- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of an Investigation)
Into Collocation and Expanded)
Interconnection)

DOCKET NO. 94-999-01
Phase I
ORDER ON REHEARING

ISSUED: February 13, 1998

SHORT TITLE

Phase I: USWC's Wholesale Rates Based on Avoided Retail Costs

SYNOPSIS

The Commission herein Orders revised wholesale discount rates for five service groups. The first service group consists of basic residence and business services, ISDN, central office features, and listing services, to which a discount rate of 14.5% applies. The second group consists of PBX and Centron/Centrex services, to which a discount rate of 22.2% applies. The third group consists of private line and advanced communications services, to which a discount rate of 11.0% applies. The fourth group consists of operator and directory assistance services, to which a discount rate of 13.4% applies. The fifth group consists of message toll services, optional calling plans, and 800 services, to which a discount rate of 17.0% applies.

APPEARANCES:

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Michael L. Ginsberg Assistant Attorney General	For	Division of Public Utilities
Kent L. Walgren Assistant Attorney General	"	Committee of Consumer Services
Douglas Owens Attorney at Law	"	U S West Communications, Inc.
Richard S. Wolters	"	AT&T Communications of the Mountain States, Inc. Attorney at Law
Jerry D. Fenn Blackburn & Stoll Attorney at Law	"	Exchange Carriers of Utah
Mark P. Trinchero Attorney at Law	"	McLeodUSA Telecommunications Services, Inc.

I. PROCEDURAL HISTORY

On October 24, 1997, the Public Service Commission ("Commission") entered its final Order in this case determining wholesale discount rates for six groups of U. S. West Communications, Inc., ("USWC" or "Company") services based on an analysis of the avoided costs of providing services at wholesale to resellers rather than at retail to end users. On November 13, USWC and AT&T Communications of the Mountain States, Inc. ("AT&T"), filed petitions for rehearing. USWC also sought clarification of one issue. On November 24, the Division of Public Utilities ("Division") filed a response to USWC's petition for rehearing and clarification.

In its petition USWC seeks rehearing on five issues:

1. The Commission erred in calculating the weighted discounts for the six service groups by failing to adjust for the residuals in the service revenue percentage;

2. The Commission erred in requiring services, whose retail rates are below cost, to be provided at a wholesale discount;

3. The Commission erred in requiring wholesale discounts on Carrier Directory Assistance which should not be subject to the requirement of a wholesale discount;

4. The Commission erred in requiring a composite discount to apply to new services, in the absence of any evidence of the avoided cost associated with such services;

5. The Commission erred in setting an excessive discount for Centron/Centrex services.

USWC also sought clarification as to whether any wholesale discount rate applies to nonrecurring charges, and if so, what evidence supports the applicable discounts.

In its petition AT&T seeks rehearing on the following two issues:

1. The Commission should reconsider the use of the AT&T avoided cost model. If the Commission determines to use the Division's Cost of Service model, ("DCOS"), the Commission should reconsider the adjustments to the DCOS model proposed by AT&T.

2. The restrictions on the resale of Centrex services imposed by the Commission are unreasonable and unlawful and should be eliminated.

The Division provided the following comments to USWC's petition for rehearing and clarification:

1. The Division agrees with USWC that the Commission's calculations are in error, but does not agree the alternative discounts filed by USWC are correct.

2. The Division agrees with USWC that Carrier Directory Assistance is a wholesale service and should not be subject to a wholesale discount.

3. The Division agrees with USWC that the composite discount rate should not be applied to new services.

4. USWC's claim that the wholesale discount for Centron and Centrex services is excessive is incorrect.

5. It is not necessary for the Commission to decide what wholesale discount rates apply to non-recurring charges in the Phase I Order.

On December 3, 1997, the Commission issued an Order granting rehearing and issued a Notice of Scheduling Conference, to be held on December 15, 1997, at which the parties and the Commission would discuss the specific issues that the Commission would rehear and the schedule for taking up those issues. During Law and Motion on December 15, 1997, the Scheduling Conference was held and the Commission addressed the petitions of USWC and AT&T.

The Commission first dealt with the petition of USWC. The Commission agreed to rehear the issue that the calculations used in setting the wholesale discounts for groups of services were incorrect. A technical conference was scheduled for December 18, 1997, to review the appropriate method of calculating group discounts from discounts of individual services. Having considered this matter at length in the original hearing, the Commission decided not to rehear the issue of the availability of wholesale discounts for services priced below costs. The Commission did decide to rehear whether Carrier Directory Assistance should be subject to a wholesale discount and whether new services should be subject to a composite discount. The Commission also decided to rehear the issue of the appropriate wholesale discount for Centron and Centrex services. Finally, at the request of AT&T in the Phase I hearings, the Commission deferred any decisions regarding the non-recurring charges for wholesale services until the Phase III, Part A hearings.

The Commission next dealt with the petition of AT&T. The Commission decided not to rehear the issue of the appropriate cost model, reaffirming its choice of the DCOS model. However, the Commission did decide to rehear the issue of restrictions on the resale of Centron and Centrex services.

A hearing was then scheduled for January 8, 1998, to take up the issues the Commission decided to rehear.

On December 30, 1997, the Commission issued a memorandum to the parties expressing the Commission's desire to obtain further information regarding the avoidability of specific operating expenses. These operating expense accounts are the following:

1. Customer Operations - Product Management Expenses (Account 6611)

2. Customer Operations - Customer Service Expenses (Account 6623)

2a. Customer Operations - Bill Inquiry, Training and Management (Account 6623.1)

3. Maintenance - Subscriber Line Repair (Account 6533.1)

4. Corporate Operations Expense (Account 6700):

a. 371A Financial Services (Account 6721.1)

b. 372C Regulatory and Governmental Relations (Account 6722)

c. 375A Legal Expense Common / Legal Regulatory Operations (Account 6725)

d. 56BK R&D Regulatory / 56BY R&D Common (Account 6727)

e. 378J Corporate Communications (Account 6728.3)

f. EC17, 02060, 56BS Other Miscellaneous (Account 6728.91)

5. Gain from Sale of Land and Artworks / Other Operating Gains and Losses (Account 7150)

II. DISCUSSION, FINDINGS, AND CONCLUSIONS

A. Determination of Aggregate Wholesale Discounts For Groups Of Services

This issue involves the treatment of the residual in calculating an aggregate discount rate for a group of services from the discount rates of the individual services. The residual is the difference between a service's actual and allowed earnings. As a result of the technical conference held on December 18, 1997, the Division, the Company, and AT&T now agree on the method of calculating the avoided cost discounts.

The revised calculations, provided by the Division, are the following:

Group 1: 14.5% Basic Residence and Business, Central Office Features, Listing Services, ISDN.

Group 2: 22.2% PBX, Centron/Centrex Services.

Group 3: 11.0% Private Line and Advanced Communications Services.

Group 4: 13.4% Operator and Directory Assistance Services.

Group 5: 17.0% Message Toll Services, Optional Calling Plans, and 800 Services.

Composite: 15.2%

Based on the agreement of the parties, the Commission accepts the revised calculations provided by the Division. Since the Company has no operational experience as a wholesale provider for its current retail services, we have used the cost structure of switched access services as a proxy for the expected cost structure for wholesale services (see Section F. below). Therefore we intend to monitor closely and may need to revisit soon the appropriateness of the wholesale discounts and the avoidable retail costs such discounts are intended to reflect as the Company gains experience as a wholesale provider of its current retail services.

B. Carrier Directory Assistance As A Wholesale Service

USWC states Section 251 Subsection C4 of the 1996 Federal Act requires incumbent local exchange carriers to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers. Carrier Directory Assistance is by definition a service provided to telecommunications carriers, is therefore already a wholesale service, and, as a result, is not subject to a wholesale discount.

The Division does not object to removal of Carrier Directory Assistance from the Group 4 wholesale discount calculations. The Division states the rates being charged to the carriers by US West by contract or through the rates charged on switched access tariffs have derived insufficient revenues to cover the ongoing costs. DCOS study results and the analyses have shown that Carrier Directory Assistance has not produced a positive return to USWC. The Division agrees to defer the pricing of Carrier Directory Assistance to the Phase III, Part C portion of the hearings.

The Commission agrees with interpretation of the 1996 Federal Act as stated by the Company. Carrier Directory Assistance is a wholesale service. Charges for these services shall be included as an issue in Phase III, Part C of this docket.

C. The Appropriate Wholesale Discount For New Services

USWC argues the discount for new services should not be the composite discount rate, as the Commission previously decided. As a new service is introduced it should be reviewed for its avoided cost characteristics. If the new service shares the avoided cost characteristics of existing services, it is possible that it may be assigned to one of the five service groups. The Company testifies that most new services would fit into one of the existing five service groups. The Division also recommends new services should be assigned to one of the five discount groups.

The Commission accepts the recommendation of the Company and the Division. A new service shall be placed into one of the five existing wholesale service groups. However, if the wholesale discount rate for a new service is contested, the wholesale discount rate shall be interim pending final resolution of the dispute by the Commission.

D. The Appropriate Wholesale Discount For Centron And Centrex Services

This issue was restricted by the Commission to a consideration of the appropriate discount rate for the group in which Centron and Centrex services are placed. As decided in II.A., the revised wholesale discount rate for Group 2, which also includes PBX services, is 22.2%.

E. Restrictions On The Resale Of Centron And Centrex Services

The parties agree that rather than taking up this issue in the current proceeding, even though rehearing on this was granted pursuant to AT&T's petition, it would be better to address this issue in the 96-049-T05 docket pursuant to McLeodUSA's petition. The Commission concurs with this agreement of the parties.

F. Avoidability Of Specific Operating Expenses re: PSC Memo

The Division describes again its basic approach to the measurement of avoided costs. Costs are defined to be either direct or indirect. The Division uses intrastate and interstate switched access services, both existing USWC wholesale services, to calculate the cost structure of wholesale services. Switched access serves as an approximation or proxy for the anticipated wholesale cost structure for current retail services. For combined switched access services, the ratio of each individual expense account relative to total operating expenses is determined, termed the proxy expense ratios. Similarly, for a given retail service, the ratio of each individual expense account relative to total operating expenses is determined, termed the retail expense ratios. For a given direct expense account, if the retail expense ratio is greater than the proxy expense ratio, then the retail expense is reduced until the two expense ratios are equal. If the proxy expense ratio is greater than the retail expense ratio, then no upward adjustment to retail expense is made. The ratio of avoided direct expenses to total direct expenses is then used to determine the portion of indirect expenses that are avoidable.

1. Product Management Expenses (Account 6611) *We seek specific evidence why product management expense for all product groups is not avoidable.*

The Division testifies the expenses for subaccounts in account 6611, except for 341A, rates and tariffs, were determined for each product based on the relative retail expense levels versus those experienced for the switched access wholesale proxy levels. For residential service, the retail expense ratios for 6611 subaccounts are lower than the proxy expense ratios, indicating costs will not be avoided, but will instead increase in a wholesale environment. The Division claims this is strong evidence that US West has only required a low level of product management, forecasting, etc., support to residential services. Further, product management support for wholesale residential services will probably exceed the past retail expense levels since carriers are more demanding of each other than their customers are of them. For all other retail products, account 6611 retail expense ratios are well in excess of the proxy expense ratios, indicating costs will be avoided.

341A - Rates and Tariffs. The Division testifies no retail expenses for subaccount 341A, rates and tariffs, will be avoided in providing wholesale services. The manpower, paper stock, reproduction, etc., requirements of US West rates and tariffs function will be greater after the approval of wholesale rates. New and replacement tariffs and price lists will initially be required. Future changes will undergo higher levels of scrutiny by wholesalers, and more frequent hearings will be required for tariff changes which heretofore were routinely processed. More frequent tariff changes will be necessary to meet the changing demands and specifications of the wholesalers.

The Company testifies this particular account is a prime example of an account that may increase rather than decrease under a wholesale environment. The cost to have the initial retail tariff filed is a cost to both the wholesale and retail operations. However, with the wholesale environment there are additional tariffs that have to be filed.

341C - Market Forecast, Market Information Administration & Analysis The Company testifies the market forecast analysis and detailed data is used by US West's engineering organization for planning and sizing outside plant facilities as well as central offices. These functions are not functions that are avoided. They are functions that in both the wholesale and the retail environment will continue to be performed. The Company now will be collecting additional data from the wholesalers to roll into its own forecasts. The Company states this is also an account that technically could have been increased. However, the Division chooses not to increase costs expected in a wholesale environment.

2. Customer Service Expenses (Account 6623) *We seek specific evidence why USWC would incur any customer service expense (e.g., billing inquiries) in account 6623 if a reseller bills and services an end user retail account.*

The Company testifies billing inquiries, made by an end user of a reseller, will often involve the reseller inquiring of US West regarding the status of the end user's service and billing. Further, the reseller itself will be reviewing its bill from US West and initiating inquiries of its own.

3. Bill Inquiry, Training and Management (Account 6623.1) *We seek specific evidence why bill inquiry management and training cost will be incurred in a wholesale supply environment.*

The Division testifies it expects the training requirements under both a wholesale and retail environment will be greater than they will be under a retail only environment since Company employees have to be retrained on providing services to two markets, not just one.

4. Subscriber Line Repair (Account 6533.1) *We desire to supplement the record regarding the degree to which network maintenance expense includes customer facing costs attendant to line repair requests that are likely to be assumed by a service reseller. We seek evidence as to why cost associated with receiving end user trouble reports are not presumptively avoided.*

The Division testifies there will be no decrease in these activities as customer contact inquiries will be replaced by carrier to carrier contacts. These expenses are not primarily customer contact expenses but rather the majority of repair expenses involves the outside repair force, including their equipment and vehicles.

5. Corporate Operations Expense (Account 6700) *We question the avoided expense assumption made in the referenced DCOS line item.*

a. Financial Services (Account 6721.2: subaccount 371A) *US West's chart of accounts associates this subaccount with nonregulated services.*

The Division testifies that expenses associated with financial services are adjusted based upon the ratio of avoided direct expenses to total direct expenses. Further, such an adjustment may overstate avoided expenses since the financial services function is a function that is going out to the financial markets and procuring money for the business and doing payroll operations.

b. Regulatory & Government Relations (Account 6722: subaccount 372C) *We seek evidence why external relations and corporate image advertising should be recovered in wholesale rates when they have been historically disallowed for retail ratemaking.*

The Division testifies the costs booked to this account are those directly associated with performing, preparing, and processing costs of studies for all services. All of the US West cost of service witnesses that have presented testimony and studies for the retail and wholesale services before the Commission booked their time to this account. There is no justification for assuming expenses will be avoided because the work performed will not decrease. Rather, such work has and will continue to increase as a result of the requirements to perform studies to define both retail and wholesale service costs and require more hearings.

Further, the Division testifies the Commission's assumption that these expenses may include those disallowed by the Commission is incorrect. All expenses disallowed by the Commission are removed from the expense accounts as part of an up front, DCOS regulatory adjustment. Therefore, all expenses listed in DCOS results for the avoidable cost expense analysis are those previously allowed by the Commission for pricing services. The advertising expenses that might be in question would be booked to account 6722 372A, public relations, which is totally avoided in the study.

c. Legal Expense Common and Legal Regulatory Operations (Account 6725: subaccounts 375A and 0100) *We seek evidence regarding USWC's method of distributing legal expenses between the common and regulatory subaccounts and a rationale for their inclusion in wholesale rate development.*

The Division testifies expenses in subaccount 375A, common legal expenses, relate to all legal matters other than antitrust and regulatory. It is the Division's understanding that these general legal expenses pertain to rights-of-way, taxes, real estate, franchises, civil litigation, contracting, etc., that are performed for the Utah plant employees and services. These common legal expenses are adjusted based upon the ratio of avoided direct expenses to total direct expenses, even though such expenses would generally benefit all retail and wholesale services in the future. Further, these expenses will not change as a result of wholesale services offered.

The Division testifies expenses in subaccount 0100, legal expenses for regulatory operations, relate almost totally to legal expenses for matters that are filed with and heard by the Utah Commission. None of these expenses will be avoided with wholesale services, but are instead expected to increase. The legal expenses incurred for matters before the Commission have significantly increased in the past three years. And based on current cost of service docket schedules, rules, and intercarrier interconnection and complaint activities, the regulatory legal expenses may not subside for several more years. Therefore, no portion of these expenses are assumed to be avoidable.

The Company testifies expenses are comprised of three components: regulated, deregulated, and common. How they get distributed and booked is based on Part 64 rules and USOA accounts. Part 64 requires direct time reporting to regulated and deregulated operations, based on Part 64 definitions. The common component is what Part 64 says is not directly assignable to either regulated or deregulated operations.

d. R&D Regulatory and R&D Common (Account 6727: subaccounts 56BK and 56 BY) *We seek evidence regarding the nature of R&D expenses booked to these accounts, the distinction between regulated and common and reasons why R&D expense should be incurred by resellers of basic services.*

The Division testifies 56BK R&D regulatory expenses pertain to research and development for service products while 56BY R&D common pertain to research and development for common systems, i.e., computer systems, processes and procedures. Each of these accounts includes expenses the Commission has approved for pricing services. Such R&D benefits services for all retail and future wholesale customers in that they are to enhance offerings, provisioning, maintenance and billing capability. The Division adjusts these expenses based upon the ratio of avoided direct expenses to total direct expenses even though the Division claims it is very doubtful that these Commission-approved expenses will decrease as a result of offering wholesale services. It is more likely that the provisioning of wholesale services will increase the R&D requirements for more sophisticated computerized systems and enhance facilities and equipment operations.

e. Corporate Communications (Account 6728.3: subaccount 378J) *We seek specific evidence why this expense is unavoidable.*

The Division testifies these costs are probably the most common of all common expenses and are Commission approved expenses assignable to all products and services. US West has never been disallowed by the Commission to have corporate officers and staff. These people require phones and equipment so that they can communicate with their departments and operating personnel and generally monitor and direct their functions. These expenses are not avoidable because all companies must have someone to lead and direct the entire show. The Division adjusts these expenses based on the ratio of avoided direct expenses to total direct expenses, even though it is very doubtful that these common expenses will decrease as a result of offering wholesale services.

f. Other Miscellaneous (Account 6728.91,.94: subaccounts EC17, 02060, and 56BS) *The record is void of evidence relating to the nature of these expenses.*

The Division testifies these accounts are Commission approved expenses for pricing services. These expenses pertain almost totally to expenses amortizing compensated absences and potentially some minor expense amount in support of the current and retired employees' Telephone Pioneers Association meetings and activities. The Division adjusts these expenses based on the ratio of avoided direct expenses to total direct expenses, even though it is very doubtful that these common expenses will decrease as a result of offering wholesale services.

6. Other Operating Income and Expense (Account 7150 and 7160), Subaccounts 515A Gain from Sale of Land and Artworks, and 516A, Other Operating Gains and Losses. *Insofar as these accounts are generally intended to reflect the income effect of non-recurring events, we seek evidence why they should be included in wholesale ratemaking.*

The Division testifies, with the support of the Company, the reason that it does not assume any portion of these accounts will be avoidable is because of the fluid nature of the account from year to year. The reason that these expenses are retained is because they were approved by the Commission for setting retail prices for the 1994 test year used in the 1995 rate case. These gains/expenses are not associated exclusively with either retail or wholesale operations. Wholesale discounts are being computed based on the avoidable retail service expenses. These discounts will be applied to retail rates approved by the Commission. It therefore makes little sense to remove approved expenses used to set retail rates.

For all the accounts about which the Commission wished to obtain further information (F.1-F.6 above), the Company and the Division provided evidence showing the amount of expenses in these accounts for switched access, demonstrating that in a wholesale environment these expenses are incurred and are not totally avoidable.

The Commission accepts the arguments put forth by the Division and the Company. No contrary evidence was provided. No further adjustment is therefore necessary.

III. ORDER Based on the evidence received in the rehearing proceeding and upon the Commission's determinations and findings contained in prior sections of this Order, we modify our Order of October 24, 1997, according to the provisions below. Unless modified by this Order, the provisions of the October 24, 1997, Order remain in effect. Wherefore, we Order as follows:

1. Wholesale discounts for US West Communications services will be based upon the following five categories:

Group 1: 14.5% Basic Residence and Business, Central Office Features, Listing Services, ISDN.

Group 2: 22.2% PBX, Centron/Centrex Services.

Group 3: 11.0% Private Line and Advanced Communications Services.

Group 4: 13.4% Operator and Directory Assistance Services.

Group 5: 17.0% Message Toll Services, Optional Calling Plans, and 800 Services.

2. An appropriate wholesale discount rate will be applied to new US West Communications services offered to retail customers in the future. The discount rate shall be either a discount rate from the most applicable existing group discount rate or a proposed new discount rate if the new service does not fit within an existing category. Proposed new wholesale discount rates shall be submitted by US West Communications prior to or at the time proposed retail rates are submitted for the new service. New wholesale discount rates shall be interim pending Commission resolution of any dispute associated with a proposed wholesale discount rate.

DATED at Salt Lake City, Utah, this 13th day of February, 1998.

/s/ Stephen F. Mecham, Chairman

(SEAL) /s/ Constance B. White, Commissioner

/s/ Clark D. Jones, Commissioner

Attest:

/s/ Julie Orchard
Commission Secretary