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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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| 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  STAFF’S PREHEARING MEMORANDUM |

COMES NOW the Staff of the Idaho Public Utilities Commission by and through its counsel and submits this prehearing memorandum for the Commission’s consideration.  The purpose of this prehearing memorandum is to outline the settled and disputed issues between the Staff and U S WEST in this case.

PROCEDURAL HISTORY

1.  Initial Application.  On June 28, 1996, U S WEST Communications filed an Application seeking a general rate increase for its Title 61 services.  At that time, U S WEST sought to increase its annual revenues from Title 61 operations by 58% or $38.054 million per year.  Notice of Application, Order No. 26552 at 1.  U S WEST calculated that the average Title 61 rate base for the 1995 test year was $154.862 million and requested a 10.55% rate of return.  Exhibit 25, p. 1.  The Company proposed to substantially increase the rates for single-party residential service to a uniform monthly rate of $22.50, an increase ranging between 86% and 122%.  Order No. 26552 at 2.  The Company also proposed to restructure its single-party business rates from the current three rate groups into a single uniform rate of $31.10.  Single-party business and public access line (PAL) pay telephone customers in rate group 1 would experience a rate increase of $5.08 (29%) while similar customers in rate group 2 would experience an increase of $2.61 (9%).  Id.

In Order No. 26552, issued August 7, 1996, the Commission suspended the rates and scheduled a prehearing conference.  At the prehearing conference held September 18, 1996, the Commission set this matter for hearing in January 1997.

On November 26, 1996, the Staff and Intervenors filed their direct testimony.  The Staff asserted that U S WEST was over collecting for its Title 61 services and recommended a rate decrease of $32.19 million.  Staff Exhibit 101.  The Staff asserted that the Company’s allocation system did not reasonably assign costs between Title 61 and Title 62.  Staff proposed a Title 61 rate base of $79.830 million and recommended a rate of return of 8.66%.  Id.  On December 3, 1996, U S WEST filed a Motion seeking an extension of time in which to file its rebuttal testimony, of not less than 45 days or until January 30, 1997.  In Order No. 26739 issued December 31, 1996, the Commission partially granted the Motion and  modified the hearing schedule.  The Company was directed to file its rebuttal testimony no later than January 28, 1997, with the Staff and Intervenors filing their surrebuttal testimony no later than February 21, 1997.  The evidentiary hearing was rescheduled to begin March 10, 1997.

2.  Revised Application.  On rebuttal, U S WEST modified its annual revenue requirement and requested an annual revenue increase from Title 61 operations of $28.255 million and increased its Title 61 rate base for the 1995 test year to $164.525 million.  Exhibit 43A, p. 1.  The Company proposed an EAS “in-region” monthly single-party residential rate of $23.62 and proposed that all other residential customers located outside an EAS region pay a monthly rate of $20.00.  Order No. 26820 at 2.  Single-party business and public access PAL monthly rates were proposed to be $31.10 (inside EAS) and $28.49 (outside EAS region).  Id.

3.  Settlement Conferences.  An informal settlement conference was convened on January 15, 1997, pursuant to Order No. 26739.  At the settlement conference, Staff agreed with U S WEST that the miscellaneous revenue adjustment was incomplete because it excluded the contra-revenue amount for rent compensation.  This settled issue is discussed in further detail below.  In addition, the Staff agreed with U S WEST that three accounts (capital leases, leasehold improvements, and intangibles) were omitted from the calculation of the Staff’s recommended Title 61 rate base.  Calculations of the actual amounts were to be performed pursuant to subsequent audits.  The Staff and the Company also agreed to use available revenue sharing amounts to fund the additional EAS calling area improvements that exceeded the $1.5 million cap in Case No. USW-S-96-4.  On February 12, 1997, the parties convened a second settlement conference.  Subsequent to the February meeting, U S WEST and Staff signed a stipulated settlement relating to affiliated expense transactions (excluding Advanced Technologies (AT) and Bellcore).  Madonna Faunce sponsored Staff Exhibit 153 relating to the settlement of affiliated transactions.

In the Staff’s surrebuttal filing, it increased the recommended rate base to $91.930 million as a result of settling several issues at the January 15th and February 12th settlement conferences.  The Staff revised its recommended revenue reduction from $32.197 million to $26.01 million.  Rev. Exhibit 101, p. 1.

On February 28, 1997, the Commission Staff again notified the parties that it intended to resume settlement discussions with the Company on March 4, 1997.  Following these discussions, the Staff and the Company executed a Second Settlement and Stipulation on March 7, 1997 agreeing to settle the following issues: directory imputation, depreciation, cost of debt, capital structure, pension asset, curtailment loss, compensated absences, FASB 106, restructuring/reengineering expenses, the lease of 1801 California Street, chart of accounts, documents of original entry, employee concessions, President’s club expenses,  advertising expenses, and costs for implementing EAS regions.  These settlement issues are discussed in greater detail below.

4.  Prehearing Motions.  On February 14, 1997, the American Association of Retired Persons (AARP) filed a Motion to Compel U S WEST to answer discovery.  On February 19, 1997, the Commission Staff filed a Motion to Compel and a Motion for Extension of Time to file surrebuttal testimony.  In Order No. 26824, the Commission denied the Motions to Compel but granted Staff an extension.

THEORY OF THE CASE

This rate case presents the first opportunity for the Commission to examine in detail the appropriate allocation of costs between a telephone corporation’s price-regulated (Title 61) and nonprice-regulated (Title 62) services. Staff’s analysis of US WEST’s cost allocation methodology reveals two fundlemental concerns.  First, appropriate cost allocation assumes that costs will be directly assigned to the product or service that has “caused” the cost to be incurred. This is inherently difficult given the fact that U S WEST’s telecommunication services use a joint or common network. Second, when the direct assignment of costs cannot be made, it appears that the Company’s allocation methodology over-allocates common costs to Title 61 services. Unless adjusted, U S WEST’s cost allocation methodology would enable the Company to improperly cross-subsidize its Title 62 operations with revenues from its Title 61 operations.  This cross-subsidy would have two adverse impacts: (1) it would cause customers of regulated services to pay excessive rates; and (2) it would chill the development of competition in southern Idaho.

The Staff urges the Commission to adopt a methodology for allocating common plant costs that address several key elements.

◆The Commission should directly assign the $45 million of Title 61 funds associated with the Tech Plus and Tech II programs to Title 61, should directly assign the corresponding and fully offsetting accumulated depreciation in the same amount (i.e., $45 million).

◆The Commission should directly assign the Company’s other digital investments — those undertaken at the Company's own initiative and for the Company’s own strategic reasons — to Title 62.

◆The local exchange plant that represents spare capacity should be allocated based upon the relative growth rates of Title 61 and Title 62 lines so that today’s monopoly customers are not cross-subsidizing the Company’s ongoing and future competitive services.

◆The Commission should allocate 5% of local loop costs to custom calling and class services to reflect the fact that the Company derives a substantial revenue stream from these Title 62 services and to reflect the fact that this revenue stream is inextricably linked to the basic local exchange line.

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.

RATE BASE

A.  Agreed or Settled 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, Dir. 16; Revised Exhibit 101, lines 3, 4, portion of 9.

2.  Accumulated Depreciation.  Staff agrees with the Company’s presentation of accumulated depreciation with the exception of specific adjustments presented by Staff in Lansing Dir. at  17, Revised Exhibit 101, line 6.

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.

4.  Customer Deposits.  The Staff agreed with the Company’s calculation of customer deposits as shown in Rev. Exhibit 101, line 8; Lansing Dir. at 17.  This reduces the rate base by $475,000.

5.  Subsidiary vs. General Ledger.  As a result of the January 15, 1997, settlement conference, the Staff agreed in principal that three accounts (capital leases, leasehold improvements, intangible assets) 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, Surr. at 3.

The Capital Lease account has two sub-accounts: buildings and software.  The Staff and Company agree 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 agree to the quantification of the Capital Leases Software sub-account as $5.495 million, the Staff recommends that this entire software amount be allocated to Title 62.  The Staff believes that the features covered by the capitalized leases are CLASS services.  Lansing, Surr. at 3. The Staff has been unable to determine the purpose or the function of the software directly related to the capitalized leases.  Consequently, the Staff recommends that this entire amount be assigned to Title 62.  The Company does not agree to the assignment of the software capital leases to Title 62.  Id.

6.  Pension Asset.  Initially, U S WEST witness Wright proposed an adjustment to record, for regulatory purposes, a Pension Asset of $9,431,000 in rate base.  Wright, Dir. at 31-34.  Staff witness 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 adjustment of $18,862,000 to reflect the Pension Asset as a ratepayer-contributed asset and a reduction of rate base.  Schneider, Dir. at 3-4.  At the March 4, 1997 settlement conference, the Staff and U S WEST agreed that the pension asset be included neither as an addition to or reduction from rate base. The change in allocators from the EAS shift results in the asset removal of $9.506 million.  The settling of this issue also requires that the deferred tax liability of $3.662 million also be removed.  This compromise is reasonable in relation to how this issue is treated in several other states.

B.  Issues in Dispute

1.  “True-Up” Adjustment to Plant-In-Service.  At the January 15th settlement conference, the Staff agreed in principal 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.  Lansing Surr. at 6.  He objects 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, the Staff did not increase plant in service for the amount of the true-up.  Lansing, Surr. at 6.

2.  Lit Fiber Optic Cable.  Based on 1995 ARMIS Reports, Lansing calculated that only 10.355% of the fiber optic cable in Idaho was “lit” or used and useful in the test year.  Lansing, Dir. at 13, Surr. at 8.  Consequently, the Staff removed $9.122 million in fiber as “plant held for future use.”  Id.  Surr. at 10; Rev. 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.  The Company states that the 1994 ARMIS Report contained an error and was corrected September 13, 1996.  Plummer, Rebut. at 4.  He argues that the entire amount of fiber should be placed in the Title 61 rate base.  Although he does not calculate the amount of fiber lit in 1995, Plummer maintains that the amount of fiber lit as a percentage of total fiber as of January 7, 1997, was 43%.  Id.

Lansing recommends 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 recorded as “plant held for future use.”  Lansing, Surr. at 10.

3.  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 PIS contained an error factor of 1.89%.  Lansing, Dir. at 11.  In the Company rebuttal, witness Wright partially accepts his 1.89% error factor. The Company has made a correcting adjustment for those accounts actually audited, but does not accept the adjustment for non-audited accounts such as buried cable for outside plant.   Wright, Reb. at 29; Elder, Reb. at 25.  Company witnesses Wright and Elder argue that the 1.89% error factor should be limited to those accounts actually audited by Staff witness Lansing.  Wright, Reb. at 30.

Lansing does not agree with the Company’s assertion that the 1.89% error factor is related to “paperwork” problems concerning the retirement of plant accounts.  Lansing, Surr. at 11-14.  Lansing disagrees and notes that U S WEST has retirements in similar magnitudes from outside plant accounts.  Lansing, Surr. at 12.

COST ALLOCATION

Disputed Issues

The Company and Staff use embedded cost models to determine costs in this case.  Intervenor AARP witness Dr. Reading proposes using a TSLRIC model while AT&T witness Radcliff recommends the use of the Hatfield model.  The Staff and Company positions are discussed in greater detail below.

1.  Assigning Tech Plus and Tech II Projects to Title 61.  Staff witness Baldwin asserts 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).  Baldwin, Surr. 39-43.  As an integral recommendation that is critically linked to this direct assignment, Baldwin recommends a corresponding and fully offsetting assignment of the full accumulated depreciation associated with the Tech investments.  She disagrees vehemently 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.  Company witness Elder disputes the Staff’s position that all depreciated reserve associated with Tech Plus should be assigned to Title 61.  Baldwin, Surr. at 42.  Baldwin argues that since 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 43.

2.  5% Local Loop.  Staff witness Baldwin recommends that the Commission directly assign 5% of the local loop investment to custom calling and CLASS services.  Direct at 41-44, Surr. at 22-31.  This recommendation recognizes that the Company’s ability to derive revenues that are substantial (see, e.g., Baldwin, Dir. Exhibit 114, Sch. 7, p. 2) and increasing (see Baldwin, Surr. 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 the Company's provision of basic local exchange lines, the Company could not derive these significant revenues.  Baldwin’s 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.  Contrary to the Company’s erroneous claim, such an assignment would not deter the development of economically efficient competition.  Based upon these principals, the Commission should allocate 5% of the local loop costs to custom services.

3.  Allocation of Total Plant in Service (TPIS).  Staff witness Baldwin presents three alternatives for the proper allocation of Total Plant in Service (TPIS) between Title 61 and Title 62 in her surrebuttal.  Common to all three alternatives, however, are the following recommendations — all of which the Commission should adopt regardless of which of the three alternatives the Commission determines to be consistent with its policy objectives (see Baldwin, Surr. at 52-53):

●As discussed above, the Commission should assign at least 5% of the Company’s unseparated local loop investment to Custom Calling/CLASS products.  Local loop investment is included in two different plant categories: “CWF1” which Staff analyzes in Schedule 1a; and as a relatively minor component of “COE,” which Staff analyzes in Schedule 1b.

●Allocate spare capacity in the local loop outside plant between Title 61 and Title 62 based upon the relative growth rates of these two categories of products.  The result of this computation is shown on line 13 of Schedule 1a of Exhibit 159.

●Directly assign to Title 61 the $45 million in accumulated depreciation that represents the Company’s expensing of the Tech Plus and Tech II plans, using Title 61 revenue sharing funds.  This is shown in Schedule 4 of Revised Exhibit 159 and in Revised Exhibit 101.

The difference among the three alternatives concerns the way that the Commission allocates digital plant that was deployed during the Tech Plus and Tech II years.

1.Staff witness Baldwin’s recommended alternative (contained in Schedules 1a, 1b, and 1c of Exhibit 159) is that all network modernization programs that the Commission directed the Company to undertake (through the Tech Plus and Tech II programs) be assigned to Title 61 and that all other new digital switches and digital subscriber loop equipment (that the Company deployed at its own initiative) be assigned to Title 62.

2.A variation on Baldwin’s recommendation would be — rather than to directly assign the Tech Plus and Tech II plant to Title 61 would be to allocate this plant between Title 61 and Title 62, to reflect the fact that Title 62 products are benefitting from the network modernization.  Under this approach, the Commission would still direct the Company to assign all other new digital switches and digital subscriber loop equipment to Title 62. This variation is reflected in Schedules 2a, 2b, and 2c of Exhibit 159.

3.Staff has also prepared another alternative, under which the Company’s digital plant additions — regardless of whether they resulted from the Commission’s explicit Tech Plus and Tech II directives or from the Company’s own strategic initiatives — would be allocated consistent with the Company’s allocation factors.  See Schedules 3a, 3b, and 3c of Exhibit 159.  The reason that this option does not yield a final TPIS allocation identical to that proposed by U S WEST is because all of Baldwin’s TPIS schedules incorporate the “common” elements described above.

The effect of the three alternatives are set out below.

SUMMARY OF PROPOSED ALLOCATIONS

                                         Title 61           Title 62       T. 61 TPIS (000's)

U S WEST              64%                36%$351,802

Staff Perferred        45%                55%  237,307

Staff Alt 1               42%                58%  218,163

Staff Alt 2               49%                51%  254,527

 RATE OF RETURN

A.  Settled Issues

1.  Capital Structure.  Staff witness Carlock had originally recommended a capital structure for the Company of 62% debt and 38% equity.  Carlock, Exhibit 128, Sch. 14.  Company witness Cummings had recommended a capital structure of 44.4% debt and 55.6% equity.  Exhibit 6.

2.  Cost of Debt.  In conjunction with the settlement of the capital structure, the Company and Staff stipulated to using the Staff recommended debt cost of 7.23% instead of the Company’s recommended cost of 7.48%.

U S WEST and Staff have stipulated to the U S WEST proposed capital structure and the Staff proposed cost of debt as part of the overall stipulation (Settlement conference March 4, 1997).  The combined effects of the cost of debt and capital structure stipulation is to increase the Company’s Title 61 revenue requirement by approximately $1.5 million and a correponding offset to the Staff’s revenue reduction.  Rev. Exhibit 101, lines 12-14. The settled capital structure and cost of debt (with the disputed cost of equity) are shown below.

LineComposite    Rate of

No.   ComponentRatio     Cost        Return

1Debt 44.4%    7.23%      3.21%

                      Staff:  11.0-12.0%           6.12-6.67%

2Common Stock 55.6%            USW 12.5-13.1%     6.95-7.28%

                  100.0%             Staff:      9.33-9.88%

                       USW:    10.16-10.49%

B.  Disputed Issue

1.  Cost of Equity.  The cost of equity is the only remaining issue in cost of capital if the stipulation is accepted.  AT&T witness Dr. Bell argues that U S WEST’s costs of capital are overstated.  Bell, Dir. at 9-10.  U S WEST continues to propose 13% while Staff proposes 11%.  The Staff’s 11% represents taking the low end of the recommended range (11% - 12%) to reflect poor service quality.  Specific issues with the return on equity include: 1) risk; 2) growth; and 3) quarterly dividend compounding.

a.  Risk.  U S WEST’s argues that it has substantial risk due to competition and that it is as risky or more risky than other telephone companies.  Staff argues through Dr. Selwyn that competition is not currently or in the near future the risk claimed by U S WEST.  Carlock states that the risk is less for USWC than for other telephone companies and the market in general for many reasons including the geographic rural nature of the service area and market power of the incumbent U S WEST.  U S WEST’s Beta is lower at .75 reflecting less risk than for the telephone groups reflected by Cummings of .79 or .82.  Carlock, Surr. at 14.

b.  Growth.  Growth is an important component of the DCF cost models used by both Staff and the Company.  Growth is projected at 6% by Cummings using the Institutional Brokers Estimate System (IBES).  Carlock uses Value Line historical, current and projected growth rates to develop the 3.5% - 4.0% range she recommends.  Carlock, Surr. at 15.  The current IBES growth rate is 5%.  Carlock, Surr. at 15.

c.  Compounding.  The quarterly compounding issue has several facets.  First , 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. Carlock has argued previously that no adjustment is necessary but adjusts the growth rate in a manner that is consistent with the method used to determine the return on equity in United Water and Idaho Power.  Reflecting higher growth projections is reasonable since dividends are not expected to increase.  Carlock states that she does not rebut this issue extensively since this change alone does not change her recommended return on equity range.

2. Income Tax/Gross-Up Factor.  Staff witness Lansing argues there are two problems with the Company’s presentation of the Idaho effective tax rate in the calculation of its gross-up factor.  First, Lansing asserts that the multi-state allocation formula to calculate Idaho’s State Income Tax should be 2.0213%.  Second, the actual “taxable income” should not be the ratio of income tax, but should be the ratio of net income between U S WEST and southern Idaho at the regulated jurisdictional financial statement level.  Lansing, Surr. at 15.  Based on what was purported to be a copy of the Company’s actual 1995 tax return filed in Idaho, Lansing used the 2.0213% figure.  Id. at 16.  For the ratio of U S WEST income and expenses, he used a ratio of 2.6196%.  Id.  This results in an effective Idaho income tax rate for 1995 of 6.1729%.  Id.; Rev. Exhibit 101, p. 8.  This Idaho effective tax rate is then used to calculate a gross-up factor (income to revenue of multiplier) of 1.6663, Rev. Exhibit 101, p. 9 and 1.5661 on Revised Exhibit 101, p. 13.

Staff and U S WEST are still discussing these issues.  The impact on revenue requirement due to the differences should be negligible.

EXPENSES

A. Settled Issues

1.  Depreciation.  Staff witness Dr. Selwyn in his direct and reubttal testimony advocated use of lives authorized by the Commission in 1988, rejection of the ELG methodology, and proposed that any reserve deficiency be recovered over the remaining lives of the assets.  Selwyn, Dir. at 28-50, Surr. at 1-29.  U S WEST’s proposed adoption of certain shortened asset lives 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 increasing Title 61 expense.

The Staff and the Company agree to settle these disputed issues.  Staff agrees 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.  U S WEST agrees to make an adjustment to the intrastate depreciation reserve and effectively write-off for this case the reserve deficiency with no revenue impact. In addition, U S WEST will not advocate recovery of reserve deficiency for U S WEST’s southern Idaho operations in the future. The net impact of this settlement is the Company will reduce its Title 61 revenue requirement by $7.1 million and the Staff will increase its Title 61 revenue requirement by $3.1 million.

2.  Rent Compensation.  The Staff agreed with the Company at the first settlement conference that rent compensation should be included as a contra-revenue expense.  Rev. Exhibit 101, line 42,  reflects the addition of rent compensation of $10.234 million in column F.

3.  Affiliated Transactions.  Staff witness Faunce examined various expense transactions between U S WEST and its affiliates including Business Resources, New Vector, Communication Services, Enhanced Services, Federal Services, USW Inc., Internation­al, Marketing Research Group, Multi-media, and Real Estate.  She calculated the Company allocated approximately $3.17 million of affiliate expenses to Title 61 operations.  Faunce, Surr. at 2; Exhibit 153.  She asserts that the Company should allocate only $1.207 million to Title 61.  Id.  This results in a difference between the Company’s and the Staff’s Title 61 allocation of $1.920 million.  Following notice to all parties, the Staff and the Company agreed at the February 12 conference to settle these affiliated expenses by splitting the difference.  Consequently, the Company will lower its Title 61 revenue requirement associated with its affiliated expenses by approximately $960,000 and the Staff will increase its revenue requirement associated with operating expenses by the same amount.  Id. and Exhibit 153.

4.  Telephone Concessions.  In direct and surrebuttal, Staff witness Stockton imputed telephone concessions revenue to Title 61 in the amount of $234,036 to match the expenses related to telephone concessions for employees and retirees.  Stocton, Dir. at 4, Surr. at 1.  At the March 4, 1997 settlement conference, Staff and the Company agreed to settle this and the following three issues by splitting the difference between the Staff and the Company’s Title 61 allocation.  The Company will increase Title 61 revenues by $117,000, and the Staff will reduce Title 61 revenues by an equal amount.

5.  President’s Club.  Staff witness Stockton disallowed $90,409 of Idaho intrastate expenses for the President’s Club recognition event because U S WEST did not provide the information to determine whether the expenses benefited Title 61 customers.  Stockton, Dir. at 10, Surr. at 4.  This event is akin to an all-expenses-paid vacation for the selected employees and their spouses, and no direct benefit could be traced to the Title 61 customer.  Staff agreed to settle this issue with the Company by splitting the difference.  The Company will reduce Title 61 expenses by $23,000 and Staff will increase its Title 61 expenses by a corresponding amount.

6.  Documents of Originating Entry.  After Stockton examined 206 documents of originating entry; she proposed an assignment to Title 62 of $857,352 and a direct assignment to Title 61 of $17,754 at the intrastate level.  Stockton, Dir. at 22, Surr. at 11.  At the March 4th conference Staff and the Company agreed to settle this adjustment.   Staff and the Company are splitting the total Title 61 difference of $468,000.  The Company will decrease Title 61 expenses by $234,000, and Staff will increase Title 61 expenses by an equal amount.

7.  Advertising.  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.  Stockton, Dir. at 25, Surr. at 13.   These advertising expenses have historically been disallowed by the Commission.  The Company argued that this type of advertising expense should now be allowed, due to competition.  Staff has agreed to settle this issue with the Company by splitting the 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.

8. Chart of Accounts.  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, Idaho.  The purpose of this adjustment is to remove 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.  Stockton, Dir. at 14, Surr. at 7.

Staff and U S WEST  agreed to settle this issue after the Company provided Staff with more detailed information.  Upon examining the detailed information provided by the Company, Stockton was able to determine that these Title 62 accounts had indeed been removed from the Title 61 revenue requirement.  The parties agreed to split the remaining 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 expense by an equal amount.

9.  1801 California Lease.  Staff witness Schneider argued that the lease at 1801 California was excessive and a reduction in the Intrastate Idaho-South revenue requirement of $173,000 was required to correct for this.  Schneider, Dir. at 16, Surr. at 6.  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 Oregon PUC Staff.  Due to the small dollar amount involved, this issue was settled with a 50-50 split resulting in a net adjustment of $43,000 at the Title 61 level as a reduction of U S WEST’s revenue requirement and a corresponding increase in the Staff’s Title 61 revenue requement.  This settlement is reasonable due to the difficulty of supporting the excessive lease charge on a unique structure in downtown Denver.

10.  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 amortization period for the implementation of FAS No. 106 - Employers' Accounting for Post-Retirement Benefits other than pensions.  Schneider, Dir. at 6, Surr. at 13.  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 on this issue.  At the March 4 conference, this adjustment was settled, see following Issue 11 for further information.

11.  Curtailment Loss Amortization.  The Company recorded a curtailment loss in 1995 in relation to a number of terminations that occurred in prior years.  The curtailment loss was the impact of these terminations on the accounting for Post-Retirement Benefits Other Than Pensions that could be measured in 1995.  This is a rare if not unique event.  Schneider, Dir. at 7.  Staff witness Schneider proposed for regulatory purposes, that rather than record this event in 1995 only, that it would be better to amortize this loss (expense) over the same period as the Transition Benefit Obligation discussed above.  This proposal resulted in a reduction of Intrastate Idaho-South revenue requirement of $1,139,000.  Id. at 2.  At the March 4 conference, this adjustment was settled.

The Staff’s TBO and the Curtailment Loss adjustments were accepted by the Company in the settlement, provided the Company is not required to fund the reserve account for FAS No. 106 for regulatory purposes.  By this compromise, the offsetting reduction in fund asset earnings resulted in a net expense reduction by U S WEST of $8,000 for Title 61.  The reasonableness of this compromise is based on the premise that the ratepayers received the benefit of the two adjustments Schneider proposed but the Company will not have any funding requirement for regulatory purposes.

12.  Compensated Absences Accrual.  Compensated absences represent any “time” the employee has earned that the employee will be away from work and still be paid as if the employee was at work.  Examples of compensated absences include vacation, sick leave and personal leave.   Schneider, Dir. at 8.  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. at 9.

The FCC adopted a ten-year phase-in period for the catch-up entry where U S WEST can 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.

Staff witness Schneider proposed an adjustment of $203,000 at the Interstate Idaho-South level because this 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 will become final.  Schneider, Dir. at 8, Surr. at 11.  Therefore, to properly reflect the 1995 test year for setting rates on a proforma basis 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 with a 50-50 split reducing the Company’s revenue requirement by $51,000 at the Title 61 level and a corresponding increase to the Staff’s revenue requirement.  This settlement is reasonable because the 1997 end to the amortization is two years after the test year.

13.  Amortization of Restructuring Expense .  The Company started a four-year Restructuring Plan in 1994 for which they took an $880,000,000 “special” charge in 1993.  Schneider, Dir. at 10.  The offsetting reserve for financial accounting purposes was used to record the expenses as they occurred until the Restructuring Plan was to be completed.  For regulatory purposes the expenses were charged to ordinary operations.  Idaho-South Regulated Title 61 expenses for 1995 totaled approximately $4,866,000.  Exhibit 108, p. 2.

Staff witness Scheider proposed that rather than record these expenses in the test year, it would be better to amortize these expenses over 15 years because the expenses in 1994 and 1995 have exceeded the economic benefits that had been received by the end of 1995.  This proposal resulted in a reduction in revenue requirement of $4,542,000.  Schneider, Dir. at 13.  At the March 4 conference, this adjustment was settled, see following Issue 14 for further information.

14.  Employee Layoff Exposure Reduction.  The primary economic benefit to be realized by the Restructuring Plan was the elimination of 10,000 personnel over the four-year period as service centers were reduced from 560 to 26 and computer systems were developed or enhanced to enable these employee reductions to occur.  As of December 31, 1995, 5495 employees were still to be terminated.  Id. at 14.

The Staff and U S WEST agreed to settle the issues of amortization of restructuring expense and employee layoff reductions following the March 4, 1997 settlement conference.  For this case, the Idaho intrastate expenses included in the test year will be reduced by $4.866 million.  This settlement effectively removes the expense from the test year so additional benefits from employee reductions do not need to be made.

B.  Disputed Issues

1.  Advanced Technologies (AT) and Bellcore Research Projects.  Staff witness Faunce calculated that the Company had assigned approximately $1.762 million in AT and Bellcore research projects to Title 61.  Exhibit 155.  She asserts that the Company has the burden of showing the reasonableness of its affiliated transactions (Direct pp. 9-10) and the Company had not met its burden of proving the reasonableness of its affiliated transactions.  More specifically, she indicated that $789,956 was for re-engineering.  Dir. at 20-23.  She proposed that $327,707 in research costs should be demonstrated to benefit or be related to Title 61 services before allocating any costs to Title 61 in this case.  Id. at 24-26.  The Company has utilized its cost allocation system 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 only to assign $16,119 to Title 61 ratepayers.  Exhibit 155.  Company witness Barrington argues that the Company’s cost allocation methodology reasonably allocates research costs between Title 61 and Title 62.  Barrington, Rebut. at 3, 8.

2.  Management Bonuses.  Staff witness Faunce argues that the Team Awards and Executive Short-term Incentive Plan 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.  Faunce Surr. at 23.  She recommended the exclusion of these bonuses from the test year because the standards upon which the bonuses were based primarily benefitted 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.

REVENUE ISSUES

1.  Reported Revenues.  The Staff agrees with the revenues reported by the Company as shown in Rev. Exhibit 101, lines 38-43; Lansing Dir. at 18-19.

2.  Directory Imputation.  In its direct and rebuttal case, the Staff had recommended that $8.645 million in directory revenue be imputed to Title 61 revenues.  Revised Exhibit 101, line 44.  Staff witnesses Carlock and Dr. 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.  At the March 4 settlement conference, the Staff agreed with the Company 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 at a cumulative value of approximately $4.2 million.  Given the litigation potential of this issue, Staff and the Company have agreed to this settlement.  In addition, the Staff will not advocate the imputation of directory revenues for U S WEST’s southern Idaho operations in the future.

SERVICE QUALITY ISSUES

A. Settled or Agreed Issues

1. Service Guarantee Program.  Staff witness Hart recommended a number of changes to the Service Guarantee Program. These changes include: 1) increase the amount of the cellular voucher to $200 the first month and $150 per month thereafter; 2) the voucher will be available in five days instead of 30 days; 3) provide voice messaging with the assignment of a telephone number, directory listing, a calling card and remote call forwarding when service is delayed beyond the two- day installation; and 4) double the non-recurring credit for customers not served by cellular.  Hart, Dir. at 14-25, 47-53, 60-61. U S WEST agreed to make these changes.  Souba, Reb. at 25, 26. Hartalso recommended that imputed revenues be included for revenue the Company could have collected, but did not due to delayed installations(Hart, Dir. at 53-54),and that the cost of providing credits under the Service Guarantee Program be below the line.Id. at 54.  Hart calculated that $112,000 be imputed to Title 61.  Revised Exhibit 101, p. 3, line 26.  Souba indicated the Company was willing to accept these changes. Souba, Reb. at 27.

B. Disputed Issues

1. Service Quality Deteriation. Staff witness Hart maintains that U S WEST’s service quality is so bad that the Commission should recognize the poor performance in the Company’s rate of Return.  He indicates that US WEST’s service quality deteriorated rapidly in 1994 and 1995. Although the rate of deterioration slowed in 1996, the overall service quality is still not acceptable.  Hart, Dir. at 12-15; Exhibit 126, Sch. 4. Hart indicates that the number of complaints investigated by the Staff has more than doubled since 1993. On a per customer basis (taking growth into account), US WEST complaints have increased 94%, while the average increase for other major utilities was only 2%.  Id. at 14-15.  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. Hart, Surr. at 6-11; Exhibit 122, Revised Sch. 1-5.   It appears the Company is obtaining the small improvement they have made in repair by delaying installs. Hart, Surr. at 7.  The areas that have improved are still well below the levels they were prior to re-engineering. Exhibit 126, Sch. 4.

Hart’s primary proof that service quality has deteriorated is based upon an analysis of complaints received by the Commission about U S WEST service.  He maintains 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 asserts that  complaints are just the tip of the iceberg. Hart, Dir. at 7-9, Surr. at 3-5; Exhibit 119. The Company claims that complaints represent too small a group to be valid.  Souba, Reb. at 10-11.  Hart also maintains that the Company’s internal measurements are open to manipulation and target levels set by the Company are just too low. Hart, Dir. at 36, Surr. at 9-11; Exhibit 123.  The Company presents results of it’s internal measurements, which it claims are a more accurate indicator of the service that is being provided, and claims that since the Company has met its own target levels for most of these indicators, service is acceptable. Souba, Reb. at 4, 9.

2.  Service Quality Return Adjustment.  Based on the Company’s poor service quality, Staff witness Hart recommends that the Company’s return on equity be lowered 50 basis points (to  11% per Carlock, Dir. at 36-37) until the Company demonstrates to the Commission’s satisfaction that service quality has improved.  The Company maintains that the return on equity adjustment is a penalty.  Souba, Reb. at 3,16.  Company witness Souba claims that service problems have essentially been resolved. Id.  The Company is meeting most of it’s own internal targets, and that service is acceptable.Id. at 14.

3.  ROC Service quality Standards.  Staff witness Hart recommends 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. Hart, Dir. at 44. He claims the  ROC criteria represent service quality before re-engineering, and that at least a year of service at this level is needed to demonstrate 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 44-45, Surr. at 14.  U S WEST complains that the requirement that it meet the ROC criteria before the adjustment is reviewed essentially makes them subject to the ROC standards while other telephone utilities are not.  Hart maintains that the ROC criteria are merely being used as the measurement criteria to determine when service service has improved sufficiently to review the return adjustment. Hart, Surr. at 14. Hart again claims that the Company’s internal targets are so low the Company can meet those targets and still be providing unacceptable service. Hart, Dir. at 36, 46, Surr. at 9.

4.  Service Quality Program.  Hart recommends the Service Quality Program be made mandatory.  Hart, Dir. at 60.  He also proposes that the residential credit for missed repair commitments be increased from $10 to $20.  Id. at 61.  The Company objects to the Commission ordering the program be made mandatory and to the increase in the missed commitment credit.

5.  Toll-Restriction.  Staff witness Hart recommends that the Commission determine that toll-restricted service is a Title 61 service.  He maintains 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 insists that the Commission has not yet decided this issue, and that toll restricted service is similar to other toll-blocking services (976, 900) that are classified as Title 61services.  Staff recommends that toll restricted service should be available for no monthly charge and with a minimal initial charge. Hart, Dir. at 55-56, Surr. at 20-22.

The Company claims 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) now.  The Company claims it is not “2-way switched interactive communications”, as defined in Idaho Code § 61-121(2).  The Company maintains the Commission has no rate-setting authority if the service is Title 62. Souba, Reb. at 28-29.

6.  Rural Zone Maps. Hart asserts 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 charges that are no longer equitable.  The Company should either update the maps or stop charging the fees. Hart, Dir. at 55-57, Surr. at 22-24.  The Company claims the primary factor in designating the zones is distance, and distance has not changed consequently, the maps are still valid. Souba, Reb. at 29-30.

7.  Measured & Flat Service At Same Location.The Company currently has a provision in its tariff prohibiting 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 maintains that it should either be enforced or removed from the tariff.  Hart, Dir. at 58-60.  The Company indicated it is working on a solution. Souba,  Reb. at 32.

8. 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 is concerned 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 recommends that the language in this tariff section include clear and consistent guidelines for imposing such special charges. Hart, Dir. at 57-58.  The Company contends that the very nature of the circumstances demands the flexibility now in the Tariff.  Souba, Reb. at 31-32.

9.  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 done an inadequate job of advising customers of this Rule and agreed to have its representatives follow a specific script to remedy the issue.  Cooper, Dir. at 4.  Staff witness Cooper states 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 3.  U S WEST does not dispute that violations have occurred (Souba, Reb. at 33), but states that because Idaho is unique in this requirement, and that occasionally an employee will make a mistake and fail to offer this option.  Souba, Reb. at 33-34).  Cooper declares Idaho is not unique in this requirement, in fact at least nine other states have this same requirement.  Cooper, Surr. at 2.  Failure to follow PUC rules is a violation, not a “mistake”.  Id.  The Company should be directed to comply.

10.  Calculating Deposits.  Rule 105.01 involves the computation of deposit amounts.  Staff was aware that U S WEST was having problems calculating deposit amounts.  Staff was led to believe that the calculation for Idaho customers would be corrected around June 1, 1996, and that it would be an automated function.   Cooper, Dir. at 5.  U S WEST states that it must use less automated methods to accurately calculate Idaho deposits.  U S WEST argues that there is inequitable treatment between telephone competitors and recommends a series of workshops and a complete set of new Telecommunications Rules.  U S WEST would like to compares itself to companies that only provide Title 62 services.   Souba, Reb. at 37. Cooper insists that such a comparison is inappropriate.  Cooper, Surr. at 3.

11.  Billing Disputes and Allocation of Payments.  Staff witness Cooper asserts that the Company has violated Consumer Rules 312.03 and 401.02 regarding the handling of certain billing disputes and allocation of payments.  By failing to allocate payments correctly or permanently remove disputed charges from the bill, U S WEST has caused customers to be toll restricted or even disconnected.  Cooper, Dir. at 6.  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.”  U S WEST agrees with Staff’s claims that customers have experienced misapplied payments, delayed deposit returns, etc.  Souba, Reb. at 44.  However, U S WEST claims that these are simply mistakes, and are not done with the intent to violate PUC rules. Id. Again, Staff recommends that the Company be directed to comply with  PUC rules.

12.  White Page Directory Listings.  Staff witness Cooper asserts that U S WEST  violated Rule 601.03 by charging for white page directory listings.  She maintains 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.  Cooper, Dir. at 9.  U S WEST alleges that it has always charged extra to list suite numbers, apartment numbers and post office boxes and considers them informational in nature.   Souba, Reb. at 38.  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 maintains 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.  Cooper, Surr. at. 7.  Addresses are sufficiently distinct from information, and Staff is confident U S WEST employees can make such distinctions. Id. at 8.

13.  Billing Rights.  Cooper voices concerns regarding billing rights information being omitted from the new bill format.  Because U S WEST bills for other service providers and billing and payment issues are complex, she believes it is reasonable to expect some printed explanation on the bill as to what customers should do to try to resolve billing problems.  Cooper, Dir. at 10.  U S WEST states they are not aware of even one complaint concerning the lack of billing rights being printed on the bill.  Souba, Reb. at 39. 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.  Cooper, Surr. at 8.

14.  Voluntary Toll Restrictions.  Customers who are toll restricted because they owe a previously unpaid final bill should not be subject to the marketing of optional products and services offered by U S WEST.  In 1995 roughly 30% of “risk” customers were permanently disconnected because of failure to pay the amounts owed for the new-established service and/or the previous unpaid final charges with an average past due amount of $266.  Cooper, Surr. at 10.  Staff agrees that if a specific optional service is requested that U S WEST should honor that request.  For existing customers who become toll-restricted due to non-payment and voluntarily request suspension of optional services as a means of catching up on their bills, Cooper recommends that the Company waive the service charges to reinstate those services to which they previously subscribed.  Id. at 10-11.

15.  Directory Listings.  Cooper states that non-published and non-listed customers should be automatically removed from solicitation lists for U S WEST products and services.  Cooper, Surr. at 11.   U S WEST believes such customers are candidates to receive these calls because they have an established relationship with the Company by virtue of being monthly subscribers.  Souba, Reb. at 43.  Cooper’s position is that customers have a legitimate expectation of confidentiality because they believe they are paying for privacy and do not want to receive solicitations from U S WEST or others.  Unless U S WEST needs to contact the customer for service-related reasons, the disclosure restrictions for non-published and non-listed information should flow to U S WEST’s marketing arm as well as its competitors.  Cooper, Surr. at 11-12.

16.  PIC Freeze.  Cooper asserts that U S WEST is currently discouraging customers from placing a primary interexchange carrier (PIC) freeze on their accounts to protect themselves against unauthorized switching of their long distance carrier. Cooper, Dir. at 15.  Staff has received an increasing number of alleged slamming and other carrier selection complaints, going from approximately 450 contacts in 1995 to over 580 in 1996.  Id. at 18.  In response to Staff’s Production Request No. 429, U S WEST states that a PIC freeze for purposes of “peace of mind” is unnecessary and potentially a future liability when customers wish to change carriers.  Cooper recommends 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, Dir. at 19.

RATE DESIGN ISSUES

A. Agreed or Settled Issues

1. EAS Adjustment.  U S WEST proposes two adjustments for the costs of the three regional calling areas approved by the Commission in Case No. USW-S-96-4. Wright, Reb. at 3.  Staff initially proposed an adjustment based upon TELRIC costs but withdrew this recommendation in surrebuttal.  Following settlement discussion Staff accepts the Company’s EAS adjustments.

First, Staff witness Eastlake accepts U S WEST’s estimated plant costs for implementing EAS as $3.7 million.  Wright, Reb.Adj.#28; Staff Revised Exhibit 101, p. 10.  Staff and the Company agree 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—up to $3.7 million.  Eastlake, Surr. at 4.  As with the Tech II project, new facilities installed with revenue sharing funds should be added at their cost and offset as an adjustment to accumulated depreciation (resulting in no rate base addition). Second, Eastlake agrees with U S WEST’s estimated shift in costs associated with separations (shifting toll minutes to local minutes), thereby increasing rate base by $8.306 million and operating expenses by $3.047 million.  Wright, Reb. at 9, Adj. #27; Revised Exhibit 101, p. 10.  The proforma revenues will be included in the test-year revenues for the purpose of determining the change in rates.

2.  Miscellaneous Issues.

a.  Measured service.  Eastlake accepts 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.  He recommended a reduction of the per minute usage charge to $.02 (rather than $.03 as proposed) and U S WEST agreed to reduce the usage rate to $.02.

b.  Installation charge.  He objected to U S WEST’s proposal to charge only $1 for installation of an additional line ($30 for one line, $31 for two lines) as promotional and likely to further jeopardize service quality.  USW withdrew its proposed change.

c.  Vacation rates.  Eastlake opposed the proposed changes in vacation rate as offering significant benefits to a small number of customers in the face of huge increases to all other customers.  Conceding that this restructure has very small revenue impacts on other customers, he withdrew his opposition.

d.  Privacy listings.  Eastlake initially noted there is no serious cost justification for current charges for nonpublished-nonlisted directory listings.  He proposed  reducing the charges for nonlisted and nonpublished service to average figures from U S WEST’s service area.  After further consideration of the burden shifted to other customers (about $.5 million), he withdrew his recommendation.

B. Disputed Issues

1.  Business-residential rate ratio. US WEST proposes to halve thebus-res ratio from about 2.6 to about 1.3, saying that competition demands reduction of the subsidy from business and the cost difference does not support such a difference. Owen, Dir. at 10; Wozniak, Dir. at 9.  Staff witness Eastlake argues that the exisiting ratios should be maintained, because the results of this case will be short-lived due to the onset of a turbulent period of change in the industry.  Eastlake, Dir. at 42.  Now is not the proper time to redo the entire structure.  Id. at 27.  He asserts 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 26, 27.

Eastlake points out that the differential has been argued and ultimately approved by the Commission in previous cases.  Id. Dir. at 24.  He notes 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 25, Surr. at 19.  Eastlake believes that the “costs” cited by the Company generally understate the costly churn and business volatility cited by Staff witness Baldwin (Surr. at 35) and are likely contaminated with Title 62 business costs. He stresses that it is unfair, to have most all of the proposed rate increase (some 98%) borne by residential customers.  Eastlake, Dir. at 24, Surr. at 20; Exhibit 129.

2. Competition and its role.  U S WEST  says there is lots of competition for local service, evidenced by Yellow Pages and by Var-Tec ad.  Owen, Reb. at 4; Exhibit 40B.  Staff points out that virtually all of Title 61 competition is prospective. Selwyn, Dir. at 10-12, 20-22.  U S WEST’s reliance on ads is contaminated with Title 62 providers or completely unregulated business.  Eastlake, Surr. at 12-13.  U S WEST says competition drives price toward cost, but not necessarily down.  Staff is in general agreement with the theoretical tendency, but disagrees on the level of actual cost.  Only the cost allocation between Title 61 and 62 will settle the “level of cost” question and provide some sense to the subsidy charges flying in both directions. Eastlake, Dir. at 9.

U S WEST characterizes Staff’s position as “extreme” in view of previous earnings reports of reasonableness.  Wozniak, Reb. at 3.  Staff’s ultimate characterization of “reasonable” included reference to audit uncertainties, especially cost allocation, that can be developed only in a general rate case and are now at issue for the first time in 10 years.  Eastlake, Surr. at 6-7.  Staff believes this case must be limited to determining the costs for Title 61 services and setting Title 61 rates.  It is the  Idaho Telecommunications Act that requires a separation between Title 61 and Title 62.   Id. at 7-8.

U S WEST obscures the real magnitude of its rate proposal, by breaking it down into two or three phases so that the individual pieces look smaller.  U S WEST (Owen, Dir. at 3-4) uses terms like simplification and consolidation and rebalance, to soften the perception by most customers. Staff provides analysis of the impact as a whole.  Eastlake, Dir. at 21-22; Exhibit 129.  Staff compares the changes to current conditions and finds huge increases for residential customers, coupled with very small changes for business customers.  Id. at 18-19; Original and Revised Exhibit 131, p. 2.

CASE SUMMARY

Because of the different cost allocation methodologies advocated by the Staff and U S WEST, the average rate bases recommended by the parties are significantly different.  Using Staff’s preferred allocation methodology, its average rate base is $91.930 million while the Company’s average rate base is $164.525 million.  This difference in conjunction with the positions advocated by each party on the disputed issues results in a revenue reduction for the Staff’s case, while the Company’s case produces a revenue requirement.

Respectfully submitted this  7th  day of March 1997.

Donald L. Howell, II

Deputy Attorney General

Attorney for Commission Staff

vld/N:USW-S-96-5.dh3

Issues

Rate Base

Cost Allocation

Rate of Return

Expenses

Agreed/Settled

Working Capital

Accumulated Depreciation

Deferred Income Tax

Customer Deposits

Subsidiary vs. General Ledger

Pension Assets

Capital Structure

Cost of Debt

Depreciation

Rent Compensation

Affiliated Transactions

Telephone Concessions

President’s Club

Documents of Originating Entry

Advertising

Chart of Accounts

1801 California Lease

Transition Benefit Obligation

Curtailment Loss Amortization

Compensated Absences Accural

Amortization of Restruturing

  Expense

Employee Layoff Exposure

  Reduction

Revenue

Requirement Impact

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Disputed

Lease Features PIS

Delayed Adjustment to Plant-in-    Service (RUC)

Lit Fiber Optic Cable

1.89% Error Factor

Assigning Tech Plus and Tech II    Projects to Title 61

5% Local Loop

Allocation of Total Plant-in-

 Service (TPIS)

Cost of Equity

Income Tax/Gross-Up Factor

Advance Technology (AT) and

 Bellcore Research Projects

Management Bonuses

Revenue

Requirement

Impact

<.262>

<.448>

<1.805>

<.978>

<1.601>

<.160>

<.785>

<.961>

<.423>

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Revenue

Service Quality

Rate Design

Reported Revenues

Directory Imputation

           credit $.50 for 1 year ≈

Service Guarantee Program

EAS Adjustment

Miscellaneous

  a.  measured service

  b.  installation charge

  c.  vacation rates

  d.  privacy listings

<8.645>

4.2

9.036

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Service Quality Deteriation

Service Quality Return

 Adjustment

ROC Service Quality Standards

Service Quality Program

Toll-Restriction

Rural Zone Maps

Measured & Flat Service

Special Construction Fees

Guarantor in Lieu of Deposit

Calculating Deposits

Billing Disputes and Allocation

 of Payments

White Page Directory Listings

Billings Rights

Voluntary Toll Restriction

Directory Listings

PIC Freeze

Business-Residential Rate Ratio

Competition and its Role

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