

**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

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

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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.<sup>1</sup> 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

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<sup>1</sup>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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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.<sup>2</sup>

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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<sup>2</sup>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, Glens 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.<sup>3</sup> 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.

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<sup>3</sup> 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<sup>4</sup> 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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<sup>4</sup>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).<sup>5</sup>

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<sup>5</sup>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.<sup>6</sup> 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. . . .

<sup>6</sup>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.

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

5. Depreciation (Adjustment to Rate Base). 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.

