Office of the Secretary
Service Date
August 12, 1997

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF U S WEST COMMUNICATIONS, INC. FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR REGULATED TITLE 61 SERVICES.	**CASE NO. USW-S-96-5** **ORDER NO. 27100**

SUMMARY OF COMMISSION ORDER

In June 1996, U S WEST Communications filed an Application seeking a general rate increase for its local telecommunication services in its southern Idaho service territory. U S WEST serves more than 400,000 access lines located in 53 telephone exchanges across southern Idaho. The Company originally sought permission to increase its annual revenues for basic local services by $38 million or an annual increase of 58%. During the course of this proceeding, this request was revised to an increase of $15.538 million. The Commission Staff originally recommended a rate decrease of $32 million but later revised its recommendation to a decrease of $19.78 million. In this Order the Commission finds that U S WEST should reduce its annual revenues by $327,000.

Late last year in a separate case, the Commission authorized U S WEST to create three regional local calling areas that include more than 315,000 customers. Customers in the calling regions now have toll-free calling to many nearby exchanges. The revenue requirements and rate design from that prior case have been included in this general rate case. After reviewing the entire record, the Commission has determined that the monthly rate for residential one-party unlimited local service for customers located outside the three calling areas should be set at $10.90. The monthly rate for residential one-party local service within a calling region will be increased from the current interim rate of $15.62 to $16.10. The differential between one-party business and one-party residential local service rates (the rate ratio) for customers within the calling areas will be reduced from its current level of 2.6 to 1.84. The monthly rates for one-party business local service will be decreased to $21.80 for customers located outside the calling regions and decreased to $29.60 inside the calling regions.

Local exchange customers will also receive a monthly credit of $1.00 resulting from the elimination of the traditional imputation of revenues from telephone directory operations. The $1.00 monthly directory credit will terminate after one year. Customers will also be permitted to switch from unlimited, flat rate local service to "measured" local service for 90 days without a service charge. Residential measured service within the calling regions will be available at $9.60 per month and will include three hours of local calling. Local calling in excess of three hours will be billed at a rate of $0.02 per minute.

TABLE OF CONTENTS

PAGE

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On June 28, 1996, U S WEST Communications, Inc. filed an Application seeking a general rate increase in its rates for most "Title 61" services in its southern Idaho service area. Title 61 services are basic local exchange services provided to all residential customers and to business customers with five or fewer telephone lines.[1] At that time U S WEST sought an increase in its annual revenue from Title 61 operations of $38.054 million or 58% per year. The Company maintained that its current revenue from Title 61 services was insufficient to cover all of its costs of providing Title 61 regulated telecommunications services including its cost of capital. U S WEST also claimed that the existing rates produce an unreasonably low return on its Title 61 investment in Idaho.

BACKGROUND

It has been more than 12 years since the Company's last general rate case. During this time, the telecommunications industry and U S WEST's Idaho operations have changed tremendously. In 1986, U S WEST completed its five-year One Party Universal Service (OPUS) project that upgraded nearly all U S WEST customers to one-party service. In 1987, the Commission approved a five-year Technology Plus program that upgraded more than 50

[1]Basic local services are subject to the Commission's traditional regulatory authority found in Title 61 of the *Idaho Code*. The Idaho Telecommunications Act of 1988 added a new chapter to Title 62 and created a modified form of regulation for telephone companies providing other than basic local exchange services in Idaho. In March 1989, U S WEST elected to remove its non-basic local services from the Commission's Title 61 authority. Consequently, non-basic services provided in southern Idaho (e.g., local services to businesses with more than five access lines, long-distance services, and custom calling features) are now subject to the Commission's Title 62 jurisdiction.

technologically obsolete rural telephone switches to state-of-the-art digital switches. Rather than reduce rates as the result of changes in federal income tax laws and other court rulings, the Company spent more than $65 million replacing the switches without increasing rates.

As competition began to emerge in the long-distance market, our Legislature enacted the Telecommunications Act of 1988. The Act was intended to maintain universal telecommunications service and to encourage innovation within the industry by instituting a "balanced program of regulation and competition." *Idaho Code* § 62-602 (July 1, 1988) now codified at *Idaho Code* § 62-602(1) (July 1, 1997). With exceptions not pertinent here, the prices for long-distance services and U S WEST's non-basic local services are no longer regulated by the Commission. It was presumed that competition would "set the rates" for those services no longer subject to price regulation under Title 61. Those local exchange companies (LECs) that continued to offer services under Title 61, were granted "exclusive service area franchise[s] for telecommunication services which remain subject to title 61." *Idaho Code* § 62-615(1) (repealed July 1, 1997).

Because prices for non-basic local services are not regulated by the Commission, the Telecommunications Act requires the allocation of costs of the common network between fully regulated Title 61 services and the non-price regulated Title 62 services. *Idaho Code* § 61-622A. To satisfy this cost allocation requirement for U S WEST, the Commission authorized the implementation of the "Revenue Sharing Plan" in 1989. The plan operated as an alternative method of allocating costs between the Title 61 services and the Title 62 services offered by U S WEST.

Since its inception, the sharing plan has produced revenues to be "shared" or attributed to Title 61 regulated services. In the first two years of the plan, the Commission directed that Title 61 sharing funds be returned to customers in the form of one-time credits. In 1992, the Commission approved a three-year network improvement project called Tech II through which, approximately $15 million of Title 61 sharing funds were used to improve more than 30 local networks of U S WEST's small rural exchanges. In addition to the Tech II project, the Commission has used Title 61 sharing funds to reduce the monthly rural zone charge for approximately 65,000 U S WEST rural customers, replace several rural switches, and fund public library and educational infrastructure projects. Order No. 26461. The operation of the Revenue Sharing Plan is described in greater detail in Order No. 26355 at 1-3. Over the last ten years and throughout these infrastructure projects, the rates for local exchange service have remained relatively stable, and in some cases, have been reduced.

Changes in the telecommunications industry have also been dramatic on the national level. Last year, Congress enacted the Telecommunications Act of 1996 generally intended to foster competition in all telecommunication markets, including the local service market. Pub. L. No. 104-104, 110 Stat. 56 (codified in scattered sections at 47 U.S.C. §§ 151 *et seq*.). In particular, Section 253(a) of the Act provides that no state may prohibit "the ability of any entity to provide any interstate or intrastate telecommunications services." In response to the federal Act, our Legislature amended various provisions of the Idaho Telecommunications Act. Further statutory and regulatory changes are also contemplated as states react to rules promulgated by the Federal Communications Commission (FCC) under the federal Act. With this background, we now turn to U S WEST's Application.

A. The Initial Application

U S WEST proposed to use an actual capital structure comprised of 44.4% debt and 55.6% equity. The Company requested that the Commission authorize a return on equity of 13.0%. Ultimately, the Company sought an overall rate of return on its Title 61 rate base of 10.55%.

The Company also proposed to consolidate its three existing rate groups into a single rate for residential customers and a single rate for business customers. Rate Group 1 customers (e.g., American Falls, Bliss, Weiser) had the smallest toll-free calling areas and, correspondingly, have the lowest single-party business and residential rates. At the time this case was filed, monthly local service rates for Rate Group 1 customers were $10.11 for residential and $26.02 for business, respectively. Rate Group 2 customers (e.g., Blackfoot, Twin Falls, Payette) had a larger local calling area and paid higher rates than the Rate Group 1 customers. Rate Group 2 residential one-party customers paid $11.01 per month while business customers paid $28.49 per month. Rate Group 3 (e.g., Pocatello, Boise, Caldwell) customers had the largest local calling areas. One-party residential customers paid $12.00 per month for unlimited local calling and business customers paid $31.10 per month. The Company recommended that the monthly rates for residential customers be set at $22.50. This would represent an increase in residential monthly rates for one-party unlimited local calling ranging from 85% to 122% depending on the rate group. Order No. 26552 at 2.

The monthly rate for one-party business customers was proposed to be $31.10. This would represent a monthly increase of 19% for Rate Group 1, 9% for Rate Group 2, and no increase for Rate Group 3 business customers. The Company proposed to implement these residential and business rates over a two-year period beginning in 1997 and ending in 1999. *Id.*

U S WEST also proposed to increase its monthly rates for measured local service for both its residential and business customers. Measured service customers currently pay a monthly flat rate plus a per-minute usage fee. The monthly flat rate for residential single-party measured service was proposed to increase from the existing levels of $5.19, $5.64 or $6.13 (depending on Rate Groups) to a uniform monthly rate of $15.50. This would represent an increase in the monthly measured local residential flat rate ranging from 153% to 199% depending on the rate group. The Company also proposed to increase its measured service usage rate for local calls from $0.02 per minute to $0.03 per minute for calls made within the customer's local calling area. The Company further proposed that measured service include three hours of outbound local calling as part of the flat rate element. Order No. 26552 at 3. The Company proposed various other changes in its remaining Title 61 rates including the rates for the Idaho Telephone Assistance Program (ITAP), vacation service, and the non-recurring charge for initial installation.

On August 7, 1996, the Commission issued a Notice of Application in this matter and established a deadline for intervention. Order No. 26552. The Commission also suspended the proposed schedule of rates and charges to allow the Commission and other parties to review the requested revenue and rate increases. *Id.* at 5, 7.

B. Parties

The following parties appeared in this case:

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(Exhibit Nos. 1-100)

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CENTURY TELEPHONE OF IDAHO AND TDS TELECOM	M. W. Richards Moffatt, Thomas, Barrett et al. PO Box 829 Boise, ID 83701-0829
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NORTHWEST PAYPHONE ASSOCIATION	Brooks E. Harlow Clyde H. Maciver Miller, Nash, Wiener, et al. 4400 Two Union Square 601 Union Street Seattle, WA 98101-2352
IDAHO CONSUMERS AFFAIRS, INC. (Exhibit Nos. 601-700)	Wendell Phillips Idaho Consumer Affairs 615 S. Phillippi Street Boise, ID 83705-1161
ID CABLE TELECOMMUNICATIONS ASSOCIATION	Ronald L. Williams Attorney at Law PO Box 2128 Boise, ID 83701-2128

AT&T COMMUNICATIONS OF THE MOUNTAIN STATES (Exhibit Nos. 801-900)	Michael Singer AT&T Communications 1875 Lawrence Street, Room 1575 Denver, CO 80202 Greg Harwood Davis Wright Tremaine 999 Main Street, Suite 911 Boise, ID 83702
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GTE NORTHWEST INCORPORATED	Fred Logan State Mgr-Reg & Govt Affairs GTE Northwest Incorporated PO Box 1100 Beaverton, OR 97006
U S WEST COMPLAINANT	David Hoffman 10555 Hwy. 55 Boise, ID 83703

In prior Case No. USW-S-96-2, David Hoffman complained that the Company's monthly rates for non-listed and non-published telephone numbers were too high. In Order No. 26488 the Commission directed that he be made a party to this case.

The only parties to present testimony and exhibits during the Commission's evidentiary hearing were U S WEST, Idaho Citizens Coalition (ICC), AT&T Communications, American Association of Retired Persons (AARP), and the Commission Staff. Idaho Consumer Affairs did not present any witnesses but did participate in the technical hearing. Initial and reply post-hearing briefs were filed by AT&T, U S WEST, and the Staff. AARP filed an initial post-hearing brief.

C. Prior Cases

There are several prior U S WEST cases that directly affect the Commission's consideration of this rate case. These cases can be divided into two types—the exchange sales and the local calling regions.

1. Sale of Exchanges. In 1995 and 1996, the Commission approved the sale of 12 U S WEST telephone exchanges to various purchasers in three cases. *See* Order Nos. 26918, 26242, 26353. In all of the exchange sales, the purchase price for the exchanges exceeded the regulatory net book value of the exchange assets. This resulted in U S WEST receiving a "gain" on the sales. To address this concern, U S WEST proposed making a "special contribution" in each of the three cases. First, in the sale of the Oakley exchange, U S WEST proposed and the Commission approved a special contribution of $186,000—$140,000 to be used by the purchaser to offset the cost of necessary telephone switch replacements and $46,000 to be returned to the Revenue Sharing Plan. Order No. 26198 at 11.

Second, in the sale of the Nu-Acres exchange to Farmers Mutual Telephone Company, Farmers Mutual received a special contribution of approximately $60,000 to reduce various rate impacts on affected customers. Order No. 26242. Finally, in the sale of ten U S WEST exchanges to six independent phone companies, U S WEST made a special contribution of $4.814 million—$3.883 million credited to the purchasers for switch replacement purposes, $606,000 returned to the Revenue Sharing Plan, and $325,000 contributed to the Idaho Universal Service Fund. Order No. 26353 at 18. For purposes of the present rate case, U S WEST stated that it adjusted the expenses and rate base to remove the effects of the sales.

2. Local Calling Regions. In April 1996, U S WEST and the Staff jointly requested that the Commission adopt a proposal to end the Revenue Sharing Plan. As part of the proposal, the parties recommended the creation of four extended area service (EAS) or local calling regions in U S WEST's southern Idaho service territory. They proposed that Title 61 revenue sharing funds be used to offset local rate increases that would otherwise result from expanding the local calling

within the regions. In Order No. 26672 issued November 1, 1996, the Commission directed that the Company implement three regional calling areas.[2]

As part of the EAS decision, Rate Group 1 and 2 residential and business customers located in the regional calling areas were consolidated into Rate Group 3. Rate Group 1 and 2 residential monthly rates were increased by $1.89 and $0.99, respectively. Rate Group 1 and 2 business rates were increased by $5.08 and $2.61, respectively. Customers located outside the local calling areas did not experience any rate increase.

In addition to the rate group shifts, the Commission approved an interim rate increase of $3.62 for all customers located within a calling region until permanent rates could be determined in this rate case. Up to now, revenue sharing funds have been used to provide an offsetting monthly credit of $3.62. *See* Order Nos. 26672 at 19 and 26820 at 1-2. The Commission also eliminated the $3.19 monthly zone charge for more than 65,000 rural customers. Even with the use of the interim credit, there remains approximately $7 million in Title 61 sharing funds available for the Commission's disposition in this case.

D. Procedural History

On September 18, 1996, the Commission convened a status conference in this matter. The parties proposed and the Commission adopted a procedural schedule including deadlines for discovery and prefiled testimony. Order No. 26626. The parties generally contemplated a five-day technical hearing in January 1997 with initial and responsive post-hearing briefs. The Staff and Intervenors were to prefile their direct testimony no later than November 19, 1996. *Id.* at 2. U S WEST was directed to file its rebuttal testimony no later than December 16, 1996.

On December 3, 1996, U S WEST filed a Motion seeking an extension of time to file its rebuttal testimony. In its Motion, the Company sought an extension of not less than 45 days or until January 30, 1997. U S WEST asserted in its Motion that the additional time was necessary to

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[2]The following exchanges were included in each of the three local calling areas:
Boise Region—Boise, Eagle, Idaho City, Middleton, Emmett, Caldwell, Melba, Nampa, Star, Kuna, and Meridian.
Twin Falls Region—Twin Falls, Jerome, Buhl, Castleford, Hagerman, Dietrich, Shoshone, Gooding, Bliss, Kimberly, Hazelton, Eden, Murtaugh, and Wendell.
Eastern Idaho Region—Pocatello, Inkom, American Falls, Lava Hot Springs, McCammon, Downey, Grace, Bancroft, Soda Springs, Idaho Falls, Rigby, Ririe, Roberts, Blackfoot, Shelley, Firth, Rexburg, Preston and Montpelier.

Eight exchanges were not included in the calling areas: Weiser, Burley, Glenns Ferry, Hailey, Ketchum, Mountain Home, New Plymouth, and Payette. Except for Weiser (Rate Group 1), the remaining exchanges are in Rate Group 2.

prepare its rebuttal given the unanticipated prefiled testimony presented by the Staff. Order No. 26739 at 1. In its direct testimony, the Staff had asserted that U S WEST was over-collecting for its Title 61 services and recommended a rate decrease of $32.19 million. The Staff also argued that the Company's allocation system did not reasonably assign costs between Title 61 and Title 62 services. In Order No. 26739 issued December 31, 1996, the Commission amended the rate case schedule. The discovery and prefile schedules were extended with the technical hearing rescheduled for March 10-20, 1997. *Id.* at 3.

When U S WEST filed its rebuttal testimony in January 1997, the Company lowered its requested revenue increase to $28.3 million, which if granted, would result in an overall increase in its annual Title 61 revenues of 42%. The Company recommended that the existing three rate groups be consolidated into two rate groups—inside the calling areas and outside the calling areas. For residential customers located within a U S WEST local calling region, the Company proposed a monthly rate of $23.62. The proposed monthly residential rate for customers located outside a calling region was $20.00. For business rates, the Company proposed that the monthly rate for single-party customers located within a calling region would be set at $31.10; while the single-party monthly rate for customers located outside a local calling region would be $28.49.

On February 20, 1997, the Commission held a status conference to take up several prehearing motions. As explained in greater detail in Order No. 26824, the Commission ruled on discovery disputes which had arisen among the parties. In Order No. 26824 issued March 4, 1997, the Commission added another week to the technical hearing. The technical hearing in this case convened on March 10 and concluded on March 27. Four public hearings were also held in Boise, Idaho Falls, Pocatello, and Twin Falls to receive public comment. Because of the added days for the technical hearing and the four public hearings which concluded April 16, 1997, the Commission again extended the post-hearing briefing schedule. Reply post-hearing briefs were to be filed with the Commission no later than May 23, 1997.[3] Order No. 26880.

The Commission received testimony from 33 technical witnesses, dozens of public witnesses, admitted hundreds of pages of exhibits, and amassed a transcript in excess of 4,000 pages.

[3] At the request of U S WEST's counsel and without objection, the due date for reply briefs was extended to May 30, 1997.

On May 29, 1997, Idaho Citizens Coalition (ICC) filed an Application for Intervenor Funding in the amount of $10,950 pursuant to *Idaho Code* § 61-617A. On June 13, 1997, AARP also filed an Application for Intervenor Funding requesting $25,000. U S WEST filed Motions in opposition to the requests on June 12 and 23, 1997.

At the conclusion of the March 1997 technical hearing, both U S WEST and the Staff had substantially changed their proposed revenue requirements. U S WEST had reduced its initial annual revenue increase from $38 million to $15.538 million, producing an overall increase in annual revenue of 20%. Conversely, the Staff moderated its position from an initial revenue reduction of $32 million to a reduction of $19.742 million. The revenue requirement changes were in addition to the $12 million increase in the base revenues resulting from creation of the calling areas. These significant changes in revenue requirement were prompted in large measure by the Company and Staff entering into two settlement agreements. Given the scope and significance of the settlements, we take them up first.

FINDINGS OF FACT

I. STAFF-U S WEST SETTLEMENTS

Prior to the technical hearing, the parties convened several settlement conferences in an effort to resolve differences and narrow the issues in dispute. As a result of the settlement conferences, the Staff and the Company entered into two stipulated settlements. The first settlement related to various affiliated expense transactions. Staff Exhibit 153. The second settlement resolved approximately 17 disputed issues. See Company Exhibit 48.

A. The First Settlement

In her prefiled direct testimony, Staff auditor and witness Madonna Faunce argued that affiliate expense transactions "are to be subject to close scrutiny and the regulated utility has the burden of proving the reasonableness of its affiliate transactions. In this instance, U S WEST Communications has the burden of proving the affiliate transactions were reasonable and cannot simply rely on the fact that expenditures were incurred." Tr. at 1698. In her rebuttal testimony, Ms. Faunce calculated that U S WEST allocated approximately $3.127 million in expenses from ten affiliates[4] to Title 61 operations. Based upon her audit analysis (excluding Applied Technologies (AT) and Bellcore research expenses), she asserted it was reasonable for the Company to only allocate $1.207 million to Title 61. The difference between the Staff's position and the Company's position was approximately $1.920 million. Exhibit 153 at 2.

Following notice to all parties, the Staff and the Company settled the disputed affiliated transactions and executed a settlement agreement ("first settlement") on February 21, 1997, saying they recognized the likelihood that neither party would fully prevail in their arguments concerning the disputed affiliated transactions. Consequently, they agreed to "divide" the $1.920 million difference. Exhibit 153. The Company lowered its Title 61 operating expenses by approximately $960,000 and the Staff increased its revenue requirement associated with affiliated expenses by the same amount. Revised Exhibit 101 at line 35 (3-26-97). Given the complexity of these affiliated issues, the parties asserted that the settlement was reasonable. Faunce, Tr. at 1741-43; Wright, Tr. at 263. No party opposed this settlement.

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[4]These affiliates included: Business Resources, Inc. (BRI); New Vector; U S WEST Communications Services; U S WEST Enhanced Services; U S WEST Federal Services; U S WEST, Inc.; U S WEST International; U S WEST Marketing Group; U S WEST Multimedia and U S WEST Real Estate. Staff Exhibit 153 at 4.

Commission Findings: Given our review of the first settlement and the fact that no party opposed it, we find: resolution of these disputed affiliated expenses is reasonable. Adoption of the settlement lowers the Company's Title 61 operating expenses by $960,000.

B. The Second Settlement

U S WEST and the Staff entered into a second settlement and stipulation covering 17 major issues. The second stipulation, embodied in Exhibit 48, addressed several major topics covering adjustments to rate base, revenues, expenses, and cost of capital issues. The Company and Staff urged the Commission to adopt this second settlement. The only settlement issues opposed by other parties were directory imputation and depreciation. AT&T Initial Brief at 6-11, Reply at 5-7; AARP Brief at 8-12. The issues in the second settlement, are discussed in greater detail below.

1. Pension Asset (Adjustment to Rate Base). Initially, U S WEST witness Margaret Wright proposed an adjustment to record, for regulatory purposes, a Pension Asset of $9,431,000 in rate base. Tr. at 307-10. The Staff opposed this adjustment. Staff witness Kent Schneider asserted that the Pension Asset was funded by the ratepayers and, consequently, should be assigned to ratepayers—not to the shareholders. Therefore, he proposed an offsetting adjustment of $18,862,000 to reflect the Pension Asset as a ratepayer-contributed asset and a reduction of rate base. Schneider, Tr. at 1065-67. At the March 4, 1997 settlement conference, U S WEST agreed with Staff that the Pension Asset be included neither as an addition to nor as a reduction from rate base. Exhibit 48. The settlement of this issue requires that the deferred tax liability of $3.662 million also be removed. Schneider noted that several other state regulatory commissions treat pension assets as proposed in the settlement. *Id.* at 1119-20, 1127; Wright, Tr. at 266.

2. Directory Imputation (Revenue). In its direct and surrebuttal case, the Staff had recommended that $8.645 million in affiliate directory (i.e., yellow pages) revenue be imputed to Title 61. Exhibit 101, line 44 (11-26-96). Staff witnesses Terri Carlock and Dr. Lee Selwyn argued that Title 61 ratepayers are entitled to ongoing imputed revenue or, as an alternative, that ratepayers ought to be compensated on a one-time basis for the net present value of directory revenue as a transfer payment. The Company opposed any imputation.

At the March 4 settlement conference, the Staff agreed to remove this imputation from Title 61 revenues. Instead, the Staff and Company agreed to providing Title 61 customers with a $1.00 credit per month for twelve months, a cumulative value of approximately $4.2 million. See

Exhibit 48. In response to a Commission question, Staff witness Carlock explained that the directory credit "provides a transition from the existing regulatory imputation of directory to no imputation of directory revenues[. I]t appeared that that was probably the direction that we ultimately would go, so that transition seemed reasonable." Tr. at 2149. Both parties asserted that settlement of this issue was reasonable, given the litigation potential of this issue. Carlock, Tr. at 2119-20, 2123; Wright, Tr. at 263-64.

In its post-hearing briefs, U S WEST argued that the continued imputation of directory revenue is neither reasonable nor lawful for several reasons. First, the Company argued that imputation is inconsistent with the Idaho and federal Telecommunications Acts. Notwithstanding the use of directory revenues in the Revenue Sharing Plan, U S WEST insisted that the Idaho Act "clearly prohibits the imputation" of directory or other non-Title 61 revenues in the setting of Title 61 rates. U S WEST Initial Brief at 43. Because the federal Act requires LECs to resell local service and sell unbundled network elements, U S WEST maintained it is no longer reasonable to impute revenue to artificially reduce Title 61 rates.

The Company also noted that recent amendments to the Idaho Telecommunications Act contained in House Bill 313 provided that the Commission "shall not require revenues earned from nonprice-regulated services or affiliates to be attributed to basic local exchange services." *Idaho Code* § 62-613 (July 1, 1997). "Although this legislation does not apply to the present case," the Company argued that this statute would certainly prohibit directory imputation in the future. Initial Brief at 44, Reply Brief at 11.

AT&T and AARP urged the Commission to reject the settlement of directory revenues. AT&T witness Dr. Howard Bell argued there is no reason for the Commission to discontinue its past practice of imputing directory revenue. Tr. at 2038-42. Relying upon the often quoted language from Judge Harold Greene's divestiture decision, AT&T urged the Commission to continue to impute yellow page revenues. AT&T Brief at 10 *citing United States v. American Tel. and Tel.*, 552 F. Supp. 131, 194 (D.D.C. 1982).[5]

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[5]The opinion states that all parties to the Modification of Final Judgment (MFJ)

> concede that Yellow Pages currently earns supra-competitive profits. . . . All those who have commented on or have studied the issue agree that the Yellow Pages provides a significant subsidy to local telephone rates. This subsidy would most likely continue if the Operating Companies were permitted to

AT&T also insisted that the proposed transitional credit of $1.00 per Title 61 line "is unconscionable in light of the [directory] amounts subject to revenue sharing in 1995." Brief at 11. At a minimum, AT&T urged the Commission to impute yellow page revenues of $27.3 million, minus any applicable expenses, as reported in the 1995 revenue sharing report. *Id.*

Intervenor AARP also urged us to reject the directory imputation settlement. Relying upon the testimony of ICC witness Dr. Tom Power and Staff witness Dr. Lee Selwyn, AARP urged the Commission to continue the revenue imputation.[6] AARP Brief at 8-12. Although Dr. Power recognized that House Bill 313 contained a provision that prohibits future directory imputation, he stated on cross-examination that the Commission should consider the discontinuance of the directory imputation as a "transfer of assets" and develop the appropriate accounting treatment for that transfer. Tr. at 2375-80. Based upon the Staff's prefiled directory imputation of $8.7 million per year, Dr. Power estimated that the total value of the directory asset being removed from Title 61 would be between $50-55 million. *Id.*; AARP Brief at 10.

3. Capital Structure (Cost of Capital). Staff witness Terri Carlock had originally recommended use of the financial capital structure for the Company of 62% debt and 38% equity. Staff Exhibit 128, Sch. 14. Company witness Cummings had recommended a capital structure of 44.4% debt and 55.6% equity. Exhibit 6. Staff agreed to adopt the Company's proposed capital structure that reflects the Company's regulatory—as opposed to financial—capital structure. Cummings, Tr. at 510-13.

4. Cost of Debt (Cost of Capital). In conjunction with the settlement of the capital structure, the Company stipulated to using the Staff recommended debt cost of 7.23% instead of the

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> continue to publish the Yellow Pages.
>
> The loss of this large subsidy would have important consequences for the rates for local telephone service. . . .

[6]At our technical hearing, U S WEST argued that Dr. Selwyn's prefiled testimony supporting a directory imputation not be part of the record given the subsequent stipulation to discontinue directory imputation. Except for the Staff, the other parties urged us to admit this testimony noting that the second settlement was completed only three days before the technical hearing. We permitted this prefiled testimony to be admitted. We recognize, however, that Dr. Selwyn's prefiled testimony supporting the continuation of directory imputation was filed prior to the second settlement. In fairness to all parties, we spread Dr. Selwyn's prefiled testimony upon the record and allowed him to be cross-examined regarding this issue. Likewise, we allowed U S WEST to submit rebuttal testimony on why the imputation should be discontinued.

Company's recommended cost of 7.48%. U S WEST and Staff stipulated to the proposed capital structure and the cost of debt as part of the overall stipulation. Exhibit 48 at 4; Carlock, Tr. at 2122-23; Wright, Tr. at 265-66. The combined effects of the cost of debt and capital structure stipulation are to decrease the Company's Title 61 revenue requirement. This produces an approximately $1.5 million offset to the Staff's proposed revenue reduction. Revised Exhibit 101, lines 12-14. The settled capital structure and cost of debt (with the disputed cost of equity) are shown below.

Component	Ratio	Composite Cost	Rate of Return
Debt	44.4%	7.23%	3.21%
Common Stock	55.6%	Staff: 11.0-12.0% USW: 12.5-13.1%	6.12-6.67% 6.95-7.28%
	100.0%		Staff: 9.33-9.88% USW: 10.16-10.49%

5. <u>Depreciation (Adjustment to Rate Base)</u>. Staff witness Dr. Selwyn in his direct and surrebuttal testimony advocated use of asset lives authorized by the Commission in 1988, rejection of the Equal Life Group (ELG) methodology, and recovery of any reserve deficiency over the remaining lives of the assets. Tr. at 2461-2505, 2538-92. U S WEST proposed adoption of shortened asset lives for certain accounts and the use of the ELG methodology in the calculation of depreciation expense. U S WEST also proposed that a reserve deficiency calculated through use of the Company's proposed lives be identified and amortized over a period of three years, thereby increasing Title 61 expense.

To resolve these disputed issues, Staff agreed to the use of U S WEST's proposed asset lives and the use of the ELG methodology in calculating depreciation expense for Title 61 ratemaking. Exhibit 48 at 3; Carlock, Tr. at 2120-21. U S WEST agreed to make an adjustment to the intrastate depreciation reserve and effectively write-off the reserve deficiency with no revenue requirement impact. Exhibit 48; Wright, Tr. at 265. In addition, U S WEST would not advocate recovery of any reserve deficiency for U S WEST's southern Idaho operations in the future. Carlock, Tr. at 2121. The settlement of this issue would reduce the Company's Title 61 revenue requirement by $7.1 million and would increase the Staff's Title 61 revenue requirement by $3.27 million.

Although AT&T did not specifically oppose the use of ELG, it opposed the adoption of shorter depreciation lives for U S WEST. AT&T Brief at 8-10. AT&T maintained that comparing U S WEST's plant lives to companies that are not Regional Bell Operating Companies (RBOCs) or local exchange companies negated U S WEST's argument. *Id.* at 8.

6. Telephone Concessions (Expenses). In her direct and surrebuttal testimony, Staff witness Kathy Stockton imputed telephone concessions revenue to Title 61 in the amount of $234,036 to match the Company's expenses related to telephone concessions for employees and retirees. Tr. at 1005, 1027-28. U S WEST argued that this issue was raised in the last rate case and, at that time, the Commission did not order any adjustment. Consequently, U S WEST asserted that a concession adjustment was not necessary. At the March 4 settlement conference, Staff and the Company agreed to settle this by dividing the difference between the positions of the parties. The Company will increase its Title 61 revenues by $117,000, and the Staff will reduce its Title 61 revenues by an equal amount. Exhibit 48 at 7; Stockton, Tr. at 1049; Wright, Tr. at 272-73.

7. President's Club (Expenses). Staff witness Stockton disallowed $90,409 of Idaho intrastate expenses for the President's Club recognition event because U S WEST did not provide sufficient information to determine whether the expenses benefited Title 61 customers. Tr. at 1011-12, 1030-31. She characterized this event as akin to an all-expenses-paid vacation for the selected employees and their spouses with no direct benefit to Title 61 customers. U S WEST argued that the President's Club is a form of employee recognition and should be considered normal operating expenses. Staff agreed to settle this issue with the Company by splitting the difference. *Id.* at 1046; Exhibit 48 at 6; Wright, Tr. at 270. The Company will reduce Title 61 expenses by $23,000 and Staff will increase its Title 61 expenses by a corresponding amount.

8. Documents of Originating Entry (Expenses). After Stockton examined 206 documents of originating entry, she proposed a direct assignment to Title 62 of $857,352 and a direct assignment to Title 61 of $17,754 at the intrastate level. Tr. at 1023, 1037-38. At the March 4 conference, Staff and the Company agreed to settle this adjustment. Staff and the Company split the total Title 61 difference of $468,000. The Company decreased Title 61 expenses by $234,000, and Staff increased Title 61 expenses by an equal amount. Exhibit 48 at 6; Stockton, Tr. at 1047-48; Wright, Tr. at 271.

9. Advertising (Expenses). Staff witness Stockton proposed an adjustment to expenses of $784,630 at the intrastate level to eliminate those expenses associated with image and corporate advertising. Tr. at 1026, 1040-41. These advertising expenses have historically been disallowed by the Commission. The Company argued that the advertising expenses should be allowed now that all telecommunication markets are subject to competition. Staff agreed to settle this issue with the Company by splitting the Title 61 difference of $267,000. The Company will reduce its Title 61 expenses by $134,000 and the Staff will make a corresponding adjustment to increase Title 61 expenses. Exhibit 48 at 6; Stockton, Tr. at 1048-49; Wright, Tr. at 271-72.

10. Chart of Accounts (Expenses). The "Chart of Accounts" adjustment is an adjustment based on the Uniform System of Accounts that starts at the FR (Financial Report) basis area ledger for Idaho. The purpose of this adjustment is to remove various account balances that are solely Title 62 expenses. Staff witness Stockton recommended a 'Chart of Accounts' adjustment of $9,827,635 at the intrastate level. Tr. at 1015, 1033-34. The Company argued that attempting to identify costs in this manner creates misleading and incorrect results.

Staff and U S WEST agreed to settle this issue after the Company provided more detailed information. After examining the supplied information, Stockton determined that these Title 62 accounts (totaling $9.757 million) had indeed been removed from the Title 61 revenue requirement. The parties agreed to split the disputed Title 61 difference of $44,000. The Company will reduce its Title 61 expenses by $22,000 and the Staff will increase its Title 61 expenses by an equal amount. Exhibit 48; Stockton, Tr. at 1046-47; Wright, Tr. at 270-71.

11. 1801 California Lease (Expenses). Staff witness Schneider argued that the Company's building lease at 1801 California in Denver, Colorado was excessive and a reduction in the intrastate Idaho-South revenue requirement of $173,000 was required. Tr. at 1079, 1088. This proposal was based on studies performed for the Arizona PUC Staff by the Irvine Group, by Arthur Andersen & Co. for U S WEST, and by the Oregon PUC Staff. The Company insisted that the Staff had not considered several critical components of lease comparability and, consequently, the Staff adjustment was inappropriate. This issue was settled by splitting the Title 61 differences of $86,000. This resulted in a net reduction of $43,000 to U S WEST's Title 61 revenue requirement and a corresponding increase in the Staff's Title 61 revenue requirement. Exhibit 48; Schneider, Tr. at

1126-27; Wright, Tr. at 268-69. The parties claimed that settling this issue is reasonable due to the difficulty of supporting the excessive lease charge on a unique structure in downtown Denver.

12. Transition Benefit Obligation (TBO). Staff witness Schneider proposed an adjustment of $397,000 at the intrastate Idaho-South level to revise the transition benefit obligation (TBO) amortization period for the implementation of FAS No. 106 - Employers' Accounting for Post-Retirement Benefits other than pensions. Tr. at 1068, 1095. The Company was using an actuarially calculated 17.3-year amortization period. Schneider proposed a 20-year amortization period for regulatory purposes since this longer period was allowable by the new accounting standard and had been used by the IPUC in other cases. At the March 4 conference, this adjustment was settled in conjunction with the curtailment loss discussed below. Exhibit 48.

13. Curtailment Loss Amortization (Expenses). The Company recorded a curtailment loss in 1995 to adjust for employee terminations that occurred in prior years. The curtailment loss was the revenue impact of these terminations on the accounting for Post-Retirement Benefits Other Than Pensions that could be measured in 1995. Staff witness Schneider argued this was a rare if not unique event. Tr. at 1069. He proposed for regulatory purposes, that rather than record this event in 1995 only, it would be better to amortize this loss (expense) over the same period as the Transition Benefit Obligation discussed above. The Company asserted that the Staff made this adjustment without considering other offsets. At the March 4 conference, this adjustment was settled. Exhibit 48 at 5. This settlement will result in a reduction of intrastate Idaho-South revenue requirement of $1,139,000. *Id.* at 1064.

The Staff's TBO and the Curtailment Loss adjustments were accepted by the Company in the settlement, on condition that the Company not be required for regulatory purposes to fund the reserve account for FAS No. 106. *Id.*; Schneider, Tr. at 1122-23; Wright, Tr. at 267. By this compromise, the offsetting reduction in fund asset earnings resulted in a net Title 61 expense reduction for U S WEST of $8,850. Exhibit 48. The parties suggested that this compromise is reasonable based on the premise that ratepayers received the benefit of the two adjustments Schneider proposed but the Company will not have any funding requirement for regulatory purposes. Schneider, Tr. at 1124; Wright, Tr. at 267.

14. Compensated Absences Accrual (Expenses). Compensated absences represent any "time" an employee will be away from work but the employee will still be paid as if at work.

Examples of compensated absences include vacation, sick and personal leave. Schneider, Tr. at 1070. To qualify for accrual accounting, the compensated absence earned would have to be owed to the employee even if the employee terminated employment. According to SFAS 43 - Accounting for Compensated Absences, compensated absences are to be expensed as earned rather than when paid. There was a "catch-up entry" required at the time of the accounting change for all past earned compensated absences that had not been paid and had not been recorded as a liability. *Id.*

The FCC adopted a ten-year phase-in period for the catch-up entry allowing U S WEST to phase in the expense impact over ten years. Effective January 1, 1988, a deferred charge was established by U S WEST for the compensated absence catch-up expense, along with a deferred credit related to the liability. These amounts are being amortized to expense on a straight-line basis over the ten-year period from January 1, 1988 to December 31, 1997. *Id.* at 1071.

Staff witness Schneider proposed an adjustment of $203,000 at the intrastate Idaho-South level because amortization of the catch-up entry is a one-time event, the effect of this amortization is known and measurable, and the amortization of the catch-up amount will be nearly complete when this rate case becomes final. Schneider, Tr. at 1071, 1093. Therefore, to properly reflect the 1995 test year for setting rates on a pro forma basis, he asserted that the catch-up amortization expense of $203,179 should not be included in 1995 expenses for ratemaking purposes.

At the March 4 conference, this issue was settled by splitting the difference. *Id.*, Tr. at 1124-26; Wright, Tr. at 268. This will reduce the Company's revenue requirement by $51,000 at the Title 61 level and result in a corresponding increase to the Staff's revenue requirement. Exhibit 48. The parties argued settlement of these issues is reasonable because the amortization ends in 1997, two years after the test year, and also the year in which the Commission will issue its Order in this case.

15. <u>Amortization of Restructuring Expense (Expenses)</u>. The Company started a four-year Restructuring Plan in 1994 for which it took an $880,000,000 "special" charge in 1993. Schneider, Tr. at 1072. The offsetting reserve for financial accounting purposes was used to record the expenses as they occurred until the Restructuring Plan was completed. For regulatory purposes, the expenses were charged to ordinary operations. Idaho intrastate expenses for 1995 totaled approximately $4,866,000. Exhibit 108 at 2.

Staff witness Schneider proposed that rather than record these expenses in the test year, it was more appropriate to amortize them over 15 years because the expenses in 1994 and 1995 exceeded the economic benefits that had been received by the end of 1995. The Company initially argued the Staff adjustment was not reasonable because the restructuring expenses were ongoing and the Staff did not consider other offsetting expenses. Staff's proposal would reduce the Company's intrastate revenue requirement by $4.866 million. Schneider, Tr. at 1076. At the March 4 conference, the Company agreed to Staff's proposal. Exhibit 48; *Id.*, Tr. at 1120-22; Wright, Tr. at 269.

16. Employee Reduction (Expenses). The Company argued the primary economic benefit to be realized by the Restructuring Plan (outlined above) was the elimination of 10,000 employees over a four-year period as U S WEST's service centers were reduced from 560 to 26 and computer systems were developed or enhanced to enable the remaining employees to increase their productivity. As of December 31, 1995, there were 5,495 employees still to be terminated. *Id.* at 1077.

The Staff and U S WEST agreed to settle the issue of employee layoff reductions. Exhibit 48. For this case, the Idaho intrastate expenses included in the test year will be reduced by $4.866 million. *Id.*; Schneider, Tr. at 1122; Wright, Tr. at 269. This settlement effectively removes the expense from the test year so additional benefits from employee reductions do not need to be calculated.

17. EAS Adjustment (Revenues and Expenses). U S WEST proposed two adjustments for the costs of implementing the three extended area service (EAS) or regional calling areas approved by the Commission in Case No. USW-S-96-4. Wright, Tr. at 3823. Staff initially proposed an adjustment based upon TELRIC costs but subsequently withdrew this recommendation. Following settlement discussions, Staff accepted the Company's EAS adjustments.

First, the Staff accepted U S WEST's estimated plant costs for implementing the local calling areas up to a maximum of $3.7 million. Wright, Reb. Adj. #28; Staff Revised Exhibit 101, p. 10. Staff and the Company agreed to recommend that the Commission use available revenue sharing funds beyond the $1.5 million cap already stipulated to in the 96-4 case to offset the cost of new facilities—or up to $2.2 million from revenue sharing funds. Eastlake, Tr. at 2201; Carlock, Tr. at 2121-22; Wright, Tr. at 273-74. As with the Tech II project, new facilities installed with revenue sharing funds should be booked at their cost and offset with an adjustment to accumulated depreciation (resulting in no rate base addition). Second, Staff agreed with U S WEST's estimated shift in costs associated with separations (shifting toll minutes to local minutes), thereby increasing Title 61 rate base by $7.451 million and operating expenses by $3.048 million. Carlock, Tr. at 2122; Wright, Tr. at 274, 3834; Exhibit 66, page 21 of 22 (Adj. #27); Revised Exhibit 101 at 10. The parties recommend the pro forma revenues be included in the test-year revenues for the purpose of determining the change in rates.

In summary, the Staff and U S WEST both asserted that the settlement of the various issues encompassed in the second stipulation was reasonable. Each party conceded issues to the other, as well as split other issues. Wright, Tr. at 263-74. As Staff witness Carlock explained,

> [t]he settlement of these issues is reasonable and in the public interest when taken as a whole. The individual components were reviewed and evaluated based upon the strengths of both the Staff and the U S WEST positions. The overall impact of the second settlement and stipulation is to move Staff's revenue requirement to a negative [$19.742] million and decrease U S WEST's revenue requirement to [$15.538] million. The disputed issues in this case are reduced and the revenue requirement difference between Staff and U S WEST is also reduced from approximately $70 million difference . . . to [$35.28] million.

Tr. at 2123.

Commission Findings: The foregoing second settlement issues demonstrate descriptions of its significance in terms of the issues it settles and the accompanying impact upon the Company's and Staff's revenue requirements. This significance is graphically portrayed when one considers the number of witnesses and prefiled testimony pages that addressed these disputed issues. Our review of the settlement, the supporting testimony, the lack of objections to most of the issues, and our examination of the directory and depreciation issues, we find it reasonable to adopt the second settlement.

We begin our discussion and examination of the second settlement by noting that only two of the seventeen issues were disputed. Although the Commission is not bound by the parties' settlement, we find the settlement of the resolved issues to be fair and reasonable, and in the public interest. IDAPA 31.01.01.276. Both the Staff and U S WEST conceded issues to one another. Given the litigious nature of many issues, the parties recognized the benefit of a timely and certain resolution of these issues. Consequently, they resolved their differences on these issues by entering the second settlement.

We now turn to the disputed directory and depreciation issues. The Staff and U S WEST urged us to consider the second stipulation as a "whole" and not to individually examine any one issue. However, we feel compelled to address these two issues individually. As we previously mentioned, the telecommunications industry is undergoing fundamental change. One area of change concerns the elimination of subsidies or support mechanisms in rates.

The Commission has historically imputed directory revenues into overall revenue requirement. Although *Idaho Code* § 62-613 was not in effect at the time this case was completed, it nevertheless has relevance on a going forward basis. This statute states that the Commission "shall not require revenue earned from non-price regulated services or affiliates to be attributed to basic local exchange service." *Idaho Code* § 62-613 (July 1, 1997). As with any ratemaking activity, the Commission is setting rates on a forward or prospective basis. Consequently, even though *Idaho Code* § 62-613 may not have been effective at the time this case was submitted for our deliberation, it is effective now and presumably during the time these rates are in effect. We find that the statute compels us to eliminate the directory imputation.

Although we do not adopt his precise recommendation, we do recognize that the directory credit is somewhat analogous to Dr. Power's asset transfer theory. We would not have been inclined to adopt the stipulation if the agreement had not included the transitional directory credit. As Dr. Power observed, the directory credit may be viewed as partial payment for removing an asset that supports basic local rates. For purposes of our decision here, we find that adoption of the settlement regarding directory imputation and the $1.00 directory credit are reasonable and in the public interest. Given the lead time necessary to establish the credit in the billing system, we order the Company to begin the credit starting with bills issued on and after September 1, 1997. Customers shall receive the credit for twelve consecutive billing cycles.

We now turn to the depreciation issues. Given the trade offs embodied in the settlement, we find: of the depreciation issues the settlement is reasonable and appropriate. More specifically, the settlement calls for U S WEST to forego its claim to a Title 61 reserved deficiency in the amount of $11.4 million. U S WEST Brief at 36. This amount is to be "booked" over a three-year period without recovery from Title 61 customers. AT&T urged us to adopt this very result in its post-hearing brief and we do so here. AT&T Brief at 7-8.

U S WEST and the Staff also urged us to adopt settlement provisions that shorten the asset lives of certain plant accounts and employ ELG methodology. The periodic adjustment of depreciation lives is prompted in a large part by the deployment of new technology and the emergence of competition in some markets. *Idaho Code* § 61-525 permits the Commission to periodically adjust depreciation rates. As pointed out in Staff testimony, the Company has been booking its Title 61 assets using ELG for several years. Had U S WEST not been using ELG and the shorter asset lives during the revenue sharing years (1989 through 1996), Title 61 customers would now be facing recovery of significantly more rate base-related depreciation costs in their rates for Title 61 services. Title 61 ratepayers have benefited by these past write-offs and the write-off of the depreciation reserve is merely an extension of that benefit.

Our adoption of the settlement and its use of ELG is further supported by recent amendments to the Idaho Telecommunications Act. In particular, *Idaho Code* § 62-622(1)(a) (July 1, 1997) provides that authorized depreciation lives shall use "forward-looking competitive market lives." We find that the depreciation settlement embodies this principle. Finally, U S WEST noted that its other thirteen state jurisdictions as well as the FCC permit the Company to utilize ELG for depreciation purposes. Tr. at 427. Based on the supporting evidence in this case, we find: that use of the ELG methodology is reasonable, appropriate, and comports with recently enacted legislation.

II. THE TEST YEAR

The Company's Application uses a test year ending December 31, 1995, based upon 12 months of actual data. The Staff and Intervenors do not oppose the use of the 1995 test year. We find use of the 1995 test year is reasonable for purposes of this case.

III. RATE BASE ADJUSTMENTS

A. Agreed Issues

1. Working Capital. The Staff agreed with the Company's calculation of working capital (materials and supplies; interest on CWIP; and cash) at the intrastate southern Idaho level as $3.949 million. Lansing, Tr. at 1583; Revised Exhibit 101 (3-26-97), lines 3, 4, portion of 9. We find it is reasonable to adopt the Company's calculation of working capital.

2. Accumulated Depreciation. Staff agreed with the Company's presentation of accumulated depreciation with the exceptions adopted in the second settlement. Lansing, Tr. at 1584, Revised Exhibit 101, line 6. We adopt the Company's presentation of accumulated depreciation except as adjusted by the second settlement discussed above.

3. Deferred Income Tax. Staff agreed with the Company's method of calculating deferred income tax except as adjusted for rate base changes including plant-in-service, accumulated depreciation reserve, and the pension asset. Revised Exhibit 101, line 7. We find the Company's method of calculating deferred income tax, with the exceptions noted above is reasonable.

4. Customer Deposits. The Staff agreed with the Company's calculation of customer deposits as shown in Rev. Exhibit 101, line 8; Lansing, Tr. at 1584. This reduces the rate base by $475,000. We adopt the Company's calculation of customer deposits.

5. Rent Compensation (Revenues). The Staff agreed with the Company at the first settlement conference that rent compensation should be included as a contra-revenue expense. Revised Exhibit 101, line 42 (3-26-97), reflects the addition of rent compensation of $10.234 million. Given the settlement of this issue between the Staff and the Company and the lack of any objection, we find: rent compensation should be included as a contra-revenue expense.

6. Gross-Up Factor and Effective State Tax Rate. The Staff and the Company also reached agreement concerning the effective state tax rate and the appropriate gross-up factor. The parties agreed that in the case of a positive revenue requirement, the effective state tax rate should be 6.594% and the gross-up factor should be 1.6722. Lansing, Tr. at 1618-19. In the case of a negative revenue requirement, the Staff and Company agreed that the state effective tax rate should be 6.1729% and the gross-up factor be 1.5661. *Id.* at 1619; Wright, Tr. at 3990. As explained in greater detail below, the Commission has determined that the Company's annual revenue requirement should be reduced. Accordingly, we adopt as reasonable the agreement of the parties that the effective state tax rate should be 6.1729% and the gross-up factor be 1.5661.

7. Analog Alarm, Station Apparatus, Terminal Equipment, Inmate Services. On page 5 of Staff witness Lansing's Exhibit 101 he recommended that four accounts be directly assigned to Title 62 services. The four accounts are analog alarm services, station apparatus non-regulated, terminal equipment non-regulated, and inmate payphone services. Lansing proposed to directly assign to Title 62 approximately $636,000 on an intrastate basis. Following discussions between

the Staff and U S WEST, Mr. Lansing agreed that those four accounts were federally deregulated Part 64 services. *Id.* at 1657. Consequently, these costs had already been removed from the Company's intrastate plant-in-service. The Company and the Staff agreed that an adjustment for these accounts should be removed from the Staff's Revised Exhibit 101 (3-26-97). *Id.* at 1657-59; Wright, Tr. at 3990.

Given the agreement between the Staff and U S WEST, we find these four accounts were properly removed from the Company's Title 61 rate base. Accordingly, we adopt the Company's position that the Staff adjustment is unwarranted.

8. Subsidiary vs. General Ledger. As a result of the January 15, 1997 settlement conference, the Staff agreed in principle that three accounts: 1) leasehold improvements; 2) intangible assets; and 3) capital leases were omitted from the calculation of the Staff recommended rate base. The Staff and the Company agreed that $3.676 million in leasehold improvements should be allocated between the Title 61 and Title 62 rate base. In addition, the Staff and Company agreed that $42,000 in intangible assets are available for allocation between Title 61 and Title 62 rate bases. Lansing, Tr. at 1597.

The capitalized lease account has two sub-accounts: buildings and switch software. The Staff and Company agreed that $4.263 million in the buildings sub-account is available for allocation between Title 61 and Title 62 rate base. Although the Staff and the Company agreed to the quantification of the software sub-account as $5.495 million (Lansing, Tr. at 1597; Reiman, Tr. at 3118), they disagreed as to the assignment or allocation of the capitalized software leases.

With the exception of the software leases (that we take up below), we adopt the agreement of Staff and U S WEST regarding leasehold improvements, intangible assets, and the building sub-account for capitalized leases.

B. Issues in Dispute

1. Software Capital Leases. Staff witness Lansing recommended that the entire intrastate amount of capitalized leases ($5.495 million) be allocated to Title 62. He asserted that he had repeatedly asked for information regarding this sub-account but the Company did not provide any meaningful information concerning the purpose or function of the software relating to capitalized leases. Tr. at 1597; Revised Exhibit 101, line 2 (3-26-97). Lansing further testified that many of the software features covered by the capitalized leases enable switches to offer Title 62 services such

as call forwarding, Caller ID, automatic call back, automatic recall, calling number delivery, selective call forwarding, and selective call rejection. *Id.* at 1598. Consequently, these leases should not be attributable to Title 61.

He further asserted that the amount of capitalized leases attributed to software should be adjusted to remove those exchanges that were sold by U S WEST to various purchasers. Company witness Beth Reiman agreed that those capitalized leases attributable to the sold exchanges in Idaho should be removed from the capitalized software leases. Tr. at 3121, 3122. She accepted, subject to check, that the leases for the sold exchanges totaled $24,795 on an intrastate basis. *Id.* at 3122.

Staff further asserted that approximately $3.556 million on an intrastate basis should be removed from Title 61 rate base and assigned to Title 62. Relying on Exhibit 172, pp. 7-9, Staff witness Lansing maintained that many of the capitalized software packages supported the deployment of Title 62 services. Ms. Reiman acknowledged during her cross-examination, leased software to provide feature group B dialing, 10XXX carrier code ID dialing, calling name and address for CLASS services, call forwarding, voice messaging, E911, and alternate billing services for voice services node are Title 62 services. *Id.,* Tr. at 3126-28. The Company did not adjust its Exhibit 66 to reflect either the adjustment for the sold exchanges or removing those software additions that supported Title 62 services. Wright, Tr. at 3988.

In its Post-Hearing Reply Brief, U S WEST claimed that the Staff was provided with leasing information relating to the Company's central office switches. Reply Brief at 11. The Company noted that it did not assign these costs to Title 61, but rather included them in cost pools which were then allocated between Title 61 and Title 62. The Company insisted that the Staff possessed unrealistic expectations when it was unable to "directly assign" costs to Title 62 or Title 61. *Id.* at 12. The Company stated that it does not maintain records with the level of detail which would allow the direct assignment of capitalized leases between Title 61 and Title 62. *Id.*

In addressing Staff's assertion that "approximately $3.556 million on a total state basis should be assigned to Title 62," the Company responded that it did not conduct a special study of the software leases. The Company continued that "if the Commission wishes to deviate from the CAAS allocation of these [lease] costs, this amount identified by Staff to be associated with Title 62 services should be the maximum that is assigned to Title 62 operations." *Id.* at 13. No other party addressed this issue.

Commission Findings: After reviewing this issue, we are persuaded that the Staff's adjustments to the capitalized leases for software are appropriate. It is unreasonable for Title 61 customers to pay for the Company's Title 62 expenses. Based upon the Staff's assertions and the Company's position, we find it is appropriate to make two adjustments to the capitalized leases. First, those capitalized leases attributable to the sold U S WEST exchanges should be removed. This Title 61 adjustment results in a removal of $14,629. Second, those software leases identified by Staff as supporting Title 62 services should also be removed from the Title 61 rate base. Staff calculated that $3.556 million on an intrastate basis should be assigned to Title 62. This results in a Title 61 rate base reduction of $2.098 million.

2. Lit Fiber Optic Cable. Based on 1995 ARMIS Reports, Staff witness Lansing calculated that only 10.355% of the Company's fiber optic cable in Idaho was "lit" or used and useful in the test year. Tr. at 1580, 1602. Consequently, he removed intrastate amount of $9.122 million in fiber as "plant held for future use." *Id.* at 1604; Revised Exhibit 101, p. 4. The Company does not dispute that the 1995 ARMIS Report shows 10.355% lit fiber, but observed that the 1994 ARMIS "corrected" report showed 11.94% lit.

Company witness Harvey Plummer stated that the 1994 ARMIS Report contained an error and was corrected September 13, 1996. Tr. at 3421. He argued that the entire amount of fiber should be placed in the Title 61 rate base. Although he did not calculate the amount of fiber lit in 1995, Plummer maintained that the amount of fiber lit as a percentage of total fiber as of January 7, 1997, was 43%. *Id.* at 3495. The Company's response to audit request No. 160 (contained in Exhibit 53) also showed that the adjusted utilization of fiber for year-end 1995 reflected 23% in use. Lansing, Tr. at 1676; Plummer, Tr. at 3494.

Lansing recommended the Commission reject the 43% calculation because: (1) the calculation is not comparable to financial data related to the 1995 test year and ARMIS Report; (2) the 43% is not related to average plant-in-service for the 1995 test year; (3) the Company has not provided data to calculate or substantiate any change in the 1995 ARMIS Report; and (4) the unlit dark fiber is not used and useful and should be classified as "plant held for future use." Tr. at 1604. He stated that U S WEST is permitted to recover the costs of plant held for future use when the plant is deployed for utility service; plant held for future use earns a carrying charge until it is reclassified as rate base. Tr. at 1674.

U S WEST argued that the Staff's proposed adjustment for lit fiber was not reasonable because information "used by Mr. Lansing was not accurate or appropriate for determination of what plant was used and useful due to discrepancies" in the data. U S WEST Initial Brief at 34 (emphasis original) *citing* Tr. at 3470, 3473. "Mr. Plummer testified that actual fiber usage for Idaho was 43%." *Id.*, Tr. at 3422. The Company also maintained that Mr. Lansing's adjustment suffered from two other flaws. First, the Company argued that calculating the actual number of fiber strands in use would violate "binder group integrity." *Id.* Relying on the testimony of Mr. Plummer, the Company argued that fibers "within an individual binder group cannot be split without the risk of damaging or breaking the optical fiber. Hence, a particular location requiring only two fibers would be served with a minimum of twelve fibers to maintain binder group integrity." *Id.*; Tr. at 3423. Second, the Company also faulted Mr. Lansing's analysis in that his adjustment did not allow for the recovery of the cost of trenching, laying the cable, and burying fiber cable. *Id.*; Tr. at 1664.

Commission Findings: Not only is the evidence regarding unlit fiber conflicting, U S WEST and the Staff offered at least four different positions. Conspicuously absent in all of the numerical data offered was a calculation showing the lit fiber for the 1995 test year. Mr. Plummer established that at least 43% of the total fiber was in use in Idaho as of January 7, 1997. However, as was pointed out by the Company, Staff's adjustment does not take into account the sizing of fiber optic lines nor does it properly recover the cost of installing such cable.

As the Company correctly pointed out, this Commission has traditionally required that utility facilities placed into service be sufficiently sized or have sufficient capacity to meet the near-term needs of the Company and customers. At the same time, we must insure that utilities are not unreasonably building too much capacity in their facilities or misallocating facilities. Unnecessary capacity may legitimately be classified as not being used and useful for the provision of utility service.

We must now weigh the conflicting evidence offered by the Staff and Company. Having considered the record in this matter, the Commission finds: that 80% of the fiber optic cable in Idaho should be considered to be used and useful during the 1995 test year. We believe that the 80% allowance reasonably compensates the Company for its fiber in use, the cost of installing such fiber, and contains sufficient capacity to fulfill the needs for such fiber. We do not believe that U S WEST should only deploy the minimum amount of fiber necessary to meet an immediate need but neither do we believe that Title 61 ratepayers should pay for excess capacity or unused fiber. Given the conflicting evidence, we find it reasonable to disallow 20% of the fiber plant until its use is documented. Accordingly, 20% of the fiber optic cable will be removed from the Title 61 rate base. This results in a Title 61 adjustment of $1.2 million.

3. "True-Up" Adjustment to Plant-In-Service (Restatement of RUC). At the January 15 settlement conference, the Staff agreed in principle that a true-up of the test year rate base should be included. Upon further examination, Staff witness Lansing concluded that it was unreasonable to true-up the 1995 test year rate base by $4,314,375. Tr. at 1600. Company witness Reiman explained that retirement unit costs (RUC) allow the Company to calculate its unit costs (for poles, cable, etc.) for its average cost assets. Tr. at 3105. She testified that the Company did not use the RUCs to retroactively change construction overheads or the rate base. Lansing objected to this true-up because: (1) this adjustment changed the "overhead" allocation factors on a retroactive basis (for the 1995 test year) rather than a prospective basis; (2) the adjustment occurred nine months after the close of the test year; and (3) approximately 50% of the adjustment was posted to the fiber cable account. Accordingly, he did not increase plant-in-service for the amount of the true-up. Tr. at 1066-67. Because RUCs do not impact the test year rate base, the Company maintained that Mr. Lansing's adjustment is unnecessary and inappropriate. U S WEST Initial Brief at 31-32; Reply Brief at 13.

Commission Findings: We find the testimony of Company witness Reiman persuasive and, consequently, reject the Staff's RUC adjustment. Ms. Reiman adequately explained that the Staff was originally given the 1994 RUC data because the 1995 RUCs had not been calculated at the time the Company replied to the Staff's production request. Initial U S WEST Brief at 32; Tr. at 1649. True-up accounting normally takes place after the close of a reporting period.

4. 1.89% Error Factor. In his direct testimony, Lansing reported he had performed an audit of plant-in-service (PIS) inventory on 22 central offices with a total inventory in excess of $163 million. As a result of his audit, he found that there was $3,085,657 in missing equipment. Consequently, he concluded that the Company's reported PIS contained an error factor of 1.89%. Tr. at 1578. Using a separations factor of 68.17%, he calculated that an intrastate amount of $10.304 million should be removed from the Title 61 rate base. *Id.* at 1579, 1605-07; Exhibit 101, page 4.

In rebuttal, Company witness Wright partially accepted Mr. Lansing's 1.89% error factor and made a correcting adjustment for some inside plant accounts of $4.4 million in Exhibit 66. Tr. at 3986-87; Reiman, Tr. at 3109. U S WEST did not accept the adjustment for other outside plant accounts such as, buildings, land, and buried cable. Ms. Wright argued that the removal error discovered by Staff would not equally apply to outside plant. Tr. at 3871-72; Elder, Tr. at 3702-03. Company witness Reiman acknowledged that the magnitude of the PIS error was 1.4%. Reiman, Tr. at 3114. Lansing did not agree with the Company's assertion that the 1.89% error factor is related to "paperwork" problems concerning the retirement of inside plant accounts. Lansing, Tr. at 1605-08. He noted that U S WEST has retirements in similar magnitudes from outside plant accounts. Tr. at 1606.

Commission Findings: We find that the Company appropriately recognized that Mr. Lansing's inventory did reveal missing plant-in-service. As noted above, the Company made a correcting adjustment in a Title 61 amount of $4.4 million as reflected in its Exhibit 66. We find such a correcting adjustment is supported by the evidence presented by Mr. Lansing. However, we do agree with the Company that utilizing an across-the-board error factor of 1.89% is not reasonable for outside plant accounts. Based upon the testimony, we adopt the Company's position that reporting errors caused by the failure to record PIS removals are not necessarily applicable to outside plant accounts. Consequently, we do not adopt the balance of the Staff's 1.89% error factor.

IV. COST METHODOLOGY

The Company and the Staff used embedded costs to develop the appropriate Title 61 rate base and expenses in this case. Intervenors AARP and AT&T urged the Commission to reject the use of embedded costs. AARP witness Dr. Don Reading proposed using a "forward looking" cost model (the Ben Johnson Telecom Economics Costs model) while AT&T witness Scott Radcliffe recommended the use of the Hatfield cost model.

A. AT&T Position

AT&T urged the Commission to determine U S WEST's costs using total service long run incremental cost (TSLRIC) methodology. The TSLRIC methodology is a type of forward-looking cost methodology. AT&T's witness Dr. William Lehr asserted there were several positive aspects of using TSLRIC methodology. First, TSLRIC methodology will encourage the emergence of competition and is consistent with other cost methodologies recently adopted by the FCC in its local competition rules. CC Docket No. 96-98, FCC 96-325, 1st Report & Order (August 8, 1996). Second, use of TSLRIC properly includes all relevant costs, provides an allowance for capital recovery, and insures a fair return on invested capital. Tr. at 1374-76. Although he acknowledged on cross-examination that AT&T was using the Hatfield model in the U S WEST-AT&T arbitration case, he asserted that the model is certainly capable of determining service costs in this rate case. Tr. at 1477.

In its post-hearing brief, AT&T also insisted that there is nothing in the existing or recently enacted state legislation that would compel the Commission to use an embedded cost study. AT&T Initial Brief at 13, Reply Brief at 8-10. AT&T concluded that the "Commission has the discretion to adopt an embedded cost methodology in this case, but it should not do so. . . . Continuing to use an embedded method in this case will slow the development of robust competition in Idaho." AT&T Initial Brief at 13 (footnotes omitted).

AT&T's witness Scott Radcliffe described the Hatfield model release 2.2, version 2, including the imputes used by the model, and the difference between release number 2.2 and prior versions of the model. Tr. at 1492, 1510-22. On cross-examination, he acknowledged that the Hatfield model 2.2.2 is not the most current version. *Id.* at 1531. He did not dispute that there may be more than 200 hundred changes from the 2.2.2 version to the 3.0 version. *Id.* at 1532.

B. AARP Position

AARP's witness Dr. Don Reading also urged the Commission to reject the Company's use of embedded costs. He recommended that the Commission direct U S WEST to submit new cost studies based on forward-looking economic costing principles. Tr. at 892. He characterized the Company's use of embedded costs as "one last attempt to convince the Commission to drastically increase basic residential exchange rate bases on allocated embedded cost methods." Tr. at 917. In addition to the sound economic principles for adopting forward-looking cost models, he noted that the Colorado and Washington regulatory Commissions had recently adopted the use of forward-looking cost models. *Id.* at 926-28.

C. U S WEST Position

U S WEST defended its use of the embedded cost study model by presenting three arguments. First, U S WEST argued that Idaho law requires the Commission to utilize embedded costs. More specifically, the Company asserted that where joint costs are involved, *Idaho Code* § 61-622A requires the Commission "to make its decision here on the basis of allocated embedded costs." U S WEST Reply Brief at 2. In addition, U S WEST maintained that Title 61 requires that the Commission calculate the rates and the return for the utility based on the fair value of the property being used by the public. Initial Brief of U S WEST at 6 *citing Artesian Water Company v. Idaho PUC*, 40 Idaho 690, 701, 236 P. 525 (1925) *quoting with approval Smyth v. Ames*, 169 U.S. 466 (1898).[7]

Second, U S WEST argued that neither AT&T nor AARP "offered an alternative basis for actually setting retail prices in this case." U S WEST Initial Brief at 7. Although Dr. Reading and Mr. Radcliffe had presented costs, neither witness had taken the necessary steps to calculate and recommend proposed rates based on those costs. *Id*; U S WEST Reply Brief at 3. Mr. Radcliffe acknowledged during cross-examination that the Hatfield model "is a model to identify costs only. It does not come up with any recommendations or how to price services based upon these costs. I mean, that's a different decision." Tr. at 1536; U S WEST Initial Brief at 7.

Finally, U S WEST insisted that the intervenors presented no evidence that forward-looking costs "differ as a practical matter from the embedded costs used by U S WEST and Staff. Other than paying lip service to 'consistency' with the costing approaches mandating by federal law for wholesale unbundled elements, there is no reason given as to why prices set on actual costs are not conductive to competition." U S WEST Reply Brief at 3.

Commission Findings: Based upon our review of the record and the arguments presented by the parties, we find that it is reasonable to utilize embedded costs in this case. We agree with AT&T that under the Public Utilities Law, the Commission has the discretion to adopt either an embedded cost methodology or some other form of cost methodology. *Idaho Code* § 61-

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[7] In its Reply Brief, AT&T asserted that U S WEST's reliance on the *Artesian Water* and *Smyth* cases are misplaced. AT&T Reply Brief at 8. AT&T suggested that the constitutional standard announced in *Smyth* has been replaced by those enunciated in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and its progeny. In *Hope*, the Court stated that it was not the method used to calculate the reasonable rate "but the impact of the rate order that counts." Reply Brief at 8.

622A provides that the Commission "shall have authority to establish just and reasonable rates for all telecommunications services which remain subject to title 61." Nowhere in the Public Utilities Law or in recently enacted amendments to the Idaho Telecommunications Act is a specific cost methodology required. Indeed House Bill 313 amended the Idaho Act to provide that: "Costs shall include authorized depreciation, reasonable portion of shared and common costs, and a reasonable profit." *Idaho Code* § 62-622(1)(a).

Inferences that the federal Act or the FCC's interconnection rules require us to adopt forward-looking costs or any other costs model are also misplaced. After the parties filed their post-hearing briefs in this matter, the Eighth Circuit U.S. Court of Appeals released its opinion concerning the FCC's Interconnection Rules. In its Opinion, the Court held that the FCC exceeded its jurisdiction in promulgating the interconnection pricing rules regarding local telephone service. *Iowa Utilities Board v. FCC*, Docket Nos. 96-3321 et al., slip op. (July 18, 1997). The Court vacated several FCC pricing rules noting that in "requiring state commissions to employ the TELRIC methodology and its other assorted pricing mechanisms, the FCC is seeking to preempt any state pricing regulation that would employ a different methodology." *Id.* at n.19. The Court held that the federal Telecommunications Act does not preempt state authority in this area and states have the discretion to employ cost methodologies of their chosing.

We also find that it is reasonable and appropriate given the evidence presented here to use embedded costs in this particular case. As noted above, AT&T witness Radcliffe presented the Hatfield model 2.2.2, but not the latest version of this model. AT&T did not update its Exhibit 803 with the latest version. It also appears to us that the Telecom Costs model suffered from a similar lack of specificity in that it used default input data instead of Idaho's specific data. AARP witness Dr. Reading conceded that the model did not contain enough Idaho-specific data. When asked by the Commission how long it would take to obtain Idaho-specific data and load it into his model, he estimated that it would take "a few months." Tr. at 997. Given our statutory obligation to render a timely decision in this matter, the Commission cannot wait "for a few months." For the reasons outlined above, we believe that use of embedded cost methodology in this case is reasonable and appropriate. This does not foreclose the possibility that some other cost methodology might be appropriate in the future.

V. COST ALLOCATION

A. Background

This case presents only the second opportunity for the Commission to examine the appropriate allocation of costs between a telephone corporation's price-regulated (Title 61) and nonprice-regulated (Title 62) services. As previously mentioned, the Commission is required to establish procedures for allocating the costs between the Title 61 and Title 62 operations of the Company pursuant to *Idaho Code* § 61-622A. U S WEST is the only company that is subject to this statute at this time. The statute provides that such allocations "shall reasonably reflect how joint-use facilities are utilized, provide reasonable stability for telephone corporations to do business planning and pricing and minimize the cost of accounting and recordkeeping to the extent possible."

To meet the requirements of this section, U S WEST has developed its Cost Accounting Allocation System (CAAS). CAAS was generally designed to allocate revenues, expenses, and investments between regulated and deregulated products at the intrastate level. U S WEST Initial Brief at 10; Tr. at 204. CAAS was not designed to specifically allocate costs between Title 61 and Title 62 and does not directly assign costs to Title 61 and Title 62. Tr. at 3681. In fact, several U S WEST witnesses acknowledged that in the 14 states U S WEST serves, Idaho is unique in its regulatory scheme of price regulating only Title 61 basic local exchange services. Baldwin, Tr. at 2741, 2745; Ilett, Tr. at 3180; Owen, Tr. at 745-46; Wright, Tr. at 3912 ("Title 61 is a classification of service which is unique to the state of Idaho. The classification has no relevance in the other 13 states in which we do business.").

Because the telecommunications network is used for both interstate and intrastate operations, costs must be segregated or must go through a process generally referred to as "separations." Separations is the process of dividing telephone property, costs, revenues, taxes, and reserves between interstate operations (subject to the jurisdiction of the FCC) and intrastate operations (subject to the jurisdiction of this Commission). In the separations process, FCC regulations found at 47 C.F.R. Part 64 require that federally deregulated products and their costs first be removed. Next, Part 36 separates the joint use network into interstate and intrastate operations. At this point, CAAS assigns or allocates costs to Title 61 or Title 62. U S WEST Initial Brief at 11.

U S WEST asserted that CAAS incorporates the standards of the Cost Accounting Standards Board (CASB) and the FCC's cost allocation rules. Both the CASB and the FCC require that costs first be directly assigned to specific products and services whenever practical. In the event that costs cannot be directly assigned to specific products or services, then they are allocated using a hierarchy of cost-causal methodologies. U S WEST Initial Brief at 10. "Primary investment, outside plant, central office equipment, is allocated first. The allocation of secondary investment, such as land, buildings, or motor vehicles, is substantially driven by the allocation of primary investment." *Id.*; Tr. at 212-17.

In Idaho, the local telephone loop[8] which makes up the bulk of the outside plant accounts is allocated through a multi-step process.

> First, 25% is allocated to the interstate jurisdiction pursuant to orders of the FCC.
>
> Second, 15% is allocated to Title 62 for intrastate toll and access services pursuant to prior Orders of this Commission.
>
> Finally, the remaining 60% is assigned or allocated between Title 61 and Title 62 in accordance with CAAS.

U S WEST Initial Brief at 11.

B. Staff Cost Allocation Adjustments

The Staff had two primary criticisms of the Company's CAAS. First, Staff witness Susan Baldwin asserted that expenses should be assigned, to the greatest extent possible, on a direct basis. Tr. at 2686. She asserted that the unique Idaho regulatory structure contributed to the Company's inability to properly allocate costs between Title 61 and Title 62. She explained that U S WEST's attempts to separate Title 61 and 62 investment in plant and equipment only at its income statement level. Consequently,

> "the back-up data to the Title 61/Title 62 model does not contain detail" at the level of individual ARMIS accounts (Response to Staff Data Request 02-136). In other words, the Company is incapable of showing how it allocates individual expenses or investments between Title 61 and Title 62, because that level of detail is lost during the CAAS process. It is impossible, then, for the Company to meaningfully answer questions regarding its allocation of investments in specific types of equipment, i.e., digital switches, digital

[8]The telecommunications pathway, usually a physical line, between the customer's premise and the central office serving that customer.

> circuits, analog circuits, and copper and fiber cable between Title 61 and Title 62 because it does not perform its allocation at that level of detail. Instead, that allocation only takes place at the aggregate level of categories such as "central office equipment" and "outside plant" (Response to Staff Data Request 02-136).

Tr. at 2734.

Second, Staff witness Baldwin recommended that the Commission adopt a cost methodology for allocating common or joint plant that reflects the Company's underlying motivation for the Company's capital investments. Tr. at 2686. The difference between the Staff's cost allocation methodology and the Company's use of CAAS is basically found in four adjustments discussed below. Under the Staff's cost methodology, Ms. Baldwin allocated all secondary investment in accordance with CAAS. Staff Exhibit 159, Schedule 1c, p. 2 of 2. She also allocated many of the central office and transmission plant accounts in accordance with CAAS. Staff Exhibit 159, Schedule 1b; Initial Brief of U S WEST at 12. With this background, we now turn to the Staff's four adjustments.

1. <u>5% Local Loop</u>. Staff witness Baldwin recommended that the Commission directly assign 5% of the local loop investment to custom calling and CLASS services. Tr. at 2756-63, 2853-72. This adjustment recognized that the Company's ability to derive revenues that are substantial (Exhibit 114, Sch. 7, p. 2) and increasing (Exhibit 159, Sch. 5, p. 3) from these products (which despite their Title 62 classification do not face competition nor are they likely to in the foreseeable future) is based upon its ubiquitous investment in substantial common plant. But for U S WEST's provision of basic local exchange lines, the Company could not derive these significant Title 62 revenues.

During his cross-examination, Company witness Dallas Elder acknowledged that the CAAS does not allocate any local plant to CLASS and custom calling services. Tr. at 3782-83; Exhibit 114, Schedule 2, Page 2. Yet he acknowledged that the total intrastate revenues derived from central office features including CLASS and custom services is $12.8 million. Tr. at 3781; Exhibit 114, Schedule 7, Page 2, Column X. Revenue from CLASS and custom calling features represents approximately 7.3% of total intrastate revenues and have grown nearly 50% from 1994 to 1995. Tr. at 3785.

To correct this inequity, Staff witness Baldwin recommended that the Commission assign a conservative portion of the loop investment to these servics. She proposed to assign 5% of the Company's local loop investment to custom calling and CLASS services to partially remedy the Company's unfair and uneconomic allocation. She asserted that her recommendation is fully consistent with sound economic principles and with the Commission's previous directives regarding the assignment of local loop plant to toll and access products.

U S WEST objected to this adjustment for two reasons. First, the Company argued in its reply brief that *Idaho Code* § 61-622A "requires cost allocation on the basis of utilization, not revenues." Reply Brief at 21. Second, Company witness Elder argued that the 15% of the local loop already assigned to Title 62 services is assumed to include suchTitle 62 products as custom calling and CLASS services. He testified at the technical hearing that current usage studies analyzing the new regional calling area show that the Title 62 toll and access usage attributable to the local network was approximately 8%. Tr. at 3772. Consequently, adding the Staff's 5% custom calling and CLASS assignment to the 15% of the local loop already assigned to Title 62 compounds the assignment to Title 61 which at best totals 13% (8% + 5%). U S WEST Initial Brief at 13-14; Reply Brief at 22. This "over allocation" to Title 62 will only exacerbate with continued expansion of EAS routes in southern Idaho. Tr. at 3335. Consequently, he argued that the 15% allocated to Title 62 for the local loop is more than sufficient to cover not only the existing toll and access usage, but any residual allocation for custom calling and CLASS services.

Commission Findings: We are not persuaded by the Company's first argument that Ms. Baldwin's recommendation is barred by *Idaho Code* § 61-622A. This statute indicates that the Commission may adopt reasonable allocation procedures "based on gross allocation factors derived from relative changes in total intrastate telecommunication service revenues or expenses." The statute should not be narrowly construed to simple examine "utilization." The purpose of cost allocation is to determine how joint-use facilities are utilized, and the procedures for determining such utilization may be based upon factors derived from changes in "revenues or expenses."

We find the Company's second argument more persuasive. As mentioned above, prior Commission Orders assign 15% of the local loop to Title 62 services. Assuming that the actual usage of the local loop for Title 62 services is approximately 8%, then the 15% portion is sufficient to encompass Ms. Baldwin's 5% recommendation. Although the Company receives substantial revenue from its custom calling and CLASS services and does not directly allocate any of the local loop for these services, we find that our existing allocation is reasonable and sufficient. Consequently, we do not adopt Staff's recommendation to assign an additional 5% of the local loop to Title 62 custom calling and CLASS services.

2. Allocation of Spare Capacity. Staff witness Baldwin asserted that local exchange plant-in-service should be allocated based upon the relative growth rates and volatility characteristics of Title 61 and Title 62 services. Tr. at 2871-87. More specifically, she argued that the allocation of spare capacity should mirror the ratio of Title 62 to Title 61 growth rates (i.e., "a ratio of 3:1 which reflects the 12.9% annual growth rate in Title 62 to the 4.3% annual growth rate in Title 61 lines"). *Id.* at 2873. Company witness Plummer testified that under the Company's current design criteria, U S WEST places three pairs or lines to each new residential customer and has done this for the last two years. Tr. at 3507; Exhibit 185, p. 2. However, only 5% of residential customers subscribed to second lines as of December 1996. Tr. at 3508.

The Company objected to Ms. Baldwin's spare capacity adjustment. Although it did not dispute her growth rates for Title 61 and Title 62 services, the Company argued that allocating "spare capacity" on the basis of growth rates creates an absurd allocation adjustment. More specifically, the Company argued that Ms. Baldwin's spare capacity adjustment produces an allocation which is the "exact opposite of the actual utilization" of the spare capacity. U S WEST Initial Brief at 15. The Company introduced Exhibit 58 to show the results of this adjustment:

Type of Line	1995 Access lines	1996 Growth Rates	Actual Utilization Line	Baldwin Allocation Lines
Title 61	374, 419	.043	16,100	5,132
Title 62	34,345	.129	4,430	15,397
Totals			20,530	20,529

Commission Findings: We decline to adopt the Staff's spare allocation adjustment. Based upon the Company's design criteria, we believe there may be some question concerning the Company's deployment of plant in excess of demand. However, we find that allocating spare capacity on the basis of line growth when compared to the vast difference between the number of Title 61 and Title 62 lines in service is unreasonable.

3. <u>Assigning Tech Plus and Tech II Projects to Title 61</u>. Staff witness Baldwin asserted that the Commission should directly assign $45.606 million to Title 61 rate base in compliance with the Commission's use of Title 61 revenues in the Tech Plus ($36.092 million) and the Tech II programs ($9.514 million). Tr. at 2887-96. As an integral recommendation that is critically linked to this direct assignment, Baldwin recommended a corresponding and fully offsetting assignment of the full accumulated depreciation associated with the Tech investments. She disagreed with the Company's proposal to allocate only $19.98 million of the combined Tech Plus and Tech II Title 61 funds to Title 61 rate base. She maintained that all depreciated reserves associated with Tech Plus should be assigned to Title 61. Tr. at 2893.

Baldwin argued that because Title 61 funds were used to fund these projects, the ratepayers are entitled to the full amount of their contributions to these two programs. "Regardless of the methodology adopted for assigning or allocating the primary investment between Title 61 and Title 62 services, if the depreciation reserve is allocated in any other way, Title 61 ratepayers will effectively be forced to pay for the Tech Plus investments *twice,* since some of the depreciation reserve that cancels out that investment will no longer be in Title 61." *Id.* at 2895 (emphasis original). She concluded that "any allocation of the depreciation reserve associated with Tech Plus or Tech II to Title 62 will give Title 62 customers a free ride, at the expense of Title 61." *Id.* at 2895.

The Company argued that there is no possibility that Title 61 ratepayers will "pay twice" for the Tech Plus and Tech II assets. U S WEST Reply Brief at 21. The Company explained that allocating the Tech Plus and Tech II investment as suggested by the Staff affects the allocation of secondary costs of maintenance, repair, taxes and so on. *Id.* at 21, Tr. at 3762. "Failure to properly allocate the underlying investment even where it has zero rate base value nonetheless skews the proper allocation of these related costs." *Id.* Consequently, the Staff's proposal does not produce a result which accurately reflects how joint-use facilities are utilized. *Id.*

<u>Commission Findings:</u> The Company does not dispute that the Tech Plus and Tech II investments have been "expended" and thus have a zero rate base value for rate setting purposes. U S WEST Reply Brief at 18, U S WEST Initial Brief at 16, Staff Initial Brief at 15-16; Staff Reply Brief at 6. Although there is no direct difference in the actual size of the rate base, the Staff asserted that the underlying assets and accumulated depreciation reserve associated with this investment should be assigned to Title 61. The argument centers upon Staff witness Baldwin's alternate recommendations associated with the $45.6 million investment and the resulting change in allocators. Tr. at 2887-99; Exhibit 159, Schedule 4.

After reviewing the conflicting testimony on this subject, the Commission adopts the Staff's recommendation where both the plant and accumulated depreciation reserve are directly assigned to Title 61. The Staff's adjustment accurately portrays the source of the investment for Tech Plus and Tech II. Although there is no disagreement among the parties that the booking of this investment has no effect on the rate base, we find it is reasonable and appropriate that the secondary investment also reflect the original source for these investments. The purpose of cost allocation is to reasonably allocate the costs for joint use facilities. The Tech Plus and Tech II investment of $45.6 million is directly attributable to Title 61 sources. Consequently, it is appropriate for the underlying or secondary investment and related expenses to recognize the source of the primary investment. We find Ms. Baldwin's reasoning reasonable and persuasive.

4. Allocation of Total Plant-in-Service (TPIS). Staff witness Baldwin presented three alternatives for the proper allocation of TPIS between Title 61 and Title 62. Included in all three alternatives were her recommendations outlined in the prior three items: (1) assigning 5% of the Company's unseparated local loop to custom calling/CLASS services; (2) allocating spare capacity in the local loop outside plant based upon the relative growth rates between Title 61 and Title 62; and (3) directly assigning to Title 61 $45 million in accumulated depreciation from the Tech Plus and Tech II network projects. The differences among her three alternatives for allocating TPIS are the ways in which the Commission should allocate digital switches and transmission equipment deployed during the Tech Plus and Tech II years. Staff Initial Brief at 16-17.

Staff witness Baldwin's first and recommended alternative is that all network modernization programs (i.e., Tech Plus and Tech II) be assigned to Title 61 and that other new digital switches and digital subscriber loop be assigned to Title 62. Tr. at 2887-99, 2903-05; Exhibit 159. Schedules 1a, 1b, and 1c. She explained that the major reason for making this allocation was that the deployment of the digital switches and transmission facilities during the Tech projects was the Company's expectation of new revenue sources from Title 62 services. Tr. at 2760. She claimed that adequate local services could have been offered from analog electronic switches and that the Commission did not direct the Company to employ the urban digital switches. *Id.* at 2760-64.

Under her second alternative, she recommended the Commission assign the Tech Plus and Tech II digital facilities to both Title 61 and Title 62 to reflect the fact that Title 62 products are benefiting from the network modernization. Staff Initial Brief at 17. Under this second alternative, all other digital subscriber loop added since January 1, 1989 would be directly assigned to Title 62. This would fairly allocate Tech Plus and Tech II improvements between Title 61 and Title 62 services "while continuing to assign accumulated depreciation solely and directly to Title 61." Tr. at 2899-2901, 2903-05; Exhibit 159 Schedules 2a, 2b and 2c.

Finally, under her third alternative the Commission could consider allocating all digital facilities as common plant — regardless of whether they result from the Commission's explicit Tech Plus and Tech II directives or from the Company's own investment. This would allocate TPIS consistent with the Company's allocation factors. In other words, this option utilizes the Company's allocation factor but contains the three prior adjustment inherent to all the TPIS alternatives. Tr. at 2901-05; Schedule 159, Schedules 3a, 3b, and 3c; Staff Initial Brief at 17.

The Company objected to all three alternatives. The Company argued that Ms. Baldwin's first alternative assigns all other digital switching and digital investment other than the fully depreciated Tech Plus and Tech II investments to Title 62. "This recommendation deliberately ignores the fact that the digital switches and subscriber loop carrier paid out of investor funds are providing Title 61 services" as well as Title 62 services. U S WEST Reply Brief at 19. The Company argued that the net effect of this recommendation would be to exclude all Idaho switching investment and most other digital investment from rate base. The Company maintained that this recommendation was "irrational" because it does not recognize that the Company's investment in urban digital switches and facilities also serves Title 61 ratepayers. Consequently, network facilities used to serve Title 61 customers are not allocated to the Title 61 rate base. *Id.*

The Company also objected to her second alternative. The Company characterized this alternative as not only assigning non-Tech digital switches and equipment to Title 62, "but it also attempts to <u>separate</u> the accumulated depreciation reserve which was created to give the Tech Plus and Tech II investments a zero rate base value, from the investments themselves." U S WEST Reply Brief at 19 *citing* Tr. at 2899. The Company complained that the effect of this alternative disallows <u>other</u> Title 61 assets that are unrelated to the Tech projects by artificially increasing the depreciation reserve on the Title 61 side. "Predictably, this second alternative produces the lowest number for Title 61 rate base of the Staff's three alternatives." *Id.*

Turning to the Staff's third alternative, the Company acknowledged that this alternative allocates digital facilities by the methodology proposed by U S WEST. *Id.* at 20; Tr. at 2901. "While this alternative is significantly superior in its recognition of digital technology as joint use facilities, it adopts the logical defect continued in the second alternative, i.e., it persists in separating the Tech Plus and Tech II accumulated depreciation reserve from the underlying assets and assigning it directly to Title 61." Reply Brief at 20.

Commission Findings: The Commission declines to adopt the Staff's first and second alternatives. It was expected that the Company would be able to offer expanded or new Title 62 services when it deployed digital switches and transmission facilities in the Tech Plus and Tech II projects. This inference or conclusion is obvious given the joint-use nature of telecommunication facilities and the historical context that both Title 61 and Title 62 revenues were subject to "sharing" during the years the Revenue Sharing Plan was in operation. As explained previously, the Tech Plus project was proposed by the Company to resolve a Commission proceeding evaluating whether the Company's rates and revenue requirement should be reduced. In the Tech II program, we used Title 61 revenue sharing funds to improve the local networks of more than 30 rural exchanges while the Company was obligated to use its Title 62 resources to improve the local networks for urban exchanges. The Company's use of Title 62 funds to upgrade the local networks of urban exchanges was an integral part of the Tech II project. We find that the first two alternatives do not satisfy the requirement of *Idaho Code* § 61-622A to reasonably allocate how joint-use facilities are utilized.

As U S WEST noted in its reply brief, its primary disagreement with the Staff's third alternative was that it contained the three adjustments common to all of Baldwin's three TPIS alternatives. Given our previous decisions rejecting the 5% Title 62 allocation and the spare capacity adjustment, we find it is reasonable to allocate TPIS using the methodology proposed by U S WEST including Baldwin's direct assignment of Tech Plus and Tech II. This results in an overall allocation to Title 61 and Title 62 as indicated in the Table below.

SUMMARY OFALLOCATIONS

	Title 61	Title 62
U S WEST	64%	36%
Staff Perferred	45%	55%
Staff Alt 1	42%	58%
Staff Alt 2	49%	51%
Commission Ordered	59%	41%

Source: Exhibit 159, Sch. 4 (3-18-97)

VI. COST OF CAPITAL

A. Cost of Equity

Determining the appropriate cost of equity is the only disputed issue remaining in cost of capital. The Company calculated that the appropriate cost of equity fell within a range of 12.5% to 13.1%, and suggested a specific return on equity of 13.0%. The Staff asserted that the reasonable return on equity ranged from 11% to 12%, and recommended a specific return of 11%. AT&T supported the Staff's cost of equity recommendation. U S WEST characterized the difference between the Staff and the Company recommendations as "primarily methodological." U S WEST Reply Brief at 23.

1. U S WEST Position. U S WEST witness Peter Cummings used a discounted cash flow (DCF)[9] method and a capital asset pricing model (CAPM)[10] method to prepare his cost of equity recommendation. From both his DCF and CAPM analyses, he proposed a return on equity

[9]The DCF method is one standard way of determining the cost of equity. This method assumes that a utility's current stock price equals the present (that is, discounted) value of all expected future dividends from the investment. The DCF method computes an investor's expected return on equity using current stock price, the expected dividend in the coming year, and the expected growth rate of future dividends. The basic DCF formula is: $K = D^1/Po + G$. "K" is the cost-of-equity capital, "D^1" is the expected cash dividend per share for the next period, "Po" is the current stock price, and "G" is the expected long-run growth rate in cash dividends. Tr. at 526, 2082.

[10]The CAPM is a risk premium analysis that calculates the expected equity return by estimating a risk-free rate of return and adding a risk premium. The basic CAPM formula is: expected return for a stock = risk-free return + (the relative risk [beta] for the stock market risk premium. "Beta" is the relative riskiness of the individual stock in relation to the average of the market. Tr. at 533.

range for U S WEST Communications, telephone companies, and comparable companies. Tr. at 551. The results of his various analyses produced the following results:

	Return on Equity
CAPM-Telephone Companies	12.2%
CAPM-U S WEST Communications	12.4%
DCF-Comparable Companies	12.6%
DCF-Telephone Companies	12.8%
DCF-U S WEST Communications	12.9%
CAPM-Comparable Companies	13.2%
Proposed Cost-of-Equity Range	12.4% to 12.9%

He calculated that the average DCF return was 12.8% (within a range of 12.6% to 12.9%) and the average CAPM return was 12.6% (within a range of 12.2% to 13.2%). Tr. at 531, 545.

He made one final adjustment to his proposed cost of equity range (12.4% to 12.9%). He increased the range by 1.17% to reflect the Company's cost of issuing common stock, commonly referred to as flotation costs. Tr. at 566, 592. Consequently, his recommended cost of equity adjusted for flotation costs ranged from 12.5% to 13.1%. Tr. at 567. Given the uncertainty or risk that the Company faces with the emergence of competition in Idaho, Mr. Cummings concluded that the Commission should authorize a return on equity in the high end of his range—13%. *Id.*; U S WEST Initial Brief at 47.

2. Staff Position. Staff witness Carlock presented a Company-specific DCF analysis and performed a comparable earnings study to check her DCF recommendation. The results of her DCF analysis produced a range of equity costs from 9.84% to 12.03%. Exhibit 128, Schedule 12, page 1 of 2. She recommended a return on equity of 11 to 12% for U S WEST. Tr. at 2083. Using the comparable earnings study, she established a cost of equity range for U S WEST of 11% to 12%. Tr. at 2080. Carlock adjusted her DCF dividend yield to reflect the cost of issuing new stock (flotation costs). Tr. at 2084-85. The Staff proposed that the authorized return on equity be set at 11% (the low end of the recommended range) to reflect poor service quality.

The Company urged the Commission not to rely upon the Staff's DCF analysis for two reasons. First, Staff witness Carlock performed only a company-specific DCF analysis, without a collaborating DCF analysis based upon a sample of comparable companies. Consequently, the Company questioned the reliability of Carlock's DCF analysis. U S WEST Initial Brief at 48.

Second, the Company maintained that Ms. Carlock's DCF dividend estimate was compounded incorrectly and her growth estimate of 3.5% to 4.0% was too low. *Id. citing* Tr. at 614-15.

3. AT&T Position. AT&T supported the Staff's cost of equity position. AT&T Initial Brief at 2-6, Reply Brief at 2-5. Although AT&T presented no direct testimony concerning the cost of equity, AT&T witness Dr. Howard Bell stated that U S WEST's costs of capital are overstated. Tr. at 1989-91.

AT&T asserted that U S WEST's DCF analyses were flawed because Mr. Cummings failed to make three adjustments when using quarterly payments of dividends rather than annual payments of dividends in his DCF analysis. AT&T Initial Brief at 5. The three adjustments that U S WEST failed to make were to reflect: (1) that the Company receives revenue on a monthly basis; (2) an assumption "that a utility earns its revenues on a quarterly rate base"; and (3) whether U S WEST was using a beginning or end of period rate base. *Id.* "Without these adjustments, U S WEST's DCF analysis based on quarterly payments of dividends cannot be relied upon." *Id.*

In its initial brief, AT&T also argued that the Commission cannot rely upon U S WEST's CAPM analyses because the Company's measurement of risk (beta) was flawed for four reasons. First, U S WEST did not adjust its comparison of U S WEST Communications' risk since targeted stock was issued in November 1995, thereby separating U S WEST Communications Group from U S WEST Media Group. In essence, AT&T argued that U S WEST was comparing post-1995 risk data with pre-1995 risk data. AT&T Initial Brief at 3. Second, AT&T asserted that some of the risk or volatility experienced by U S WEST Communications is caused by its association with U S WEST Media Group. *Id.* Third, U S WEST's use of Value Line and Merrill Lynch betas were unreliable because these companies compute a raw beta which is subsequently adjusted toward 1.0. *Id.* at 4. Finally, the Company used daily prices for computing its beta for U S WEST Communications stock but used weekly or monthly stock prices to calculate the betas for the comparison companies in its CAPM analysis. *Id.*

AT&T next asserted that adjusting U S WEST's cost-of-equity range to reflect flotation costs is inappropriate. AT&T insisted that stock issuance costs are one-time expenses incurred when the stock is issued and are not ongoing capital costs. It noted that U S WEST had not issued any new stocks since 1992. *Id.* at 6, *citing* Tr. at 592. Consequently, AT&T concluded that it is inappropriate to recover flotation costs which should have been expensed when incurred more than five years ago. *Id.*

a. Risk. U S WEST argued that its cost of equity should be set higher because it is subject to substantial risk due to competition and that it is as risky or more risky than other telephone companies. Staff witness Dr. Selwyn argued that competition is not currently or in the near future the risk claimed by U S WEST. Company witnesses Wilson and Wozniak acknowledged that only two local exchange competitors had entered into local service agreements with U S WEST and U S WEST residential customers can only obtain wireline service from U S WEST. Tr. at 145, 796-97. Carlock stated that the risk is less for U S WEST than for other telephone companies in the telecommunications market for many reasons including the geographically rural nature of the service area and market dominance of the incumbent service provider, U S WEST.

During cross-examination, Company witness Cummings conceded that Commission acceptance of the second settlement including the issues of depreciation (ELG), capital structure, and cost of debt reduces the Company's risk. Tr. at 574-75.

In its initial brief, AT&T stated that U S WEST has artificially inflated its risk determinations for the return on equity analyses. AT&T Initial Brief at 3-5, Reply at 205. AT&T asserted that U S WEST is not facing greater risk. AT&T Reply Brief at 2. It took specific issue with Mr. Cummings' recommendation that the Company's authorized return on equity should be higher in the range—13.0%. AT&T stated that "U S WEST's speculation [concerning risk] is contradicted by Staff's evidence." *Id.* at 2. AT&T observed that Staff witness Dr. Selwyn testified that U S WEST has a dominant position in the Idaho telecommunications market and is not subject to near term competition. *Id.*, *citing* Tr. at 2414-15, 2427-60. AT&T also concluded that U S WEST's risk has not increased as a result of the federal Telecommunications Act. *Id.* AT&T claims that due to these flaws in U S WEST's model and the inflationary impacts on risk analysis, the cost of equity range developed by U S WEST should be rejected and Staff's range adopted. U S WEST countered that Idaho is not an isolated market and that risks do exist for U S WEST. U S WEST stated that AT&T did not present cost of capital testimony and AT&T's arguments are not supported by direct testimony.

b. Growth. Growth is an important component of the DCF cost models used by both Staff and the Company. Growth was projected at 6% by Company witness Cummings using the

Institutional Brokers Estimate System (IBES). Staff witness Carlock used Value Line historical, current and projected growth rates to develop the growth rate of 3.5% - 4.0%. Tr. at 2106. In her surrebuttal testimony, Carlock updated and corrected her U S WEST growth factors. She reaffirmed her estimated DCF growth rate in the range of 3.5% - 4%. Revised Exhibit 128, Sch.12, page 2 of 2. She stated that:

> Investors realize growth in dividends and stock appreciation. The projected growth in dividends can be individually reviewed. The stock appreciation must focus on other factors. Growth in book value impacts changes in revenues and ultimately the growth in earnings. Growth in earnings then impacts the potential dividend growth. Therefore all three of these factors are important to analyze when projecting the expected growth rate to use in the DCF analysis.
>
> The historic two-year growth factors in 1996 show negative growth in earnings per share, zero growth in dividends and 7.34% growth in book value per share. The three-year growth factors for 1997 reflect current growth in earnings per share of 1.09%, zero growth in dividends, and growth in book value per share of 6.6%. The projected growth rates, estimated to 1999-2001, reflect 5% growth in earnings per share, zero growth in dividends, and 6% growth in book value.

Tr. at 2106-07. She concluded that her estimated growth rate was reasonable.

On cross-examination, Cummings acknowledged that the current IBES growth rate is 4.5% as compared to the growth rate of 6.0% used in his DCF calculations. Tr. at 575. Adjusting his DCF cost of equity range to reflect the current IBES growth rate, would result in a range of 11.1% to 12.9%.

c. Dividend Compounding. U S WEST reflects quarterly compounding by adjusting the dividend payment each quarter as if additional amounts would be paid. No additional amounts are actually paid. Staff witness Carlock adjusted the dividend growth rate to reflect the quarterly compounding. Tr. at 2085; Exhibit 128, Sch. 12 at 1. Her annual effective growth rate with quarterly compounding was 3.513% to 4.015%—rounded to 3.5%-4.0%. Tr. at 2085. She asserted reflecting higher growth projections for dividends is not necessary since dividends are not expected to increase. The quarterly compounding adjustment alone did not change her overall recommended return on equity range of 11% to 12%. *Id.*, Staff Initial Brief at 19, Reply at 8. AT&T recommended that U S WEST's quarterly payment of dividends not be utilized because U S WEST did not make additional adjustments to reflect the quarterly payments. AT&T Initial Brief at 5.

Commission Findings: We find the fair and reasonable return on equity for U S WEST to be 11.2%. This return is within the range recommended by Staff witness Carlock and supported by AT&T. This return on equity also falls within U S WEST's DCF range when adjusted to reflect the more current lower growth rate as conceded by Mr. Cummings. Tr. at 575. Any point within these cost of equity ranges meets the legal requirement of allowing a utility the opportunity to earn a fair and reasonable return on equity.

Based upon her testimony, we also find Ms. Carlock's DCF growth rate to be reasonable. Her DCF analysis did include an adjustment for quarterly compounding that did not change her overall growth range of 3.5%–4.0%. We also accept the Staff and Company positions that flotation costs should be included in the cost of equity. However, we reject the Company's flotation methodology and accept the Staff's flotation adjustment to the dividend yield. Staff's adjustment is consistent with prior Commission Orders and there is no compelling reason to change this practice.

We find the Company's business risk and the relative financial risk are not as great as portrayed by U S WEST in its testimony. Financial risk pertains to the risk inherent in U S WEST's capital structure while business risk pertains to the inherent risks in the Company's operations. Acceptance of the second settlement issues of capital recovery (depreciation), yellow pages, capital structure, and cost of debt, along with other decisions of the Commission (including the reduction in the business/residential ratio), all reduce the risks of U S WEST. Given the testimony of Staff witnesses Carlock and Dr. Selwyn as well as Mr. Cummings' concession that the Company would face less risk if the Commission adopted the second settlement, we find that the Company's risk does not support selecting a higher return in the cost of equity range.

Using the authorized 11.2% return on equity produces an overall allowed rate of return of 9.43%. The authorized capital structure, costs of capital, and rate of return is shown below:

Component	Ratio	Composite Cost	Rate of Return
Debt	44.4%	7.23%	3.21%
Common Stock	55.6%	11.2%	6.22%
	100.0%		9.43%

VII. EXPENSES

Disputed Issues

1. Advanced Technologies (AT) and Bellcore Research Projects. Staff witness Faunce calculated that the Company had assigned approximately $1.762 million in Advanced Technologies (AT) and Bellcore research projects to Title 61. Exhibit 155. Because AT and Bellcore are affiliates of U S WEST Communications, she asserted that the Company has the burden of showing the reasonableness of such affiliated transactions. Faunce, Tr. at 1697-98. Based upon her review of these research expenses, she maintained the Company had not met its burden of proving the reasonableness of its affiliated transactions. The Company has utilized its cost allocation system (CAAS) as justification that its affiliated research expenses were reasonable and prudent. Based upon her review of the research projects, she argued that it was reasonable to authorize only approximately 1% of the AT and Bellcore expenses.[11] Exhibit 155.

Company witness Maggie Barrington insisted that the CAAS reasonably allocated the costs of AT and Bellcore research costs between Title 61 and Title 62. Tr. at 1866-67, 1876-77. She admitted that CAAS does not consider individual projects. *Id.* at 1894. Of the 1300 research projects, approximately 75% of the projects are common to both Title 61 and 62, approximately 25% are Title 62, and less than 1% (3 projects) are exclusively Title 61 projects. Tr. at 1910, 1964. She acknowledged on cross-examination that many research projects appear to be Title 62 projects: new speech services (Exhibit 163, p. 4; Barrington, Tr. at 1918; Advanced Intelligent Network (AIN) (Exhibit 165; Barrington, Tr. at 1922); Internet-Light Global Broadband Services (Exhibit 173; Tr. at 1929); PCS Consulting (Exhibit 174; Tr. at 1930); Consulting for Carrier Market Unit (Exhibit 178; Tr. at 1937); IntraLATA PIC Projects (Exhibit 196; Tr. at 1952); and Call Waiting Deluxe (Exhibit 200.10; Tr. at 1959). Despite the Title 62 nature of these research projects, these projects were placed in cost pools which allocated costs of these projects to Title 61.

In its initial post-hearing brief, the Company argued that Ms. Faunce provided no evidence that the research expenses for AT and Bellcore are too high or otherwise unreasonable. Initial Brief at 23. In its reply brief, the Company characterizes the dispute regarding these expenses

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[11]AT and Bellcore research expenses also included costs relating to the Company's Restructuring Plan. Our approval of the second settlement and its restructuring issue resulted in an adjustment of Ms. Faunce's proposed disallowances. The disallowances dropped to 68.2% for AT and 80.2% for Bellcore. U S WEST Initial Brief at 23.

as "one over cost allocation methodology." Reply Brief at 27. The Company's basic defense of its allocation of the research expenses was that the "CAAS methodology provides a reasonable allocation of cost to Title 61 which reflects the joint use of the network and which minimize the costs of accounting and recordkeeping in compliance with *Idaho Code* Section 61-622A."[12] Initial Brief at 27; Reply Brief at 27.

Commission Findings: We find that the Company has failed to meet its burden of demonstrating the reasonableness of its affiliate transactions by simply relying on its use of the CAAS system. As Ms. Faunce cited in her testimony, our Supreme Court has ruled that transactions between affiliate companies are to be subject to close scrutiny and the utility has the burden of proving the reasonableness of its affiliate transactions. *General Telephone of the Northwest v. Idaho PUC,* 109 Idaho 942, 712 P.2d 651 (1986); *Boise Water Corporation v. Idaho PUC*, 97 Idaho 832, 555 P.2d 163 (1976). U S WEST has the burden of proving that its affiliate transactions are reasonable. The Company cannot simply rely on the fact that expenditures were incurred.

Company witness Barrington acknowledged that many projects appear to be solely Title 62 projects yet were placed in cost pools that were subsequently allocated to Title 61. She was unable to explain in detail how Title 62 research expenses are assigned to specific cost pools and then subsequently allocated to Title 61. She deferred questions to Company witness Elder. Tr. at 1912-13. Mr. Elder, when asked to explain how research project expenses are assigned to accounts and cost pools, suggested "that was something maybe Ms. Barrington could have answered." Tr. at 3804. From this exchange, we find that the Company was unable to satisfactorily explain how Title 62 research expenses can be appropriately allocated to Title 61.

As was demonstrated here, using the CAAS system does not take into account the unique Idaho regulatory structure. Placing Title 62 expenses in the cost pools resulted in the allocation of these expenses to Title 61. This is contrary to the standards of the cost accounting standard board

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[12]*Idaho Code* § 61-622A in pertinent part provides:

For any telephone corporation which provides telecommunication services pursuant to both title 61, Idaho Code and title 62, Idaho Code, the commission shall establish procedures for allocation of costs between telecommunication services provided pursuant to title 61, Idaho Code, and telecommunications services provided pursuant to title 62, Idaho Code. Such allocations shall reasonably reflect how joint-use facilities are utilized, provide reasonable stability for telephone corporations to do business planning and pricing and minimize the cost of accounting and record keeping to the extent possible. . . .The commission shall have authority to establish just and reasonable rates for all telecommunication services which remain subject to title 61, Idaho Code.

(CASB) that provides the first allocation step is to "directly assign [costs] to specific products or services whenever practical." Tr. at 208-09. As the Company's cost allocation witness Frank Ilett stated, the Commission does have the authority to adjust or reclassify costs that it deems to be inappropriately allocated. Staff Reply Brief at 8, Tr. at 3184. While we have no doubt that utilizing CAAS in eight of the fourteen states, may "minimize the cost of accounting and record keeping," it does not, as demonstrated in this case, reasonably allocate expenses related to joint-use facilities. *Idaho Code* § 61-622A; Tr. at 205.

Although we have generally adopted the Staff's position, we do not adopt its entire Title 61 adjustment. Just as the Company's cost allocation system does not reasonably allocate expenses between Title 61 and Title 62, we find that the Staff's disallowance does not reasonably allow sufficient research costs to Title 61. While we do not believe that the Company must examine each project individually, it has an obligation to show that its research expenses reasonably relate to Title 61 operations. Ms. Barrington's testimony did reveal that some research projects were related to Title 61. Consequently, we find it is reasonable for the Company to include 20% of its AT and Bellcore research expenses in its results of operation.[13] This results in an additional Title 61 allowance of $290,481.

2. Management Incentive Plans. Staff witness Faunce argued that the Team Awards and executive Short-term Incentive Plan (STIP) bonuses should not be charged to Title 61 ratepayers. She argued that bonuses paid under these plans were based upon achievement of certain financial, business and corporate goals not directly related to Title 61 services. Tr. at 1763. She recommended the exclusion of these bonuses from the test year because the standards upon which the bonuses were based primarily benefited stockholders—not Title 61 customers or services. She did include 20% of the bonuses in revenue requirement or $103,022 as Title 61. Exhibit 155.

The Company argued that Ms. Faunce's disallowance of the Team Awards and STIP pay was not supported by the evidence and was contrary to sound compensation practices. Initial U S WEST Brief at 28. Although the Staff argued that the bonuses were not reasonably calculated to improve Title 61 services, Company witness Paul Gobat testified that the bonuses are an integral part of the overall compensation of managers and executives. Tr. at 1846. He argued that if

[13] The 20% is in addition to the restructuring expenses referenced in note 11 above.

incentive pay were eliminated, then base pay rates would have to be increased to cover the "gap" to maintain comparable compensation. Tr. at 1816.

Commission Findings: We reject the Staff's proposed adjustment concerning this issue. We find that U S WEST's witness adequately explained that incentive pay was part of the Company's overall total compensation plan. Staff did not assert that total compensation was excessive. To retain valuable employees, base salaries would have to be increased in the event that the incentive plans were eliminated. The Staff did not adequately demonstrate that the incentive pay was merely awarded for meeting business objectives unrelated to Title 61 operations.

3. Memorandum Expenses. U S WEST claimed that the cost allocation system (CAAS) "allocated" $2.5 million in expenses to Title 61. More specifically, the Company indicated that these expenses were the costs for Title 62 services utilized in support of Title 61 operations. U S WEST Initial Brief at 30. These memo expenses were not discussed by any party at the technical hearing but appear as a footnote to the Company's Exhibit 22. In its Post-Hearing Reply Brief, the Staff acknowledged that it did not specifically address this issue because the Company offered no evidence to support this "allocated expenditure." Staff Reply Brief at 8. The Staff did not include these expenses in its case.

Commission Findings: Although not prominently mentioned, the Company's Title 61 revenue requirement did include $2.50 million in Title 62 services used to support or deliver Title 61 services. The Company did not specifically calculate this expense but allocated the "memo expense" to Title 61 operations through CAAS. Based upon the state of the record, we find: that the Company has met its minimum burden of proof regarding this issue. While the Staff may have found argument with the amount or the methodology of calculating the memo expense, it did not present any testimony contrary to this point. We believe that it is reasonable to conclude that the Company does utilize Title 62 services to support its Title 61 operations. Consequently, we shall allow these expenses.

VIII. REVENUE ISSUES

1. Reported Revenues. The Staff agreed with the revenues reported by the Company as shown in Rev. Exhibit 101, lines 38-43; Lansing, Tr. at 1585-86. Given the agreement of the parties and the lack of any objection, we adopt the revenues reported by the Company during its test year

as $81.791 million. Adjusting for settlement issues and the non-published and non-listed rate design issues, the adjusted revenue is $80.766 million. See Appendix, Line 46, Col. L.

2. Revenue Sharing Funds. Since termination of the revenue sharing plan pursuant to Order No. 26672 in November 1996, revenue sharing funds have been used to offset the $3.62 interim rate increase for customers located within the local calling regions. Having finally adopted permanent rates in this proceeding, it is now necessary to address the appropriate disposition of these funds.

As previously mentioned, the Commission has available for disposition in this proceeding an estimated $7.035 million in Title 61 revenue sharing funds as of August 1, 1997. By the time the rates approved in this Order are implemented and August revenue sharing credits are issued, we estimate that the balance of the sharing funds will be approximately $6 million on September 1, 1997. This amount must be further reduced by approximately $2.2 million to fund capital improvements for the three local calling areas as agreed to in the second settlement.

When we issued Order No. 26672 in November 1996, we contemplated using Title 61 revenue sharing funds in the form of monthly credits to offset possible revenue increase established in this Order. Since that time, however, the Commission has received many additional requests from customers in outlying exchanges to be included in the regional calling areas. As the evidence portrayed in this case, implementing EAS is often an expensive proposition. Given the fact that the second settlement contemplates a directory credit thereby moderating the immediate rate increase for Title 61 residential customers, we believe it is appropriate to retain these revenue sharing funds for a limited time in the event they may be needed to defray the cost of U S WEST implementing future EAS petitions. We will examine the status of the revenue sharing funds twelve months from the date of this Order. At that time, the Commission will make its final determination as to the appropriate disposition of the Title 61 revenue sharing funds.

Consequently, we shall direct the Company to forward the balance of revenue sharing (approximately $3.8 million) to our USF administrator within 14 days of this Order. The administrator shall segregate these funds from Idaho USF funds and may invest the sharing funds in a manner similar to USF no-risk investments.

IX. SERVICE QUALITY ISSUES

A. Agreed or Uncontested Issues

1. Service Guarantee Program. Staff witness Wayne Hart recommended a number of changes to the Company's Service Guarantee Program. These changes included: 1) increase the amount of the cellular voucher to $200 the first month and $150 per month thereafter; 2) make the voucher available in five days instead of 30 days; 3) provide voice messaging with the assignment delayed due to lack of facilities beyond the normal two day service interval; and 4) double the non-recurring credit for customers not served by cellular. Tr. at 1145-56, 1178-84, 1191-92. U S WEST agreed to make these changes. Souba, Tr. at 3242-43, 3244-45. Hart also recommended that the Commission impute revenues be in those instances when the Company could have received service revenue, but did not due to delayed installations (Hart, Tr. at 1184-84). He also suggested that credits provided to customers under the Service Guarantee Program be reported below the line. *Id.* at 1185. Hart calculated that $112,000 in forgone revenue should be imputed to Title 61. Revised Exhibit 101, p. 3, line 26. Company witness John Souba indicated the Company was willing to accept these later changes. Tr. at 3246.

Given the agreement between the Company and the Staff, we adopt the proposed changes to the Company's Service Guarantee Program. As calculated by Staff witness Hart, $112,000 will be imputed to Title 61 revenues.

2. Idaho Telephone Assistance Program (ITAP). Company Vice-President Barbara Wilson offered to institute a voluntary assistance program for fixed or low income customers below the 60 years of age threshold for the existing ITAP system. Tr. at 158. She explained that U S WEST's offer was contingent "only if the Commission grants substantially all of the [requested] price increase." *Id.* at 123; 159. Company witness Mary Owen also testified that the existing ITAP eligibility restriction of 60 years of age should be lowered or eliminated. Owen, Tr. at 704. Staff did not contest this issue.

Although we are pleased that the Company suggested that the ITAP age threshold be eliminated or reduced, we decline the Company's invitation to institute a "voluntary" program. While we agree with the Company that the age restriction is a barrier to assistance and should be eliminated, we believe that the Commission does not currently possess the requisite statutory authority to adopt such a voluntary program. We believe the appropriate forum for implementing such a change is at the Legislature. *Idaho Code* § 56-903(1) establishes the eligibility criteria as "sixty years of age or older." We look forward to the Company's support for legislative removal of the age restriction for ITAP eligibility.

B. Disputed Issues

1. Service Guarantee Program. Staff witness Hart made several other suggested improvements for the Company's Service Guarantee Program. First, he recommended the program be made mandatory. Tr. at 1191. Second, the residential credit for missed repair or installation commitments should be increased from $10 to $20. *Id.* at 1192. Third, credits should apply to second lines and that the credits be awarded automatically not just on request. Fourth, the Company should institute a cellular "loaner" program for customers who do not desire to purchase cellular phones. Finally, Hart recommended that the available service credit be doubled if the customer does not want to participate in the cellular program.

Company witness Souba objected to making the Service Guarantee Program mandatory and to the increase in the missed commitment credit. He argued that the program should remain voluntary so that the Company may change its terms to meet customer needs without Commission intervention. Tr. at 3240; U S WEST Reply Brief at 29.

Commission Findings: The Commission finds that the Service Guarantee Program should not be made mandatory. Although the Commission has the authority to order corrective actions for poor service quality, we believe that the Service Guarantee Program will become an integral part of customer service once competitors enter U S WEST's local markets. Because we do not find that the Service Guarantee Program should become mandatory, we need not discuss Mr. Hart's specific recommendations but we find that his suggestions have merit and encourage the Company to seriously consider their incorporation into its Service Guarantee Program.

2. Service Quality Deterioration. Staff witness Hart maintained that U S WEST's service quality is so bad that the Commission should recognize the poor performance in setting the Company's rate of return. He claimed that U S WEST's service quality deteriorated rapidly in 1994 and 1995. Revised Exhibit 120 (2-21-97). Although the rate of deterioration slowed in 1996, he asserted the overall service quality is still not acceptable. Tr. at 1143-46; Exhibit 126, Sch. 4.

Hart calculated that the number of complaints investigated by the Staff has more than doubled since 1993. On a per customer basis (taking growth into account), U S WEST complaints have increased 94%, while the average increase for other major utilities was only 2%. *Id.* at 1145-46. The Company's own measurements show some improvement in some areas (access, repair commitments kept and appointments offered); held orders show sporadic but inconsistent improvement; and some areas (install appointments offered and commitments kept) show declines or no improvement at all. Tr. at 1199-1204; Exhibit 122, Revised Sch. 1-5. Hart opined that the Company is making a small improvement in repairs by delaying installations. Tr. at 1200. The areas that have improved are still well below quality levels prior to the Company's re-engineering program. Exhibit 126, Sch. 4.

Based upon his analysis of complaints received by the Commission, Hart testified that the Company's service quality had deteriorated. He maintained that complaints are valid indicators of service quality, especially when the difference between past performance and performance of other utilities is as dramatic as it is for U S WEST. He asserted that complaints are just the tip of the iceberg. Hart, Tr. at 1138-40, 1196-98; Exhibit 119. Hart also maintained the Company's internal measurements are open to manipulation and target levels set by the Company are just too low. Hart, Tr. at 1167, 1202-04; Exhibit 123.

The Company argued that its quality of service has not deteriorated and suggested that the Staff's exhibits and testimony did not accurately depict U S WEST's service. U S WEST Initial Brief at 50. The Company suggested the Commission focus on the complaint categories dealing with repair and the provisioning of service, (held orders, miscellaneous installations, out-of-service, and miscellaneous service quality) to determine the Company's current service quality. In its initial brief, the Company pointed out that network repair and provisioning represented roughly 28% and 16% of the total number of complaints/contacts made with the Commission Staff in 1995 and 1996, respectively. *Id.* The Company asserted that this represents only 37% of the investigative complaints for 1995 and it dropped to 33% in 1996. *Id.* at 50-51. The Company asserted that the data provided to it by the Staff and shown in Company Exhibit 51 does not comport with Staff's revised Exhibit 120. Although Exhibit 51 "is hard to decipher in specific detail, it appears that it shows 1995 investigations for U S WEST at about 2.25 per 1,000. For 1996, it shows that number increasing at least one investigation per 1,000." U S WEST Reply Brief at 30. Based upon the number of access lines in 1995, for the Staff's chart to be correct, investigations would have had to increase by 408 in 1996 over 1995. Based upon the Staff's data, however, the numbers show an increase to be only 100. The Company maintained that this demonstrates the inaccuracy of the Staff's graphic depiction of U S WEST's service quality. *Id.* at 31.

Commission Findings: Based upon our review of the evidence and the arguments presented in the briefs, we find that the Company has adequately rebutted the Staff's reliance on complaint information and the data contained in revised Exhibit 120. However, we do not accept the Company's suggestion that our review of its service quality should primarily concentrate on simply repair and provisioning issues. We do not agree with the Company's assertion that "network issues . . . generally attract most of the attention of regulators." U S WEST Initial Brief at 50. The Company's Basic Service Measurement (BSM) Report shows that the monthly average for held orders significantly decreased from 1995 to 1996, but held orders are not the entire picture. Exhibit 41C. Although we are pleased to see that the Company's held orders have decreased from 1995 to 1996, we still receive reports about inordinate delays in installing new service. While we cannot go into the details of every held order, we are encouraged by this improvement, and hope the Company will continue to improve. Many witnesses at the public hearings also expressed opinions that the Company's service had deteriorated. Given the Company's problems with re-engineering and the apparent abandonment of its soft dial tone program, we believe that the public perceives the Company's service has deteriorated. We encourage the Company to implement measures to improve customer service.

3. Service Quality Return Adjustment. Based on the purported poor service quality, Staff witnesses Hart and Carlock recommended that the Company's return on equity be lowered 50 basis points to 11% until the Company demonstrates to the Commission's satisfaction that service quality has improved. Tr. at 2090-91. Company witness Souba claimed that service problems have essentially been resolved. Tr. at 3200-01, 3224-25. The Company is meeting most of its own internal targets, and service is acceptable. *Id.* at 3221-22; U S WEST Initial Brief at 50-54; Reply Brief at 29-32.

Hart recommended that the Company meet each of the Regional Oversight Committee (ROC) criteria for at least a year before it is eligible to have the return (ROE) adjustment reviewed. Tr. at 1175. He claimed the ROC criteria represent the level of service quality before re-engineering, and that at least a year of service at this level is needed to demonstrate that service quality problems have been resolved. Normal, seasonal fluctuations would allow the Company to meet the standards for short periods of time, even though problems have not really been fixed. *Id.* at 1175-76, 1207. He said that the ROC criteria are merely being used as the measurement criteria to determine when service has improved sufficiently to review the return adjustment. *Id.* at 1207.

<u>Commission Findings:</u> As mentioned above, we find the Staff's attempt to show the Company's service quality did not rise to a level that justifies imposing a service quality adjustment in the Company's equity return. As discussed previously, we have established the Company's return on equity at 11.2%. While some improvement in service quality has occurred in the past year, the Company needs to continue to focus on issues of customer service. We would be pleased to have the opportunity to recognize outstanding customer service with an addition to the Company's rate of return. However, the level of service being provided at this time does not warrant such action. Because we decline to adopt the proposed adjustment, we need not consider using the ROC standards as measuring criteria.

4. <u>Toll-Restriction</u>. Hart next recommended that the Commission determine that toll-restriction service is a Title 61 service. He maintained that toll-restricted service is local service only, without any access to toll or Title 62 service, which is as basic as service can get, and is therefore a Title 61 service. He also insisted the Commission has not yet decided this issue, and that toll restricted service is similar to other toll-blocking services (976 or 900) that are classified as Title 61 services. He concluded that toll restricted service should be available for no monthly charge and with a minimal initial charge. Tr. at 1186-87, 1213-15.

The Company claimed that the toll restriction should be a Title 62 service. It argued that the Commission "accepted" toll restriction "for filing" as a Title 62 service, and the Commission has insufficient justification to impose the "take-back" provisions of *Idaho Code* § 62-605(5).

<u>Commission Findings:</u> Based upon the testimony provided by Staff witness Hart, we find: that toll restriction is appropriately considered a Title 61 service. We see no difference between toll restriction and other toll-blocking services that are classified as Title 61 services. Consequently, we adopt Staff witness Hart's recommendation that toll restriction service should be made available at no monthly charge but have a non-recurring initial charge of $6.00. At the time U S WEST made its Title 62 election, the Company's Vice President conceded that the Commission retains the authority to decide whether telecommunications are Title 61 or Title 62 services. Order No. 22416 at 7-8. As to the issue of whether accepting a Title 62 price list for filing constitutes Commission acceptance, we reject that argument. As we have previously stated, "accepting" price lists for filing is a ministerial function that should not and does not imply Commission approval. Order No. 25933 at 14.

5. Rural Zone Maps. Hart asserted that the maps the Company uses for imposing rural zone connection charges are out of date, and that growth in some of the formerly rural areas has resulted in connection charges that are no longer equitable. He argued that density is a significant factor in the cost of service. He recommended that the Company either update the maps adjusting for density or stop charging different connection fees. Tr. at 1186-88, 1215-17. Company witness Souba responded by claiming the primary factor in designating the zones is distance. Because distance has not changed, the maps are still valid. Tr. at 3249-52.

Commission Findings: We agree with Staff witness Hart that the rural zone maps should be updated to reflect current conditions including new wire centers. The Company shall be required to update its rural zone maps and submit them for Staff review no later than 120 days from the service date of this Order.

6. Measured & Flat Service At Same Location. U S WEST's tariff currently prohibits the mixing of flat and measured service at the same location. Citing concerns that this provision is administratively unworkable, the Company has chosen not to enforce this provision. Hart maintained that the prohibition should either be enforced or removed from the tariff. Tr. at 1189-91. The Company witness Souba indicated that U S WEST is working on a solution. Tr. at 3255.

Commission Findings: We believe that it is inappropriate to have measured and flat rate service at the same location. The Staff's concern is that the Company should better police this issue. U S WEST noted that it was working on a solution to this problem. One possible solution may be that at such time as additional service is ordered at a single location, the Company identify the current type of local service. The Company could then advise customers that mixing local services at a single location is not allowed and could prohibit such service from being installed. We shall instruct the Company to advise the Commission Staff of its solution to this problem no later than 90 days from the service date of this Order.

7. Special Construction Fees. Section 4.4.6.A of the Company's tariff allows it to impose "special construction charges" to address "unusual conditions." Hart voiced concern that the Company is imposing such charges on a more frequent basis, and that it may not be doing so in an

equitable manner. He recommended that the language in this tariff section include clear and consistent guidelines when such special charges may be imposed. Tr. at 1188-89. The Company countered that the very nature of the circumstances demands the flexibility now in the tariff. Souba, Tr. at 3253-55.

Commission Findings: Although we believe that the Company's tariffs should clearly indicate when the imposition of special charges is allowed, we decline to order any specific changes at this time. We agree with the Company that listing all of the various conditions when special construction charges may be used is difficult. We encourage the Staff and the Company to work together to resolve any tariff language differences concerning the imposition of special construction charges. In the event that this issue cannot be resolved, the Staff may bring it to our attention.

8. Guarantor in Lieu of Deposit. Commission Rule 103.01 requires that a local exchange company accept a written guarantee of payment for a residential account from another residential customer of the local exchange company. In January 1992, the Company admitted it had not satisfactorily advised customers of this Rule and agreed to have its representatives follow a specific script to remedy the issue. Cooper, Tr. at 1313. Staff witness Carol Cooper stated that the problem is still not fixed. Failure to advise customers of their right to obtain a guarantor is so common that PUC investigators now routinely advise customers of the option. *Id.* at 1312.

U S WEST witness Souba does not dispute that violations have occurred (Tr. at 3256-57), but stated that because Idaho is unique in this requirement, occasionally an employee will make a mistake and fail to offer this option. Tr. at 3256-59. Cooper declared Idaho is not unique in this requirement, and at least nine other states have this same requirement. Tr. at 1333. Failure to follow PUC rules is a violation, not a "mistake," and the Company should be directed to comply.

Commission Findings: We find that the Company is required to comply with our deposit and guarantee rules. Consequently, the Company is directed to comply with the rule. Company customer service representatives should be instructed on the specific requirements of the Idaho rule.

9. Calculating Deposits. Commission Rule 105.02 provides the formula for calculating deposit amounts. Although the Staff was aware that U S WEST was having difficulty calculating deposit amounts in accordance with the rule, IDAPA 31.41.01.105.02. Staff believed that the diffculty would be corrected around June 1, 1996, when it would be an automated function. Cooper, Tr. at 1314. U S WEST subsequently determined that it cannot use an entirely automated process

to accurately calculate Idaho deposits. U S WEST argued that there is inequitable treatment between telephone competitors and recommends a series of workshops and a complete set of new Telecommunications Rules. Company witness Souba suggested that U S WEST be compared to companies that only provide Title 62 services. Tr. at 3264. Cooper insists that such a comparison is inappropriate. Tr. at 1334.

Commission Findings: U S WEST must comply with the Commission's deposit Rule 105.01.

10. Billing Disputes and Allocation of Payments. Staff witness Cooper asserted that the Company has violated Consumer Rules 312.03 and 401.02 regarding the handling of certain billing disputes and allocation of payments. IDAPA 31.41.01.312.03 and 401.02. By failing to allocate payments correctly or to permanently remove disputed charges from the bill, U S WEST has caused customers to have their toll access restricted or service disconnected. Cooper, Tr. at 1315. Cooper asserted that disputed billing amounts are to be removed no later than two billing cycles. Disputed amounts not removed continue to be reflected on the bill as part of the "Total Amount Due." Company witness Souba did not dispute Staff's claims that customers have experienced misapplied payments, delayed deposit returns, etc. Tr. at 3274. However, he claimed that these are simply mistakes, and are not done with the intent to violate PUC rules. *Id.* Again, Staff recommended that the Company be directed to comply with PUC rules.

Commission Findings: The Company is directed to comply with this rule and all PUC Telephone Customer Relations Rules. The Company should take whatever measures are necessary to insure that Idaho's customer service rules are followed in all instances.

11. Addresses in Directory Listings. Staff witness Cooper also asserted that U S WEST violated Telephone Customer Service Rule 601.03 by charging for white page directory listings. IDAPA 31.41.01.601.03. She maintained that a directory address should include a suite number, apartment number, or a post office box number as part of the free listing—depending on the customer's preference. Tr. at 1318. U S WEST witness Souba alleged that the Company has always charged extra to list suite numbers, apartment numbers and post office boxes and considers them informational in nature. Tr. at 3265-66. If the Company changes its policy, there would be a problem defining what can reasonably be considered as an address, and that "driving directions" could be included in the definition. *Id.* Cooper maintained that if U S WEST has always charged

extra for listing of suite numbers, apartment numbers and post offices boxes, it has always been in violation of Commission Rule 601.03. Tr. at 1338. Addresses are sufficiently distinct from information, and Staff is confident U S WEST employees can make such distinctions. *Id.* at 1339.

Commission Findings: Within the directory space allowed, the Company should publish the full address in the white page directory listing including apartment or suite numbers. However, a "P.O. Box" is not a location and we believe the Company should be able to charge for this additional service. If the length of the full address exceeds the normal and customery space allowed, then an additional charge is also appropriate.

12. Billing Rights. Cooper voiced concerns because customer "billing rights" information has been omitted from the Company's new bill format. Because U S WEST bills for other service providers and billing and payment issues are complex; therefore, it is reasonable to expect some printed explanation on the bill as to what customers should do to try to resolve billing problems. Tr. at 1319. Billing rights information is provided by other utility companies, including other LECs in Idaho, and they utilize the reverse side of the bill or unused space to provide this information. *Id.* at 1339.

Commission Findings: The Commission believes that it is appropriate for billing rights information to periodically be included on customers' telephone bills. We direct the Staff and the Company to jointly determine what information should be portrayed on the billing statement.

13. Voluntary Toll Restrictions. Staff advocated that customers whose access to toll services is restricted because they owe unpaid final bills should not be subject to the marketing of optional products and services offered by U S WEST. Staff witness Cooper claimed that roughly 30% of "risk" customers in 1995 were permanently disconnected because of failure to pay the amounts owed for newly established service and/or the previous unpaid final charges with an average past due amount of $266. Tr. at 1341. Staff agreed that if a customer specifically requests an optional service, than U S WEST should honor that request. For existing customers whose access to toll services becomes restricted due to non-payment and the customers voluntarily request suspension of optional services, Cooper recommended that the Company waive the service charges to reinstate those services to which they previously subscribed. *Id.* at 1341-42.

Commission Findings: Although the Staff's recommendation is well meaning, we are concerned that implementing this recommendation would be administration cumbersome and infeasible. However, such a program used on a case-by-case basis in conjunction with the Company's collection activities may be beneficial to both the Company and customers alike. We encourage the Company to explore this possibility, but we do not require its adoption.

14. Privacy of Directory Listings. Cooper stated that customers with non-published or non-listed telephone numbers should automatically be removed from solicitation lists for U S WEST products and services. Tr. at 1342. U S WEST argued that such customers are eligible to receive these calls because they have an established relationship with the Company by virtue of being monthly subscribers. Souba, Tr. at 3273. Cooper's position was that customers selecting these privacy services believe they are paying for privacy and freedom from unwanted solicitations from U S WEST or others. Unless U S WEST needs to contact the customer for service-related reasons, the use restrictions for non-published and non-listed customer information should apply to U S WEST's marketing arm as well as its competitors. Tr. at 1342-43.

Commission Findings: We agree with the Staff that customers subscribing to non-published and non-listed services should be removed from the Company's solicitation lists. These customers have a legitimate expectation that they will not receive solicitation from either U S WEST or other telephone solicitors. We agree that the disclosure restrictions for non-published and non-listed information should apply to U S WEST's marketing activities as well as to those conducted by other companies.

15. PIC Freeze. Cooper asserted that U S WEST is currently discouraging customers from placing a primary interexchange carrier (PIC) "freeze" on their accounts. A PIC freeze protects customers against the unauthorized switching of their long distance carrier. Tr. at 1324. The number of slamming complaints and other carrier selection complaints increased from approximately 450 complaints in 1995 to over 580 complaints in 1996. *Id.* at 1327. In response to Staff Production Request No. 429, U S WEST stated that a PIC freeze for purposes of "peace of mind" is unnecessary and potentially a future liability when customers wish to change carriers. Cooper recommended that the Commission direct U S WEST to discontinue its efforts to discourage customers from implementing a PIC freeze if customers seek such protection. Cooper, Tr. at 1328.

Commission Findings: We believe that the Company should be neutral in advising customers about the possibility of a PIC freeze. If customers desire to freeze their PIC selections, the Company should honor those requests without advocating against that action.

X. RATE DESIGN ISSUES

A. Agreed or Settled Issues

1. Measured service. The Company proposed to increase its monthly rates for measured local service for both its residential and business customers. Measured service customers pay a monthly flat rate plus a per-minute usage fee. The Company recommended that the monthly flat rate for residential customers increase by more than 100% to a uniform monthly rate of $14.13 inside the local calling regions and $12.13 outside the calling regions. Exhibit 45C. The Company and the Staff agreed to retain the current measured service usage rate for local calls at $0.02 per minute. Tr. at 2197, 2218-19, 3572. The monthly flat rate charge for measured service is approximately 60% of the monthly unlimited calling rate. The Company proposed that the monthly flat rate charge for measured business service be set at a uniform rate of $17.00. Exhibit 40D. The Company also proposed to eliminate the existing discount for evening and weekend calls and to include three hours of outbound local calling for both measured residential and business service as part of the flat rate. Order No. 26552 at 3. Staff witness Bill Eastlake accepted the Company's proposal to create a 180 minute free allowance but noted its benefit was swamped by the proposed increase in the monthly recurring charge. Tr. at 2182.

2. Installation charge. The Company proposed increasing its non-recurring charge for the installation of residential local service from its existing rate of $30.00 per line to a uniform $31.00 regardless of the number of lines ordered. Order No. 26552 at 4. Eastlake objected to U S WEST's proposal to charge only $1 for installation of an additional line ($30 for one line, $31 for two or more lines) as promotional and likely to further jeopardize service quality. Eastlake, Tr. at 2185-86, 2218-19. U S WEST withdrew its proposed change. Owen, Tr. at 3573.

3. Vacation rates. U S WEST proposed to restructure its monthly rates for vacation service. Vacation service allows a customer to discontinue service at a particular location but reserves the telephone number until the service is reinstated. The Company proposed to eliminate the existing one-time charge to suspend residential service of $20.00 and to reduce the restoration charge from $20.00 to $15.00. The monthly rate for vacation service would be changed from its existing charge of 50% of the applicable local rate to a uniform monthly charge of $10.00. The rates to suspend and restore business vacation service would be changed from a one-time charge of $25.50 to $15.00, while the one-time restoration rate would be increased from $20.00 to $30.00.

The Company proposed that the monthly rate for business vacation service be set at a uniform monthly rate of $15.00. Company witness Owen urged the Commission to accept the Company's "simplified restructure." Tr. at 3577. U S WEST estimated that the restructuring of vacation rates could be accomplished by November 1997 as part of the Company's billing changes. Eastlake opposed the proposed changes in vacation rates because the change only benefited a small number of customers in the face of potentially large rate increases for all other customers. *Id.* at 2190. However, he later conceded that this restructure has very small revenue impacts on other customers, so withdrew his opposition. *Id.* at 2220

4. Rates for Directory listings. Examination of this issue was prompted by a formal complaint filed by David Hoffman requesting that the Commission lower U S WEST's rates for non-published and non-listed telephone numbers. See Case No. USW-S-96-2. The Title 61 monthly rates for non-listed and non-published telephone numbers are currently $2.50 and $4.00, respectively. In Order No 26488 issued June 16, 1996, the Commission directed that this issue be examined in this general rate case. Company witness Owen recommended that the current privacy listing rates remain the same. Tr. at 3573-76.

Staff witness Eastlake initially noted there is no serious cost justification for current charges for non-published and non-listed directory listings. *Id.* at 2188. He proposed reducing the rates for non-listed and non-published service to the average rates for all U S WEST's states. *Id.* at 2189. He subsequently withdrew his recommendation after considering the revenue requirement burden that would be shifted to other customers. *Id.* at 2189, 2218-19.

Commission Findings: We find it is reasonable to adopt the agreements between the Company and the Commission Staff, set out above with the exception of the rates for directory listings. We find it is reasonable to adjust the rates for non-listed and non-published listings. We reduce the monthly rates for non-listed and non-published listings to $.50 and $.75, respectively, and implement a non-recurring implementation charge of $25.00. This reduction in rates brings monthly rates more in line with the costs of providing the services. We calculate that this change in rates result in an annual Title 61 revenue decrease of about $1.25 million.

B. Disputed Issues

1. Business-residential rate ratio. U S WEST proposed to reduce the existing business-residential ratio from about 2.6 to about 1.3 by applying its requested revenue increase to residential

rates. Owen, Tr. at 663; Wozniak, Tr. at 771-72. Company witness Owen argued that the cost of providing business service versus residential service no longer justifies a business price more than double the residential price. Tr. at 3567-68. She and other Company witnesses urged the Commission to reduce the ratio to bring rates more in line with cost. Tr. at 3542.

Staff witness Eastlake argued that the existing ratios should be maintained for several reasons. First, he pointed out that the differential has been argued and ultimately approved by the Commission in previous cases. *Id.* at 2178. He also noted countervailing factors besides cost that have been recognized as important in previous cases, such as higher peak hour usage by business and higher value of service for business. *Id.* at 2179, 2216. He next asserted there is not now nor likely to be any real competition in the future for Title 61 businesses that would necessitate such a change. *Id.* at 2180-81. Finally, he argued that the results of this case will be short-lived due to the onset of a turbulent period of change in the industry. Tr. at 2196. Now is not the proper time to redo the entire structure. *Id.* at 2181.

Commission Findings: Based on our review of the record and the arguments advanced by the parties, we conclude that it is appropriate to reduce the existing business-residential ratio from its present 2.6 level. We find it is appropriate and reasonable to reduce the business-residential ratio to 2.0 by raising residential rates and lowering business rates. Although we do not decide the exact cost of business service as related to residential service, it is appropriate to reduce the ratio and more accurately reflect the relevant cost burden of each service on the network. Adopting a 2.0 ratio results in an annual revenue shift of about $5.5 million. As described in greater detail below, the actual business-residential rate ratio for customers inside the regional calling areas is reduced to 1.84 when the EAS charge is added.

C. Adopted Rate Design

Having decided the major revenue and design issues in this case, we now turn to deciding Title 61 rate structure and the applicable rates. Both the Company and the Staff generally advocate that the Commission abandon the existing three rate group structure and adopt two rate groups: One rate group for customers located inside the regional calling areas and the other for customers located outside the calling areas. The other major factor to be considered in the construction of the rates is the revised business-residential rate ratio of 2.0. Finally, the Staff and U S WEST urged us to retain the existing rate relationships between unlimited local calling, measured local calling, unlimited ITAP service, and measured ITAP service.

Using these parameters, the Commission has determined that the residential one-party unlimited local service rate outside a calling region shall be set at $10.90. This represents a monthly increase of $.79 for customers in existing Rate Group 1. Rate Group 2 residential customers will experience a rate decrease of $.11 per month.

Given the size and cost of the newly created local calling regions, we believe that customers located in the calling areas should be assessed higher rates in conjunction with the expanded calling area. As we mentioned at the beginning of this Order, the Commission had established an interim rate additive of $3.62 for customers located within an EAS calling region. The Commission has concluded that the fair and reasonable differential between residential rates inside and outside the local calling region should be $5.20. Consequently, the monthly rate for residential one-party unlimited local service within a calling region will be increased from the interim rate of $15.62 to $16.10.

Because we have reduced in the business-residential rate ratio, business customers located outside the local calling region will experience a rate decrease for one-party unlimited business service. The monthly rate for one-party business local service for customers located outside the local calling regions will be set at $21.80. This represents a monthly rate decrease for Rate Group 1 business customers of $4.22 and $6.69 for Rate Group 2 business customers.

The Commission finds that the reasonable EAS monthly differential for businesses inside the regional calling areas is $7.80. As we have previously mentioned, business customers located inside the calling areas receive substantial benefits from the expanded calling areas and many urged us to implement the calling regions. Consequently, the monthly rate for one-party business local service for customers located inside the local calling regions shall be set at $29.60. This represents a monthly rate decrease of $1.50 for Rate Group 3 business customers. The complete rate design is set out in the Appendix attached to this Order.

Because the rate changes being implemented may cause customers to re-examine the type of local service they subscribe to, we further direct that the Company waive its service order charges for a period of ninety (90) days from the effective date of this Order for customers switching from flat rate service to measured service. This will allow customers with limited local calling to switch to a more economical local service. The monthly rates for all local services are set out in the appendices. Pursuant to *Idaho Code* § 61-622A, the Commission finds that the rates set out in the body of this Order and in the appendices are fair, just and reasonable.

XI. INTERVENOR FUNDING

On May 29, 1997, the Idaho Citizens Coalition (ICC) filed a timely Application for Intervenor Funding in this case. The ICC sought intervenor funding in the amount of $10,948.25. This amount included $9,150 in consulting fees; $1,120 in research fees; and expenses of $678.25.

In support of its Application, ICC stated that it is a charitable non-profit corporation representing residential customers. ICC Application at 3. The Coalition indicated that it has no other sources or revenue to draw upon to meet these expenses. ICC noted that many of its recommendations materially differed from the testimony offered by the Staff. In particular, ICC offered testimony concerning forward-looking costs instead of embedded costs, urged the Commission to continue the imputation of directory revenues or consider an asset transfer mechanism, and criticized the Company's use of the CPI as an indicator of price.

On June 13, 1997, the American Association of Retired Persons (AARP) also submitted an Application for Intervenor Funding in the amount $25,000. This Application was subsequently amended on June 17, 1997. In its Application, AARP listed its fees and expenses as totaling more than $43,000. Amended Application at 3. It listed legal fees in the amount of $10,410; expert witness fees of approximately $31,500; and expenses of approximately $1,550. AARP stated that it also was a non-profit organization and is not able to adequately recover its costs from its membership. *Id.* at 5. It argued that its costs were reasonable given the level of participation at the hearing and that its testimony significantly differed from the testimony and exhibits of the Staff. In particular, AARP urged the Commission to consider forward-looking costs instead of embedded costs in this case, and vigorously opposed the Staff-U S WEST settlement regarding the elimination of directory revenue.

U S WEST opposed both intervenor funding requests. The Company generally asserted that neither intervenor materially contributed to the Commission's deliberation or ultimate decision in this docket. Motion at 2. U S WEST argued that the $1,120 in research fees for ICC's Fothergill are not permitted under the statute. *Idaho Code* § 61-617A provides that intervenor funding may be used to "pay all or a portion of the costs of one or more parties for legal fees, witness fees, and reproduction costs." U S WEST argued that since Mr. Fothergill is neither an attorney nor a witness in the case, that expense should be disallowed. U S WEST also argued that AARP is a national organization which claimed approximately 130,000 members in Idaho. The Company claimed that there is "no reason to believe that . . . AARP will suffer financial hardship" if intervenor funding is denied.

On June 20, 1997, ICC filed a response to U S WEST's Motion. In its response, ICC argued that simply because a "utility finds an intervenor's testimony objectionable or uninteresting . . . does not tell us anything about whether that testimony was useful to the Commission in understanding the issues in developing its decisions. ICC Response at 1. Turning to Mr. Fothergill's requested fee, ICC noted that he provided administrative support for an expert witness at a fraction of the cost of an attorney. *Id.* at 2. ICC also asserted that the Commission has consistently rejected the notion that intervenor funding is contingent upon the Commission adopting a position advocated by the intervenor. The Coalition argued that it assisted the Commission in evaluating testimony and developed its decisions by presenting testimony on alternative ways at looking at regulatory problems and revealed underlying weaknesses in testimony.

Finally, ICC noted that denial of intervenor funding in this case would be contrary to the very purpose of the intervenor funding statute, *Idaho Code* § 61-617A. It insisted that the intervenor funding

> is intended to assure that citizens' groups with a direct interest in the outcome of the case have an opportunity to fully participate. Without intervenor funding, testimony would be limited mainly to that of the utility, the Staff, and well-heeled industrial groups. Such an outcome would impoverish the Commission's hearing and the democratic process they are supposed to embody.

Id. at 3.

Commission Findings: Having reviewed the Application and the Motions in opposition, the Commission grants intervenor funding to both ICC and AARP. Contrary to the assertions of U S WEST, the Commission finds that both intervenors materially contributed to the deliberation and the decisions rendered in this case. Both intervenors offered relevant testimony on various issues including the directory imputation, the directory credit, the use of embedded versus forward-looking costs, alternative cost models, and cross-examined witnesses. In addition, we specifically recognize Mr. Fothergill's preparation and cross-examination of Drs. Lehr and Reading. We further find that both intervenors presented testimony and exhibits materially different from the Commission Staff and addressed concern of residential customers particularly low income\fixed income customers. We further find that the cost of intervention appear reasonable and that recovery of such costs would present a significant financial hardship to both intervenors.

Based on our review of the itemized funding requests, the Commission awards intervenor funding in the amount of $10,948.25 to ICC. We find its fees and costs are reasonable. We award the balance of the intervenor funding (in the amount of $14,051.75) to AARP. The awarded expenses shall be chargeable to the class of residential customers and amortized by the Company over a three-year period.

ULTIMATE FINDINGS OF FACTS AND CONCLUSIONS OF LAW

U S WEST Communications, Inc. is a telecommunications corporation subject to our regulatory jurisdiction pursuant to *Idaho Code* Title 61 and 62. The Commission has jurisdiction over this matter as authorized by *Idaho Code* §§ 61-502 and 61-622A.

Having fully reviewed the record in this proceeding, we find that the Company's rates annual revenue requirement for Title 61 services is unreasonable and direct that it be reduced by $327,000. We find it is just and reasonable for the Company to receive an 11.2% return on equity and an overall rate of return of 9.43%.

We have established the Company's revenue requirement at a fair, just and reasonable level, and we have significantly altered the Company's rate design structure to more closely reflect relative cost levels. We further find that the rates and charges for the Title 61 services set out in this Order are fair, just and reasonable.

We further find that it is reasonable to award ICC its intervenor funding request of $10,948.25 and to provide the balance of the allowed amount, $14,051.75, to AARP.

O R D E R

IT IS HEREBY ORDERED that U S WEST Communications institute the rate changes embodied in this Order no later than August 21, 1997. The Company shall submit Title 61 tariffs conforming to the rates set out in this Order no later than August 21, 1997.

IT IS FURTHER ORDERED that the Company's proposed rates for Title 61 services contained in its Application are denied.

IT IS FURTHER ORDERED that the Company provide Title 61 customers with a $1.00 credit for twelve (12) consecutive billing cycles beginning September 1, 1997. This credit reflects the transition credit for directory imputation as specified in the second settlement and adopted by the Commission.

IT IS FURTHER ORDERED that the Company waive its non-recurring service order charges for customers desiring to switch from flat-rate local service to measured local service and vice-versa. This waiver shall extend for ninety (90) days from the date of this Order.

IT IS FURTHER ORDERED that the Hoffman complaint, Case No. USW-S-96-2, be closed as the issues have been resolved with this Order.

IT IS FURTHER ORDERED that U S WEST pay the intervenor funding awards set out above within fourteen (14) days of the service date of this Order.

IT IS FURTHER ORDERED that U S WEST shall forward to the Idaho USF Administrator the remaining balance of Title 61 revenue sharing funds within fourteen (14) days of the date of this Order.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in Case Nos. USW-S-96-5 or USW-S-96-2 may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order or in interlocutory Orders previously issued in Case Nos. USW-S-96-5 or USW-S-96-2. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* §§ 61-626 and 62-619.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 12th day of August 1997.

Dennis S. Hansen

DENNIS S. HANSEN, PRESIDENT

Ralph Nelson

RALPH NELSON, COMMISSIONER

Marsha H. Smith

MARSHA H. SMITH, COMMISSIONER

ATTEST:

Myrna J. Walters

Myrna J. Walters
Commission Secretary

Vld/O:USW-S-96-5.dh6

REVENUE REQUIREMENT CALCULATION
CASE NO. USW-S-96-5
U S WEST COMMUNICATIONS, INC

COMMISSION ORDER **AUGUST 1, 1997**
EXHIBIT 101 Page1

ALL DOLLARS WITH "000" OMITTED

SYD LANSING C:\965FL13.WK4

#		-C- (A+B=C) (HIDE A&B) ADJUSTED INTRASTATE BOOKS	-D- STAFF DIRECT ASSIGNMENT TO TITLE 61	-E- STAFF ASSIGNMENT NOT TITLE 61	-F- SETTLEMENT NUMBER TWO: DIRECT TO TITLE 61	-G- SETTLEMENT AGREEMENT NUMBER TWO: INTRASTATE ALLOCATED TITLE 61 /62	-H- COMMISSION ORDERED ADJUSTMENT TO TITLE 61	-I- (C-D-E-F+G-H=I) AVAILABLE TITLE 61 TITLE 62 ALLOCATION	-J- COMMISSION ORDER: ALLOCATION TITLE 62	-K- COMMISSION ORDER: ALLOCATION TITLE 61	-L- (D+F+H+I=N) TITLE 61 TOTAL
				Page 3							
1	Average Plant in Service	534,073	45,606	166,840			(136,852)	458,479	187,976	270,503	316,109
2	Capitalized Leases etc.	13,476		5,495			(2,910)	10,891	4,465	6,426	6,426
3	Materials and supplies	2,247						2,247	921	1,326	1,326
4	Cash Working Capital	(2,524)						(2,524)	(1,035)	(1,489)	(1,489)
5	Pension Assets	9,431		18,862		(9,431)		0	0	0	0
6	Accumulated Depreciation	(234,067)	(45,606)	(14,247)	(11,443)	(7,276)	(4,799)	(150,696)	(61,785)	(88,911)	(145,960)
7	Deferred Income Tax	(48,742)		(2,960)	4,860	(6,208)	261	(44,695)	(18,325)	(26,370)	(21,510)
8	Customer Deposits	(475)						(475)	(299)	(176)	(176
9	Adjust Ave. Rate Base	(29,115)						(29,115)	(11,937)	(17,178)	(17,17
10	EAS ADJUSTMENT				2,159			0	(5,292)	5,292	7,45
11	**Average Rate Base**	**244,304**	**0**					**244,112**	**94,689**	**149,423**	**144,999**
12											
13	**Return for Debt Payment 7.23%**										4,655
14	**Return on Equity 11.2%**										9,029
15	**Gross Up For Taxes 1.5661**										5,112
16	**TOTAL RETURN ON RATEBASE**										**18,795**
17	Maintenance	23,405		8,472		5,984		20,917	8,576	12,341	12,341
18	Engineering Expense	3,728		1,700				2,028	831	1,197	1,197
19	Network Operations	5,505		99				5,406	2,216	3,190	3,190
20	Network Administration	556		77		(2)		477	196	281	281
21	Access expense	9,145		9,145				0	0	0	0
22	Other	(29)		0				(29)	(12)	(17)	(17)
23	Total cost of services	42,310		19,493				28,799	11,808	16,991	**16,991**
24	Intervenor Funding						8				8
25	Customer Operations	29,531		1,513			(841)	28,859	19,336	9,523	9,523
26	Corporate Operations	22,091	58	6,229	507	1,635	(492)	17,931	11,297	6,634	7,199
27	Property and Other Taxes	4,496						4,496	1,843	2,653	2,653
28	Uncollectibles	1,781						1,781	1,193	588	588
29	Total Selling and General	57,899	58	7,742				53,067	33,669	19,398	**19,972**
30	EAS Costs	0	2,129		918			0	0	0	3,047
31	Other Operating	1,146		731				415	170	245	24
32	Depreciation	36,492		11,481		7,276		32,287	13,238	19,049	19,0
33	Amortization	1,625		1,333				292	120	172	172
34	Total expenses	139,472	2,187	40,780				114,860	59,004	55,856	**59,477**
35	SETTLEMENT AGREEMENT NO. 1		2,167	4,121							2,167
36	**TOTAL REVENUE REQUIREMENT**										**80,439**
37											
38	Local Revenues	110,472					(1,254)	109,218	37,803	71,415	71,415
39	Toll Revenues	57,227						57,227	57,227		
40	Access Revenues	13,675						13,675	13,675		
41	EAS PROFORMA REVENUE				10,286			0			10,286
42	Rent Compensation	(10,234)						(10,234)	(6,294)	(3,940)	(3,940)
43	Miscellaneous	4,912						4,912	2,136	2,776	2,776
44	Directory	0	8,645		(8,645)			8,645		8,645	0
45	Imputed Revenue	0	346		(117)			346		346	229
46	Total Revenue	176,052						183,789	104,547	79,242	**80,766**
47											
48	**IDAHO SOUTH JURISDICTION REGULATED REVENUE REDUCTION**										**(327)**

APPENDIX TO
ORDER NO. 27100
Page 1 of 3

U S WEST Monthly Rates

Residence

Class of Service			Prior Rate	Interim Rate	% Change	Ordered Rate	% Change
Unlimited Local Calling	RG1	Out Region	$10.11	$10.11	0%	$10.90	8%
	RG1	In Region	$10.11	$15.62	55%	$16.10	3%
	RG2	Out Region	$11.01	$11.01	0%	$10.90	-1%
	RG2	In Region	$11.01	$15.62	42%	$16.10	3%
	RG3	In Region	$12.00	$15.62	30%	$16.10	3%
Measured Local Calling	RG1	Out Region	$5.19	$5.19	0%	$6.75	30%
	RG1	In Region	$5.19	$6.13	18%	$9.60	57%
	RG2	Out Region	$5.64	$5.64	0%	$6.75	20%
	RG2	In Region	$5.64	$6.13	9%	$9.60	57%
	RG3	In Region	$6.13	$6.13	0%	$9.60	57%
Unlimited ITAP Local Calling	RG1	Out Region	$6.57	$6.57	0%	$7.65	16%
	RG1	In Region	$6.57	$12.08	84%	$10.50	-13%
	RG2	Out Region	$7.47	$7.47	0%	$7.65	2%
	RG2	In Region	$7.47	$12.08	62%	$10.50	-13%
	RG3	In Region	$8.46	$12.08	43%	$10.50	-13%
Measured ITAP Local Calling	RG1	Out Region	$1.65	$1.65	0%	$2.35	42%
	RG1	In Region	$1.65	$2.59	57%	$5.25	103%
	RG2	Out Region	$2.10	$2.10	0%	$2.35	12%
	RG2	In Region	$2.10	$2.59	23%	$5.25	103%
	RG3	In Region	$2.59	$2.59	0%	$5.25	103%
4-Pty Service Station Local Calling	RG1	Out Region	$7.02	$7.02	0%	$7.70	10%
	RG1	In Region	$7.02	$11.96	70%	$12.90	8%
	RG2	Out Region	$7.65	$7.65	0%	$7.70	1%
	RG2	In Region	$7.65	$11.96	56%	$12.90	8%
	RG3	In Region	$8.34	$11.96	43%	$12.90	8%

RG1 - Weiser
RG2 - Burley, Glenns Ferry, Hailey, Ketchum, Mountain Home, New Plymouth, and Payette
RG3 - All other exchanges are in EAS rate group 3

U S WEST Monthly Rates

Business

Class of Service			Prior Rate	Interim Rate	% Change	Ordered Rate	% Change
Unlimited Local Calling	RG1	Out Region	$26.02	$26.02	0%	$21.80	-16%
	RG1	In Region	$26.02	$31.10	20%	$29.60	-5%
	RG2	Out Region	$28.49	$28.49	0%	$21.80	-23%
	RG2	In Region	$28.49	$31.10	9%	$29.60	-5%
	RG3	In Region	$31.10	$31.10	0%	$29.60	-5%
Measured Local Calling	RG1	Out Region	$13.15	$13.15	0%	$11.20	-15%
	RG1	In Region	$13.15	$17.00	29%	$19.00	12%
	RG2	Out Region	$14.38	$14.38	0%	$11.20	-22%
	RG2	In Region	$14.38	$17.00	18%	$19.00	12%
	RG3	In Region	$15.69	$17.00	8%	$19.00	12%
Unlimited Flat Trunks	RG1	Out Region	$31.61	$31.61	0%	$25.90	-18%
	RG1	In Region	$31.61	$36.69	16%	$33.70	-8%
	RG2	Out Region	$34.08	$34.08	0%	$25.90	-24%
	RG2	In Region	$34.08	$36.69	8%	$33.70	-8%
	RG3	In Region	$36.69	$36.69	0%	$33.70	-8%
Semi-public Lines	RG1	Out Region	$24.53	$24.53	0%	$20.75	-15%
	RG1	In Region	$24.53	$29.36	20%	$28.55	-3%
	RG2	Out Region	$26.88	$26.88	0%	$20.75	-23%
	RG2	In Region	$26.88	$29.36	9%	$28.55	-3%
	RG3	In Region	$29.36	$29.36	0%	$28.55	-3%
Public Access Lines	RG1	Out Region	$31.92	$31.92	0%	$30.00	-6%
	RG1	In Region	$31.92	$37.00	16%	$37.80	2%
	RG2	Out Region	$34.39	$34.39	0%	$30.00	-13%
	RG2	In Region	$34.39	$37.00	8%	$37.80	2%
	RG3	In Region	$37.00	$37.00	0%	$37.80	2%

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