, but the affiliate provides the service to the general public in the normal course of business, then this prevailing price should be used to determine the price charged to the regulated provider.

14.2.3 When a regulated provider furnishes to a nonregulated affiliate a service which is neither tariffed nor offered to the general public in the normal course of business, or when a regulated provider receives from a nonregulated affiliate a service which is not offered to the general public in the normal course of business, the cost of the service should be valued at the fully allocated cost, determined in a manner that complies with these cost-segregation standards and rules.

14.3 Prevailing Price. The mere offering of a service to unaffiliated persons or entities is not sufficient to establish a prevailing company price. The company must show that the service is actually provided to a sufficient number of unaffiliated persons or entities to establish a prevailing price.

14.4 Manual Content. The providers must include in their cost-segregation manuals a statement identifying affiliates that do engage in transactions with the provider. They shall describe the nature, terms and frequency of those transactions.

14.4.1 Nature of transactions. The company must state in its manual, for each service transaction, a description of of the nature of the transactions (that is, whether the service involves the provision of services or asset transfers).

14.4.2 Terms of affiliate transactions. The company must state in its manual the terms at which the service is provided (that is, at tariff rate, prevailing company price, or fully distributed cost).

14.4.3 Frequency of affiliate transactions. The company must state in its manual the frequency with which the service is rendered.

14.5 Transactions with nonaffiliates. Providers must state whether the services listed in the portion of the manual concerning affiliate transactions are offered to nonaffiliates, and if so, the terms and frequency at which they are provided to the nonaffiliates.