

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

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IN THE MATTER of the Application of ) UTILITY DIVISION  
U S WEST Communications, Inc. to ) DOCKET NO. D96.12.220  
Restructure its Prices for Regulated )  
Telecommunications Service. ) ORDER NO. 5965c

**FINAL ORDER**

APPEARANCES

FOR THE APPLICANT:

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**BEFORE:**

DAVE FISHER, Chairman

NANCY MCCAFFREE, Vice Chair

BOB ANDERSON, Commissioner

DANNY OBERG, Commissioner

BOB ROWE, Commissioner

**I. INTRODUCTION AND BACKGROUND**

1. U S WEST Communications, Inc. (U S WEST) filed an application on December 26, 1996 to restructure prices it is authorized to charge its Montana customers for some of its regulated telecommunications services. These services include local exchange service, toll service, access charges to interexchange carriers, operator services and other related services. Although U S WEST did not request an overall rate increase, the rebalancing of rates proposed by U S WEST would increase rates for certain services and decrease rates for others. For residential customers, U S WEST proposed an increase of \$4.00 per month for flat-rated access lines and \$2.00 per month for all measured service lines. U S WEST also proposed to establish a single rate group for business exchange access lines, thereby lowering rates for some business customers; a restructure of message toll service (MTS) rates, lowering some toll rates and increasing others; and decreases in carrier access charges.
2. Another U S WEST tariff filing, originally docketed as D97.5.85, proposed to increase the local measured usage rate for Basic Public Access Lines (PAL). On June 10, 1997, the Commission consolidated U S WEST's PAL tariff filing in this Docket.
3. Intervenors in this action initially included AT&T Communications of the Mountain States, Inc. (AT&T), MCI Communications Corp., the Montana Telephone Association (MTA), Montana Independent Telecommunications Systems (MITS), the Montana Consumer Counsel (MCC), Touch America, Citizens Utilities Company, and Northwest Payphone Association (NWPA). AT&T subsequently moved the Commission to withdraw from the proceedings; the motion was granted on February 24, 1998. Prior to withdrawing, AT&T was an active intervenor in this Docket, filing testimony and participating in discovery. Active participants throughout this Docket include U S WEST, MITS, MCC, and NWPA.
4. The Commission scheduled and noticed a hearing for April 22 and April 23, 1998. Although the Commission had intended to hear all issues in the case at that hearing, it was notified informally that U S WEST and the MCC had stipulated to resolve some of the issues. The Stipulation was filed on April 14, 1998. Issues involving PAL services were not part of the U S WEST/MCC Stipulation. Thus, the Commission heard testimony concerning the PAL issues and the proposed Stipulation reached between U S WEST and MCC.
5. On April 14, 1998, along with the Stipulation, U S WEST filed a Motion in Limine requesting an order governing the introduction of pre-filed testimony and exhibits into evidence in the hearing. This motion requested that the Commission limit the number of witnesses required at the hearing and admit the prefiled testimony of most of the witnesses without requiring their presence for cross-examination. The Commission partially granted U S WEST's Motion in Limine and required policy witnesses to testify. As a result of granting the parties' Motion in Limine and their agreement, many of the issues were not explored as extensively as they might have been absent the Stipulation. Most particularly, the testimony of MCC's and U S WEST's witnesses was not subject to cross-examination by an opposing party.

6. The Commission advised the parties at the hearing that it would hold public (satellite) hearings in several cities prior to deciding whether to approve the Stipulation. The Commission also issued extensive written questions about the Stipulation that the parties answered in written form as late-filed exhibits. These and other data responses are part of the record.
7. On May 22, 1998, Ronan Telephone Company (RTC) and its Consumer Advisory Committee (Committee) petitioned for late intervention. Both entities cited the increase in short-haul toll rates that was a part of the Stipulation as cause for permitting them to intervene. The increases in the lower mileage bands as proposed by the Stipulation were higher than what U S WEST had initially proposed. Although the Commission denied both petitions on May 27, 1998, it nevertheless issued a notice instructing the MCC and U S WEST to provide specific responses to the issues raised by RTC and the Committee. Both U S WEST and the MCC responded as requested, again urging the Commission to accept the Stipulation.
8. The Commission conducted satellite hearings in Missoula, Helena, Great Falls and Ronan. The June 2, 1998 hearing in Ronan was attended by many of the consumers served by RTC and Hot Springs Telephone Company (HSTC). At that hearing, numerous individuals protested the agreement in the Stipulation to raise MTS rates higher than what had been originally proposed by U S WEST in its application. The Commission also received letters concerning the proposed increase in local measured service rates for business customers.
9. Both RTC and the Committee requested reconsideration of the denial of their petitions to intervene in the proceeding. On June 16, 1998, the Commission reconsidered the Committee's request for late intervention and granted intervention to the Committee; the Commission denied RTC's similar petition.
10. In a series of work sessions held during the week of June 15-19, 1998, the Commission considered the Stipulation proposed by MCC and U S WEST, the comments and letters received from interested persons, and matters which had been noted by the Committee. On June 18, 1998, the Commission voted to reject the Stipulation as not being in the public interest and to request additional comments.
11. On June 30, 1998 the Commission issued Order No. 5965b, the Posthearing Order and Request for Comments (Posthearing Order). This order set forth the Commission's tentative rate design decisions and requested comments on them and on other matters by July 14, 1998. The Commission received comments from the MCC, MTA, MITS, U S WEST and the Committee.
12. Following receipt of comments, the Commission met several times to consider various rate design alternative proposals developed by Commission staff with assistance from U S WEST. At a work session held on August 12, 1998, the Commission reversed its prior conclusion as set forth in paragraph 9 in the Posthearing Order, and voted 3-2 to accept the Stipulation proposed by U S WEST and MCC with some modifications and conditions.
13. The Stipulation did not address payphone issues. Issues involving PAL rates are separately addressed in this Order. Other issues not covered by the Stipulation, but important in resolving this matter, involve policies regarding automatic Lifeline enrollments and the joint use of flat and measured service. These are also addressed separately in this Order.

## **II. NWPA'S MOTION TO STRIKE PORTIONS OF U S WEST'S REPLY BRIEF**

1. When post-hearing briefing had been completed in this Docket, NWPA filed a Motion to Strike Portions of U S WEST's Reply Brief. NWPA objected to U S WEST's having included a footnote and related text in its reply brief, contending that U S WEST had improperly injected a new issue in the reply brief and that NWPA had no opportunity to respond to that issue. NWPA also moved to strike U S WEST's Appendix 2 to its reply brief and the portion of the brief that relates to the Appendix.
2. With regard to the first of these issues, NWPA argues that this is an attempt by

U S WEST to raise revenue requirement as an issue on PAL rates for the first time, and that this prejudices NWPA. The pertinent text in U S WEST's Reply brief states, "The PAL rates proposed by U S WEST in this docket are part of the revenue neutral rate design proposed in the stipulation between U S WEST and the MCC. If the Commission lowers the PAL rates, as urged by NWPA, it will have to raise other rates." Footnote 5 states, "The PAL rates proposed by U S WEST would contribute an additional \$250,899 in annual revenues to the revenue neutral rate design set forth in the stipulation between U S WEST and the MCC."

3. The Commission concludes that this is not an attempt to inject new issues by U S WEST. This Docket is a significant step in restructuring rates for a more competitive telecommunications market. It involves

redesigning rates in a revenue neutral manner. As discussed below, the PAL rates are part of this overall rate design.

4. NWPAs request to strike Appendix 2 attached to U S WEST's Reply Brief is premised on U S WEST's statement in the brief that, "Upon discovering its mistake, U S WEST withdrew fraud protection from its compliance filing." NWPAs alternatively requests, if Appendix 2 is not stricken, that the Commission consider the NWPAs attachment to its motion to strike. The attachment is a letter to the FCC from U S WEST which clarifies that U S WEST did not *withdraw* CustomNET from its payphone compliance filing. Rather, U S WEST requested that it be allowed to remove CustomNET from its compliance filing because U S WEST believed it is not a payphone specific feature because it is generally available to and purchased by the entire range of local exchange customers.
5. The Commission denies NWPAs Motion to Strike Portions of U S WEST's Reply Brief. The Commission takes official notice of the documents filed with the FCC that were attached by U S WEST to its Reply Brief and by NWPAs to its Motion to Strike Portions of U S WEST's Reply Brief.

## **II. FINDINGS OF FACT AND COMMISSION DECISION**

### **A. RATE REBALANCING**

#### **The U S WEST/MCC Stipulation**

1. In the proposed Stipulation, U S WEST and MCC agreed, *inter alia*, to reduce the increase in residential local exchange service rates, restructure the MTS rates from what was originally proposed, and change the reduction in switched access rates. U S WEST and MCC agreed there should be no change in rates to customers under the Telephone Assistance Plan (TAP) and that other changes should be implemented in two steps (each revenue neutral). U S WEST also agreed not to propose any further increase in residential local exchange rates before the year 2000.
2. U S WEST and MCC agreed that the restructuring described in the Stipulation was just and reasonable and should be authorized by the Commission. U S WEST and MCC described the restructuring agreed to in the Stipulation as "a phase-in of the original U S WEST restructuring proposal, proportionately reduced so that the increase in flat-rated residential local exchange rates, over the period of the phase-in, is limited to \$2.95 per month."
3. The Commission finds some merit in the U S WEST/MCC proposed Stipulation and adopts the Stipulation with some necessary modifications as explained below. The most important modification to the Stipulation regards MTS. Others involve the Measured and Message business services and the City Connection Plan.
4. The Commission concludes that adopting a slightly modified version of the Stipulation will result in numerous benefits. First, U S WEST agrees to a rate moratorium until January 1, 2000. This rate moratorium limits rate increases U S WEST might otherwise seek and does not permit U S WEST to file a request to increase rates until that date. Without this condition, U S WEST could immediately seek to further rebalance its rates. Second, by lowering MTS rates, the Stipulation achieves much of the needed rate rebalancing that is required to position U S WEST for a more competitive intraLATA toll market.
5. Third, the Stipulation decreases U S WEST's access charges by roughly seven percent. This decrease should encourage interexchange toll carriers to compete in the Montana intraLATA long distance markets. When this reduction flows through to toll prices, as it must, it will benefit toll users and partially offset some of the increase in the residential basic service rate.
6. Fourth, the changes in residential and business rates should benefit local exchange competition in Montana. By raising the recurring monthly residential rate by \$2.95, competitors will have an increased incentive to enter and compete for U S WEST's residential market. Lowering the recurring monthly business rate in U S WEST's larger exchanges will result in a single flat business rate of \$37.06 per month. This lower rate may enable U S WEST to compete with new businesses that seek to enter local markets. Depending on one's definition, collapsing the business rate to one statewide rate may reduce or eliminate "value of service" pricing.
7. Finally, the Stipulation does not accept either the MCC's or U S WEST's cost-of-service testimony as the basis for any of the rate changes. By this condition, the Stipulation disassociates the resulting rates from the cost-of-service studies and testimony filed in this docket. This condition is appropriate because MCC and U S WEST could not agree on the cost-of-service basis for any rates in this docket.
8. The single most important reason for U S WEST's rebalancing application was its desire to lower MTS rates in order to compete with other providers of intraLATA toll service. The Commission concludes that

U S WEST's rates must be rebalanced in order to accommodate and encourage competition in telecommunications markets. U S WEST's intraLATA toll prices must decrease in order for U S WEST to be able to effectively compete in these toll markets once it begins to provide intraLATA equal access no later than February 8, 1999.

9. Given that certain telecommunication markets remain monopolized, thereby creating the need for traditional ratemaking treatment, simply reducing MTS rates is not an appropriate solution. U S WEST has a right to generate revenues that allow it the opportunity to earn its last Commission-authorized rate of return. Therefore, when some rates decline with rate rebalancing there must be a compensating increase in other rates. Simply lowering MTS rates is also not a competitively neutral solution. The Commission's decisions must balance competing goals and policies.

#### Modifications to the U S WEST/MCC Stipulation

10. Attached to this Order as Attachment "A" is the Stipulation proposed by U S WEST and the MCC. All modifications to this Attachment "A" are explained in the following paragraphs.
11. The single most important modification involves mitigating the Stipulation's toll rate impacts. At present, U S WEST's basic toll service tariff has 48 different MTS rates. While the Stipulation simplifies this overly complex toll rate design by creating postalized rates for all MTS calls, it creates another problem in the process--egregious toll rate impacts for some customers.
12. The Stipulation's toll rate impacts depend on a customer's calling patterns. A customer-specific analysis would require detailed information about the duration, time of day and distance of every call for some defined time period. The Ronan Committee supplied some data for customers of RTC and HSTC which details a one-month calling experience for customers in the exchanges served by these two companies. U S WEST provides intraLATA toll service to consumers throughout the state, including its own customers, customers of RTC and HSTC, and customers of other small companies. Although the Commission does not have data with details specific to all customers affected by the proposed changes in MTS rates, enough detail is available to demonstrate significant toll rate impacts. One example of a significant impact is illustrated by the proposed change in the shorter mileage bands--the proposal would increase the price for an additional minute of use in the off-peak period by up to 566 percent. This increase and others gave rise to unique impacts on certain communities.
13. Parties that commented on the Commission's June 30, 1998 Posthearing Order highlighted numerous MTS impacts. The MTA estimated significant impacts for two of its members, Lincoln Telephone Company and Southern Montana Telephone Company (SMTC). For SMTC, the proposed day rate is an increase of 283 percent. MITS estimated a nearly \$1 million impact for four of its members. The Ronan Committee estimated a \$1.4 million short-haul MTS rate increase for "rural areas." The Committee's estimate appears to reflect all independent company impacts.
14. The Commission concludes that the unusual MTS increases that U S WEST and the MCC agreed upon in the Stipulation do not conform to Bonbright's principles. *See* James C. Bonbright et al., Principles of Public Utility Rates (2d ed. 1988). Bonbright's three most relevant principles are public acceptability, rate stability and the fairness of cost apportionment. On the other hand, U S WEST needs MTS rates that allow it to compete in the intraLATA toll market once intraLATA dialing parity is in place--no later than February 1999. Without MTS rate rebalancing, U S WEST could lose substantial market share to its intraLATA toll competitors.
15. As a result of the concerns received, and to balance the interests of U S WEST and its customers, the Commission modifies the Stipulation to mitigate some of the more egregious MTS rate impacts. The Commission finds that two mileage bands rather than the one proposed in the Stipulation will substantially simplify the existing MTS rate structure. U S WEST presently has 48 MTS rates; this decision reduces that number to four instead of the two proposed in the Stipulation. This moves U S WEST's MTS rates in the right direction and somewhat mitigates the "rate shock" some MTS users will experience.
16. As a result, U S WEST's MTS tariff will have two mileage bands. The existing three lowest mileage bands will collapse into a single short mileage band. The five highest existing mileage bands will collapse into a single long mileage band.
17. The two resulting mileage bands will each have an on-peak and an off-peak rate. In the short mileage band, the on- and off-peak rates will equal \$0.13 and \$0.07 per minute, respectively. In the long mileage, band the off-peak rate will equal \$0.12 per minute. This \$0.12 rate will approximate the competitive price offered by many long distance companies. The long mileage band's peak rate must be computed residually but will approximate \$0.284 per minute for the first year after implementation and will drop to \$0.224 per

minute after one year.

18. Another modification to the Stipulation also results from maintaining consistency between rates. The Commission finds merit in mitigating the impact of the Measured rate for business. In lieu of the Stipulation's \$4.64 increase in the monthly rate for measured business service, the Commission approves a change that increases the rate by \$1.36. However, because the monthly charge increase is limited to \$1.36, the usage rate must increase from \$.01 to \$.02 per minute. The overall effect is the same as a \$4.64 flat rate increase. With this Measured rate modification, the Message rate may not increase by the full amount in the stipulation. Rather, it may only increase by \$1.36.
19. A final modification to the Stipulation regards an optional calling plan called City Connection Plan. This plan is an optional toll calling discount plan. Subscribers are charged a monthly rate for which they may select a frequently-called city and receive a 20 percent discount from the MTS rates for calls to that city. They also receive a five percent discount for all other intraLATA calls. The Stipulation eliminated the City Connection Plan, but U S WEST has since concluded that because of the resulting rate impacts, the plan must continue. *See* U S WEST's August 18, 1998 letter to Chairman Fisher. By retaining this plan, U S WEST must collect additional revenues in the amount of \$61,240 per year to maintain revenue neutrality.

#### Implementation of Rate Rebalancing

20. U S WEST will implement other extended area service (EAS) rate changes from the Commission's Order No. 6073a in Docket No. D98.5.100 and Order No. 6074a in Docket No. D97.10.206. In U S WEST's August 18, 1998 letter to Chairman Fisher, U S WEST stated its intent to implement the rate changes arising from these two dockets concurrently with the rate changes authorized in this Docket. U S WEST also stated that the date for implementing the changes in the EAS dockets—September 10, 1998-- is now somewhat tentative because its union workers are out on strike.
21. The Commission concludes that U S WEST should implement both the EAS rate changes and the changes arising from this Docket at the same time. Therefore, U S WEST is authorized to implement the rate changes arising from this Order as of September 10, 1998, and should attempt to coordinate these changes with the changes from the EAS dockets.

#### Other Matters

33. The Commission is unanimous in its concern about low participation in the Lifeline program. The Commission seeks an institutional change that would result in the automatic enrollment in that program for all U S WEST's customers who receive Medicaid. U S WEST asserts that disclosure limitations exist due to the income basis for Medicaid eligibility requirements used in the Lifeline program. U S WEST further states that as long as income-based Medicaid eligibility criteria are used for the Lifeline program, neither the Commission nor U S WEST has sufficient access to information to permit enrollment in the program without some level of customer involvement.
34. However, after having communicated with "the administration," U S WEST believes it is possible to have a check off for automatic Lifeline enrollment placed on Medicaid assistance applications. *See* U S WEST's Comments filed on July 14, 1998. Those exercising the check off could be automatically enrolled by the State. The Commission welcomes U S WEST's commitment to pursue this program. U S WEST should report back to the Commission within ninety days with a plan to implement the automatic enrollment of Medicaid customers in the Lifeline program.
35. The Commission is also concerned that U S WEST has not permitted customers to have two or more lines that combine flat and measured use at the same location. In its July 14, 1998 comments, U S WEST agreed to such combinations if they are limited to residential customers with three lines or less. The Commission finds that U S WEST should implement the Commission suggestion. U S WEST should file such a proposal with the Commission within ninety days.
36. A third concern is the low participation by residential subscribers in local measured service. The rates approved in this Order will increase the difference between flat and measured residential service, making this service an even better deal for many residential subscribers who presently subscribe to flat-rated service. The Commission directs U S WEST to include in any notice of the increased rates to subscribers the option to subscribe to local measured service, and to continue educating its subscribers about this option. Further, the Commission encourages U S WEST to offer local

measured service to all new subscribers and to existing subscribers making changes in their service.

## **B. PAYPHONE ISSUES**

1. The contested issues between U S WEST and NWPA involve basic public access lines (PAL), fraud protection, and the revenue impacts raised by removing deregulated payphone revenues from the rate base.
2. The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *amending scattered sections of the Communications Act of 1934*, 47 U.S.C. ' 151, *et seq.* (1996) (the 1996 Act), grants jurisdiction to the Federal Communications Commission (FCC) over payphone matters previously regulated by state commissions. Pursuant to § 276 of the 1996 Act, the FCC issued several orders concerning payphone services and preempts any inconsistent state tariff and pricing requirements. The FCC concluded that the "new services test" is necessary to ensure that central office coin services are priced reasonably. In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Report and Order, CC Docket No. 96-128, FCC 96-388, ¶ 145 (Rel. Sept. 20, 1996) (Report and Order). The Report and Order requires LECs to provide fraud protection, special numbering assignments, and installation and maintenance of basic payphone services to other providers of payphone services on a nondiscriminatory basis. *Id.*, at ¶ 148. The FCC also requires states to determine the intrastate rate elements that must be removed to eliminate any intrastate subsidies. *Id.*, at ¶185. In its Order on Reconsideration in CC Docket No. 96-128, released on November 8, 1996, at ¶ 143, the FCC noted that, "we concluded that LEC payphones must be treated as unregulated, detariffed CPE in order to ensure that no subsidies are provided from basic exchange and exchange access revenues or access charge payphone service elements as required by the Act."
3. The FCC requires incumbent LECs to provide central office coin transmission services to PSPs in a nondiscriminatory manner so that competitive payphone providers can offer payphone services either using instrument-implemented "smart" payphones or "dumb" payphones that use central office coin services, or some combination of the two in a manner similar to the LECs own operations. Incumbent LEC provision of coin transmission services on an unbundled bases must be treated as a new service. Order on Reconsideration, at ¶ 146. Any basic network services or unbundled features used by a LEC in its own payphone operations must be available on a nondiscriminatory, tariffed basis to PSPs. *Id.*, at ¶ 162. Unbundled features or functions must be tariffed in both state and federal jurisdictions. *Id.*
4. Tariffs for basic payphone services and unbundled functionalities filed with state commissions pursuant to the FCC's payphone orders must be cost based, consistent with the requirements of § 276 of the Act with regard to the removal of subsidies from exchange and exchange access services, and nondiscriminatory. LECs are not required to file tariffs with the FCC for the basic payphone line for smart and dumb payphones, but states must ensure that the basic payphone line is tariffed by the LECs in accordance with the requirements of § 276 of the Act. Prices for unbundled features must be consistent with the FCC's new services test described at 47 C.F.R. § 61.49(g)(2). *Id.*, at ¶ 163.

### U S WEST's PAL Rates

5. U S WEST's PAL tariff filing originally requested approval of a \$0.04 per minute usage charge. U S WEST later filed an amended application which modified the proposed PAL rate from the proposed \$0.04 per minute usage charge to a \$0.06 per message charge. U S WEST's witness Ms. Barbara Wilcox testified that this modification of the usage charge made it necessary to reevaluate the monthly rate for Smart PAL to keep the same price/cost relationship for Smart PAL as for the Basic PAL. As a result, U S WEST proposed a higher monthly rate for measured Smart PAL. U S WEST proposed to raise the monthly recurring charge from \$22.57 to \$29.60.
6. David A. Wick testified on behalf of NWPA regarding U S WEST's current and proposed rates and rate structure for PAL services used by payphone service providers (PSPs). NWPA believes that the differences in the rate structure between U S WEST's Basic PAL service and Smart PAL service discriminate between U S WEST's own payphones and PSP's payphones.
7. To explain this discrimination, Mr. Wick testified that most non-LEC (local exchange carrier) PSPs use Smart payphone sets that provide call rating, answer detection, coin collection, and other functions unique to coin-operated payphones services. If permitted by U S WEST's tariffs, PSPs could connect their payphones to any number of different kinds of lines including flat or measured business lines. Mr. Wick stated that PSPs are like any other businesses that need telephone lines to conduct business. He further stated that the PSP's lines are functionally and technically equivalent to the line serving the business at

which the PCP's payphone is located. Mr. Wick further explained that it is important for PSPs to have complete parity with business customers, including the option to subscribe to flat-rated service at a higher price. NWPA argues that its concerns about discriminatory rates are eliminated if the Commission adopts U S WEST's measured and flat business line rates for Basic and Smart PAL.

8. NWPA asserts that U S WEST's proposed measured and flat business rates cover all PAL costs even when compared to U S WEST's cost study. If the Commission finds that U S WEST's business rates cover its costs, NWPA urges the Commission to adopt PAL rates that mirror U S WEST's business rates. According to NWPA, requiring full parity between PAL and business line rates will cover direct and shared costs, will eliminate rate discrimination against PSP's, and will serve the public interest by promoting lower payphone rates and widespread deployment of payphones.
9. U S WEST argued that PAL rates should not mirror the business local exchange rates because business line customers use telephone service for administrative purposes, and in contrast, PSPs resell access to the network to the general public. U S WEST argues that because the uses are dissimilar, complete parity with business customers--including having the option to subscribe to flat-rate service at a higher price--should not exist. U S West further reasons that PSPs are not competing against purchasers of business access lines, but rather, against other PSPs and the payphone operations of LECs. U S WEST resists a flat Basic PAL rate.
10. NWPA asserts that none of U S WEST's proposals comply with the FCC's payphone orders. NWPA notes that the FCC left to the states the task of ensuring that rates for access lines offered to PSPs are priced at rates that meet the new services test. All LECs must price their PAL service above cost. NWPA contends that the new services test requires U S WEST to file a cost study to demonstrate the direct cost of providing the new service.
11. Although U S WEST filed a cost study in this proceeding, NWPA argues that U S WEST's cost study fails to study PAL service. U S WEST's cost study is its new "loop is a loop" methodology (referred to in the remainder of this Order as "Loop Study"). NWPA emphasizes that instead of studying PAL loops, U S WEST's Loop Study inappropriately uses all loops in Montana, including residence loops and non-working loops. In spite of the FCC's clear directive to use the new services test to study the service that is being priced, U S WEST continues to rely on its inappropriate Loop Study, asserting that the Loop Study requires U S WEST to increase PAL Rates. NWPA argues that under the new services test, only direct costs of the service are to be included in calculating the ratio of price to cost.
12. Both U S WEST and NWPA argue that the other has misapplied the new services test. NWPA argues that the cost of providing the service is somewhat lower than U S WEST's calculation using that test. U S WEST argues that NWPA presented no expert witness at the hearing who was capable of addressing the FCC's new services test and that NWPA's post hearing brief was nothing more than the unsupported argument of NWPA's counsel. U S WEST further asserts that, even if NWPA's arguments were true, the proposed rates would still satisfy the new services test. U S WEST explained that its proposed PAL rates would only fail the new services test if they were lower than the cost of providing the service as measured by the new services test, or the Commission determined that the resulting margin was unacceptably high.
13. U S WEST contends that once the appropriate price floor for a new service is established for the service through application of the new services test, the Commission could establish the price for the service based upon the same considerations it uses to price any other telecommunications service. There is no evidence in the record to suggest that any of the prices proposed by U S WEST for PAL services do not cover costs. Because the Commission cannot determine the price floor by applying the new services test in this case, if the price covers the cost as the record indicates, the prices should be considered reasonable if they are within a reasonable range of U S WEST's business line rates. The Commission concludes that U S WEST's PAL rates do satisfy the requirement of the new services test that prices cover costs, even if NWPA's arguments are accepted as true. The Commission further concludes that the margin is not unacceptably high and, therefore, the second prong of the new services test is satisfied. These conclusions are explained below.
14. The primary purpose of the test is to ensure that new services are not subsidized by existing services and that the markup above cost for a new service is reasonable. The Commission has discretion to determine a reasonable margin for U S WEST's PAL service. U S WEST's witnesses Owen and Wilcox established that the cost/price relationship in the proposed PAL rates is not much different from that established for business local exchange service.
15. The Commission agrees with U S WEST that no provision of the 1996 Act directly or indirectly requires that PSPs receive PAL service at cost. Section 276(a) does not require LECs to provide services at cost. Section 276(a) simply requires that local exchange companies make available to PSP's the same services

that are available to their own payphones, at a nondiscriminatory price, and that no LEC can subsidize its payphone operation through its overall rate structure. U S WEST has met these requirements with its proposed rates.

16. The Commission's primary concern is ensuring that U S WEST's payphone-related services are available to private payphone companies on an unbundled basis, and at reasonable and non-discriminatory rates, terms, and conditions. The FCC's new services test requires that a service be priced at or above the actual cost of providing the service and that prices for other products and services do not increase as a result.
17. The Commission concludes that U S WEST's proposed PAL rates satisfy the FCC's new services test. The Commission further concludes that the PAL rates need not mirror the business measured and flat rates. The Commission accepts U S WEST's argument that PAL line usage is not similar to business line usage. PAL lines are used to resell access to the network to the general public while a business line is used primarily for administrative purposes. In addition, it has not been demonstrated in this proceeding that the average length of a PAL loop is comparable to the average length of a business line loop.

#### Fraud Protection

18. Call screening is an optional fraud protection service provided by LECs to PSPs. PSPs provide direct dial access to 10XXX, 950 and 800 numbers and thus need call screening to identify the type of calls that should be completed without additional information from the caller. Mr. Wick testified for NWPA that outgoing call screening is provided under different names by different LECs. For most companies, it is a service that PSPs order separately and for which they pay an extra charge. U S WEST's call screening service is offered to other customers as CustomNET. This fraud protection service is not unique to payphone service.
19. NWPA asserts that fraud protection is a payphone service and, as such, is subject to the new services test. NWPA points out several reasons to support this argument: First, PSPs must purchase fraud protection for all of their lines in order to prevent fraudulent call billing to their payphones. In contrast, he noted that other users of CustomNET are a very small percentage of U S WEST's total number of customers who potentially could subscribe to the service. NWPA agrees that the majority of Montana access lines using CustomNET are not payphones. NWPA contends, however, that the percentage of PAL subscribers ordering screening services is many times the percentage of other customers ordering screening.
20. Second, NWPA argues that PSPs are a captive customer for this fraud protection service. Nearly all payphones subscribe to fraud protection. Prison and jail payphones do not require screening and comprise most of the total number of payphones without fraud protection, according to Mr. Wick.
21. Ms. Wilcox disputed the NWPA's assertions, arguing that fraud protection is not an essential service as NWPA claims and that CustomNET is not used by all payphones. Further, PSPs have the option to use smart payphones, which can be adapted to provide a voice message during any operator-handled call which advises the operator that the call has originated from a payphone, and that no charge should be billed to the payphone. Ms. Wilcox recommended that the price for this service should not change. She opined that PSPs want lower rates to increase their profits at the expense of other users of regulated services. Ms. Wilcox testified that the Commission determined a reasonable margin for the optional fraud protection service more than ten years ago and has captured that margin in its subsequent ratemaking decisions. U S WEST claims that the rate charged for CustomNET is reasonable in light of the value received.
22. Most importantly, U S WEST contends that fraud protection is not a payphone service subject to the FCC's new service test. U S WEST was required to make a compliance filing with the FCC in response to its order reclassifying payphone services. U S WEST states that it included CustomNET in its compliance filing because it mistakenly believed that the FCC's payphone Report and Order required it to include fraud protection in that compliance filing. U S WEST later requested that the FCC permit U S WEST to remove CustomNET from its compliance filing based on its argument that it is not a payphone-specific feature and because it is generally available to and purchased by the entire range of local exchange customers.
23. NWPA argues that U S WEST should either provide fraud protection at no additional charge or substantially reduce the rate based on its costs. NWPA contends that U S WEST is applying an exorbitant markup of 50,000 percent to its fraud protection service. NWPA identified the direct cost for screening as set forth in U S WEST's compliance filing with the FCC as \$0.01. The rate for CustomNET is \$5.00.
24. The Commission concludes that NWPA has not provided sufficient evidence to demonstrate that fraud protection is exclusively a payphone service and should be priced using the FCC new services test. While it is true that most PSP's use this service it is also available to other customers requesting this type of

protection. U S WEST has priced fraud protection as a value of service rather than a value of cost. Because fraud protection is a regulated item, in the future the Commission will review fraud protection and consider repricing it at a value of cost. The Commission concludes that the rate for CustomNET should not change at this time.

#### Payphone Revenue impacts

25. NWPA argues that the most serious shortcoming of U S WEST's May 1997 filing is its failure to fully and properly analyze the revenue associated with PAL service. NWPA asserts that U S WEST's filing does not estimate the effect of new services on traffic and revenue, including the traffic and revenue of other services. NWPA also asserts that U S WEST failed to analyze the impact of the service on its switched access revenue, which is intended to cover part of the loop cost.
26. NWPA was not alone in identifying this revenue impact. Before withdrawing from this proceeding, AT&T's witness, Mr. Warren Fischer, testified that there was a substantial revenue increase for U S WEST as a result of moving payphone investment from the regulated rate base. Mr. Fischer's testimony is not part of the record, but the testimony of U S WEST's rebuttal witness, Mr. Wayne Culp, discusses the points Mr. Fisher made in his testimony. Mr. Culp disputed the *amount* of the increase, but conceded that a revenue increase existed. Mr. Culp placed that amount at \$1.7 million.
27. The Commission requested comments in Order No. 5965b about considering this testimony in any resolution of the issues in this Docket. U S WEST and the MCC both commented on this issue. U S WEST responded by restating that the Commission ruled on February 13, 1997 that this Docket was not to be treated as a revenue requirements case. U S WEST further argued that the Commission has seldom allowed single issue ratemaking. U S WEST also pointed to Mr. Culp's testimony, in which he stated that U S WEST has invested more than \$172 million in Montana's rate base since the Commission last determined U S WEST's revenue requirement. U S WEST argued that this amount would dwarf the \$1.7 million revenue increase.
28. MCC stated that they are opposed to single item rate adjustments such as the payphone issue. Tempting as it may be to address what seems to be a known revenue requirement reduction, MCC asserts that the Commission is most frequently called upon to address a single item cost increase such as depreciation, which the utility is in a unique position to know about, on an ongoing basis. MCC further stated that the best long run policy is to allow an opportunity to address all cost and revenue items simultaneously.
29. The Commission recognizes that increased revenues exist as a result of the FCC's deregulation of payphones. The Commission also notes that although it considered and rejected a full revenue requirements case on February 13, 1997, the consolidation of the payphone filing in this Docket was not addressed until nearly four months later and, in fact, the payphone filing was not made until May 1997.
30. In the past, however, this Commission has resisted single item adjustments because the overall revenues and expenses of the utility are not examined. The utility's earnings can only be determined by examining all items in a revenue requirements case. The Commission concludes that the record in this proceeding is insufficient from which to determine the actual revenue increase from payphone deregulation. The Commission further concludes that it should continue to resist single item adjustments.
31. The Commission's review of AT&T's and U S WEST's testimony filed in this Docket indicates that a revenue requirements case is needed. Because AT&T withdrew from this proceeding, its testimony is not part of the record and U S WEST's estimated \$1.7 million revenue cannot be fully addressed in this Docket and will have to be examined at another time.
32. NWPA also contends that U S WEST failed to analyze revenue from optional Extended Area Service (EAS). U S WEST contends that EAS surcharges should not be included in the new services test for payphone services. EAS surcharges only apply to flat-rated access lines, whereas U S WEST proposed only measured rates for Basic PAL lines.
33. NWPA's assertion is based on its argument that the Commission should authorize flat-rated Basic PAL lines at U S WEST's business line rate. The Commission's rejection of a flat rate for Basic PAL lines renders any further consideration of this issue unnecessary.

#### IV. CONCLUSIONS OF LAW

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

2. The Commission has authority to do all things necessary and convenient in the exercise of the powers granted to it by the Montana Legislature and to regulate the mode and manner of all investigations and hearings of public utilities and other parties before it. Section 69-3-103, MCA.

3. The Montana Public Service Commission is the state agency charged with regulating telecommunications carriers in Montana and properly exercises jurisdiction in this Docket pursuant to Title 69, Chapter 3, MCA.

4. Adequate public notice and an opportunity to be heard has been provided to all interested parties in this Docket, as required by the Montana Administrative Procedure Act, Title 2, Chapter 4, MCA.

5. The FCC's new services test requires that services subject to the test be must be cost based, consistent with the requirements of 47 U.S.C. § 276 with regard to the removal of subsidies from exchange and exchange access services, and nondiscriminatory. States must ensure that the basic payphone line is tariffed by the LECs in accordance with the requirements of 47 U.S.C. § 276. Prices for unbundled features must be consistent with the FCC's new services test described at 47 C.F.R. § 61.49(g)(2). In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Report and Order, CC Docket No. 96-128, FCC 96-388, ¶ 145 (Rel. Sept. 20, 1996); Order on Reconsideration, FCC 96-439 (Rel. Nov. 8, 1996) Id., at ¶ 163.

#### **IV. ORDER**

THEREFORE, based on the foregoing, IT IS ORDERED

1. that the Stipulation presented to the Commission by U S WEST and the Montana Consumer Counsel is accepted subject to the modifications and conditions discussed herein;
2. that U S WEST's proposed rates for payphone services are approved;
3. U S WEST shall file a proposal to implement the automatic Lifeline enrollment within 90 days;
4. U S WEST shall file a proposal to implement the combination of flat and measured service within 90 days;
5. U S WEST shall notify its customers of the availability of local measured service as discussed in this Order; and
6. NWPA's Motion to Strike is denied.

U S WEST may implement the rate changes authorized by this Order as of September 10, 1998.

DONE AND DATED at Helena, Montana, this 26<sup>th</sup> day of August, 1998, by a vote of 3-2.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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DAVE FISHER, Chairman

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NANCY MCCAFFREE, Vice Chair

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BOB ANDERSON, Commissioner, dissenting

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DANNY OBERG, Commissioner

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BOB ROWE, Commissioner, dissenting

ATTEST:

Kathlene M. Anderson

Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806

**DISSENT OF COMMISSIONER ROWE**

**U S WEST DOCKET 96.12.220, Order No. 5965c**

I dissent from the Commission's decision primarily because the residential rate increase is significantly more than I am prepared to support without a revenue requirements case to provide the basis for all rates. When the second portion of the rate increase approved in this docket takes effect in the Fall of 1999, flat residential rates for eighty percent of residential customers will be \$20.38. A revenue requirements case would have allowed the Commission to say with

confidence about any rate which might have eventually been set, whether higher or lower, **A**This is fair.**@**

I disagree with the Commission's specific decision. However, the post-hearing process of carefully reviewing the record, modeling various alternatives, and taking into account citizen comment about several specific rate design elements produced a significantly better result for many Montana customers than would have obtained by simply approving the stipulation. This opinion first recognizes some of the benefits of the Commission's post-hearing work, then further explains my concern about the absence of a revenue requirements filing, and finally suggests that this case was a missed opportunity to pursue more customer-friendly, choice-driven approaches to rate redesign and rebalancing.

## **I. BENEFITS OF THE COMMISSION'S DECISION.**

The Commission's order includes the following advantages, most of which are supported by all Commissioners:

### **A. Short-haul toll.**

In addition to simplifying and lowering **A**MTS**@**toll rates overall, the Commission has specifically responded to concerns first raised by customers of Hot Springs Tel and Ronan Tel by cutting in half the stipulated increase in short-haul toll rates. This was in direct response to concerns first raised by citizens in those communities, and later echoed by phone companies which serve other areas in rural Montana. The smaller increase in short-haul rates is much more consistent with Bonbrightian principles of good rate design, including understandability and public acceptability.

Despite the Commission's substantial improvements over the stipulation, short-haul toll rates will increase over rates currently in effect. It will still be necessary to pursue the other strategies identified and discussed at the excellent public hearing in Ronan on June 1, 1998, and in filings with the Commission. Toll calling is a vital part of phone service to the many small town and rural Montanans served by smaller companies, who typically have much smaller local calling areas but geographically much larger **A**communities of interest**@**of schools, health care providers, governments, businesses, friends and families. We all have more to do to ensure these needs are met.

### **B. Lifeline.**

Lifeline (which provides assistance with local phone bills) is a potentially valuable program to those moderate and low income Montanans, including many elderly, who are eligible. Without expanding eligibility, much more needs to be done to increase participation by those who are eligible. The Commission's decision speaks directly to this long-standing concern.

### **C. Residential Local Measured Service.**

Residential local measured service (LMS) was expanded and made more attractive at the time Extended Area Service (EAS) was implemented. The LMS options allow most customers to save significant amounts on their local phone bills. The Commission's decision makes residential LMS an even more attractive option, and also directs U S WEST to pursue ways to expand participation by those who would benefit.

### **D. Second-line flat rate.**

The Commission heard from many customers who would like to use LMS on one line while retaining flat service on a second line (for example a data line). The Commission's order responds to this customer interest.

### **E. Business measured service.**

Business LMS is heavily used by Internet Service Providers (ISPs) who lease many lines, but use them primarily for incoming traffic. In response to their concerns, the Commission has restructured the business LMS rate.

### **F. Access rate reduction.**

Reducing access rates paid by long distance companies to connect to the local phone system should benefit customers, provided the reductions are flowed through to reduce long distance rates paid by customers as required by Section 69-3-

### **G. Business rate reduction.**

The Commission's decision substantially lowers local rates for most business customers. This is clearly a benefit. However, the Order does this primarily by increasing residential rates significantly more than what Commissioner Anderson and I were willing to accept. My concern, again, focuses especially on the absence of a revenue requirements showing that the significant increase in residential rates is justified.

## **II. A REVENUE REQUIREMENTS CASE SHOULD NOT HAVE BEEN WAIVED.**

At the start of this case, the Commission voted four-to-one (over my dissent) to grant US WEST's request to waive the requirement in our rules that rate cases include a revenue requirement filing. The Montana Consumer Counsel (MCC) and AT&T opposed the waiver, but did not request reconsideration or further review.

The request to waive a revenue requirements case was premised in significant part on the need for a speedy decision to prepare for what was then expected to be the rapid advance of local telephone competition. Revenue requirements cases are generally required by Montana law to be concluded within nine months, while this case lasted much longer.

Periodic revenue requirements cases may be especially important in this rapidly-changing industry. While the Commission reviews detailed annual financial reports, it has not reviewed a complete revenue case since the 1990-92 time period. Among **potential** contested issues are possibly differing costs of capital; possibly declining cost of providing plain old telephone service (POTS); possibly increased cost per unit of labor but decreased units of labor; any effects of the sale of rural telephone exchanges by U S WEST; investment by U S WEST in its remaining Montana service territory; changes required by state law (such as ending imputation of yellow pages revenue to lower the revenue requirement recovered from other customers); changes possibly required to implement the Federal Telecommunications Act (such as removing deregulated investment from the rate base which is recovered from customers of regulated service). I know neither the direction of each specific issue, nor the complete list of issues, nor the cumulative change in revenue requirement, nor its direction. I do know this is an important issue which should be confronted.

At the hearing, U S WEST witness Rick Hays explained that the stipulation precluded U S WEST from filing a revenue requirements case during the next two years, providing predictability and stability in rates. MCC witness Allan Buckalew continued to advocate a revenue requirements review, and said the Stipulation did not prevent another party from requesting a revenue requirements review.

As the case progressed the error in the Commission's initial decision to waive a revenue requirements filing became much clearer. Significant revenue-related issues were developed through the process of discovery and pre-filed testimony. However, it would have been unfair to reset the clock and require U S WEST to refile with a revenue requirements case.

Specifically, U S WEST responded to AT&T testimony by stating that the decrease to the revenue requirement recovered from ratepayers which would be required by removing the deregulated investment to serve pay phone providers would be no more than \$1.7 million. AT&T's testimony was never received into evidence, as AT&T withdrew from the case. U S WEST's testimony is a part of the record. This was a specific revenue requirements issue, not contemplated when the waiver was granted, but directly related to issues in the case.

When requested by the Commission to comment on whether the Commission should adjust for the \$1.7 million, U S WEST and others responded, in significant part, that it would be inappropriate to make a single issue adjustment without considering other potentially offsetting changes. I generally agree. However, U S WEST failed to distinguish this potential single issue adjustment which would be adverse to U S WEST, from others favorable to U S WEST, which it sought, and which the Commission approved. I hope this case leads both U S WEST and the Commission to adopt strong positions against single issue revenue adjustments in all but the most unusual and dire circumstances.

## **III. PREPARING FOR COMPETITION AND MISSED OPPORTUNITIES.**

Rate rebalancing generally refers to three potential adjustments: 1) Increasing residential and lowering business rates; 2) increasing local and lowering access rates; and 3) increasing rural and lowering urban rates. This case concerned the first two forms of rebalancing.

Rebalancing is advocated to move rates closer to the cost of providing service and eliminate unequal contribution to shared costs, in order to prepare for the advent of local competition. Pressure for rate rebalancing demonstrates that the appealingly simple statement, "Competition drives down prices," is sometimes incorrect.

Removing cross-subsidies is a specific rate rebalancing issue. Cross-subsidies occur only when a customer does not pay the marginal cost of providing that service, leaving that cost to be recovered from other customers. The terms "subsidy" and "cross subsidy" were often misused in this case. Some cross-subsidies clearly do exist using any economic costing method, and others certainly may, depending upon what costing method is used. However, misuse of a specific economic concept, "subsidy," causes one to misidentify the problem and to neglect a range of possible solutions.

The larger problem than true cross-subsidy is probably unequal contribution to shared, common or overhead costs. This problem, however, may be susceptible to a number of solutions which avoid the zero sum game of win/lose rate rebalancing.

Economists George Compton and Audrey Curtis have proposed a non-bypassable charge based on the value of the telephone network to various classes of customers. For example, the value of a residential network is high not only to those who live in the neighborhood, but also to those who call the neighborhood. Value-based pricing is not an anomaly of regulated industries, but is common in many less-regulated industries such as air travel, cable television, or the provision of free parking by merchants and malls (giving away parking is certainly not cost-based). One of the strongest arguments for federal universal service support to high cost areas is the value to low cost areas of being able to call the rest of the country.

Harry M. Shooshan and John Haring have proposed "rate rebalancing without pain," taking advantage of customer-driven choices to consume more or fewer telephone services to achieve necessary rate rebalancing. This approach would be much more consistent with the Telecommunication's Act's purpose of promoting customer choice.

Unfortunately, the parties evinced little interest in pursuing either the Compton/Curtis or the Shooshan/Haring approaches, or in using them as a starting point to devise Montana solutions. Should further rebalancing be pursued, I hope the parties and the Commission will describe the issues more accurately and think about solutions more broadly.

#### IV. CONCLUSION.

As a result of this Order, Montana is now among the states that have moved far to rebalance residential rates. Rebalancing was done to promote competition. Now, it is the parties' and ultimately the Commission's responsibility to ensure that Congressional intent is realized, and that customers receive the benefits of competition and universal service as well as the burdens of increased rates to prepare for eventual competition.

RESPECTFULLY SUBMITTED this 26<sup>th</sup> day of August, 1988.

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BOB ROWE

Commissioner