- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Request of US WEST COMMUNICATIONS, Inc. For Approval of an Increase in Its Rates and Charges.	)))))	DOCKET NO. 92-049-05 REPORT AND ORDER

ISSUED: April 15, 1993

SHORT TITLE

1992 General Rate Case

SYNOPSIS

The Commission herein orders an increase in revenue requirement of $4,970,000. The cost of capital is set by the Commission at 12.0 percent rate of return on common equity and 10.64 percent rate of return on investment. The Company is to begin a phase-in to full accrual accounting for the cost of postretirement benefits other than pensions.

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I. PROCEDURAL HISTORY

On June 5, 1992, US West Communications, Inc. (hereinafter USWC or the Company) filed a request for an increase in rates.

Also on June 5, 1992 USWC filed a Motion for a Protective Order. On June 23, 1992, the Commission issued a Protective Order in this matter.

On July 14, 1992, a prehearing conference was held in this matter pursuant to notice. At that prehearing conference, appearances were entered by US West Communications, Inc., the Division of Public Utilities, the Committee of Consumer Services, AT&T of the Mountain States, Inc., MCI Telecommunications, Inc., Contel of the West, Inc., Exchange Carriers of Utah, Inc., and the Utility Shareholders Association. The Commission ruled that all parties who made an appearance at the prehearing conference, as well as Tel-America, Inc., which had entered an earlier appearance, would thereafter be treated as parties to this proceeding.

On July 21, 1992, the Commission issued its Procedural Order in this matter. In that Order, the Commission established a schedule for filing testimony and established dates for hearings in this proceeding. In the Procedural Order, the Commission required parties to make a filing on July 28, 1992 regarding the appropriate test year in this matter. Thereafter, position statements regarding test period were filed by the Company, the Division, and the Committee.

On August 10, 1992, the Commission issued an Order and Notice of Hearing, in which it ruled that an historical 1991 test

period without post-test-year adjustments would be required and that the parties would be permitted to provide argument and testimony with regard to this decision and their view as to the appropriateness of such a test period. Thereafter, on August 24, 1992, USWC filed a Brief and Objection regarding test-year issues; USWC also filed the testimony of Carl Inouye. Contel of the West filed the testimony of John Blanchard. The Committee filed the testimony of Michael L. Arndt. The Division filed the testimony of Ingo Henningsen; the Division also filed a Petition for Clarification and Rehearing.

On August 26, 1992, a hearing was held for the purpose of arguing issues related to projected test years and post-test-year adjustments. Thereafter, on October 9, 1992, the Commission issued an order in which it affirmed its August 26, 1992 bench order requiring the Company to file a 1991 historical test year, without post-test-year adjustments, but left parties free to file additional alternatives if desired. In the October 9 order, the Commission further stated that "the Company may file its 1992 test year, a 1991 historical test year with all known adjustments, positive or negative, and whatever else it may deem relevant. The other parties are likewise allowed to file whatever they deem relevant."

In addition to the parties appearing at initial Prehearing Conference in this matter, the following parties filed petitions to intervene: Utah Payphone Association, Utah Power & Light, and the Utah Telecommunications Management Association (UTMA). Their petitions to intervene were granted by the Commission.

Pursuant to the schedule established by the Commission, several parties filed written direct, rebuttal and surrebuttal testimony relating to the various issues in his proceeding.

On November 2, 1992, the Company filed a Motion to Strike portions of the direct testimony of Committee witness William Dunkel. Thereafter, on November 6, 1992, the Committee withdrew portions of the testimony of Mr. Dunkel, thus resolving the Motion to Strike issue.

On November 23, 1992, the Commission held hearings regarding rate of return and capital structure issues. Thereafter, the Commission at the request of USWC following issuance of an order in Docket No. 92-999-04, determined to delay the bulk of the hearings scheduled for December 1992 until January and February 1993. The Commission nevertheless went ahead and held Public Witness Day on December 11, 1992, pursuant to the publication of notice.

The Commission held hearings with regard to revenue requirement issues from January 19, 1993 through January 22, 1993. Hearings were held on spread of rates issues from February 1, 1993 through February 4, 1993.

On February 10, 1993, the Commission heard oral argument on revenue requirement issues. On March 31, 1993, oral argument on rate spread issues was heard.

II. DISCUSSION, FINDINGS, AND CONCLUSIONS WITH RESPECT TO REVENUE REQUIREMENT

A. INTRODUCTION AND TEST-YEAR ISSUES

A "test year" is the information base for constructing the "test period," which is intended to represent the period new rates will be in effect. In this docket, the test year filed by the applicant and parties is 1991. It is an historical test year using actual results of operations for that year. Ideally, each element of 1991 test-year revenues, expenses, and investment should be examined during this proceeding for correctness of accounting and for reasonableness of amount. This examination will lead to the accounting and reasonableness adjustments which will convert the 1991 test year to a ratemaking test period.

The logic of constructing a test period--based on the 1991 actual results of operations--is straightforward. To begin, the financial and operating results of the total company, reported in the uniform system of accounts, must be divided among the several states which the utility serves. This step is accomplished following accounting procedures established by the Federal Communications Commission (FCC). Under these procedures, the Company's revenues, expenses and investment in Utah are separated into those interstate in nature, subject to FCC jurisdiction, and those intrastate, subject to Utah Commission jurisdiction. This is the starting point for determining Utah jurisdictional revenue requirement.

Utah intrastate revenues, expenses, and investments first must be adjusted to accord with standing Utah regulatory policies, an action which may require imputation of revenues or disallowance of expenses and/or investments. The result will show whether the Company actually earned its allowed rate of return in this

jurisdiction, and thus will also show the effectiveness of previous regulatory decisions. Because the test year looks forward to the period when new rates will be in effect, the second kind of adjustment must annualize specific revenue, expense and investment changes which occurred during the test year. Examples might include new plant coming into service, new wage rates which may have been adopted, or a previously ordered rate change which may have taken effect, all within the test year. A third category of adjustments are those which normalize the test year by removing the effects of accounting adjustments. Accounting adjustments made in the test period but relating to prior periods must be removed. When information is available, accounting adjustments made following the test period but relating to the test period should be included. Generally these adjustments consist of true-ups of accrual accounts to match actual experience. A fourth category of adjustments are those which normalize the test year by removing the effects, if applicable, of abnormal weather patterns that occurred during the test year, or perhaps the cyclical pattern of local business conditions. Finally, a fifth category of adjustments are those which go beyond the issue of accounting and address the reasonableness of revenues, expenses, and/or investments. All these categories of adjustments, while routinely advocated and often made, must be examined during rate case proceedings. The basis of the examination is the historical test year information; in other words, reported, actual results of Company operations during the year.

There is, however, an additional, problematic category of adjustments at times proposed. These are the post-test-year adjustments for significant events expected after the test year but prior to the effective date of new service rates. An example in this docket is the adjustment to include the costs of postretirement health care benefits. The argument for including such an adjustment is that it is a known, even if future, event, and that its revenue requirement effect is measurable.

During the past five years or more that our practice has been to rely on historical test years, we have come to understand the undesirable effects of post-test-year adjustments and have sought to exclude them. Our reason, briefly stated, is that to consider them properly, a future test year will be required. We are reluctant to give up the considerable regulatory benefits of the historical test year. A brief statement of the argument follows.

First, the Company has unequalled access to the financial and accounting information describing its operations. It could, therefore, propose adjustments strategically. Regulators are not a surrogate management, and must rely on a presumption of management competence.

Second, a post-test-year adjustment presents a special and serious case of matching and information insufficiency. It is a single-item adjustment, proposed because it is "known and measurable." Since, by definition, it is outside the test year, it cannot be analyzed in a test-year context of matched revenues, expenses, and investments. Hence, it is akin to a single-item rate

case. All the arguments against conducting single-item rate cases argue against consideration of post-test-year adjustments. The fact is, events do not occur in isolation. The utility is a complex web of economic relationships, each of which changes as the result of external and internal forces and events. This is the proper context for considering any proposed adjustment. A competent management will optimize Company operations **given** an expected, known and measurable, change. This means offsetting effects are probable. Moreover, economic life goes on, bringing a multitude of other events, influences, and changes. The net effect of all of this cannot be known outside full rate case examination. This is the importance of the matching concept in the ratemaking process. When mismatching occurs, so much pertinent information remains unknown, unmeasurable, and unconsidered. This is the very reason for the objective of matching and for the practice of avoiding single-item rate cases.

Third, standard ratemaking presumes a sharing of the risks of the uncertain future between shareholders and ratepayers. Periodic rate cases ensure this result when historical test years are used to set utility service rates. Once new service rates are in effect following the rate case, Company earning performance is in management's hands. Should the Company exceed or fall short of earning the allowed rate of return, corrective action awaits the next rate case. This classic regulatory view of risk-sharing underlines the importance of regulatory lag. It is an inducement to management efficiency. When, by contrast, post-test-year adjustments are permitted, some of the risk of the unknown future will be shifted

from shareholders to ratepayers. All subsequent management actions to offset the effects of that adjustment will tend to expand earned return beyond what has been allowed. This again shows that the proper context for evaluating a proposed post-test-year adjustment is a complete examination of the forecast chart of accounts, or in other words, a future test year. What precision may be gained by considering the post-test-year adjustment is lost in the forecasting required for all other accounts.

The fourth argument explains our preference for historical test years on grounds that projected test years inefficiently use limited regulatory and company resources and diffuse accountability. Properly done, a projected test year requires all the information that an historical one does, plus account-specific projections. Anything less is a shortcut. In a future test-year proceeding, the projections must be carefully examined because they are simply the debatable results of systematic conjecture, concerning which there is little or no accountability: the future is uncertain and the probability is very high that the projection will be wrong. To spend regulatory resources on forecasting methods and assumptions diverts resources away from an examination of the reasonableness of test-year revenues, expenses, and investments in an economic context. This may lead to the even less acceptable expedient of simply "factoring" large aggregated categories of revenues and expenses up or down by some amount, taking the place of the line-item forecasts. In this case, even less is reviewable, and there is even less accountability. This lack of economic examination and accountability may harm the

incentive to efficiency, and consequently transfer the risks of inefficiency to the ratepayer in the form of increased costs of service.

Summing the argument, should consideration of proposed post-test-year adjustments force the use of a future test year, there is little reason to believe, absent compelling circumstances, that a more accurate representation of the rate-effective period would result than with an historical test period, unadjusted for post-test-year events. Moreover, there are good reasons to avoid a future test year. It diminishes economic examination and accountability, replaces actual results of operations data with difficult-to-analyze projections, and plays to the Company's strength, which is the control of critical information. The efficiency incentive conferred by regulatory lag is dampened, and the risks of the future are transferred to ratepayers. This is too high a price to pay simply to accept post-test-year adjustments.

In the final analysis, the success of a selected test year in representing the rate-effective period will be measured by the rate of return the Company actually earns during that period. There is no reason to believe, absent special, compelling circumstances, that an historical test year adjusted to include post-test-year items, or a projected test year if that is the result, would more capably represent the rate-effective period than would the historical test year that does not include such adjustments.

However reasonable post-test-year adjustments may appear when considered on their own merits, such adjustments would be likely

to distort the test year by increasing revenue requirement unjustifiably. This benefits the Company and harms the ratepayer. We conclude that absent compelling reasons which mitigate the concerns just expressed, we will not permit post-test-year adjustments absent rate case examination of revenues, expenses, and investment for the same post-test-year period. It is simply unreasonable to consider post-test-year adjustments in isolation. Post-test-year adjustments thus may transform an historical test year into a projected test year. Given the important regulatory benefits of using the historical test year, this is an unacceptable outcome where the better alternative is available and appropriate.

B. RATEMAKING POLICY ADJUSTMENTS

There are fifteen ratemaking policy adjustments. These adjustments all are a product of prior Commission decisions. Only three adjustments, Cash Working Capital, Medical/Dental Amortization, and Merit Award Amortization are in dispute.

1. BELLCORE DIVIDEND

Bellcore, a research company, is equally owned by each of the seven Regional Bell Operating Companies, including US West Communications. The dividend income paid to USWC by Bellcore is reported as included in non-operating accounts, accounts which are excluded from the determination of revenue requirement for USWC. However USWC's share of investment in Bellcore is included in the

rate base of USWC. It is the policy of this Commission to include both the dividend income from and investment in Bellcore in the determination of the revenue requirement of USWC. The basis for this policy decision is found in Docket No. 88-049-07 which adopts the recommendation of the National Association of Regulatory Utility Commissioners' September 1988 Multi-State Audit Report. This adjustment includes Bellcore dividends and investment as Company revenue and rate base items. No party opposed this adjustment which adds $200,300 to test-year revenues and increases test-year income by $173,300. It also adds $1,133,000 to test-year rate base.

2. CAPITAL LEASE REVERSAL

Under Part 32 accounting, the FCC has accepted capitalized leases which allows a utility to put long-term capital leases into rate base instead of treating lease payments as an expense. In Docket No. 88-049-07 the Commission found capitalization of leases to be inappropriate for ratemaking. The Commission stated that the matching of cost to customer usage appeared to be better accomplished by treating leases as expenses. No party opposed this adjustment. This adjustment adds $52,400 and $28,000 to test-year expenses and deferred income taxes respectively, thus reducing test-year income by $80,400. In addition this adjustment removes $451,800 from the test-year rate base.

3. CASH WORKING CAPITAL

Beginning with Utah Power & Light Docket Nos. 80-035-17, 81-035-13, and 82-035-13 and continuing with Mountain Bell Docket No. 85-049-02, the Commission has approved the cash method of calculating the Cash Working Capital adjustment to the determination of rate base. This method focuses on cash outflow and cash inflow during the test period for maintaining daily operations and excludes items which do not require a current cash expenditure for external transactions with third parties such as depreciation, deferred taxes, and return on common equity. Lead-lad studies comparing the difference in the timing lag between cash inflows and cash outflows are used to estimate the amount of the adjustment.

The Company argued that under the present cash method, investors were being denied a return on a portion of their investment since no recognition is given to the time lag between when ratepayers consume services and when they pay the Company for the use of plant and equipment by making cash available to investors for the return of capital (depreciation) and return on capital (net operating income). The Company argued that the timing lags on depreciation and net operating income represent uncompensated investment. The Company claimed such a policy was inconsistent with the objective of permitting investors the opportunity to earn a fair rate of return on all capital, including working capital. In support of its position, the Company cited a Federal appellate court remand of an FCC decision which excluded non-cash items from lead-lag studies. In addition, the Company argued that a negative Cash Working Capital adjustment is

appropriate only insofar as ratepayers have funded plant and equipment.

The Company recommended that the Commission allow the inclusion of depreciation and net operating income in the lead-lag study. If the resulting adjustment is negative, the Company recommended that the adjustment be eliminated unless there is a demonstration that ratepayers have provided funds to purchase plant and equipment.

Both the Division and the Committee advocated the present cash method and opposed the Company's recommendation. The Division and the Committee argued and we find that Cash Working Capital represents the investment required to meet current expenses of external transactions and therefore only current outlays should be included in the lead-lag study. Depreciation and net operating income do not require a current cash expenditure and therefore do not need additional cash from investors. Lags associated with depreciation and net operating income, i.e. transactions between Company management and shareholders, are adequately accounted for by capital markets.

The Division testified and we find that if the Commission were to order the inclusion of depreciation and net operating income in the Cash Working Capital calculation, then the lags associated with the payment of interest to bondholders and dividends to shareholders should also be recognized. The Company argued that management acts as a proxy for investors and therefore there were no lags associated with internal transactions such as the payment of

interest and dividends. The only relevant lag according to the Company is that associated with the receipt of revenues necessary to recover the costs of depreciation and net operating income.

We find that this issue has been advanced by the Company in Docket Nos. 85-049-02 and 88-049-07 in which the Commission rejected the Company's position and accepted negative Cash Working Capital adjustments of $1.041 million and $6.872 million respectively. The stipulated revenue requirement of Docket Nos. 90-049-03 and -06 contained a negative $14.103 million Cash Working Capital adjustment.

We further find that in no jurisdiction in which the Company serves are lags associated with depreciation and net operating income included in the calculation of Cash Working Capital. (In some of the Company's jurisdictions lead-lag studies are not undertaken.) In response to questioning from the Commission, the Company could not positively cite an instance in which other jurisdictions in the country have adopted the Company's position.

An FCC decision excluding non-cash items from lead-lag studies was appealed to the D.C. Court of Appeals. The D.C. Court remanded it back to the FCC to further explain the reasoning behind their decision. Upon remand, the FCC did not change its position of excluding non-cash items. The FCC decision was again appealed and is now pending at the D.C. Court of Appeals. This is essentially the information which is new since the prior Utah Commission decision and is what warrants, in the view of the Company, a reconsideration by the Utah Commission.

We find that the purpose of the Cash Working Capital adjustment to rate base is to compensate investors for funds advanced by them to meet the expenses of daily operations necessitated by external transactions with third party vendors. It is not simply to recognize leads and lags associated with all revenues and all costs of providing service. Moreover the outcome of the appeal of the FCC decision is not known. No jurisdiction is known to include lags associated with depreciation and net operating income. The Commission therefore rejects again the recommendation of the Company and finds in favor of the present cash method. The revenue and expense lag days, to which all parties agree and are provided by the lead-lag study, result in a negative $9,493,500 Cash Working Capital adjustment to test-year rate base.

4. DIRECTORY IMPUTATION

On January 1, 1984, then Mountain Bell, without the review or approval of this Commission, transferred its directory assets and personnel to US West Direct, a subsidiary of US West, Inc. US West Direct then published directories for Mountain Bell pursuant to a negotiated publishing agreement. In Docket No. 85-049-02 the Division argued that the transfer of assets was contrary to the intent of the Modified Final Judgment in that revenues from directory operations should support local rates. The Division also showed that the publishing fee provided a lower contribution than would have been the case if Mountain Bell had retained the directory operations. The Commission adopted the Division's recommendation that US West

Direct's revenues and assets transferred by Mountain Bell should be treated for ratemaking as if they were still part of Mountain Bell's operations. In Docket No. 88-049-07, the Company testified that by 1988 the payments from US West Direct to USWC had ended. In that docket, the Commission reiterated its position that revenues from directory publishing should support local rates. No party opposed this adjustment which adds $20,637,000 to test-year revenues and increases test-year income by $12,939,500.

5. EXCESS ACCUMULATED DEFERRED TAX TIMING DIFFERENCE

In Docket No. 88-049-07 the Commission adopted the Division recommendation of returning to ratepayers over two years, beginning January 1, 1989, the deferred income taxes accumulated in excess of 46 percent, i.e. the "unprotected" excess accumulated deferred income taxes. The FCC allows the company to flow through unprotected amounts over a period longer than two years. By 1991, the test year in this docket, ratepayers had received the benefit of the return of the unprotected amounts over 1989 and 1990 for ratemaking purposes. The books of the company however reflect the longer flow-through period. This adjustment removes the effect of the Company's flow-through period from the test-year results to avoid a double-counting of the benefits to ratepayers. No party opposed this adjustment which for the test year increases deferred income taxes and decreases income by $22,700. This adjustment also increases test-year rate base by $870,100.

6. EXTERNAL RELATIONS ADVERTISING

In Docket Nos. 83-049-05 and 88-049-07 the Commission found that expenses for corporate image, informational and promotional advertising would not be allowed recovery in rates absent an analysis of the benefits to ratepayers. No party opposed this adjustment which removes $380,100 of external relations advertising from the test-year expenses, resulting in a decrease in test-year income of $238,300.

7. FCC/PSC DEPRECIATION DIFFERENCE

In November, 1990 USWC submitted its triennial depreciation study to both the FCC and this Commission. In Docket Nos. 90-049-03 and -06, the Company proposed changing Utah intrastate depreciation rates previously approved by the Commission in 1988. In Docket Nos. 90-049-03 and -06 the Commission adopted the Division's recommended depreciation rates effective from January 1, 1991 through December 31, 1993. Such rates were consistent with the Company's proposed Modernization Plan and resulted in Utah depreciation expense and reserve higher than the those of the FCC. This adjustment brings depreciation expense from the FCC level to the Utah intrastate level. No party opposed this adjustment which adds $372,500 to test-period expenses resulting in a decrease in test-year income of $217,200. This adjustment also removes $3,770,500 from test-year rate base.

8. FIVE & FIVE CURTAILMENT GAIN

The pension fund for management employees has had a surplus of assets for several years. In 1990, a one-time gain was created when USWC bought out the pension benefits of eligible employees. The Company proposes to amortize the gain over five years. In Docket Nos. 90-049-03 and -06 the Commission accepted a stipulation which incorporated this amortization. No party opposed this adjustment which removes $473,500 from test-year expenses increasing test-year income by $296,900.

9. INTEREST ON CUSTOMER DEPOSITS

In Docket No. 88-049-07, customer deposits were removed from rate base thereby requiring operating expenses be increased to recognize the cost of those funds, i.e. the interest paid on customer deposits. No party opposed this adjustment which adds $131,700 to test-year expenses and decreases test-year income by an equal amount.

10. INTEREST SYNCHRONIZATION

In Docket No. 85-049-02 the Commission found it appropriate to impute additional interest expense into the computation of income taxes in order to attribute the overall cost of capital to the debt component of Job Development Investment Credit or the accumulated deferred investment tax balance. This adjustment reduces the federal and state income tax expenses in the test-year by the tax effect of the imputed additional interest expense. No party opposed this

adjustment which removes $340,400 from test-year income tax expenses, increasing test year income by an equal amount.

11. MEDICAL/DENTAL AMORTIZATION

In adopting Part 32 accounting methods, Mountain Bell in 1987 changed from cash to accrual accounting for expenses associated with employee medical and dental benefit plans. The Company proposed this adjustment to amortize the embedded balance resulting from the change in accounting methods over the ten-year period 1988-1997. This adjustment was included and unopposed in Docket No. 88-049-07. This treatment is also similar to that given Compensated Absences (Employee Vacation Pay) in Docket No. 88-049-07.

Initially the Division opposed the Company's adjustment but withdrew its opposition stating it had supported this type of amortization in the past. The Division recommended "...that USWC be required to affirmatively request Commission approval in advance of including accounting method changes in reported results of operations (DPU reports) or in rate cases in order for regulators to evaluate the costs and benefits of the changes and determine their appropriateness and effect on Utah operations."

The Committee opposed the inclusion of this adjustment, claiming that the Commission had not specifically adopted this proposed accounting change in prior orders and that the adjustment would result in higher expenses to ratepayers despite no change in costs.

The Commission notes and finds that it has previously determined regarding Compensated Absences in Docket No. 88-049-07 that the amortization over ten years of the nonrecurring expense associated with the change from cash to accrual accounting is reasonable. In accordance with past decisions, and there being no substantive reason to change, the Commission finds the adjustment proposed by the Company to be reasonable. This adjustment adds $98,000 to the test-year expenses reducing test-year income by $68,100. It also removes $194,600 from test-year rate base.

The Division has argued that it is essential that the Company bear the responsibility of bringing accounting changes to the attention of regulatory agencies. The Commission agrees. The Commission will adopt the Division recommendation regarding Company disclosure of accounting changes to regulatory agencies.

12. MERIT AWARD AMORTIZATION

This issue is similar to that of employee medical and dental benefits. In 1987 the Company also changed from cash to accrual accounting for the expenses associated with merit awards. The Company proposed this adjustment to amortize the embedded balance resulting from the change in accounting methods over the ten-year period 1988-1997. This adjustment was also included and unopposed in Docket No. 88-049-07. The positions of the parties on this issue are identical to those taken regarding the Medical/Dental amortization discussed previously. As stated above, the Commission has previously found in Docket No. 88-049-07 that the amortization over ten years of

the nonrecurring expense associated with the change from cash to accrual accounting is reasonable. In accordance with past decisions, and there being no substantive reason brought forward in this docket to change, the Commission finds the adjustment proposed by the Company to be appropriate. This adjustment adds $436,900 to the test-year expenses reducing test-year income by $247,100. This adjustment also removes $1,253,500 from test-year rate base.

13. POSTRETIREMENT BENEFITS CURRENT SERVICE

In 1989 the FCC changed from cash to accrual accounting for the expenses associated with postretirement medical and dental benefits plans. In Docket Nos. 90-049-03 and -06 this Commission accepted a stipulation which incorporated accrual accounting for the expenses associated with such benefits for only the current service of active employees. This adjustment recognizes the timing difference between the time the FCC and the Commission began accrual accounting for current service. No party opposed this adjustment which removes $2,056,100 from test-period rate base.

14. RATE OF RETURN TO AFFILIATES

Expenses paid by USWC to affiliates include a return component calculated using a weighted average rate of return on equity authorized in the Company's 14 intrastate jurisdictions. For the 1991 test year the 14 state weighted average was 13.36 percent. In Docket No. 88-049-07, the Commission found that the Utah intrastate share of transactions with affiliates should be priced based on the Utah allowed rate of return of equity, which is 12.2 percent in the 1991 test year. This adjustment removes that portion of affiliate expenses resulting from the difference between the 14-state weighted average and Utah rates of return on equity. No party opposed this adjustment which removes $38,000 from test-year expense, thus increasing test-year income by $23,800.

15. SHORT-TERM AFUDC DEPRECIATION

The Company is allowed by the Commission to accrue interest on short- and long-term plant under construction and then amortize it over the life of the plant. The long-term amortization is included in test-year results of operation. This adjustment adds the 1991 short-term amortization expense to the test-year results. No party opposed this adjustment which adds $1,132,000 to test year-expenses, reducing test-year income by an equal amount. In addition this adjustment adds $6,497,800 to test-year rate base.

16. ACTUAL EARNINGS ON A REGULATORY BASIS

The test-year results which incorporate the above ratemaking policy adjustments provide actual rates of return on a regulatory basis for the 1991 test year. On this basis the Company's earned rate of return on rate base was 12.46 percent. Using the Company's 1991 test-year capital structure, the earned rate of return on equity on a regulatory basis was 14.91 percent, exceeding the Company's allowed rate of return on equity of 12.2 percent. Thus in 1991, ratepayers paid shareholders 1991 revenues which were $13,023,000 in excess of those necessary for the Company to have earned its allowed rate on equity.

C. ANNUALIZING ADJUSTMENTS

1. JULY 1991 RATE REDUCTION

In Docket Nos. 90-049-03 and -06, general revenues were reduced by $19.799 million and the consequent rate reduction went into effect July 1, 1991. The annualization of this reduction, to which all parties agree in principle, is intended to lower revenues for the first six months of 1991 as if the rate reduction had been in effect throughout the entire test year.

The Company initially proposed reducing test-year revenues by one-half of the $19.799 million revenue reduction to account for the six months during the 1991 test year when the rate reduction was not in effect. Since the $19.799 million revenue reduction was calculated using 1990 billing units (October 1989 - September 1990), the Company also proposed a further reduction in revenues to reflect

the growth in billing units which occurred since that time. Both the Division and the Committee opposed the inclusion of the additional growth adjustment.

During the course of the hearings, the Company and Division jointly developed an estimate of the revenue effect of the rate change in the test period. To measure the annual effect of the rate change, rates effective before and after July 1991 were applied to average monthly billing units for 1991, matching the mid-1991 effective date of the rate change, then multiplied by the twelve months of the year.

In two markets, Switched Access and Toll services, explicit recognition was made for an increase in test period billing units resulting from the July 1991 rate reduction. Revenues obtained from Switched Access for post-July 1991 rates included a 1.2 percent increase or stimulation. For Toll services the revenue decrease was offset by 10 percent to account for an increase in test-period billing units. The annual revenue decrease was then multiplied by a ratio, the sum of average monthly access lines from January to June 1991 relative to the sum of average monthly access lines from January to December 1991, to annualize revenues for January through June of 1991.

At issue is the tradeoff between simplicity and precision. While the approach advocated by the Committee and initially the Division is simple and understandable, it does ignore the effect of the change in billing units between October 1989-September 1990 and January-December 1991. We find that when information regarding test-

period billing units is available, its matching with other test-period information should provide a more suitable estimation of the effects of the rate change on the test-period results. It is on this basis that the Commission accepts the adjustment jointly recommended by the Company and the Division. This adjustment reduces test-year revenues by $10,543,400 and results in a $6,587,500 reduction in test-year income.

2. 1991 MANAGEMENT SALARY INCREASE

This adjustment, offered by the Company and supported by the Division, annualizes the management salary increases which became effective May 1, 1991 and averaged four percent. The Committee opposed this adjustment on the grounds that while the price of employees' services increased during the test year, the number of employees had declined and was expected to continue to decline beyond the test year. To recognize the price increase while ignoring offsetting quantity decreases would result in an overestimate of the costs of management employees. The Committee therefore recommended that test-year costs remain unadjusted for either price or quantity changes.

The purpose of this adjustment is to increase expenses for January to April of 1991, as if the salary increase had been in effect throughout the entire year. We find that using the average level of employment for the test period when annualizing the effect of a price change within the test period matches and captures some of the effect of declining employment within the test period, providing

a balance between ratepayers and shareholders regarding the effects of the test-year volume change. It does, however, ignore post-test-year changes.

We further find that to consider any quantity adjustment based on the changes occurring after the test year and throughout the rate effective period would necessitate a consideration of changes in all quantities of services provided, expenses incurred and investment undertaken after the test year. As a general rule, post-test-period adjustments are acceptable only in the context of a future test period.

Therefore the Commission concludes that the adjustment proposed by the Company is reasonable. This adjustment increases test-year expenses by $414,900 and reduces income by $260,200.

3. 1991 OCCUPATIONAL WAGE INCREASE

This adjustment, offered by the Company and supported by the Division, annualizes the occupational wage increases which became effective August 5, 1991, and averaged two and a quarter percent. The Committee opposed this adjustment again on the grounds that it recognizes only the price increase and not the offsetting quantity decreases, current and expected, thereby overestimating the costs of occupational employees. The Committee therefore recommended that test-year costs remain unadjusted for either price or quantity changes.

The rationale of the Commission decision is the same as that provided regarding the 1991 Management Salary Increase above. The

Commission finds the adjustment proposed by the Company to be appropriate. This adjustment increases test-year expenses by $738,000 and reduces income by $462,700.

4. INSIDE WIRE MAINTENANCE

This adjustment annualizes the impact of the increase in the monthly charges for inside wire expenses which occurred in August and October of 1991 using the average number of subscribers during the 1991 test year. This adjustment also removes costs associated with the settlement of the Inside Wire Lawsuit filed in New Mexico. All parties agree to this adjustment which increases test-year revenues by $2,030,000, deceases expenses by $9,000, and results in an increase in test-year income of $1,274,100.

D. ACCOUNTING ADJUSTMENTS

Accounting adjustments are those which incorporate or remove from the test-period results and/or events which are not normal or recurring. These adjustments remove bookings made during 1991 that relate to results of prior years and/or include bookings made in 1992 that relate to 1991 results.

1. AT&T ACCIDENTS AND DAMAGES

In 1991, $526,000 was accrued in Utah for accident and damage payments to AT&T. In February and April of 1992, payments of $175,000 and $88,000 were made to AT&T for 1991 performance and the

Company booked this adjustment in April of 1992. Thus the excess accrual for the 1991 test year was $263,000. On a Utah intrastate basis, the overaccrual was $196,400. This adjustment, quantified by the Company, was agreed to by the Division. The Committee's proposed adjustment was $199,000. This out-of-period accounting adjustment is necessary to normalize the test-year results. As quantified by the Company, this adjustment reduces test-year expenses by $196,400 and increases test-year income by $123,100.

2. EXECUTIVE LONG-TERM COMPENSATION

The Committee recommended that an accounting true-up for officer long-term incentive pay booked in 1991 that related to 1988 through 1990, an expense equal to $77,000, be removed from the test year. The Company claimed removal of true-ups booked in 1991 relating to prior years ought to extend to incentive payments for employees other than officers, i.e. team awards, as well as officer long-term incentive pay. First, the Company stated that test-period expenses should be increased by $33,000 to reflect the payments made in the first quarter of 1991 for team awards earned in 1990, the 1991 payout being less than that accrued during 1990. Second, the Company stated that test-period expenses should be increased by $124,000 to reflect the payments made in the first quarter of 1992 for team awards earned in 1991, the 1992 payout being greater than that accrued during 1991. Both the Committee and the Company have presented recommendations which accept as reasonable the expenses incurred for incentive pay and address the accounting of such

expenses for the purposes of constructing a normalized test period. The Division, however, challenged the reasonableness of the expenses rather than the accounting treatment of such expenses. The Commission addresses the reasonableness of such expenses in Section E, number 6, which renders a decision here unnecessary. The recommendations of the Committee and the Company, accepting the reasonableness of expenses related to incentive pay and addressing accounting treatment, are not accepted. The reasonable expenses for incentive pay are discussed and decided in Section E, number 6.

3. **INCOME TAX SETTLEMENTS**

During 1991 the Company booked a number of income tax adjustments that related to prior years. A Utah tax audit for the years 1976-1984 resulted in a settlement between the Company and the state of Utah requiring the Company to pay higher state income taxes. An accounting entry was made in 1991 to recognize this liability.

Tax entries were also made in 1991 to recognize three settlements of tax disputes. The first is a settlement between the IRS and AT&T regarding certain divestiture costs, the second is an IRS agreement regarding customer deposits in 1978, and the third arose out of federal tax audits for 1981-1983. On balance these settlements were favorable to USWC.

A tax entry was also made in 1991 that was a true-up of the 1990 federal and state income tax liability. The Company proposed reversing all these tax adjustments made in 1991 that related to prior years.

All parties agreed to the Company's quantification of the adjustment. However, the Division and Committee objected to the inclusion of the true-up related to 1990 income taxes. Both parties cited a seeming pattern in which accrued taxes were overstated in each period then reversed in the subsequent period. This overstatement and reversal caused tax expenses charged to ratepayers to be overstated in each rate case since ratepayers did not receive the benefit of the reversals.

The Division recommended that a true-up of 1991 income taxes, made in 1992, be included in this case as well as a true-up of 1990 income taxes. The Committee recommended that the true-up related to 1990 income taxes be denied until the Committee, as well as the Division, had received and had an opportunity to review the true-up related to 1991 income taxes.

In the following adjustment, Number 4 below, the true-up of 1991 income taxes is considered. Consistent with our finding in Number 4 below, we find that when true-up information is available, it will appropriately normalize the test year. Therefore the Commission finds that the adjustment proposed by the Company is reasonable. This adjustment decreases test-year expenses by $26,300 and increases income taxes by $1,273,000, resulting in a decrease in test-year income of $1,246,700.

4. 1991 INCOME TAXES

In January of 1993 the Company provided the 1992 true-up of 1991 income taxes, amounting to a $242,000 increase in test-year tax

expense. The Division agreed with this adjustment as proposed by the Company. The Committee did not accept this adjustment. We find that the inclusion of the true-ups for both 1990 (Number 3 above) and 1991 income taxes as they affect 1991 results provides the appropriate normalization of test-year results when such information is available. Therefore the Commission concludes that the adjustment proposed by the Company is reasonable, increasing test-period tax expense and reducing income by $242,000.

5. INDEPENDENT COMPANY TOLL/ACCESS

In 1991, a number of accruals related to prior years were reversed and actual toll/access revenue and access expense were booked for Independent Company cost settlements and access expense. The Company proposed removal of these true-ups, related to prior years, from the test-year results. In 1992, accruals were reversed and actual toll/access revenue and access expense for 1991 were booked. The Company proposed inclusion of these true-ups since they are related to the test year. Both the Division and the Committee agreed to the Company's recommendation. Given the parties' agreement, the Commission finds the Company's recommendation to be reasonable. This adjustment increases test-year revenues by $650,200 and decreases expenses by $628,500. Test-year income increases by $801,800.

6. INVENTORY/DEPRECIATION

During 1991 several inventories were completed, primarily of materials and supplies and central office equipment. As a result of these inventories, accounting adjustments were made that related to prior years. The Company proposed removing the effect of these accounting adjustments from the test-year results. Accounting adjustments made in 1992 that relate to 1991 were also included in the Company's recommendation. The effect of the Company's recommendation was to increase test-year expenses by $2,593,400. The Division supported the Company's adjustment.

The Committee claimed that the Company's corrections resulted from prior overcharges due to lack of personnel training, input errors and incomplete paperwork, factors admitted by USWC in response to Committee data requests. These overcharges served to overstate the Company's revenue requirement in prior years. The Committee argued that because of the nature and magnitude of these corrections and because they went undetected until the 1991 test period, it would be incorrect to merely eliminate these corrections, or increase expenses, as prior period accounting entries. The Committee proposed amortizing the adjustment over two years, thus recommending that one half of the Company's recommendation, or $1,296,700, be added to test-year expenses.

The Commission finds that there were other accounting true-up adjustments for which the Committee did not recommend a two-year amortization that related to prior years, years which were test years for ratemaking. We also find that the Company keeps its books in accordance with the best information available at the time and that

revision of those booked results, when better information becomes available with the passage of time, does not mean that what was originally booked was improper.

The Commission finds that true-ups of prior years' accruals are not evidence of improper booking. The removal of accounting entries relating to prior periods and the inclusion of accounting entries relating to the test year together provide an appropriate normalization of test-year data. The Commission therefore accepts the recommendation of the Company which increases test-year expenses by $2,593,400 and decreases test-year income by $1,626,100.

7. MOTOR VEHICLES

In 1991 an accounting entry was made to reverse motor vehicle expense that should have been capitalized in a plant account in 1990. The adjustment removes the effect of this accounting entry because the expense reversal relates to 1990. No party opposed this adjustment which adds $133,900 to test-year expenses and decreases test-year income by $84,000.

8. PROPERTY TAXES

In 1992 an accounting entry was made to true-up an over-accrual of 1991 property taxes. This adjustment includes the effect of the 1992 entry because the true-up relates to the 1991 test year. No party opposed this adjustment which removes $1,352,900 from test-year tax expense and increases test-year income by $848,300.

9. REVENUE BOOKING

Toll calls placed after the close of business in 1991 were inadvertently processed and booked in December 1991. This adjustment removes the 1992 toll revenues from the test-year result. No party opposed this adjustment which removes $286,000 from test-year revenue and decreases test-year income by $179,300.

10. US WEST, INC. AND BUSINESS RESOURCES INC. BILLINGS

In 1991 US West, Inc. changed its monthly billing procedures from an actual basis to one based on one-twelfth of the annual budgeted services provided to USWC. Twice each year, in July and in December, US West, Inc. issues USWC a true-up bill reflecting the actual cost of services provided. The Division and the Committee presented recommendations which were based on the same true-up amounts for US West, Inc. but used slightly different Utah state and intrastate allocation factors to obtain the Utah intrastate share. The US West, Inc. billing true-up had the effect of decreasing test-year expenses. In addition, the Division included the true-up of billings from Business Resources, Inc. (BRI), which had the effect of increasing test-year expenses. The Company supported the recommendation of the Division. The BRI billing true-up is, for the purpose of constructing the test period, not different from the US West, Inc. billing true-up, which all parties support. The Commission therefore accepts the recommendation of the Division which

removes $241,000 from test-year expenses and increases test-year income by $151,100.

11. UNIVERSAL SERVICE FUND

In 1991 an accounting entry was made for payment to the Universal Service Fund that relates to 1990. This adjustment reverses the effect of the entry by increasing revenue. No party disputed this adjustment which adds $178,000 to test-year revenues and increases test-year income by $111,600.

12. VOUCHER CORRECTION

In October 1991, the Company incorrectly booked one or more vouchers. In the same month a correcting entry was made. The allocation factors used for the correction were different than those used in the original entry, resulting in an overstatement of Utah costs. This adjustment removes from test period the intrastate portion of the overstated Utah costs. The Division and the Committee recommended decreases in test-year expenses of $351,000 and $359,000, respectively. The Company supported the recommendation of the Division. The Commission accepts the recommendation of the Division. This adjustment removes $351,100 from test-year expenses and increases test-year income by $220,100.

E. OTHER NON-AFFILIATE ADJUSTMENTS

1. AT&T DAMAGE CLAIM

During 1991, the Company made a payment to AT&T resulting from the failure of USWC to comply with the guidelines of its billing and collection contract with AT&T. The Division proposed removing

the effects of this payment from the test year. No party opposed this adjustment which removes $154,500 from test year expenses and increases test year income by $96,900.

2. **AT&T SWITCHING PAYMENT**

In May and June of 1991 a problem developed on USWC's network so that AT&T had to carry switched official US West interLATA traffic between Salt Lake and Boise. The test period results include a $606,000 payment made by USWC to AT&T for back-up network service. Due to the irregularity of the amount, the Committee recommended the expense be amortized over two years, requiring that $303,000 be removed from the test period results.

The Company claimed that it is normal to make payments to back-up carriers, although the payments may be abnormal in their timing. The Company claimed that to disallow an expense because it is irregular in its occurrence denies the Company an opportunity to recover a prudently incurred expense and would be confiscatory. In addition, the Company argued that if the expense of USWC's use of back-up service are to be adjusted to normal levels, so too must an adjustment to normal levels be made in the revenues received by USWC for its provision of back-up service to private networks. The Division did not support the Committee's recommendation.

We find that the purpose of constructing a test period is to characterize normal and recurring costs in order to provide the Company an opportunity to earn an allowed rate of return. Moreover the removal of abnormal and/or nonrecurring events is the purpose of the annualizing and normalizing adjustments. We further find that

such an action is confiscatory only insofar as the abnormal event is expected to be recurring. The Company did not provide evidence of abnormalities regarding the revenue it receives for the provision of back-up service which might offset the abnormal cost increase experienced by the Company in using back-up service provided by AT&T. Therefore the Commission concludes that the recommendation proposed by the Committee to be appropriate. This adjustment removes $303,000 from test year expenses and increases test year income by $190,000.

3. ANTITRUST EXPENSE

In Docket No. 85-049-02 the Commission adopted the policy of disallowing the costs of antitrust settlements for ratemaking purposes. The Commission stated that to include such costs in rates would reduce the incentive for the Company to avoid illegal activities. In Docket No. 88-049-07, the Commission again rejected the Company's request to include antitrust settlement costs as legitimate expenses for ratemaking purposes. In addition, the Commission stated that if the Company intends to seek a change in a previous order, it has the burden to mount a convincing new argument. In Docket Nos. 90-049-03 and -06 revenue requirement was settled by stipulation among the parties. Included in the stipulation were two adjustments disallowing antitrust expenses.

In the current docket the Committee again recommended, based on prior Commission policy, that antitrust expenses be eliminated for ratemaking purposes. The Committee stated that these expenses in

1991 were $3.5 million on a total company basis and $219,000 on a Utah intrastate basis.

The Company claimed that these expenses are not for the settlement of antitrust violations but are for the cost of maintaining a legal department to ensure compliance with the Modified Final Judgment and all other antitrust laws. The Company argued that the activity represented by these expenses is preventive in nature and undertaken for legitimate and prudent business purposes. The Division did not support the Committee's recommendation.

The Committee presented the transcript of proceedings before Judge Greene involving a settlement reached by US West in February of 1991. The settlement included four major provisions: 1) The Company admitted to violating the MFJ with respect to four different services; 2) the Company agreed to pay a $10 million fine which would neither be tax deductible nor paid for by ratepayers; 3) the Company would agree to a civil enforcement order requiring US West to put in practices to ensure that there will be no discrimination in the future; and 4) the United States would not further investigate or continue prosecuting further matters that are admitted. The Committee stated that the $10 million was the largest civil penalty the Justice Department's antitrust division has ever levied against one defendant.

Judge Harold Greene, in accepting the settlement as reflecting a beneficial change in Company attitude toward the MFJ, made the following comment: "...US West certainly in the past has brought proceedings and required others to bring proceedings that had

no purpose and were many times entirely frivolous and simply trying to exhaust the other side as well as the court." Clearly the disallowances ordered by this Commission in three previous general rate cases did not provide sufficient incentive for the Company to refrain from illegal or wasteful activities prior to 1991.

The new evidence introduced in this case is that these expenses are not for the settlement of antitrust violations, but instead are to maintain a legal department to ensure compliance with antitrust laws. The Company presented no evidence that relates the cost of complying with antitrust laws to service benefitting Utah ratepayers of local and intrastate telecommunications service. Therefore the Commission finds these expenses unreasonable for ratemaking purposes. This adjustment removes $219,000 from test-year expenses and increases income by $137,300.

4. BODILY INJURY LAWSUIT

In 1986 a USWC employee was involved in an auto accident injuring another party. A settlement could not be reached and the Company contested in court the demand of the injured party. A jury sided with the injured party and set an award which the Company paid in 1991. The intrastate portion of the award was $296,000. Both the Division and the Committee recommended that the $296,000 be removed from test-year expenses since the expenses were properly incurred prior to the 1991 test period. The Division also cited the unusual nature of this claim and stated that the amount was unusually high.

The Company claimed it is improper for the Commission to second guess management as to the probability and amount of a liability. In addition, the Company argued that the practice of disallowing costs that are irregular in occurrence or abnormally high in amount would make the regulatory process confiscatory.

The Division testified and the Commission finds that just as it is standard ratemaking practice to normalize a test year by removing items related to prior periods, so too is it standard ratemaking practice to normalize a test year by removing the effects of unusual or nonrecurring items. (See also the Commission rationale for the AT&T Switching Payment adjustment above.) This adjustment removes $296,000 from test year expenses and increases income by $185,600.

5. **EXECUTIVE COMPENSATION--SALARY BASE**

On April 1, 1992, we requested the Division to examine executive compensation. Lacking resources, the Division determined to rely on the recent Regulatory Impact Review of US West, Inc., performed by Schumaker and Associates for the US West Regional Oversight Committee, which concluded that base salaries were 7.7 percent above the market average. The Division also determined that the Company's Base Pay Plan sets salaries on the basis of a market analysis. The Division proposed an adjustment to reduce Utah intrastate operating costs by $34,000 in order to bring executive compensation to market levels. We find that the alleged disparity is small, well within a reasonable operating range, which the Company

defined to be plus or minus 10 percent of market. Moreover, we find that the total compensation package, of which base salaries are just a part, is reasonable in a market context. The Committee did not independently analyze the issue. We find that base salaries closely approximate market and are in fact within a reasonable range. No adjustment is required.

6. EXECUTIVE COMPENSATION--LONG-TERM INCENTIVE PLAN

The Division proposed to eliminate long-term incentive plan costs as unreasonable for recovery in rates. We find that the Plan rewards executives on the basis of financial performance using criteria which benefit shareholders rather than ratepayers. The Plan focuses upon shareholder total returns. The awards are not based upon individual or team performance, productivity, customer service, or cost control. The Regulatory Impact Review of US West, Inc. concluded and we find that long-term compensation should be linked to benefits for ratepayers, and this should be closely associated with performance appraisal. The Division recommended elimination of the 1991 Utah intrastate portion of program costs, $250,000, and asked that the Commission order USWC to implement the recommendations of the Review on this subject. The Committee did not independently analyze the issue. The Company asserted that the Plan did benefit ratepayers since better performance can be recognized both in stock price and in cost-of-service reduction. The Company showed that the Review had concluded that long-term incentive pay is 62 percent below the average of incentives reviewed in the study. The Company also

argued that the overall compensation package, which consists of stock options and performance shares, for executives is reasonable.

In a Mountain Bell rate case, Docket No. 85-049-02, the Commission disallowed a portion of management bonuses because the awards were based upon the Company's financial performance in the Utah jurisdiction which was in part dependent upon regulatory climate and Commission decisions; in other words, factors beyond management's control. In Docket No. 88-049-07, we rejected a proposed adjustment to USWC corporate team award bonuses because they were contingent upon the financial performance of the utility and its parent organization, and designed to enhance shareholder earnings. Regulators commonly allow recovery of bonus program expenses where they are tied to individual performance, productivity, and customer service criteria. We find, however, that such is not the case here. The program is tied only to shareholder total return. Moreover, it remains the fact that shareholders may be affected by regulatory decisions; that is, not solely by the actions of Company management. We find that the Division's proposed adjustment should be allowed because the program is solely for the purpose of increasing shareholder wealth. The indirect ratepayer benefit claimed by the Company is little more than words. We wish to see specific criteria of the sort just mentioned guiding the program before we will consider the expenses suitable for recovery from ratepayers. This adjustment will decrease test-year expenses $250,000 and increase income $156,750.

7. INSIDE WIRE LAWSUIT

USWC included $9,400 in test-year expenses to recover costs associated with settlement of an inside wire lawsuit filed in New Mexico. The Division argued that in connection with certain previous antitrust cases, the Commission had refused to allow recovery from ratepayers of settlement costs of similar cases, where illegal or unfair utility actions had been claimed. The Committee testified and we find that these expenses of the class action lawsuit are extraordinary and non-recurring, and thus not eligible for recovery in rates. We find that the Company made no argument for the recovery of these expenses that we have not considered in reaching our decisions in similar cases. These decisions hold also for this docket. The costs will not be recovered from ratepayers. This adjustment reduces expenses in the test year by $9,400 and increases income by $5,894.

8. **PENSION ASSET**

Pension costs are recoverable in utility service rates. Pension fund earnings have been unexpectedly favorable during recent years, making reductions in pension expense, termed the "pension credit," necessary. The magnitude of the credit, as approved in Docket Nos. 90-049-03 and -06, is $4.2 million. This credit continues in effect. The amount proposed for the present docket is $4 million, a $200,000 reduction.

According to the Company, overearnings and the pension credit have produced an inequity for shareholders. Ratepayers have benefitted from pension credits in the amount of the fund surplus. Rate cases using test years 1988, 1989, and 1990, have treated the pension credit as a negative expense which reduced test-year revenue requirement. The 1991 test year in this docket includes $4 million of pension credits. Investors should not have been affected by the credits but the lower cash flows from the rate reductions have not been offset by cash from the pension fund because pension law does not permit it. The cash remains invested in the fund where it continues to support fund earnings which in turn further reduce the positive pension accruals that would become part of test-year expenses. The Company contends that this income cannot belong to ratepayers because the monies which generate it have been credited to them. The corresponding amount in the fund belongs to investors. To overcome this inequity, the Company proposes to create a $14.8 million pension asset, the amount of the accumulated pension credits, in the form of an addition to rate base, to which normal earnings and

income taxes would apply. Though based on the amount of past accumulated credits, the Company testified that the resultant asset merely offsets the effect of the test-period pension credit.

The Division opposed creation of a pension asset. The Division testified and we find that the Company is responsible for managing the pension fund and must return excess earnings to ratepayers. The pension credit and the proposed pension asset arise as a result of the Company's adoption, without Commission approval and therefore without Commission-approved terms, of SFAS 87. By contrast, when Utah Power requested Commission approval to adopt SFAS 87, the authorization it received also removed the effects of the change for ratemaking purposes.

We find that excess pension fund earnings are the result of ratepayer overpayment in prior years, which, in turn, are the result of unforecasted but highly favorable fund earnings. Excess earnings have been returned to ratepayers as credits reducing revenue requirement, but federal law has prevented the Company from withdrawing the corresponding cash from the fund. This gives rise to the problem, which USWC would correct by creating the pension asset.

We further find that this proposal merely solves one inequity by creating another. USWC would be made whole, and it would continue for years to receive the authorized rate of return, plus related taxes, on the rate base addition. Meanwhile, there is no guarantee that overearnings will continue. Earnings are the result of stock market performance. If fund earnings are insufficient to cover the fund's obligations, rates would rise to make up the

difference. USWC would not contribute monies to the pension fund until the asset reached zero. If the pension fund grew instead, the pension asset would grow also. Pension asset growth is the Company's current expectation. The asset would grow until the pension credit disappears. Ratepayers bear all risk.

The Division proposed that all options should be investigated in a subsequent docket before the Commission permits a pension asset addition to rate base. For example, the Division suggested that the Company might have access to pension fund excess monies if it applied them to other retiree expenses. The vehicle to accomplish this is a 401(h) account, which can be established under the Internal Revenue Code.

The Division recommended deferral of this issue to a separate docket in which the amounts at issue would be determined on a prospective basis only. Should the Commission decide to respond to the pension asset proposal in the present docket, the Division urged that a way be found to share the pension credit between ratepayers and shareholders rather than creating a pension asset. The Division also noted and we find that other state jurisdictions have not adopted the pension asset approach, with the single exception of Colorado where it had not been a contested issue but part of a stipulation.

The Committee opposed the pension asset proposal. It testified that pension credits only arise because ratepayers have overpaid pension expense. The Company proposal would compute the pension asset retroactively to 1987, which the Committee contended

involves impermissible retroactive ratemaking. The Committee argued that the pension credit can only affect ratepayers when rate reductions ordered in rate proceedings take effect. Thus regulatory lag would affect the amount of the claimed benefit and the Company, in calculating credits since 1987, failed to recognize this. In spite of the fact that ratepayers have overpaid, the pension asset would require ratepayers, inequitably, to pay a return plus associated taxes on funds accumulated. According to the Committee, had the pension asset been in rate base in 1990, the Company would have recovered over 19 percent--the allowed return plus taxes--from ratepayers in spite of the fact that the fund experienced negative earnings of 1.9 percent. The Committee further testified that USWC has always been aware of restricted access to pension fund monies. It also is aware of current opportunities such as the 401(h) account, used by other utilities to extract excess cash from pension funds, but has chosen to ignore them. The Committee recommended rejection of the proposal and deferral of further consideration until the next rate case, when all options, including those having less adverse consequences for ratepayers, could be examined.

We find that the record evidence does not contain a comprehensive analysis of the problem the Company has identified. More importantly, it leaves in doubt the central contention that pension credits have necessitated the uncompensated use of investor funds. While this doubt exists, we cannot find the present situation inequitable. But even if the evidence conclusively showed that inequity, we would find the pension asset proposal an unacceptable

remedy because the pension asset addition to rate base risks creating a still greater inequity. We find that ratepayers overpaid in the past and under the proposal would overpay in the future. We note that during the years the pension credits have reduced revenue requirement, and the fund was overearning, so too was USWC overearning in this jurisdiction. Further, the claims and counterclaims have not produced evidence permitting us to determine whether the Company's proposal involves retroactive ratemaking. The same is true of the disputed effect of regulatory lag on the calculation of the size of the pension asset. But our decision on the proposal does not turn on the inability to resolve the retroactive ratemaking and regulatory lag claims. These are important only regarding the Company's proposal. Our principal finding is that a comprehensive analysis of alternatives is necessary and has not been possible in the present docket. Absent such an analysis, the Company's proposal must be rejected.

9. RENT COMPENSATION

Some investments, the costs of which are incurred in a single state, are related to plant, equipment, and facilities used in the provision of service to several states. Investments associated with functions performed in one state for the benefit of other states are tracked and charged to other states via the Rent Compensation Study. Eighty-four percent of the computers in Utah are used in the provision of service to other states with Utah being attributed Rent Compensation revenues.

Included in the Rent Compensation study are calculations of depreciation expenses. In Docket Nos. 90-049-03 and -06 the life of the General Purpose Computer plant account was lengthened, lowering depreciation expense effective January 1, 1991. However not until January 1, 1992, did the Rent Compensation study, based on 1991 plant balances, incorporate the change in Utah depreciation rates. Thus the 1991 test-year results do not reflect the decreased Rent Compensation revenues attributed to Utah which correspond to the decreased depreciation expenses being recovered in Utah. Instead the 1991 results include Rent Compensation revenue at a level that reflects the old depreciation rate.

When the Commission ordered the 1991 rate reduction, the effect of new depreciation rates on Rent Compensation revenues was not incorporated. The Company claimed that a fully matched test period should reflect three interrelated events: the 1991 rate reduction, the represcribed depreciation rates, and the offsetting effect on Rent Compensation. It recommended that Rent Compensation revenue be lowered by the incremental effect of the lower Utah depreciation rate, net of updates and other changes in the 1992 Rent Compensation Study. The Company recommended a decrease in income of $2,602,700.

The Division opposed the Company's recommendation as inappropriate since the new Rent Compensation Study was not effective until after the test period, in 1992. The Division compared 1991 and 1992 results on an equal basis and concluded that post-test-year adjustments, particularly the change in Rent Compensation, that would

increase revenue requirement in this case are offset by increases in revenues or decreases in other expenses in 1992 and should not be included in a 1991 test period. Moreover, if the 1991 rate reduction had included the effect of the change in depreciation rates, then the 1991 rate reduction would have been less and Company earnings during 1991 would have been higher.

Initially the Committee proposed an adjustment which reflected the effect of lower depreciation expense on Rent Compensation revenue but subsequently supported the position of the Division that no adjustment is necessary.

The Company, on rebuttal, identified and corrected four errors in the Division's comparison of 1991 and 1992 results. The Company also added the Division's proposed SFAS 106 costs to the 1992 results. The Company testified that the rate of return projected for 1992 with the inclusion of rent compensation and the Division's SFAS 106 costs was less than the allowed rate of return that the Division recommended.

It is clear that 1991 test-year Rent Compensation revenues do not reflect the represcribed depreciation rates effective during the test year. The adjustment proposed by the Company is similar in concept to the "true-up" nature of the accounting adjustments discussed in Section D. We find that to calculate test-period Rent Compensation revenue using test-period depreciation rates provides an expense amount appropriate on a going forward basis. We further find that appeals to changes in other accounts occurring beyond the test period provide no basis for judging the reasonableness of this

account. Therefore the Commission adopts the recommendation of the Company. This adjustment removes $3,023,100 from test-year revenue and adds $1,127,900 to test-year expenses, resulting in a decrease of ratemaking income of $2,602,700.

10. UNCOLLECTIBLES

The Committee recommended, and we find reasonable, an adjustment to uncollectible expenses due to unreasonably high write-offs in the 1991 test year, similar to that adopted in Docket No. 88-049-07. We find that the uncollectible expense is an amount accrued to meet estimated write-offs. The 1991 uncollectible expense was $2,817,833 while the average uncollectible expense for 1989-1991 was $2,243,897. The average net write-offs for 1989-1991 was $2,603,855. We find it reasonable that test-year expenses be reduced by the difference between the 1991 uncollectible expense and the average of 1989-1991 net write-offs, or $214,000.

We further find that the Committee's adjustment may be conservative given 1992 uncollectible expense of $2,154,304 and 1992 write-offs of $2,442,378. We find that its adjustment was based on average net write-offs before the annualization of the July 1, 1991 rate reduction and that any change in uncollectible expenses resulting from the annualization of the rate change was in addition to its proposed uncollectible adjustment. The Division supported the Committee's recommendation.

The Company argued that the write-offs for 1991 were not unreasonably high. The Company also argued that the Committee did

not present justification for why the 1989-1991 history of write-offs should be the basis for disallowance of 1991 expenses. The Company also claimed that the Committee's recommended adjustment double-counted the $86,000 reduction in uncollectible expense incorporated in the July 1991 revenue annualization adjustment.

We find that the 1991 uncollectible expense was significantly higher than either the 1989-1991 average uncollectible expense accruals or average actual write-offs. Therefore, in this instance, it is appropriate that uncollectible expense be adjusted to reflect the average of 1989-1991 actual write-offs. Since the Committee based its adjustment on average net write-offs before the annualization of the 1991 rate reduction, no double counting occurs. This adjustment removes $214,000 from test-year expenses and increases income by $134,200.

F. OTHER AFFILIATE ADJUSTMENTS

Affiliation presents regulators with problems of power and control. In the holding company structure, the holding company has power and controls its subsidiaries, including the utility, directing them toward the overall corporate goal of profit maximization. The holding company's strategic objectives may be incompatible with regulatory objectives, which include service quality, universal service, and equity or fairness. Yet these regulatory objectives are statements of public policies which govern the provision of public utility service.

Specifically, the holding company may make investments which do not benefit and may harm utility ratepayers. For example, risky

diversification may raise the cost of capital. Or, the utility may be kept out of lucrative markets in favor of unregulated affiliates, shifting profits to the holding company rather than benefitting ratepayers through the lower rates made possible by economies of scope. Business relationships between the utility and the subsidiaries may give rise to cost shifting and cross-subsidization if the utility pays too much for services received from affiliates and receives too little for services provided to them. A source of this is cost allocation, where the tendency would be to apportion excessive joint and common costs to the utility. Another source is the uncompensated transfer of trained employees or the inadequately compensated transfer of assets, both tangible and intangible. In all, ratepayers may pay for activities which do not benefit them or pay disproportionately much for benefits actually received. Another side of this picture concerns competitors, who may be harmed if affiliates reap special cost-saving or informational advantages from relationships with a regulated utility. The market power of a dominant firm is a problem, and strategic information sharing not only can be anti-competitive but in telecommunications often raises privacy concerns.

Any of these may occur because, lacking enough authority, regulators may be unable to prevent them. The information needed to protect ratepayers may be unavailable or untimely because it is generated and controlled by the utility and its affiliates. Pre-approval of affiliate relationships and transactions is unlikely.

Thus, regulatory decisions typically are limited to rate case adjustments. These come after the fact and are always reactive.

In past cases, we have disallowed 10 percent of USWC's affiliate transaction charges because the utility did not meet its burden to justify them. Such a disallowance is again requested by the Committee in the present docket, though limited to the utility's relations with certain affiliates only, and the Division has recommended a 20 basis point rate-of-return penalty. Both proposals are based on an asserted USWC failure to justify affiliate transactions. In addition, both parties advocated specific disallowances.

1. BELLCORE PROJECT

In Docket No. 85-049-02, the Commission ordered research and development costs associated with Bellcore's 800 service and ISDN projects to be capitalized and amortized over the future useful life of the service, thus to be recovered from the beneficiaries, the users, of the service. In the present docket, USWC applied for recovery of a small amount of Bellcore research and development costs which the Commission had previously ordered to be recovered directly from users of the associated services and not from the general body of ratepayers. The Division proposed elimination of those costs. Additionally, the Committee proposed elimination of Bellcore Project No. 480004, Washington Information Services, disallowed by this Commission in a prior docket. We find that USWC inadvertently included the identified expenses in this docket, acknowledged it, and

did not challenge the exclusion of them. We therefore find that these costs should be excluded from revenue requirement. We conclude that for ratemaking purposes, expenses should be reduced by $2,000 and income should be increased by $1,300.

2. US WEST, INC. CORPORATE OVERHEAD

The Committee proposed to disallow recovery of 38 percent, or $1,667,327, of US West, Inc's. 1991 charges for executive management, corporate finance, accounting, federal regulatory, and public relations services performed for USWC. The Committee argued USWC is capable of providing these services internally and therefore alleged the charges are duplicative. We find that the Committee's charge lacks evidentiary foundation. The Company elicited from the Division, on cross examination, and we find that the Division found no evidence of duplication; otherwise the Division took no position on the issues. We find that the recently concluded Regulatory Impact Review of US West, Inc., Schumaker and Co., August 1992, commissioned by the US West Regional Oversight Committee, a group of regulators from the 14 states in which USWC provides service, found no duplication. Though the Regional Oversight Committee's study had not been reviewed in detail on this record, the Division's witness attested to its objectivity and reliability and we find it to be objective and reliable. He stated that his testimony on affiliation relied upon it extensively. We approve of the regional audit approach. Through it, the resources of the 14 jurisdictions can be brought to bear upon affiliation problems. Utah's regulatory

resources alone have not proved adequate. For this and the other reasons cited we conclude that the Committee's proposal is unreasonable. Our willingness to accept the Regional Oversight Committee's audit conclusions in this docket, and the general approach to affiliation which it suggests for future dockets, is contingent upon the immediate, scheduled implementation by USWC of that audit's recommendations. Failure will cause us to reject the approach in future.

3. AFFILIATE CONTRIBUTIONS AND LOBBYING

As an affiliate, USWC had been allocated costs from US West, Inc. during the test year which include certain charitable contributions, and lobbying and antitrust expenses, which the Commission in prior cases had ruled were not recoverable from ratepayers. The Division identified these expenses and recommended their removal from revenue requirement. This recommendation drew, in part, from a Supreme Court ruling in Case No. 900020, which concluded that "when the Commission rules in a rate proceeding that, as a matter of law, certain categories of expenses cannot be charged to ratepayers, that ruling establishes law that controls future cases..." Adding that these expenses are not reasonable and necessary costs of providing telephone service, the Committee supported the Division's position. The Company did not oppose the recommendation. In addition to the agreement of the parties, we find that our previous rulings on this matter remain controlling. These expenses have no place in utility revenue requirement, and we

conclude recovery should not be permitted. This adjustment decreases expenses by $17,000 and increases income $10,700.

4. RESEARCH AND DEVELOPMENT COSTS OF FAX STORAGE AND FORWARD TECHNOLOGY

The Division testified that during a two-year period about $1 million was expended by US West Advanced Technologies, Inc., on three FAX research and development projects, identified as 1540PD, 1436AP, and 1569PD. These costs had been recovered in part from USWC, and had been included in test-year expenses. The three projects contributed to the introduction of a product called "FAX Mail" by US West Enhanced Services, Inc., an unregulated affiliate. This, the Division contended, is an unwarranted subsidy. USWC proposed to remove from test-year expenses the costs of developing the unregulated subsidiary's FAX Mail service. Though in this instance USWC itself came forward with the adjustment, the general problem illustrated lies at the heart of our continuing concern with affiliate relations: the employment of after-the-fact regulatory techniques to identify sources of cross-subsidization harmful to ratepayers leaves much to chance. We find that the proposed adjustment is appropriate and should be made. It results in a $14,000 decrease in test-year expenses and a corresponding increase in income of $8,800.

5. RESEARCH AND DEVELOPMENT COSTS OF UNREGULATED SERVICES

According to the Division, the research and development costs of such products and services as Gateway service, electronic white pages, Videotext E-mail, videotext messaging, and voice messaging, should be partially disallowed because the services will be, or now are, partially or wholly unregulated. Additionally, the Commission in Docket No. 85-049-02 identified these services as "bells and whistles," raising the issue of the proper incidence of cost recovery. Moreover, certain of these projects support services that will not be deployed for an indefinite time. Research and development costs for voice messaging, the Division testified, should, as an unregulated service, be totally disallowed. The Division's proposed disallowance would reduce expenses $190,000. USWC agreed to the disallowance of the unregulated voice messaging costs, some $169,100, but contended that the proposal by the Division to disallow the costs of projects 2502CD and 2504CD turned on unwarranted speculation about the timing and nature of potential services. We find that the Division has not supported its claims that such services would probably be unregulated. However, the Division's proposed disallowance again raises the issue of cross-subsidization, and again illustrates the difficulty of trying to prevent it after-the-fact. The Company controls relevant information, regulatory resources are limited, and the future market for such services is uncertain, though the Company is in the best position to determine how the services may be delivered, whether by regulated Company or unregulated affiliate. Ratepayers must not bear

the risk and costs of such a situation unless benefits clearly are proportional. Nonetheless, in this instance, the evidence does not support a conclusion that the projects should be disallowed, but we conclude that the research and development costs of voice messaging may not be recovered from ratepayers. Therefore, expenses should be reduced by $169,100 in this docket, increasing ratemaking income $106,000.

We conclude, further, that the regulatory process and ratepayers dependent upon it would benefit from a statement of explicit standards delineating ratepayer interest in research and development activities. To ensure that those who support the costs of research and development also are its beneficiaries, we further conclude that the issue of whether such costs should be capitalized or expensed must be resolved. We will hereafter establish a docket to address both issues.

6. RESEARCH AND DEVELOPMENT COSTS OF E 9-1-1

Test-year expenses included the costs incurred by US West Advanced Technologies, Inc. to develop software permitting communities to use E 9-1-1 service without the need for expensive, special equipment. USWC had reimbursed the affiliate and the expenses were included in its rate increase application. The Division recommended disallowance on grounds that the Commission had already provided for recovery of the costs of implementing E 9-1-1 in Docket No. 88-049-07, adequately compensating the Company for providing it throughout its service territory. The Division's review

did not reveal ratepayer benefit from the affiliate's expenditures, though it did note that some communities do not yet have E 9-1-1 service. The Division speculated that such communities might be able to receive it using the software developed by Advanced Technologies called CIRCE (projects 1528PD, 1547PD and 2201CD), but, testified the Division, this would require a further Commission decision. The Company agreed that the adjustment should be made. As a result of its different approach to affiliate disallowances, the Committee took no position on this adjustment. We find that the adjustment is appropriate and that the thrust of our comments on the two previous issues are apropos. This one again touches on ratepayers bearing research and development costs from which they may not benefit. The adjustment results in a decrease in expenses of $115,100, and an increase in income of $72,200.

7. **US WEST ADVANCED TECHNOLOGIES, INC. RESEARCH AND DEVELOPMENT PROJECTS**

In Docket No. 85-049-02, the Commission stated that a customer desiring to subscribe to basic service only should not be forced to pay for research to develop new, non-basic services. Nevertheless, USWC includes in its test-year expenses, for which it seeks recovery, payments to US West Advanced Technologies, Inc., the affiliate performing the research. The Committee therefore proposed a $657,088 adjustment to reduce test-year expenses to properly account for such research projects. These projects include CIRCE E

9-1-1, voice dialing, video on demand, gateway services, videotext E-mail, and enhanced voice messaging. The Division testified that this proposed adjustment duplicates in part its proposed disallowances for identified projects, the subjects of items 4, 5, and 6 above, and supported no further such adjustment. USWC argued that the projects are part of a concerted effort to advance and modernize the network and would thus benefit all customers. USWC asserted that the Committee had placed no evidence on the record to support its claims and had not countered the testimony of USWC's witnesses that the benefits of research and development are widely spread.

The heart of the matter, according to both the Division and the Committee, is USWC's continuing failure to meet its burden to justify its affiliate relationships and transactions. The Committee's approach is to request at least a 10 percent disallowance of affiliated interest billings to USWC as compensation for this failure, whereas the Division attempted a more detailed examination of the relationships and purposes behind the billings. The Division alleged that USWC had consistently failed to provide relevant information in spite of having been asked for it many times. The Company countered that it had provided not just requested information but specific though largely qualitative testimony on the costs and benefits of research and development conducted by affiliates. This testimony, it asserted, more than met its burden, whereas the claims of the Division and the Committee often amounted to little more than assertion.

The Committee proposal in part duplicates adjustments proposed by the Division, and elsewhere decided by us. It reflects a different approach to the ratemaking problem of affiliate interests than the Division's. Each party labors under the difficulties we have already catalogued. Nevertheless, we are no longer where we were at the time of the 1985 rate case; the telecommunications world has changed and with it the concept of basic service. Both continue to evolve. The affiliation problem has been studied rather more than it had been at that time, and some ground has been gained on the issue of regulatory information requirements. In addition, the Division has reviewed and relied upon the Regional Oversight Committee sponsored audit of US West, Inc. and US West Advanced Technologies for purposes of this docket. We are certainly aware that definition of the Company's burden in the form of specific information requirements is still to come. We have a rule on the subject under consideration. Be this as it may, the record provides no support for the Committee's proposed disallowance. We find that, to the extent it does not duplicate adjustments proposed by the Division and already made herein, the Committee proposal must be rejected. There is no further effect on ratemaking expenses or income.

8. **US WEST BUSINESS RESOURCES, INC. AIRCRAFT BILLINGS**

This adjustment is proposed by the Division and separately by the Committee to remove an expense each claimed is both nonrecurring and abnormally high, necessitating adjustment to normal

levels. We find that the unusual timing of aircraft purchases and sales resulted in inordinately high aircraft expense during the test period. Where USWC was billed for additional corporate aircraft expense owing to the addition of new aircraft, the Division witness testified and we find the incremental cost to be greater than the cost of commercial transportation. The Division proposed a disallowance based on this rationale and on a prior Commission order, Docket No. 91-2010-01, in which the Commission held that just and reasonable rates should be based on the least-cost option reasonably available to the utility. The Committee proposed a smaller adjustment to specific fixed and variable costs to normalize 1991 aircraft charges for reduced operations during 1991. The Company argued that aircraft expenses are a legitimate cost of doing business and should be recoverable in rates. Second, the Company asserted that adjustments really attempt to annualize a volume change, in part a post-test-year event, and thus are counter to established Commission test-year policy. Third, it stated that these proposals amount to normalizing adjustments, but ones which would have the effect of denying recovery of a legitimate expense because a case for excessive charges cannot be made by comparing the cost of a corporate air service to commercial transportation. Other, nonquantifiable values, such as security, timeliness, and the opportunity to conduct business while traveling raise the value of corporate air travel.

The proposed adjustments go to the reasonableness of the expense, which can only be determined by reference to out-of-test-year experience or to an external standard. Our order in Docket No.

91-2010-01, cited by the Division, suggests as much. In its assessment of reasonableness, the Division employs experience. It also employs a standard--commercial transportation--and the Commission's least-cost rationale. The Committee bases its recommendation on out-of-test-year experience. We do not accept the Company's claim that the quality of the transportation experience for employees invalidates the Division/Committee concern or the adjustments, though it is a mitigating consideration. Still, the general rule is that abnormally high, and/or nonrecurring expenses normally are not recoverable in rates. Based on the evidence, we conclude that the general rule applies here and that the adjustment proposed by the Division is the best approximation on the record of the decrease in expense necessary to produce a result that is reasonable for recovery in rates. It is appropriate and should be accepted. This results in a decrease of expenses of $194,000 and an increase in income of $121,600.

9. US WEST BUSINESS RESOURCES, INC. 10 PERCENT PENALTY ON TRANSACTIONS

In Docket No. 88-049-07, the Commission disallowed 10 percent of certain affiliate costs for which recovery in utility service rates had been sought by USWC. The Commission had determined that information was insufficient to show the costs to be necessary and reasonable. In the present docket, the Committee proposed a 10 percent disallowance of the charges billed to USWC by Business

Resources, Inc., an affiliate. On a Utah intrastate basis the charges total $3,827,160. This is an unregulated subsidiary which provides delivery, procurement, material management and other services to USWC. We find that these services had not been competitively bid, had been shown to be higher in cost than alternative suppliers in USWC's own study (the "Value Study"), and had not been demonstrated to be necessary for provision of utility service. Given USWC's alleged failure to meet its burden, the Committee asserted that its 10 percent proposed disallowance was conservative. We find that the Value Studies, conducted by selected consultants for USWC, lacked the objectivity to be the basis for consideration of the reasonableness of charges for services provided by this affiliate. In response to the alleged failure of USWC to meet the burden of justifying affiliate transactions, the Division proposed a rate of return penalty, and did not propose specific disallowance for this affiliate's charges. The Company argued that the Value Study is reliable, having been performed by outside consultants. This Study showed that the affiliate's charges are reasonable, though on the high side of the range suggested by the possible alternative suppliers surveyed. The Company testified that this finding, given USWC's performance and service quality requirements, demonstrated the reasonableness of the affiliate's charges. Testimony was also provided by USWC to show that the services are necessary for its utility operations.

Thus far in our consideration of affiliate relations and transactions we have commented upon how difficult it is for

regulators to determine the reasonableness of them for ratemaking recovery. We have pointed to the information problem as a particular source of the difficulty, though there are others as well. The Division provided a detailed description of the basic conflicts over the information required to test the reasonableness of USWC affiliated relationships and therefore expenses. The Regional Oversight Committee's audit of US West, Inc. and US West Advanced Technologies, Inc. we found to be the single bright spot in an otherwise bleak picture, and we therefore determined to rely upon it. No such audit of US West Business Resources, Inc. exists. Instead, we have the assertions by USWC that its private search for consultants to perform value studies is objective, that the results of such studies are objective, and that the services of this affiliate are both necessary and reasonable for the provision of utility service. The two parties having the interest and, to a limited extent, the resources to engage affiliate questions, the Division and the Committee, vigorously dispute the assertions. We conclude that the Value Studies lack objectivity and should not be relied upon for ratemaking purposes. We also conclude that the evidence is insufficient to show that this affiliate's charges are reasonable and necessary for recovery in utility rates. USWC's stated presumption that it must do business with its affiliates is troubling to the Commission. Competitive bidding, which would include USWC's affiliates, would protect ratepayers and would help USWC in its effort to convince the Commission to include the entire affiliate charge in rates. We have tried, vigorously, but apparently

unsuccessfully, to define the kind of information we require since shortly after the regional holding company was formed. The value study approach is USWC's latest effort to meet our requirements, and those of the other jurisdictions in which it serves as well, but it is at best a compromise effort which ignores, partially on alleged legal grounds, some of the points of greatest importance to us. It also is formulated and conducted without regulatory involvement. We find that the Committee's proposed 10 percent adjustment is both acceptable and conservative. We conclude that such an adjustment must be made until the information can be routinely developed which will permit us to establish just and reasonable rates. This adjustment decreases expenses $382,700, and increases income $240,000.

10. US WEST COMMUNICATION SERVICES, INC. 10 PERCENT PENALTY ON TRANSACTIONS

The Committee proposed that 10 percent of the charges billed to USWC by Communications Services, Inc., an affiliate, be disallowed because USWC had not justified these charges as necessary and reasonable. On a Utah intrastate basis, the charges total $1,544,000. In Docket No. 88-049-07, the Commission determined that such a disallowance was appropriate when the Company had failed to meet its burden. We find that this affiliate billed USWC, in part, for product and market management services that USWC could provide for itself or that it obtained from another affiliate, Advanced

Technologies, Inc. Based on a Value Study, USWC argued that the product and market management service components of the affiliate's billing to USWC were very small. The Company asserted that the Committee had done no analysis of the functions actually performed by the affiliate, and so its claims were groundless. The Division's position on affiliate issues where the claim is a Company failure to meet its burden is a rate of return penalty; no specific position on the present issue was taken. Upon review of the record, we find that the Company has not met its burden to provide sufficient information to permit us to determine that the affiliate's charges are reasonable for services necessary to the provision of utility services. It is not sufficient for the Company simply to rebut the claims of another party; instead, it has an affirmative obligation. We have already stated our unwillingness to rely on the value studies, and there is no other source of information, such as a regionally sponsored audit, to which we might turn. We conclude that the proposed 10 percent disallowance should be accepted. This decision decreases expenses by $154,400 and increases income $96,800.

11. US WEST REAL ESTATE, INC. (BETA WEST PROPERTIES) TRANSACTIONS

According to the Committee, the Utah intrastate portion of the charges billed USWC by US West Real Estate, Inc., formerly BetaWest Properties, a US West, Inc. subsidiary, totaled $576,848 during the test period. Approximately 78 percent of these charges

are for rental of USWC's headquarters building at 1801 California Street, Denver, Colorado. This building and several others owned by the affiliate have recently been sold. We find that the rental payment, as shown by a Company exhibit, was 34 percent above average market rates for the area during the test period. The Committee recommended full or partial disallowance of these costs because, it alleged, the Company had failed to justify them. USWC argued that the rental is necessary to the provision of utility service and that the rate was within the range of rates an independent third party would have charged, for a building of that quality and location, at the time the lease was signed. The Division, for the reason stated above, again took no position on the specific issue.

The particular issue here is not the necessity of adequate office space. We have insufficient evidence on the record to permit examination of whether the particular space is excessive. The issue is the cost of the facilities that ratepayers are asked to bear and whether that cost is reasonable. The record shows a lease rate above market, but USWC's arguments concerning quality and location must be considered as ameliorating factors. Nevertheless, it is reasonable to inquire into the relevance of a lease rate dating from 1984 as a basis for the 1991 test-year charges ratepayers are being asked to bear. What makes us particularly uncomfortable is the charge, now under investigation by the Colorado Commission, that the real estate subsidiary was able to offset significant losses by selling the property occupied by the utility at a substantial premium because of this same, very favorable, long-term lease. This is a concern we

lack the record to resolve, but we feel the problem suggested cannot be ignored. What is undisputed is that the lease rate is above market. We conclude that under the circumstances, which turn most particularly upon the opportunity for ratepayer-borne cross-subsidies within the holding company structure of subsidiaries, a disallowance equal to the amount the lease rate is above market is appropriate and should be adopted. The required adjustment decreases expenses $113,000 and increases ratemaking income $70,900.

12. US WEST SERVICE LINK, INC. BILLINGS FOR OPERATING MARGIN ON OPERATOR SERVICES

Prior to March, 1991, Service Link, Inc. provided operator services to USWC on the basis of market, as distinguished from fully distributed cost-based, prices. It is a long-standing regulatory principal that cost-based prices are used for regulatory purposes unless a compelling argument can be made that relevant market prices exist which should instead be used. In early March, these operator services were integrated into USWC's Network and Technologies organization and Service Link's employees were transferred to USWC. Based on fully-distributed cost studies obtained from the Company by the Committee, we find the market price to be greater than fully distributed cost. The Division proposed an adjustment to remove the effects of this difference for the two months, January and February, of the test year. This difference, which is operating margin on operator services, is a non-recurring cost amounting to $94,000 on a

Utah intrastate basis. The Committee independently proposed the same adjustment and argued that the fully distributed cost basis is appropriate and in line with regulatory precedent in Utah. We find this adjustment appropriate for the reasons stated by the Division and the Committee. The adjustment decreases expenses $94,000 and increases ratemaking income $58,900.

13. THE 20-BASIS POINT RATE OF RETURN PENALTY

The Division asserted that USWC had failed to meet its burden to justify the affiliate transactions charges it sought to recover in rates. Though acknowledging that regulators have been somewhat successful in finding information to adjudge the ratemaking impacts of affiliation, the Division stated that this in no way minimizes USWC's burden because USWC is not responsible for the increased information. In fact, according to the Division, it had been continually frustrated in its efforts to acquire information from USWC. For this reason, the Division proposed that the Commission assess a 20-basis point rate of return on equity penalty in this docket. In the Division's view, this might be the only way to provoke a more cooperative attitude. During the course of the hearing, the Division altered this recommendation by stating that allowed return on equity should come from the lower end of the reasonable range. The Committee supported the Division's proposal and reiterated its concern with USWC's refusal to follow competitive bidding procedures, the holding company's policy of creating and dissolving subsidiaries, and the problems created by transferring

employees between the utility and the affiliates. USWC contested this characterization of its relationships and of its efforts to comply with regulatory reporting requirements. The Company testified that it had invited the Division and the Committee to audit its transactions with affiliates, and had made substantial efforts to provide information to satisfy regulatory concerns in this case. We find that the proposed penalty is not supported by evidence on the record, is not warranted, and would be punitive. Given the penalties that we have heretofore imposed on the affiliate transactions, we find no additional penalty here.

G. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS (PBOPs)

1. BACKGROUND

a. Docket No. 92-999-04

The move from a cash to an accrual basis of accounting is required by the Statement of Financial Accounting Standards No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions (SFAS 106). The change has been prompted by increasing health care costs which have raised concerns about potentially significant liabilities incurred by companies and undisclosed to their shareholders and the public. SFAS 106 requires that PBOPs be recognized for financial reporting purposes as deferred compensation and accounted for on an accrual basis for fiscal years beginning after December 15, 1992, for companies with over 500 employees.

In addition to the financial reporting requirement, which by itself is not controlling for the purpose of establishing regulated utility rates, there are two principal ratemaking issues. Increasing health care costs present generational inequities regarding matching the recovery of employment costs to the provision of employment service. In addition, external funding begun now can offset the future costs of employee benefits resulting in possibly lower ratepayer outlays over the long run. For these reasons the Commission in its Order dated November 25, 1992, in Docket No. 92-999-04 (the "generic" docket), authorized utilities in Utah to begin accrual accounting for the PBOP costs related to the current service of current and future employees and to remain on a cash basis or Pay-Go accounting for the PBOP costs related to the past service of current employees and retirees.

The Commission order in effect authorized utilities to record a regulatory asset under the provisions of Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS 71), for the difference between the Commission method and full SFAS 106 accrual accounting.

According to testimony provided by PacifiCorp in the generic docket, the Financial Accounting Standards Board (FASB) established in July 1984 the Emerging Issues Task Force (EITF) to assist in the early identification of problems in implementing authoritative pronouncements. The EITF is comprised of 13 voting members with a consensus obtained if no more than two members disagree with a position. PacifiCorp further testified that the Securities and

Exchange Committee (SEC) has consistently taken the position that it would challenge any accounting that differs from a consensus of the EITF.

At a November 19, 1992 meeting, the EITF reached several tentative conclusions that apply to a rate-regulated enterprise's recognition of a regulatory asset for SFAS 106 costs. At a January 21, 1993 meeting, the EITF reached consensus on the tentative conclusions reached at the November 19, 1992 meeting.

The EITF reached a consensus that a regulatory asset related to SFAS 106 costs should not be recorded if the regulator continues to include PBOP costs in rates on a pay-as-you-go basis for continuing postretirement benefit plans. Hence the terms of the Commission order in the generic docket do not satisfy the requirements for recording a regulatory asset under the provisions of SFAS 71.

The EITF reached a consensus that a regulatory asset can be recognized for the difference between SFAS 106 costs and PBOP costs included in rates if 1) it is probable that future revenue in an amount at least equal to the deferred cost (regulatory asset) will be recovered in rates, and 2) all of the following criteria are met:

1. The regulator has issued an order or policy statement that allows for the deferral of SFAS 106 costs and for the subsequent inclusion of those deferred costs in rates.
2. The annual SFAS 106 costs (including amortization of the transition obligation) will be included in rates within approximately five years from the date of adoption of SFAS

106. The change to full accrual accounting may take place in steps, but the period for deferring additional amounts should not exceed approximately five years.

3. The combined deferral recovery period authorized by the regulator for the regulatory asset should not exceed 20 years from the date of adoption of SFAS 106. To the extent that the regulator imposes a deferral recovery period for SFAS 106 costs greater than approximately 20 years, any proportionate amount of such costs not recoverable within approximately 20 years should not be recognized as a regulatory asset.

4. The percentage increase in rates scheduled under the regulatory recovery plan for each future year should be no greater than the percentage increase in rates scheduled under the plan for each immediately preceding year.

Following issuance of the Commission's order, requests for rehearing were immediately filed, generally asking reconsideration of the Commission's decision not to move to full accrual and suggesting the Commission had created an alternative having consequences unexamined on the record. The Commission granted rehearing. At rehearing, PacifiCorp presented testimony on the phase-in alternative to adoption of full accrual. PacifiCorp suggested that, in the interest of rate stability and on a utility-specific basis, the Commission could choose to allow adoption of SFAS 106 if the impact on total Utah jurisdictional revenue requirement is one percent or less. In the event the revenue requirement effect is greater than

one percent, a five-year phase-in to full accrual would be appropriate. This proposal responded to the reasons the Commission had initially decided not to permit full accrual by providing an alternative identified by the EITF as acceptable.

b. Docket Nos. 90-049-03 and -06

Utah began recognizing in rates a portion of the SFAS 106 obligation upon implementation of the Order in Docket Nos. 90-049-03 and -06. By stipulation of the parties accepted by the Commission, USWC was permitted to collect current service costs in excess of the pay-as-you-go method amount effective January 1, 1991. The Stipulation stated, "In the case of Post Retirement Benefits (PRB), the annual impact of the PRB obligation for current service...shall be included in the final revenue requirement calculation in this case." (Stipulation and Joint Motion on Revenue Requirement Issues, Docket Nos. 90-049-03 and -06, October 30, 1990.) The Stipulation provided that $2.568 million would be included in revenue requirement.

2. DOCKET NO. 92-049-05

SFAS 106 changes generally accepted accounting principles (GAAP) and is effective for financial reporting purposes for fiscal years beginning after December 15, 1992 for large companies like USWC. The adoption of an accounting change for ratemaking purposes

can only occur in a rate case, even if the accounting change is booked outside of the test year.

The Company's application for full recovery of post-retirement health care benefits (PBOPs or PRB) expenses, assuming a Commission decision permitting full accrual, required an increase in test year expenses of $11,331,800. This was subsequently revised and increased to include that associated with life insurance and the effect of SFAS 106 on US West Direct, bringing the total to $11,911,000.

Though supporting full accrual accounting and arguing for adoption of PBOP's in rates in this docket, the Division opposed the inclusion of the affiliate US West Direct's expenses. US West Direct is not a part of USWC and is not made so, contrary to the assertions of USWC, by an imputation of US West Direct's revenues for purposes of USWC's rate case. The imputation has an independent regulatory history raising no suggestions about Direct's status as an affiliate. Because the Division had not audited the actuary's calculation of the PBOP obligation, and had accepted it for purposes of this docket on the representations of the Company and its actuary, the Division opposed the inclusion of the life insurance portion of SFAS 106 in rates at this time. No documentation provided by the Company showed that the amount for life insurance had not already been included. The Company provided rebuttal evidence showing that the amount had not been included, is small because it had already been prefunded by the Company, thus generating income to offset the expense, and argued that it should be included.

The Division recommended that the Commission adopt full accrual of postretirement benefits other than pensions for accounting and ratemaking purposes, that each utility adopting SFAS 106 be required to file certain reports with the Commission, and that the Commission require full external funding of the amount collected in rates unless the utility could demonstrate substantial savings to the ratepayers by not funding.

The Committee argued that the proposed implementation of a 1993 accounting change in rates in a docket employing a 1991 test year is a post-test-year adjustment. No forecast 1993 revenues, expenses, or investment data is on the record, and, stated the Committee, USWC could not provide it, having claimed it would be too speculative. The Committee pointed to the conflict between this position and the Company's apparent ability to forecast future medical and insurance costs thirty and more years into the future, as the basis for the proposed PBOPs adjustment in rates in this docket. The Committee recalled the Commission order in Docket No. 89-057-15, a Mountain Fuel Supply Company rate case, wherein the Commission stated (pp. 5-6), "In our opinion, to permit out-of-period adjustments is almost certain to upset the test-year match of revenues, expenses, and investment....Selective adjustments, in short, may yield a less representative test period for ratemaking purposes than no adjustments at all." On the basis that PRB is a post-test-year adjustment, the Committee opposed its inclusion in rates. The Committee also testified that the amount presently in rates in excess of pay-as-you-go, the result of the Stipulation in

Docket No. 90-049-03 and -06, should be returned to ratepayers through a reduction in 1991 test year expenses.

Following the rehearing in Docket No. 92-999-04, the Commission by memorandum dated February 25, 1993, notified all parties of its tentative decision to permit the move to full accrual for ratemaking purposes for USWC, though on a phased-in basis consistent with the guidelines promulgated by the Emerging Issues Task Force. Recalling that testimony on a phase-in scheme had been presented during rehearing in the generic case, and that that record had been incorporated into the present record, the memorandum requested USWC to provide information necessary to calculate the revenue requirement impact of this decision. Two key questions lie at the heart of this decision. First, if this decision permits a post-test-year adjustment to be made, how does this square with the Commission's well-known position (as previously stated in this order) opposing such adjustments? Second, what is the Commission's regulatory rationale for a phase-in?

a. Accepting the Post-Test-Year Adjustment

This accounting change is a post-test-year adjustment that is of external origin (i.e., the utility is not its source). GAAP is not controlling for ratemaking but the conditions imposed upon the utility by a regulatory failure to adopt accrual accounting are in this instance unacceptable. The amount provided for in rates to establish the external fund is to be recalculated on a routine, periodic basis, with differences in requirement reflected in rates.

Hence, the ratepayer is protected from the possibility of overpayment. In our view, these features establish a certain uniqueness not likely to be found in other proposed post-test-year adjustments.

Thus, we agree with the Committee that the proposal to implement SFAS 106 in this docket constitutes a post-test-year adjustment to the 1991 historical test year. The Division is incorrect to characterize it as a mere accounting change and to rationalize its inclusion as an out-of-period "true up." Though an accounting change, it occurs in 1993 and is not a true-up of 1991 results. The Company presented the argument that failure to include it in this docket may deprive the Company of an opportunity to earn the allowed rate of return. We have considered such arguments in detail in other dockets, as the Committee's testimony correctly reminds us, and we have summarized, in Section A, above, the reasons why we have concluded that such adjustments, as a rule, should not be considered in connection with historical test years. We find and conclude that the request to implement for ratemaking purposes in this docket the accounting change from a pay-as-you-go to an accrual basis for post-retirement health care benefits is a proposed post-test-year adjustment.

Nevertheless, the change in accounting treatment has been made and the ratemaking issue is squarely before us. Two arguments compel consideration of this post-test-year adjustment in this case, while qualifying it as a unique event. It therefore will not cause us to reconsider our general position opposing such adjustments. The

Commission will soon initiate rulemaking on test-year issues, including post-test-year adjustments.

First, we find that the adjustment concerns the ratepayer obligation for recovery of the cost of USWC employees' future health care benefits. This involves paying today for costs forecasted over the lifetimes of current employees. We find that these costs are rising rapidly and the expectation is that this will continue. To delay accrual funding would produce an unacceptable increase in the burden future ratepayers will face, thus destroying the match in time between the delivery of employee services and the concomitant recovery of the costs of these services in utility rates. It would also deprive the fund of earnings. The greater the amount placed in a fund, and the earlier it is done, the greater will be the earnings contribution to recovery of the total obligation.

Second, we find that the amount to be recovered from ratepayers will be determined by an independent actuary. As we order below, the funds collected will be placed in an external fund, on a scheduled basis, dedicated solely to the payment of present and future retiree benefits, and not for any other purpose of the firm. The shareholder therefore can have no claim to these funds. The amount necessary to meet the obligation will be recalculated periodically by the actuary, and if, as expected, it changes, appropriate adjustment will be made to prevent over- or under-recovery from ratepayers.

The danger in accepting post-test-year adjustments is that the mismatching of revenues, expenses, and investment they cause risks harming ratepayers, or, though less likely, shareholders. We find that this mismatching is eliminated by the unique "balancing" characteristic of the PBOPs funding process, the length of the forecast period necessary to measure costs, and the dedicated nature of the external fund. Periodic actuarial recalculation of the external fund requirement reduces the potential harm to ratepayers of overpayment or underpayment. Over- or underpayment does not flow to or from shareholders but becomes a credit or debit to ratepayers in meeting fund requirements. In one instance harm arises because the ratepayer obligation is a forecast one, dependent upon debatable assumptions. But as we move forward in time, actual experience will alter these assumptions, changing the funding obligation and thus the amount due from ratepayers. The fund, however, remains dedicated to the sole purpose of providing for future employee benefits. This sort of periodic reassessment of a very long-term obligation is not the case with the usual post-test-year adjustment, which remains objectional because it cannot be squared with other post-test-year changes in revenues, expenses, and investment until the next rate case. The consequence of mismatch alters, in unknown ways, the sharing between shareholders and ratepayers of the risks of the ratemaking process. The Commission finds five compelling reasons which allow for the inclusion of PBOP costs as a post-test-year adjustment. First, the fund is external over which the shareholder has no claim. Second, the fund is dedicated solely to the payment of

retiree health benefits. Third, in order to measure current ratepayer contributions, forecasts of costs must be made over the lifetimes of current ratepayers. Fourth, funding today provides fund earnings to be used as an offset to ratepayers' future contributions. Fifth, the fund requirements are periodically recalculated. As a result of these conditions, the shareholder is not at risk concerning actuarial estimates of the costs of retiree health care benefits. The ratepayers alone bear this risk. We conclude that the external fund, its dedicated purpose, and the periodic recalculation of the funding requirement offer the unusual opportunity to minimize ratepayer risk, therefore allowing us to accept this post-test-year adjustment. Should circumstances change such that the effect of external funding is detrimental to ratepayer interests we will revisit the issue.

b. Rationale for Phase-In

Our review and consideration of the record provides convincing support for a five-year phase-in of the ratemaking obligation created by the accounting change. Arguments include the uncertainty of the magnitude of the obligation, sharing the risk of regulatory lag between ratepayers and shareholders, the time value of money to ratepayers, rate stability, and relation to unregulated firms' recovery of these costs.

The uncertain future is described by a set of actuarial assumptions covering many years presented in the testimony of USWC. These were not rigorously examined by the parties on the record. It

is assumed that the current means of providing postretirement health care benefits by the employer will continue. No change in the federal role has been anticipated, despite the current political upheaval and public clamor for a complete revamp of the health care delivery system. We have no testimony exploring the adequacy of the actuarial discount rate or of the fund earnings rate. Nor do we have other than the Company's cursory view of the expected age composition of its work force, the labor force turnover rate,the mortality rate--all the factors needed to determine the number of employees becoming eligible to receive benefits. The same lack of examination is true of the cost per employee, the medical inflation rate and potential federal participation in the provision of benefits. Although the impact may be mitigated by the balancing effect and periodic recalculation, the upshot is that the potential for error in the estimation of the funding obligation falls on ratepayers. The evidence establishes that the potential embodied in these assumptions is for over-, not under-, estimation of the funding obligation. We find no reason this should be so, particularly when the acceptable phase-in alternative is at hand.

We find that the proposed move to full accrual in this docket would require a large increase in rates today, followed by successive decreases in the yearly flow of money to the fund during the 20-year amortization of the transition benefit obligation. Unless a rate case were held in each of the following 19 years, all else equal, no reduction to rates to reflect the decreasing funding requirement would be forthcoming. The effect is that regulatory lag

benefits only the Company, and in every period. We find that this is without justification. We find that a phase-in approach would more equally distribute the effects of regulatory lag between shareholders and ratepayers by placing the burden to file a rate case requesting a rate increase on the Company during the five-year phase-in period, insofar as its rates did not provide revenues sufficient to recover the PBOP costs. Ratepayers would still bear the risks of regulatory lag during the remaining fifteen years. But it is important to note that when the burden of regulatory lag is borne by the Company it is an important inducement to efficiency. We conclude that the burden of regulatory lag created by the PBOPs issue must be shared and further that the inducement to efficiency is not to be sacrificed by our response to this accounting change.

Rate stability is a long-standing ratemaking objective. It refers to the desirability of avoiding swings in rates. Consumption and investment decisions must assume a path of rates over time, and these are upset by unforeseen fluctuations. A move to full accrual would immediately increase revenue requirement by over three percent, a large and unexpected increase following years of rate decreases for the typical residential and business customer. As a phase-in would minimize this single-year effect, and in addition would allow for a growing customer base to dampen the rate effect of the increased revenue requirement over the next several years, we find the phase-in desirable in our effort to promote rate stability.

To the extent that regulation serves as a proxy for competition, we find that a phase-in will spread recovery of the

PBOPs obligation over time in a manner not unlike what must occur in unregulated markets which do not get immediate price relief.

We find that to order full accrual now would deprive ratepayers of money that otherwise would support consumption or investment in other opportunities. Thus, there is an opportunity cost element to this funding decision that we should not ignore. Likewise, money has time value to ratepayers, meaning there is a rational preference to pay later rather than to pay now, and this too should be considered. Ratepayers should not be deprived of money today to support a move to full accrual in one year when an acceptable alternative, which phases-in and thus defers the obligation, is available to us.

It remains for us to determine the amount to be phased-in as a consequence of this rate case, therefore entering revenue requirement, and to establish the path, in terms of percentages, for subsequent increases during the remainder of the five-year period.

Using 1991 test-year information on the record, including the actuarial valuation of the cost of future health care benefits, we determine the cost of the past service obligation, which is to be phased-in, considering that the cost of the current service obligation is already being recovered in rates. Having fully considered the record and based on our decisions to this point, we conclude that 50 percent of the past service obligation should be phased-in now. This amount will provide for a well-established fund, given what already is in rates, and will permit a substantial flow of earnings ultimately to reduce the future ratepayer obligation. But

it is not so large as to create immediate rate shock or to defeat the rationale we have developed favoring phase-in. Fifty percent for the first year leaves a moderate amount to be spread over the remaining four years. Our decision results in an expense increase of $4,957,000 and a decrease in income of $3,107,400. (See Appendix I for the calculation of this amount.)

As the record now stands, we find that the impact on rates caused by our choice today of the phase-in percentage for each of the remaining phase-in years will be much less than the potential variation in the actuarial valuation of the transition obligation as it is recalculated in subsequent years. Be this as it may, given a five-year phase-in period and the 50 percent starting point, we conclude that the percentages for the following four years should be 65, 80, 90, and 100. This has the virtue of simplicity and is straightforward enough that potential disputes of interpretation may be minimized. It also will meet the EITF guidelines which set the five-year phase-in period, establish the 20-year amortization period, and require an order of this commission authorizing the transition to full accrual. But essentially the guideline is that the change in rates in each subsequent year must be no larger than in the prior year. We conclude that our statement of the phase-in path meets the EITF requirement.

We recognize that given the complexity and variability of the actuarial calculations and the simplicity of the Commission's phase-in guidelines, questions will undoubtedly arise about actual amounts to be accrued in future years, particularly during the phase-

in. Therefore we will establish a task force to analyze these issues and provide guidance to the Commission and the parties. During the phase-in period and in cooperation with the task force we will expect the Division to audit and otherwise make recommendations as to the reasonableness of Company PBOP programs and the accuracy of the calculations of future liabilities and current accruals.

H. COST OF CAPITAL

1. POSITIONS OF THE PARTIES

Peter C. Cummings and Charles M. Linke presented rate-of-return testimony for the Company; George R. Compton did so for the Division, and Matthew I. Kahal, for the Committee. Their rate of return on equity recommendations, updated to be current at the end of the hearing, ranged from the Company's 13.5 percent to the Division's 11.3 percent. The Committee recommended 11.5 percent.

a. Cummings, USWC

Due to declines in cost of capital after he had filed direct testimony, Witness Cummings lowered his estimate of USWC's required return by 30 to 40 basis points to reach his final recommendation of 13.5 percent. This is the Company's recommendation; Witness Linke provided corroborating testimony on methods of analysis and rationale.

According to Mr. Cummings, the legal standards governing rate-of-return awards are that the allowed return must be

commensurate with investments of corresponding risk, and that it must be sufficient to maintain and support the Company's creditworthiness--its financial integrity and ability to attract capital on reasonable terms. Mr. Cummings' estimation tools were the Discounted Cash Flow model (DCF) and the Capital Asset Pricing Model (CAPM). He applied these models to three sets of proxy companies: the regional holding companies like US West, Inc., the parent of USWC; a group of independent telephone companies; and selected non-utility industrial companies, chosen by Mr. Cummings on the basis of his assessment of comparable risk. His risk comparability criteria were cash flow variability equal to or greater than USWC and the AA- or higher bond rating. Mr. Cummings used the quarterly dividend version of the DCF model. He also argued in favor of including equity issuance costs, termed "flotation," in the rate-of-return award. He calculated this cost to be 20 basis points. Accordingly, he argued that the Company's cost of equity capital is investors' required return plus flotation.

Perhaps the central argument of Mr. Cummings testimony is that cost of capital cannot reasonably be estimated using one technique only. Nor would it be reasonable to base an estimate on just one firm, such as US West, Inc. Nor is it reasonable to base an estimate on utilities alone. The chance of estimation error is too great. Though he testified that USWC is less risky than US West, Inc., he did not estimate cost of capital for the parent, and then, by making a risk adjustment, derive USWC's. In fact, he argued

against this approach, and instead indirectly estimated USWC's equity cost by using proxy companies.

Mr. Cummings reached his recommendation by averaging, unweighted, the results of his proxy company calculations, except those he chose to disregard as unrepresentative. To be certain his recommendation was reasonable, he compared it to his estimate of the market return required for the average stock of average risk, 15 percent, and, based on his testimony that USWC is less risky than this, found 13.5 percent to meet this test. He also compared the 8.7 percent cost of new USWC debt to his recommendation, and derived a risk premium of 4.8 percent, which is conservative in his judgment given the historical difference between returns on stocks and bonds. He therefore testified that his recommendation is reasonable based on the risk premium test.

Mr. Cummings recommended the use of USWC's capital structure for Utah, which he testified reflects the equity and debt financing used to provide Utah's telephone service. It consists of an allocated share of the debt acquired before USWC was formed in 1991 plus financing since then, and is 38.1 percent debt and 61.9 percent equity. Embedded debt cost is 8.43 percent. Mr. Cummings argued that the large equity ratio reduces financial risk, is typical for the industry today, and is necessary to offset the increasing business risk the Company faces. He asserted that this capital structure helped the Company to maintain a AA- bond rating, allowing the Company to finance investment on favorable terms regardless of market conditions. In the last case the Company financed all

investment internally; in this case, just 75 - 80 percent is internally financed. Applying his 13.5 percent equity recommendation to this capital structure yields a rate of return on rate base of 11.56 percent.

b. Linke, USWC

Witness Linke's testimony echoed Mr. Cummings on several key points. He used both the DCF and CAPM approaches, applying them to three sets of proxy companies--regional holding companies, independent telephone companies, and industrial companies, as Mr. Cummings had done. The comparable industrials were selected using the "K-L Spanning" approach, an optimization technique using DCF logic and "the law of one price," which he had developed as a means of indirectly measuring required return for a firm like USWC which does not issue equity. Many portfolios of companies demonstrating cash flow variability similar to USWC's are selected, based on the assumption that such variability, properly "mimicked" by these portfolios, adequately captures risk. He testified that the returns on these portfolios will indicate the proper required return for USWC. Other selection criteria employed were Moody's bond ratings, beta, common equity ratio, and availability of IBES growth rates. Mr. Linke endorsed the DCF model, and stated that 90 percent of institutional investors, who account for 80 percent of New York Stock Exchange transactions, use it to evaluate stocks. He used the quarterly dividend version of the DCF as Mr. Cummings had done. Mr. Linke also argued for the use of CAPM.

To derive his recommendation for investors' required return, Mr. Linke averaged (unweighted) the results of his DCF and CAPM calculations. He placed a band of plus-or-minus 50 basis points around his calculated cost of capital to account for estimation error, and added 20 basis points for flotation costs, an amount accepted from Mr. Cumming's testimony. Together, these present Mr. Linke's estimates as a range. He testified in favor of a return award at the upper end of the range because book returns consistently have exceeded market returns for regulated companies, and thus the higher award is necessary to meet legal criteria of comparable returns for investments of comparable risk. He testified that the cost of capital estimated by Mr. Cummings was reasonable based on the similarity of his own, just slightly lower, results. Mr. Linke endorsed the use of the USWC capital structure proposed by Mr. Cummings.

c. Compton, Division

Division witness George R. Compton recommended a rate of return award of 11.5 percent, which he testified could be directly derived from calculations for US West, Inc. As did the other witnesses, Mr. Compton stressed the decline in interest rates and in the returns on alternative financial instruments since our last rate-of-return decision for USWC. He cited the example of long-term corporate bonds, the investment he stated is most like utility stocks, which have declined by over 200 basis points. He noted, however, that telephone utility stocks have fallen only about half

that much, most likely due to a perception that the risks of diversification and competition are increasing for the industry.

Mr. Compton applied the simple DCF model to US West, Inc. He testified that the quarterly dividend version of this model is unnecessary and misleading, based on his argument that the standard way of measuring returns differs from the regulatory measurement such that allowed return can be below investors' required return while still permitting the Company to earn its cost of equity. For the same general reason he also recommended ignoring flotation costs. He argued against the use of CAPM.

To test the reasonableness of his US West, Inc. equity return estimate, Mr. Compton used the DCF formula adopted by the Federal Energy Regulatory Commission and applied it to each of the regional holding companies. The average of these estimates is lower than is the result of his DCF analysis of US West, Inc., which he testified is consistent with his effort to err on the side of a conservative rate-of-return recommendation.

Mr. Compton testified that US West, Inc. has more business risk than does USWC, which derives over 60 percent of its revenues from stable local service. Partially as a result of its diversification efforts, more than 28 percent of US West, Inc.'s assets are outside USWC. He testified that a reasonable estimate of the difference in risk is 50 basis points, and that this amount should be subtracted from his return estimate for US West, Inc. to derive his recommended return for USWC. This direct approach to an

equity recommendation, he asserted, is preferable to the indirect or proxy approach.

Mr. Compton testified that an analysis of non-utility companies is not a requirement of the Hope and Bluefield decisions. Maintenance of financial integrity and the ability to attract capital on favorable terms are unambiguous legal requirements of the return decision, but in these two respects, he testified, the current AA-bond rating and the fact that market value exceeds book value by more than 50 percent show that rate-of-return decisions have been liberal.

Mr. Compton testified that a return award of 11.5 percent would result in an interest coverage ratio very near USWC's 1991 actual one, and thus would be sufficient to maintain the current AA-bond rating. He argued that state regulators should not abdicate to bond rating agencies in any event and expressed incredulity at the rating requirements being imposed by them on telephone utilities. In his view, to increase equity return awards correspondingly would be tantamount to forcing ratepayers to support such companies' risky non-utility activities.

Mr. Compton estimated that actual capital costs are lower using the proposed USWC capital structure, with its higher equity ratio, than would be the case for a lower one, if the equity return, as is true of the Division's recommendation, is sufficient to provide needed fixed interest coverage. He therefore supported use of the USWC capital structure for Utah advocated by Mr. Cummings.

d. Kahal, Committee

Mr. Kahal noted the decline in capital costs as the other witnesses had done, and argued that forecasters expected this trend to continue into 1993. Some forecasters are even showing longer-term corporate bond yields and inflation to continue at expected 1993 rates. Currently low interest rates are not an aberration, he stated.

Mr. Kahal employed the DCF method to estimate cost of equity for the regional holding companies. The midpoint of the range he derived for these companies is 11.7 percent. He based his estimate of the growth (g) variable on IBES projections, on his analysis of historical earnings growth, and on Value Line's projections of both earnings and dividend growth. He selected 6 percent. The stock price he used was the six-months' average ending in August, 1992. He argued against using the quarterly DCF model. Mr. Kahal testified against an adjustment for flotation. He recommended a 20 basis point reduction from his 11.7 percent proxy evaluation of regional holding companies, to account for USWC's lower risk, to reach his USWC equity cost estimate. His final recommendation thus was 11.5 percent.

Mr. Kahal employed CAPM to check his DCF results. Ordinarily, he testified, he would not do so because CAPM is a flawed technique which he does not advocate using. He resorts to it only when, as in this case, its use by other witnesses necessitates a response. This check produced 11.9 percent as the average for the regional holding companies, compared to 11.7 percent for the DCF approach.

Mr. Kahal supported the use of the capital structure proposed by Mr. Cummings, but with one proposed alteration to account for the debt associated with the Leveraged Employee Stock Ownership Program. This has the effect of reducing the equity ratio from 61.9 to 60.9 percent. Mr. Kahal opined that this strong equity ratio reduces financial risk, and therefore an equity award at the lower end of the range of reasonable estimates would be appropriate.

2. DISCUSSION, FINDINGS AND CONCLUSIONS

a. Background

i. Our Rate-of-Return Decision in Docket Nos. 90-049-03 and -06 Was Reasonable

Company witness Cummings characterized our most recent rate-of-return decision, 12.2 percent in Docket Nos. 90-049-03 and -06, as unreasonably low. His reasons were the same as he now uses to argue for a higher return award in the present docket. We conclude, however, that our rate-of-return decisions have been effective and fair. The best indicator for this is the Company's actual performance in this jurisdiction, measured by its realized earnings. We find that the earned rate of return on equity for USWC, recognizing policy decisions of this Commission, was 14.9 percent for 1991. The 1991 earned rate of return was higher in Utah than any other USWC jurisdiction. Even though shareholders have enjoyed overearnings, ratepayers have benefitted from the rate reductions ordered during the period December 1987, to July 1991. The Company's

market-to-book ratio has been, and remains, significantly greater than one, indicating that investors expect the Company to earn more than the rate of return required to induce them to invest in Company equity securities. We find that USWC has had no difficulty attracting capital on favorable terms. The Company continues to enjoy a AA- bond rating, or the equivalent rating given by other rating firms, and to finance most investment internally. We find that USWC is financially fit. Thus, we find that the Company's financial fitness and its success in the capital markets, which are indications of actual performance on the basis of our regulatory decisions, show our rate-of-return decisions to have been just and reasonable. Most particularly, in the estimation of this Commission, the balance struck between the interests of ratepayers and shareholders has been fair.

ii. A Rate-of-Return Decision must Balance Ratepayer and Shareholder Interests

The testimony in this docket centers on the application of formal models. This gives the appearance of objectivity to results. We must state, however, that determination of rate of return is a subjective exercise. It has been termed an act of political economy rather than one of objective science; a decision which balances the interests of consumers against the interests of shareholders. As this is a question of fairness, there is no scientific (objective) way to establish the correct rate of

return. The best available information must be used to establish a zone of reasonable estimates. The allowed rate of return selected from this range is a matter of judgment.

The subjective nature of the decision can be illustrated by considering that the allowed rate of return must provide management the incentives to efficiently run the company that otherwise would be provided by competition and the pursuit of profit in the unregulated economy. An incentive adjustment is a matter for informed speculation, but it and like factors can influence whether the allowed rate comes from the top, middle, or bottom of the zone of reasonable estimates.

b. Summary of the Recommendations of the Parties

Company testimony boils down to two interdependent propositions: first, the DCF used alone is insufficient to estimate investors' required return, and second, equity cost for USWC can only be estimated indirectly by examining other equity-issuing companies of comparable risk. It was argued that not one but several such proxy companies must be evaluated. This effort produced a number of calculations which the witnesses averaged to derive the cost of capital for USWC. The Division's witness testified that this approach is flawed. He instead directly estimated equity cost for the parent company, and by subtracting an adjustment to account for USWC's lower risk, derived the equity cost for USWC. The Committee witness analyzed regional holding companies as proxy companies using the DCF and derived USWC's equity cost from this by making a risk

adjustment as the Division had done. Each witness subjected his results to reasonableness tests. In updated testimony, the final estimates of investors' required return ranged from 11.3 percent to 14.2 percent. A narrower range is produced by the witnesses' 11.3, 11.5, and 13.5 percent recommendations. The DCF model estimates are at the low end of these ranges, while the high end is defined by CAPM estimates for the independent telephone companies and the industrial companies claimed by the USWC witnesses to be comparable in risk to USWC.

c. The Role of the DCF Model

i. Our Past Rate-of-Return Decisions Have Increasingly Relied Upon the DCF Model

In Docket Nos. 90-049-03 and -06 evidence persuaded us that at those moments when capital costs change direction the DCF may not properly estimate required returns. Perhaps to the point, DCF results in that docket varied widely. This was contrary to the experience of the previous several rate cases. Therefore our decision, a 12.2 percent allowed rate of return, was based both on the DCF and on influential testimony about alleged increasing competition faced by the Company, uncertainty about the state of the economy, lack of expert consensus about interest rate movements in the near term, and potential changes in state and federal regulation. In contrast to that docket, and in line with all our previous experience, no such testimony and no such suggestions

about the inadequacy of the DCF method appear on the present record. In fact the DCF estimates, stated on comparable terms, are virtually identical. Four expert witnesses, representing three different points of view, have for practical purposes derived the same results. This is significant and unusual. Therefore, the burden of breaking away from reliance on the DCF falls to the Company witnesses who advocate doing so.

ii. Estimating Dividends, Growth, and Market Price

Dividend growth ("g" in the DCF formula) is the most controversial and difficult to estimate of the three DCF variables. But in this docket, the four witnesses arrive at the same 6 percent estimate for it. Nor does the dividend yield component of the model differ materially. As a result, we find that there is no significant difference in price, dividend and growth estimates used by the four witnesses to describe US West, Inc.

iii. The Quarterly Dividend Version of the DCF

Company witnesses advocated use of the quarterly dividend version of the DCF model. This added 20 to 25 basis points to the equity cost estimate. We find that this overestimates investors' required return and would overcompensate them. We find further that the effect of paying dividends quarterly is more than offset by other factors. There is no evidence that investors use this form of the DCF model and in fact it would overcompensate

investors. In past cases we have not permitted the quarterly dividend adjustment. Arguments in favor of it in this docket are not new. The Division's analysis opposing it, however, is more refined and effective than we have heretofore seen. We conclude that the quarterly adjustment should not be made.

iv. Results of DCF Applications in this Docket are Similar

On the basis of the preceding findings and conclusions, and making the corresponding adjustments, we further conclude that the witnesses' applications of the DCF model to US West, Inc. produce results that are for practical purposes the same, i.e., 12.0 percent.

d. The Capital Asset Pricing Model

i. Arguments Supporting CAPM

CAPM was advocated by the Company witnesses, and, applied to industrials, indirectly produced the highest estimates of equity capital cost for USWC. The Company witnesses argued for CAPM on grounds that holders of well-diversified portfolios of stock are concerned only with systematic, or non-diversifiable, risk. Factors other than movements of the market as a whole which affect stock price--together, unsystematic risk--can be offset by stocks within the portfolio having different risk characteristics. Beta measures the remaining, systematic, risk, showing how the return of the subject stock varies with respect to the return on the market. It is the risk measure of interest to the institutional investors typically holding such portfolios. Beta is a key variable in CAPM, as are an estimate of the risk-free rate of return, and an estimate of the risk premium.

ii. Arguments Against CAPM

We find that CAPM is today uniformly producing cost-of-capital estimates higher than is the DCF. The central problem with CAPM is the assumption that beta fully captures risk. Proof of the difficulty of properly estimating its variables, including beta, is the fact that when CAPM is employed by various experts the results differ widely. Whatever the attraction of beta and CAPM in academic circles, the model most often fails in the

regulatory context, as it has consistently in this jurisdiction. We find that the choice of the risk-free rate is not objective, and that the analyst is required to estimate the required return on the market, a task every bit as subjective as estimation of USWC's required return. Finally, we find that beta is not appropriate as the sole measure of risk since it measures historical, not current or prospective, risk.

iii. The CAPM is Problematic and We Will Not Rely on it

We have evaluated these arguments in past cases and do not detect anything new here which would cause us to change our opinion of CAPM. We have rejected it before and do so again here. We are hesitant to be guided by a method which on the one hand produces results which can be miles apart, depending on subjective choices the analysts must make about the key variables, and on the other is consistent only in being advocated by utility expert witnesses to establish ever new highs for the range of reasonable estimates. It is also the fact that the reasonableness checks (average return for the market and risk premium) employed by the USWC witness share with CAPM this same subjectivity and are objectionable to us for the same reasons CAPM is.

e. Comparable, or Proxy, Companies

i. Comparable Companies must be Comparable in Risk

USWC does not issue equity capital. Therefore, its equity cost must be estimated indirectly by considering the relationship between risk and return. This is done by using proxy companies. Those chosen by the Division and the Committee are US West, Inc., and the other regional holding companies. USWC's witnesses analyze regional holding companies, independent telephone companies, and industrial companies, but their return recommendations principally rely on the industrials. The obvious point is that to be relevant, a proxy company must be comparable in risk to USWC. Therefore, the key to this approach is the measurement of risk comparability, which, unless done properly, will not yield proxy companies that are in fact comparable. Returns calculated for them, whether based on the DCF or the CAPM, will not be helpful indications of USWC's cost of equity capital.

ii. Risk Measurement Criteria

For risk measurement, the Company witnesses principally rely on cash flow variability and use it to select the industrial firms they intend to prove comparable to USWC. We focus on the asserted risk comparability of the industrials, because the other two categories of allegedly comparable companies, regional holding companies and independent telephone companies, do not figure prominently in the Company's final recommendation. Cash flow variability as a risk criterion is new to us, but we find that it may ignore aspects of risk we consider important. These include whether a firm is regulated or not, what degree of competition it is subject

to, how dynamic the technology in the industry is, and other forward-looking aspects of business risk. None of these is captured by examining past cash flow variability. We find that added that cash flow variability is not used by investors, analysts, or regulators to determine risk. Neither is the K-L Spanning approach used by Company witness Linke, which depends upon it. In previous cases, we have been persuaded that evidence on the particulars of USWC's business risk is important in the determination of risk comparability. Without it as a guide to selecting proxy companies we have not been comfortable considering industrials truly comparable. That remains the case in this docket and is important because the Company's recommendation turns on its assertion that the industrials it has selected are comparable in risk to USWC. USWC's witnesses fail to convince us that the industrial companies they have selected are comparable in risk to USWC. We therefore conclude that the analysis of industrials should carry little weight in our USWC equity return decision.

iii. We Face No Legal Requirement to Base Our Rate-of-Return Decision on an Analysis of Industrial Companies

The Company asserted that analysis of industrials is required by the **Hope** and **Bluefield** decisions of the US Supreme Court. Opportunity cost is the essence of their argument. We conclude that analysis of industrials is not a legal requirement because, first, the market completely adjusts the price of the

subject firm's stock to reflect opportunity costs; second, it is nearly impossible to identify firms of corresponding risk; and third, Supreme Court cases hold for comparing actual earnings and not the estimates of future earnings required to employ either DCF or CAPM.

iv. US West, Inc. and the Regional Holding Companies are Reasonable Proxies for USWC

We find that estimation of the cost of capital for USWC should start with either US West, Inc. or the regional holding companies, or both, after which a risk adjustment should be made to account for USWC's lesser risk. There is no evidence on this record to suggest that the regional holding companies do not share risk characteristics and are not comparable companies in the manner meant by the guiding Hope and Bluefield U.S. Supreme Court decisions. Each witness employed an analysis of them either to reach a recommendation of cost of capital for USWC or to establish the reasonableness of a recommendation derived another way. The Committee performed a DCF analysis of the holding companies as proxies. The Division witness's DCF analysis of these companies provided a reasonableness check on his DCF analysis of US West, Inc. The Company's witnesses analyzed them but did not base their recommendation on the particular results.

f. USWC is Less Risky than US West, Inc.

Having estimated required return for US West, Inc., the Division subtracted 50 basis points to account for USWC's lesser risk, and in this way reached its rate-of-return recommendation for USWC. The Committee used the mid-point of the range of holding

company results and subtracted a risk adjustment of 20 basis points to reach its recommendation. In Docket No. 90-049-03 and -06, we quantified this risk differential at 50 basis points. In the present docket, 50 basis points is again advocated by the Division, whereas 20 basis points is the deliberately conservative estimate used by the Committee. Company witness Linke provided corroborating evidence in that a 40 basis points difference can be derived from his work, though he did not advocate this as a measure of risk difference and cautioned against it on grounds that an amount this small could simply be the result of measurement error. Mr. Cummings' qualitative assessment is that USWC is less risky than its parent. We find that US West, Inc. is a riskier entity than is USWC.

g. The Proposed Adjustment for Flotation

Company witnesses argued that cost of capital must include an adjustment of 20 basis points for recovery of issuance costs or "flotation." Such costs, they testified, whether or not they appear in the Company's accounts, are a continuing obligation that is recoverable from ratepayers. The Division witness supported the adjustment in concept but testified that owing to offsetting factors it should not be made in this case. We find a number of reasons why the adjustment should not be made. These include the fact that no such costs appear on the Company's books; that there is no evidence such costs were transferred to the Company upon divestiture and reorganization in 1984; that the Company, except for a 1990 issue, for which Utah's share of the costs amounts to only

about $100,000, has not issued new equity; that the Company does not anticipate a new issuance during the test year; that there is no evidence earned return has been insufficient to recover such costs; and finally, that the adjustment cannot be justified because stock continually sells much above book value. We are familiar with these arguments from past cases. Based on our evaluation of them, we have not permitted an explicit allowance for flotation costs. Nothing in the present record causes us to change this position. We cannot find that failure to increase allowed equity return by 20-basis points would harm the Company by depriving it of the opportunity to earn its cost of equity capital. To the contrary, there is ample reason to believe an explicit adjustment would overcompensate the Company. Therefore, we conclude that a 20-basis point addition to equity return for flotation should not be permitted.

h. Summary of Evidence

The evidence on this record is clear in certain key respects. First, the use of industrials as proxy, or comparable companies, selected principally on the basis of the cash flow variability risk criterion, produces a recommended return award at the high end of the range and is not convincing. Second, this is partially the result of using CAPM to analyze these companies. Third, the exercise produces results that are significantly higher than our last award, regardless of the uncontested fact that capital costs have declined since then. Fourth, we have been obliged to note the complete absence of evidence to suggest that our rate-of-return

awards have been too low and have concluded that they have been reasonable. Fifth, application of the DCF produces more reliable results. Sixth, on the basis of all the evidence in this case we have concluded that this analysis, applied to US West, Inc. and/or the regional holding companies, is the correct starting point. Seventh, when stated comparably, the DCF of each witness produces virtually the same 12.0 percent result for US West, Inc., and 11.7 percent as the average for the several regional holding companies in the Committee's analysis. Eighth, USWC is less risky than US West, Inc., and the magnitude of this risk difference has been presented in testimony as ranging up to 50 basis points. We therefore conclude that a reasonable allowed rate of return on equity for USWC is between 11.5 percent and 12.0 percent.

i. The Allowed Rate of Return on Equity

In the previous case for USWC (Docket No. 90-049-03 and -06) the Company sponsored the testimony of Dr. Davidson and others who indicated that technological change and increased competition were changing the character and thus the risk of investing in telephone utilities. In that case we also ordered the modernization of USWC's telephone network in rural Utah. In spite of the fact that we could discern no direct relationship between return on equity and investment decision making in Utah on the part of USWC we recognized the logic of the relationship between rate of return and discretionary investment on the part of the utility.

The Commission found that capital costs had declined since the previous rate of return decision of 11.8 percent and that taken alone this would argue for a reduction in allowed return. Nevertheless the Commission determined that other compelling factors have a role to play and cited, among other things, increasing risk, the wide range of cost of equity estimates obtained by witnesses, and that the utility may to a degree be shedding certain utility characteristics. We placed principal reliance on the DCF, but found that the required return exceeds the cost of capital estimate produced by mechanical application of the DCF model and raised the allowed return to 12.2 percent.

In this case we again look principally to the DCF model for a cost of capital estimate and conclude that the range of reasonable allowed rate of return on equity is from 11.5 to 12.0 percent. The Company did not provide much specific testimony on changing technology and increased competition in the industry in this case, but nevertheless these issues came up time and again in live testimony and cross examination. In fact it was this testimony which caused us to establish an investigatory docket to deal with the issues of what is basic telephone service, what competition exists, and what is its impact. While this new docket will not help directly with the cost of capital determination, it may well provide us with new directions in overall regulatory policy.

The modernization of USWC's network in rural Utah, which was part of the justification for increasing the cost of equity in the last case is continuing. The other factors which we considered in

our last order have not changed. Clearly the cost of capital has come down since the last case, and we cannot overlook that fact, but we are reluctant to cause a major reduction in the Company's rate of return on equity at this time. While we believe that USWC's risk and therefore its cost of equity is more than zero basis points less than US WEST Inc's we are going to reduce the allowed return on equity for USWC to the top of the range we have found reasonable. The Commission finds that the allowed return on equity for USWC should be 12.0 percent.

j. Capital Structure

i. The USWC-Utah Capital Structure

All witnesses agreed that it would be appropriate to adopt the USWC-Utah actual capital structure, as proposed by the Company, for purposes of this docket. This capital structure is 38.1 percent debt and 61.9 percent equity. Cost of debt is 8.43 percent. We find that this is a least-cost capital structure from the ratepayers' standpoint. We find that this capital structure is appropriate for rate setting purposes and should be adopted for rate setting purposes in this docket.

ii. The Proposed Leveraged Employee Stock Ownership Program Adjustment

Questioning why the equity ratio is higher in this USWC structure than in US West, Inc.'s, which is a riskier entity, the Committee witness testified that one reason is the highly

leveraged subsidiary US West Capital Corporation/Financial Services, which, operating in real estate and finance, has 87 percent debt. But, he stated, it is also due to the debt associated with the Leveraged Employee Stock Ownership Program (LESOP), which appears only on US West, Inc.'s books. Under this program, trust funds use debt, guaranteed and partially serviced by US West, Inc., to purchase stock for employees. But, he asserted, since USWC accounts for the majority of US West, Inc.'s operations, cash flow, earnings and dividends, it is really USWC that is guaranteeing and servicing this debt. Hence, in his opinion, a proportionate share of LESOP debt should be allocated to the USWC capital structure. He testified that the LESOP adjustment is required by the FCC. He recommended an adjustment lowering the equity ratio from 61.9 percent to 60.9 percent, still, he stated, well within the AA rating range. Company witnesses opposed this adjustment, based on their argument that US West, Inc. alone stands behind and services this debt. The Commission is concerned that we don't have sufficient information to make this adjustment. We request that the Division look into this issue before the next USWC rate case. The Commission finds that this adjustment should be rejected at this time.

iii. Capital Structure and Rate of Return on Rate Base

The combination of an 12.0 percent allowed rate of return on equity and the capital structure we have adopted produce an allowed rate of return on rate base of 10.64 percent. We conclude that this rate is fair and reasonable.

I. SUMMARY

A summary of revenue requirement is presented in Table 1 below. The first column shows the 1991 actual results on a regulatory basis, i.e., the adjustments discussed in Section B. The next three columns present the positions of the Company, the Division, and the Committee. Each party's position is a characterization of test-period ratemaking income and rate base. The ratio of ratemaking income to rate base yields test-period rate of return on rate base. Using the 1991 capital structure provided in this case, the test-period rate of return on equity is shown. Each party's recommended allowed rates of return are also shown. The resulting change in revenue requirement is then calculated. The decision of the Commission is shown in the final column.

TABLE 1
SUMMARY OF POSITIONS OF THE PARTIES
AND COMMISSION DECISION ON REVENUE REQUIREMENT
($ Million)

	1991	USWC	DPU	CCS	PSC
	Regulatory Results	Adjusted Results	Adjusted Results	Adjusted Results	Adjusted Results
Revenues	$320.495	$309.009	$312.738	$313.414	$309.501
Expenses	226.314	240.699	227.373	221.028	232.861
Taxes	34.737	25.725	32.087	33.875	28.832
Ratemaking Income	59.444	42.585	53.279	58.510	47.808
Rate Base	477.219	504.028	477.542	478.992	477.747
Rate of Return on Rate Base	12.46%	8.45%	11.16%	12.22%	10.01%
Rate of Return on Equity	14.93%	8.46%	12.83%	14.65%	10.97%
Allowed Rate of Return on Rate Base	10.77%	11.57%	10.21%	10.30%	10.64%
Allowed Rate of Return on Equity	12.20%	13.50%	11.30%	11.50%	12.00%
Revenue Change	($13.023)	$25.511	($7.326)	($14.829)	$4.907

III. DISCUSSION, FINDINGS, AND CONCLUSIONS WITH RESPECT TO REVENUE SPREAD AND RATE DESIGN

A. COST OF SERVICE

In all dockets since 1984, we have stressed the importance of cost-based pricing for telecommunications services. The history of this effort was fully recounted in Report and Order, Docket Nos. 90-049-03 and -06, issued June 19, 1991. It will not be repeated here. Suffice it to say that we find no reason on the present record to deviate either from cost-based pricing, though modified below to account for relevant concerns, or continued reliance upon the Division's fully distributed cost study (DCOS). The Report and Order in the cited docket also contains a description of DCOS. In recent dockets, this cost study has been used to determine revenue spread, with direct implications for rate design. In the present docket, all parties have accepted and relied upon the DCOS model and results filed in the Division's testimony. The Company and the Committee, however, proposed certain modifications which are discussed below.

B. REVENUE SPREAD

In addition to ratemaking objectives, some of which are attainable through cost-based pricing, considerations important in telecommunications pricing today include the influence of market determinants. That pricing objectives at times may conflict, and that market information is speculative, is shown on the record in the

present docket, and has been described as a key ratemaking problem in Report and Order, Docket Nos. 90-049-03 and -06. This discussion will not be repeated here. It is now familiar to parties. No party raised these concerns to new levels with unusual arguments or claims in this proceeding.

Embedded cost of service analysis lies behind revenue spread and is the starting point for pricing. DCOS has been accepted by all parties and is used for this purpose in this proceeding with very little disagreement. The Committee, however, raised three issues of importance to DCOS. These are a proposed change in the nontraffic-sensitive cost-allocation factor, a concern with the way video dial tone depreciation is allocated, and an assertion that information used by DCOS, which comes from the Company's Cost Accounting Allocation System (CAAS), is not reliable. In addition, the Company argued, as it had in the past, that directory revenues should be spread more broadly among services than is done in DCOS. The directory revenues issue is again presented to us based on arguments considered in a previous case. We reaffirm our previous decision not to alter the Division's DCOS treatment of directory revenues. We are unable to resolve the Committee's proposed adjustments at this time. The schedule in this proceeding has not provided sufficient time to fully consider them. We find that the adjustments would not affect the outcome of this case in any way, however, given our decisions on revenue spread and pricing, and therefore, upon our further review of the record, we will at a later time inform parties how we would intend to resolve them. This may require further formal or informal

proceedings. In all events, the Committee is free to bring them forward again in a proper proceeding.

In past cases, we have determined that both embedded or fully distributed and long-run incremental cost of service analyses are useful for pricing utility services. We find that the record in this case is not sufficient to advance our consideration of long-run incremental costs and their role in pricing. In particular, we find that we cannot resolve issues concerning the differences between the Company's approach to developing these costs and the total service incremental cost approach advocated by MCI. We intend, however, to closely monitor the developments in the Oregon jurisdiction, where this issue is under careful consideration.

There are trade-offs among ratemaking or pricing objectives which cannot be avoided and must be resolved by this Commission in the exercise of its public interest responsibilities. This is simply to state our traditional approach to the task of pricing, but we also acknowledge that we must consider the changing technological and institutional environment in which telecommunications services are provided.

Finally, in view of its importance in this docket, we note the role played in this docket by price restructuring proposals. In previous dockets, prices have changed in response to the factors mentioned above, most particularly cost of service, pricing objectives, and market considerations. The parties have recommended, and we agree, that it is now time to continue rationalizing the structure of tariffed rates by simplifying where possible to account

for relationships among services. In addition, we seek to correct discrepancies that may have crept unnoticed into the tariff as a result of the many alterations made to it in recent cases.

On this record, the essential difference between the Company and the Division is that, though both agree that the prices of a number of services should be increased, the Company would propose to do so only in the case of a revenue requirement increase larger than we have granted in this proceeding. Thus, the Company would back away from many of these proposals, and instead, proposes to increase rates for residential service. The Company argued that the recent history of residential rate decreases makes possible an otherwise justifiable but modest rate increase without harm or threat to universal service. All cost analyses, stated the Company, show residential rates to be underpriced. Should the Commission first turn to the other services and increase prices there, the Company would recommended focusing on switched access and PBX/Centron rates as candidates for reduction, again based on performance relative to cost of service. The Division maintained that the prices for certain other services should still be increased, independent of the size of the overall revenue requirement change, and only after this has been done should attention be turned to residential rates.

The Committee proposed modest decreases in residential and business service rates, and otherwise generally agreed with the Division that increased rates for other services are justified. MCI and AT&T took the position that switched access rates should be reduced and the proposed payphone set use fee should not be adopted.

Public access line (PAL) rates were the subject of a stipulation of the parties that was presented to the Commission during the proceeding. The Utah Payphone Association argued in favor of adopting a set use fee though its principal concerns had been resolved by the stipulation.

The Commission's revenue spread decisions are presented in Table 2, Revenue Spread. The discussion turns to the specific issues of rate design.

C. RATE DESIGN

1. UNDISPUTED PRICING PROPOSALS

Given the emphasis in this proceeding on restructuring, and the fact that the change in overall revenue requirement is not large, parties are in agreement about a number of rate design changes. These are:

Foreign Directories

Market Expansion Lines

Public Access

Business Custom Calling Services (Call Forward)

Private Line

Personal Service Number

New Number and Custom Intercept

Switched Access Billing and Transport Restructuring

Companion Line

UBOTS

Telechoice Option Package

Changes in the ratio for Residence 2-Party, 4-Party, 8-Party and Business 4- and 8-Party Services.

One aspect of the agreement is the need to make minor corrections to currently tariffed rates, owing to problems not corrected in the last docket but subject to repricing consideration in the present docket. No party has objected to these pricing changes, and all agreed that the restructuring involved should be adopted. We find these changes will provide correct price signals to the users of these services and that these rates should be adopted. The revenue spread implications are shown on Table 2.

2. DISPUTED PRICING PROPOSALS

Parties are in dispute as to the remaining services. Some involve minor adjustments to previously adopted rates, and none of them are inconsistent with our approach to and objectives for pricing. Table 2 shows the required aggregate changes.

a. Residence Nonrecurring Charges

These adjustments were recommended by USWC at a greater revenue increase than has been found reasonable by this Commission. The Committee and the Division both recommend some modification of the charges based upon arguments put forward by the Company, but they differ in proposed treatment of the residential dial tone line non-recurring charge. The Division proposed an increase. The Committee

has opposed it as detrimental to attainment of the Universal Service goal and argued that raising the rate could decrease telephone penetration rates. The Committee asserted that the high cost of service connection is an important cause of low penetration among low-income households. We find that the policy of Universal Service continues to be important, and that connection costs to be a barrier to acquiring service. We therefore find that nonrecurring charges should be increased with the exception of that associated with dial tone line.

b. Business Nonrecurring and Network Access Register (NAR) Digital PBX Trunks Nonrecurring Charges

USWC proposed an increase in these charges on the assumption of an increase in revenue requirement greater than that we have awarded. The Company therefore dropped support for the change, but the Division and the Committee proposed that the adjustments be adopted in order to properly align all business services nonrecurring charges. In order to insure that customers who create the installation or change of service costs pay for them, we find that the proposed adjustments should be adopted.

c. Business Message Extended Area Service

The Division proposed to add an intraoffice usage charge to the business measured usage services. Using the inventory of one-party measured lines (1MB) provided by USWC for this docket,

and a $2.50 per month fixed charge, the annual revenue increase would be $62,755. This rate was applied previously but was dropped in the last rate case. This proposed adjustment restores and adjusts the charge. The Committee concurred and USWC did not oppose the adjustment. The Commission finds that the adjustment should be made.

d. Centron-Business Alternative Answer

This increase was proposed by USWC under the assumption that the increase in revenue requirement would be greater than we have permitted. It was supported as necessary by the Division and the Committee, in order to properly align it with other similar business service offerings, regardless of the change in overall revenue requirement. We find that for this reason the adjustment should be made.

e. USWC Payphone Usage Charge

Based on cost analyses showing the need for increases to provide proper returns, USWC proposed to increase the payphone coin rate from $0.25 to $0.35 and to implement a usage charge of $0.35 for all completed intra-state calls. The Division and the Committee opposed the increase of the payphone coin rate, on the argument that the cost analyses were inconclusive, but supported the proposal to establish a $0.25 coin usage charge for all completed intrastate calls. MCI and AT&T opposed the set use fee for completed

intrastate toll calls. They argued USWC cannot now distinguish intra- from interstate toll calls, nor does it have FCC approval for the charge. According to AT&T, the FCC has declared that a use fee is inappropriate if payphones are in rate base, as is the case in Utah. This means the Iowa situation, where a set use fee has been adopted but the phones are not in rate base, is not applicable. Interexchange carriers already pay access charges that are greater than long-run incremental costs, according to MCI, so to add the use fee is inappropriate. The Utah Payphone Association supported the use fee concept for USWC and asserted it would be appropriate to extend it to private payphones. Though DCOS shows a negative return for this product category, we find that USWC does not report total revenues that could be attributed to the coin telephone. We find that long distance calls completed from the payphones should contribute revenues to the coin payphones. USWC instead books these revenues as toll revenues and does not identify when a call is completed from a payphone. The Commission has previously recognized that a payphone is an extension of local service. The advantages of having payphones available for emergency needs and convenience when away from home or office, is a benefit that must be recognized. As a result, the Commission finds that an increase to $0.35 is not justified at this time; the $0.25 rate will be maintained. However, the Commission does find that a usage fee for completed intrastate payphone calls would provide compensation when calls are made using a credit card or for third-party billing usage of a USWC payphone.

This fee, which we herein set at $0.25, will improve the earnings of the payphone DCOS product category.

f. PBX Trunk and Centron NAR Hunting Charge

USWC proposed to restructure inward, outward, and two-way PBX trunks, pricing these services at the same rate. In addition, USWC proposed to restructure the prices for Centron network access registers, inward, outward, and two-way. The Division strongly opposed this restructuring. We find that the USWC proposal was not cost-justified, was offered merely to place the Company in a better competitive position, and was not supported by an analysis of differential impacts on its customers. Hence, the proposal would have undesirable equity effects; some customers would receive an unjustified but substantial rate increase. No useful Subscriber Line Usage Study exists for out-only trunks, so there is no usage basis to support the USWC proposal. The Division proposed removing $4.00 from current rates for each individual service on grounds that when the hunting element was separated from these services in the last rate proceeding, the $4.00 increment was left in usage rates. This proposed adjustment would correct this problem. The Commission finds that the Company's proposal is not supported on the record. The Commission further finds that the Division's proposed $4.00 reduction in the rates for these services has some merit. Given our focus on restructuring rates, correcting service inequities in a manner having little revenue impact, and the high return for these services in the

DCOS results, we conclude that a reduction of $1.79 per PBX trunk and Centron NAR is appropriate and should be adopted.

g. Restructure and Reprice DID Recurring and Nonrecurring Charges

USWC proposed these adjustments at a higher than adopted revenue requirement increase in order to cover costs and to price to market. The Division and the Committee adopted the proposal and advocated the restructuring of Direct Inward Dialing (DID) to add new offerings and to simplify the rate structure with respect to other similar services. The Commission finds that administrative simplicity and customer understanding are long-standing regulatory objectives. The Commission concludes, therefore, that the proposed rate restructure will simplify the tariff and should be adopted.

h. Residence and Business Privacy Listings

USWC originally proposed the increase for these listings based on the assumption of a revenue requirement increase greater than that allowed and on the uncompensated impact that privacy listings have on directory assistance. Privacy listings create additional work load for directory assistance. The Division adopted and supported this adjustment. We find that many persons subscribe to this service in order to avoid harassing phone calls. Thus, an increase in a sense causes them to pay double in order to purchase protection. No evidence suggests current prices are less

than the costs of providing service. We find there is no reason to increase these rates.

i. Residential and Business Premium Listing

USWC proposed this increase for a higher level of revenue increase than that granted in this order. This adjustment was adopted by the Division and the Committee and supported because premium listings are enhancements to directory listings, are entirely discretionary, and are intended to meet unique requirements. They argued that it is therefore appropriate to price such services on the basis of value of service. Doing so will help to maintain the prices for essential services lower. The Commission finds that the proposed rationale, first presented by the Company and adopted by both the Division and the Committee, is acceptable, and therefore the proposed rates for premium listings should be adopted.

j. Busy Line Verify

USWC proposed an increase to busy line verify and interrupt service to both recover their costs and to better align USWC's rates with those of other competitors such as AT&T. The Division and the Committee agreed and supported the Company's proposal to price at market for this service. The Commission finds pricing at market for competitive services, where there is no dispute concerning cost coverage or conflict with other regulatory

objectives, to be appropriate, and therefore the proposal should be adopted.

k. Local Service Directory Assistance

Both USWC and the Division recommended an increase in the directory assistance rate from $0.35 to $0.45, while continuing the one free call per month. The increase was opposed by the Committee. DCOS shows this service to be substantially underearning. The proposed increase would also align the rate for this service more closely with those of other USWC services. The Commission finds that directory assistance is a service in which the user directly creates the cost for it. It is appropriate for those who rely on the operators to provide numbers, as opposed to using their directories which are provided to the customers, to pay a rate which covers the cost of providing the service. The Commission therefore adopts the proposed increase in the directory assistance rate.

l. Residential Dial Tone Line, Usage, and Extended Area Service

USWC and the Division proposed to increase residential telephone service rates. The Committee opposed any such increase. DCOS indicates that residential flat access and usage, including extended area service, are underearning. The Commission notes that it is not unusual for service or product categories in DCOS to underearn, and some underearn by substantially greater margins than residential services. Moreover, this is not the case to change rates

substantially, and we have determined, given the small increase in revenue requirement which we have found reasonable, to restructure and realign rates first. Thus, to the extent that this effort does not exhaust the change in overall revenue requirement, our focus will be on discretionary services and business services. On this basis, there is no justification for an upward adjustment of residential service rates in this proceeding.

m. Business Dial Tone Line, Usage, and Extended Area Service

The Committee proposed a reduction in these service rates based on the rationale that they are overearning as shown by DCOS. The Company has long advocated decreasing business service rates, but in this docket at the allowed revenue requirement focused on other business services. The Division did likewise in order to properly restructure and align service rates. The Company argued that business service rates should come down in response to competitive pressure. The Company has no targeted business-to-residential price ratio although the ratio has been the subject of testimony and Commission orders in the past. The Division maintained that a ratio of 2-to-1 is an appropriate regulatory goal. Current prices are slightly above that. The Commission finds that a reduction in business service rates is not warranted at this time.

n. Option Calling Plans

USWC proposed three new volume discount plans which would have the effect of reducing revenues by $654,000. These calling plans were opposed by the Committee and the Division. We find that the toll market is becoming an oligopoly where the competitors' prices tend to move together, thus nullifying competitive effect of price changes, and in this case resulting in the decrease in revenues suggested by USWC. We find that this loss in revenues is not appropriate. The Company's proposal to tailor rates to meet competitive pressures through volume reductions should

not be adopted unless it can be demonstrated that the return of or increase in USWC customers would increase revenues or at least not reduce them. No such evidence is on the record in this proceeding. The Commission has approved many competitive contracts over the last year which the Company proposed in response to the competition for toll services of AT&T and the resellers in the State. In the case of the special contract, the Company faced the loss of the customer and therefore all the associated revenues. The Option Calling Plans are a response to competitive pressure but we find no showing on the record that it will result in increased revenues. We further find that the decrease in revenues incident to adoption of the volume discount plans would be inappropriate.

o. Switched Access

USWC proposed to reduce the number of mileage bands from 7 to 4, to reduce local transport rates in the remaining bands, and to reduce the terminating carrier common line charge while retaining the current rate for the originating carrier common line charge. This proposal would reduce switched access revenues $411,071. MCI and AT&T supported the proposal, and argued that current rates are above applicable costs. Both the Division and the Committee oppose a reduction in transport rates. The Division argued that DCOS shows that the interstate product group is not covering costs, so a rate reduction to match the FCC-approved interstate elements of switched access is not appropriate. The Division also argued that the returns on intrastate switched access and intrastate

toll services should be similar. The Company's pricing proposal would further upset this balance. The Division also noted its expectation that a future proceeding will restructure switched access rates so a change now is premature. The Committee argued that switched access rates should be applied to cellular service, and otherwise opposed the company's proposal. The Committee proposed to increase originating access common carrier line charge from one cent to two cents. The Division opposed this Committee change on grounds that an increase in the originating access rate might promote bypass. The Commission will adopt the proposal to decrease, in revenue neutral fashion, the number of mileage bands. All parties support this restructure. The Commission finds that all remaining proposals to alter switched access rates, either to increase or decrease them, are not justified on this record. We are concerned to alter rates without a comprehensive analysis of the relation between toll services, extended area service, and switched access because doing so may have effects beyond those discussed on the record in this proceeding. We have long requested such an analysis. We find that we lack the evidentiary basis to permit the selective adjustment of the rates for elements of switched access service and therefore such proposals should be rejected.

p. Custom Calling

An increase in custom calling rates was proposed by USWC on the expectation of a larger revenue requirement increase than permitted in this docket. The Committee supported the proposed

increase in rates at the allowed increase in revenue requirement. The Division opposed the increase in custom calling rates because of the current lack of service penetration in rural communities. The Division argued that higher rates would decrease penetration. The rural areas have had a lower penetration of these services than in the Wasatch Front area. The Commission finds that custom calling services are discretionary and so value of service pricing considerations are relevant. The Company has argued that in such instances, to price above long-run incremental cost, but in accordance with market determinants, is the correct approach. On this basis, we find that the increase in the rates for custom calling services as originally proposed by the Company, and supported by the Committee, should be adopted.

q. Cellular Carrier Access

The Committee proposed changes to the Type 1 interconnect for cellular and radio common carriers that interconnect with the public network. USWC agreed with the Division's recommendation to treat this issue in the proposed restructuring of direct inward dialing (DID) exchange service previously discussed and adopted by this Commission. The Division recommended that a new structure and associated price levels also apply to radio common carriers.

USWC proposed to redefine the entire Radio Common Carrier Direct Inward Dialing/Direct Outward Dialing offering as well as the cellular Type 1 offering. USWC argued that such modifications

should not be made at this time, however, pending negotiations with these carriers. Therefore the Company does not support a Commission-required tariff change in this docket.

The Commission finds that current efforts by the Company should be encouraged. We will adopt the Division's position on these issues. We find that the DID arrangement for radio common carriers is appropriate because it would align this service with comparable services.

TABLE 2
REVENUE SPREAD

	Product/Service	USWC	DPU	CCS	PSC
1	Foreign Directories	$805,000	$805,000	$805,000	$805,000
2	Residence NRC	0	100,947	72,203	72,203
3	Bus., NARS & Digital PBS Trunk NRC	0	22,651	22,651	22,651
4	Market Expansion	43,500	43,500	43,500	43,500
5	Business Message EAS	0	62,700	62,700	62,700
6	Public Access	(156,928)	(156,928)	(156,928)	(156,928)
7	Business CCs CI Fwd	(144)	(144)	(144)	(144)
8	Centron - Bus Alt Ans	0	311,361	311,361	311,361
9	Private Line	344,704	344,704	334,704	344,704
10	USWC Payphone Usage	1,436,000	629,643	629,643	629,643
11	Personal Service Number	(73,684)	(73,684)	(73,684)	(73,684)
12	New # & Custom Intercept	(76,938)	(76,938)	(76,938)	(76,938)
13	PBX Trunk Hunting ($4.00)	(1,391,036)	(1,246,114)	0	(557,013)
14	Centron NARS ($4.00)	(21,346)	(148,148)	0	(66,222)
15	Switched Access	1,585	1,585	1,585	1,585
16	Restructure & Reprice DID - RC	0	819,000	861,991	819,000
17	Restructure & Reprice DID - NRC	0	42,877	0	42,877
18	Companion Line	12,275	12,275	12,275	12,275
19	Privacy Listing - Residential	0	815,466	0	0
20	Privacy Listing - Business	0	38,740	0	0
21	Premium Listing - Residential	0	40,875	40,875	40,875
22	Premium Listing - Business	0	261,261	261,261	261,261
23	Busy Line Verify & Interrupt	0	26,062	26,062	26,062
24	DA Local Service (.35 to .45)	1,158,059	1,158,059	0	1,158,059

25	Residence 2-pty @95%	19,285	7,753	7,753	7,75
26	Residence 4&8-pty @90%	na	2,633	2,633	2,63
27	Business 4&8-pty @90%	617	619	619	61
28	Telechoice Option Package	478,962	478,962	478,962	478,96
29	Residential DTL	3,552,000	0	(118,420)	(
30	Residential Usage	na	483,602	(42,200)	(
31	Residential EAS	na	215,000	(59,140)	(
32	Business DTL	0	0	(85,720)	(
33	Business Usage	0	0	(21,880)	(
34	Business EAS	0	0	(44,180)	(
35	Optional Calling Plans	(654,782)	0	0	31
36	Switched Access	(411,071)	0	0	(
37	Custom Calling	0	0	693,774	693,77
38	Cellular Carrier Access	0	0	528,000	(
39	CCLC (Originating $.01 to $.02)	0	0	470,000	(
	TOTAL	5,066,058	5,023,319	4,988,318	4,906,88

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that:

1. USWC may increase its revenues by $4,907,000 in accordance with the spread and rate design portions of this Order.

2. USWC incorporate the revenue increase into its rates and schedules in conformance with Table 2 herein and file appropriate revised tariffs with the Commission, which tariffs shall take effect on April 15, 1993.

3. USWC shall establish an external fund dedicated solely to the payment of present and future retiree health care benefits.

4. The Stipulation of the parties on rate design for public access lines is accepted and approved.

5. To the extent the Commission has inadvertently omitted from the ordering provisions of this Order any duty or obligation intended to be imposed upon USWC or the Division, which duty or obligation is otherwise clear from the language of preceding portions of this Order, it is hereby incorporated herein by this reference and made a part hereof.

6. Within 20 days of the issuance of this Order, an aggrieved party may file a written request for review by the Commission. If such request is denied in writing within 20 days or deemed denied by Commission inaction after 20 days, the aggrieved party then has 30 days following such denial within which to appeal to the Supreme Court. A failure to seek review by the Commission is a waiver of appeal rights.

DATED in Salt Lake City, Utah this 15th day of April, 1993.

Stephen F. Mecham, Chairman

James M. Byrne, Commissioner
Pro Tempore

Attest:

Julie Orchard, Commission Secretary

COMMENTS OF COMMISSIONER STEPHEN C. HEWLETT CONCURRING IN PART AND DISSENTING IN PART

I concur with the decision of my colleagues in this Order with the exception of the determination on return on equity and postretirement benefits other than pensions (PBOPs).

RETURN ON EQUITY

With respect to cost of capital, I found the evidence compelling that a reasonable allowed rate of return on equity for US West Communications (USWC) is between 11.5 percent and 11.8 percent.

It is clear to me that the cost of capital and long-term interest rates have dropped significantly from the 12.2 percent found to be just and reasonable in the last rate case, Docket Nos. 90-049-03 and 06.

The DCF model produces results more reasonable than CAPM in this case. Using the DCF model all four expert witnesses derived the same cost of capital for US West, Inc., 12.0 percent. I find persuasive the testimony of these four witnesses, representing three different points of view, that USWC is less risky than US West, Inc. by a range of 20 to 50 basis points. In the last rate case, this Commission quantified the risk differential between US West, Inc. and USWC at 50 basis points, which results in a cost of capital requirement of 11.5 percent.

The specific cost of equity for the purpose of calculating revenue requirement in this proceeding should be 11.5 percent.

POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

I concur with my colleagues that PBOPs should be phased-in for USWC but I cannot accept the majority view that it should be included in a 1991 historical test year. PBOPs is clearly a post-test year adjustment and in conformity with past Commission decisions should not be considered by this Commission in this Docket.

The basis for my dissent is fully explained in the Commission's discussion of post-test year adjustments on pages 11-15 in this document.

SFAS 106 requires that PBOPs be recognized for financial reporting purposes on an accrual basis for fiscal years beginning after December 15, 1992 or in the case of USWC, calendar year 1993. Including PBOPs in a 1991 historical test year, which is over one year past the end of the test year, is tantamount to conducting a single-item rate case which this Commission in the past has not

allowed. The inclusion of PBOPs as a post-test year adjustment causes serious mismatching because so much pertinent information remains unknown, unmeasurable, unanalyzed, and unconsidered. The Commission, using a 1991 historical test year in this Docket, analyzed 1991 revenues, expenses, and investments. Allowing PBOPs, a 1993 expense for USWC, does not allow rate case examination of 1993 revenues, expenses and investments.

Another reason that PBOPs should not be considered in this Docket is that a complete audit of PBOPs was not conducted by the Division and the Committee. USWC's medical, dental and life insurance benefits were not analyzed by the Division and the Committee and these parties could not testify if these costs were just and reasonable. No audit was undertaken to analyze the actuary's calculations or assumptions used in the calculation of USWC's PBOPs obligation. The Division accepted for purposes of this Docket the representations of the Company and its actuary.

Stephen C. Hewlett, Commissioner

APPENDIX I
POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

Docket No. 92-049-05, 1991 Incremental Expense ($000)

	COST FACTORS		
1a.	Percent of Cost Expensed	89.45%	Input, p.4, line 4c
1b.	Percent of Cost Capitalized	10.55%	Input, p.4, line 4b
1c.	Midyear Convention	50.00%	Input, p.4, line 8b
1d.	Depreciation Rate	6.58%	Input, p.4, line 8c
1e.	Expense Factor	89.80%	1a + (1d * 1c * 1b)
	SERVICE COST PLUS INTEREST		
2a.	Medical and Dental	2,383	Input, p.4, line 1d
2b.	Life Insurance	328	Input, p.8, line 1d
2c.	Total	2,711	2a + 2b
2d.	Expense Factor	89.80%	1e
2e.	Service Cost Expense	2,434	2c * 2d
3a.	**BENEFIT PAYMENT**	3,630	Input, p.4, line 7b
	INTEREST COST ON APBO		
4a.	Medical and Dental	8,407	Input, p.4, line 2d
4b.	Life Insurance	1,095	Input, p.8, line 2d
4c.	Total	9,502	4a + 4b
4d.	Expense Factor	89.80%	1e
4e.	Interest Expense	8,533	4c * 4d
	RETURN ON ASSETS		
5a.	Medical and Dental	0	Input, p.4, line 3a
5b.	Life Insurance	874	Input, p.8, line 3d
5c.	Total	874	5a + 5b
5d.	Expense Factor	89.80%	1e
5e.	Return Expense	785	5c * 5d
	TBO AMORTIZATION		
6a.	Medical and Dental	5,059	Input, p.4, line 5f
6b.	Life Insurance	130	Input, p.8, line 5d
6c.	Total	5,189	6a + 6b
	PHASE-IN OF ACCRUAL FOR PAST SERVICE LESS PAY-GO		
7a.	Full Accrual for Past Service	12,937	4e - 5e + 6c
7b.	Benefit Payment (Pay-Go)	3,630	3a
7c.	Past Service Difference	9,307	4e - 5e + 6c - 7a
7d.	Phase-In Percent	50%	Commission Decision
7e.	Phase-In Amount	4,653	8a * 8b
8a.	**TOTAL PHASE-IN EXPENSE**	10,718	2e + 3a + 8c
	EXPENSES IN CURRENT RATES		
9a.	Current Service Expenses, Med/Dent	2,131	1a * 2a
9b.	Benefit Payment (Pay-Go)	3,630	3a
9c.	Total Expenses in Current Rates	5,761	9a + 9b
10.	**INCREMENTAL EXPENSE**	4,957	8a - 9c

Input Source: Docket No. 92-999-04, USW Late filed Exhibit 1, pgs. 4 & 8