even worse. Attachment 2 to these reply comments is a press release jointly issued by the Texas Office of Public Counsel, Consumers Union, and the American Association of Retired Persons. Page 2 contains a table showing that customers would have increases ranging from $7.30 to $11.04 per month. These rate increases are unfair, unjust, unreasonable and completely unacceptable. They graphically portray the industry's attempt to have captive customers pay the tab for competitive alternatives of others.

Finally, the LEC proposals are based on the inaccurate assumption that basic local service is subsidized and, therefore, shifting joint and common costs to captive local exchange service customers is appropriate under the terms of the Act. As discussed above, to the extent that this argument relies on the cost of the local loop as a direct cost of local service, this argument is wrong. It flies in the face of consistent rulings by the Supreme Court, the Commission and the States. It is contrary to the Act and should be rejected out of hand, along with proposals to establish "affordability benchmarks" at prices far above reasonable, cost justified levels.

## V. UNIVERSAL SERVICE FUNDING SHOULD BE BASED ON FORWARD LOOKING COSTS, NOT EMBEDDED OR FULLY DISTRIBUTED COSTS

BellSouth (Attachment, p.6.) and SBC (p. 13) assert that a universal service fund should be based on either embedded or fully distributed costs. The Commission should reject this proposal because it would force every customer and every competitor to pay higher costs to protect incumbent LECs from the effects of competition. The purpose of funding universal service should be to cover the economically efficient cost of providing universal service. It should not reward inefficiency. Universal service funding should be calculated based on the efficient, going forward costs of providing service, not on embedded, fully distributed or historical costs.

BellSouth, through NERA, criticizes the BCM because it does not depict "the actual costs of an actual local exchange carrier." (BellSouth Attachment, p. 38) This is exactly why a forward-looking

model[10] would produce cost estimates superior to those based on embedded or fully distributed costs. Embedded and fully distributed costs would reflect a network designed for historical or strategic reasons, not a network designed to provide efficient service today. Consistent with this analysis, the Commission should require that reimbursement for costs incurred to provide universal service pursuant to the Act, including advanced services to schools and libraries, should be based on forward looking costs, not embedded costs.

Basing universal service support on forward looking costs would not preclude incumbent LECs from fully recovering their investment. Incumbent LECs have substantial advantages over would-be entrants, including a 100% market share at the outset of competition, name recognition, control over service ordering and repair processes for resellers, advantages due to cumbersome interim number portability arrangements and control of the essential facilities that every competitor must connect to in order to provide service. Further, the construction of competing local exchange facilities is an expensive and time consuming process and will occur gradually (if at all, in some markets). The LECs will be the dominant facilities-based providers for basic local service for many years to come. In the meantime, in addition to serving the vast majority of customers, the LECs will receive revenue from resellers operating in their markets and from competitors wishing to purchase unbundled facilities.

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[10] Examples of forward-looking studies for sizing universal service funds include the BCM as modified by Hatfield & Associates and presented in a California universal service proceeding and the cost studies prepared by Dr. Ben Johnson for the Pennsylvania Office of Consumer Advocate and submitted to Pennsylvania's universal service proceeding (Docket Nos. I-00940035 and L-00950105)

**CONCLUSION**

NASUCA requests that the Commission consider and adopt the recommendations in these Reply Comments in the Final Order issued.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I, Mary Gubisch, hereby certify that copies of the foregoing "Ex Parte Reply Comments of the National Association of State Utility Consumer Advocates (NASUCA)" have been mailed by first class United States mail, postage prepaid, on the 26th day of June, 1996, to all parties of record as shown on the attached list.

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# Attachment I

SERVICE DATE
APR 11 1996

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

| | | |
|---|---|---|
| WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, | ) | DOCKET NO. UT-950200 |
| Complainant, | ) | FIFTEENTH SUPPLEMENTAL ORDER |
| v. | ) | |
| U S WEST COMMUNICATIONS, INC., | ) | COMMISSION DECISION AND ORDER REJECTING TARIFF REVISIONS; REQUIRING REFILING |
| Respondent | ) | |

**BACKGROUND:** On February 17, 1995, U S WEST Communications, Inc. (USWC or Company) in Docket No. UT-950200 filed with the Commission certain tariff revisions designed to effect statewide a general rate increase of $204,613,922 over four years in its provision of intrastate telecommunications services. By order dated March 8, 1995, the Commission suspended the effective date of the tariff revisions pending investigation and hearing as to whether the proposed rates are fair, just, reasonable, and sufficient. The Company requested and received an extension of time to permit negotiations among parties and it waived the suspension date for a further two weeks to accommodate the hearing schedule.

**COMMISSION:** The Commission rejects the Company's request for increased rates and charges, and directs it to file tariffs to effect a decrease in rates of $91.5 million, which is approximately 9.8% of the Company's affected revenues.

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## PART ONE:

## OVERVIEW

This is an important proceeding. It comes at a defining time for telecommunications regulation in Washington state It is among the longest proceedings the Commission has heard in years. The Commission heard from 52 expert witnesses, received nearly 800 exhibits, comprising over 10,000 pages of prefiled written testimony and documentation. The record ran to more than 4,200 pages of transcript testimony over 23 days of hearing, and 14 party intervenors participated in addition to the Company, Commission Staff, and Public Counsel. The proceeding generated as much intensity as any other Commission proceeding in recent memory.

The reason for this level of activity and intensity has been the nature, diversity, significance and magnitude of the issues posited by the Company's general rate increase filing. It is important from a historical perspective because it is the first general rate case filed by USWC since 1982, and thus the Commission's first opportunity in that time to examine the Company's overall operations. The Commission in February 1989 filed a complaint on its own motion against the Company's rates. A settlement agreement resolved the complaint and resulted in a $337.75 million rate decrease over five years. The agreement also instituted an alternative form of regulation (AFOR) for the Company, which reduced the Company's regulatory burdens.[1] The AFOR ended in December, 1994, and its termination was one of the reasons this case was filed.

This proceeding also is important from a forward-looking perspective as well: it considers policies and pricing that will carry USWC into the competitive environment mandated by the federal government in the Telecommunications Act of 1996.[2]

For years, this state's statutory and regulatory telecommunications policy has directed open markets and consumer choice, balanced by universal service concerns. This order is a key part of the foundation of a sustainable competitive marketplace. Because of its importance,

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[1] RCW 80.36.135 authorizes the Commission to "waive such regulatory requirements under Title 80 RCW for a telecommunications company subject to an alternative form of regulation as may be appropriate to facilitate the implementation of this section[.]" In adopting the plan, the Commission found that the public policy goals of RCW 80.36.300 would be achieved; that the goals delineated in RCW 80.36.135 would be met, and the conditions for approving the plan contained in that statute would be satisfied.

[2]The Federal Telecommunications Act of 1996, Pub.L.No.104-104, 110 Stat. 56, to be codified at 47 USC Sections 151, et seq. The Act will also be referred to in this document simply as "the Telecom Act."

and the amount of money at stake, the case has drawn unprecedented interest and participation by interested parties and the public. At public meetings, and through letters and telephone calls, the Commission has heard from more citizens about this case than any other. To the members of the public who took time to express their views, we extend our appreciation.

The details of the Commission's conclusions, and specific reasons for our findings, are contained in this Order. In this introductory section we briefly summarize some of the policy principles that governed our decision and describe a number of significant issues.

## I. POLICY PRINCIPLES

State telecommunications policy is governed by the Regulatory Flexibility Act, which directs the Commission to preserve universal service, promote diversity in services, ensure that competitive services are not subsidized by monopoly rates, and permit flexible regulation of competitive telecommunications companies and services.[3] The recent federal Telecom Act federalizes that same policy. It begins a new phase of competitive development in which Congress envisions robust competition in all communications markets including, significantly, the local exchange. The Telecom Act reserves substantial roles for state regulatory commissions to effect such competitive development.

Whether robust competition develops will depend on how the law is implemented at both the state and federal levels. Despite some limited competitive entry, USWC is still by far the dominant player in its service territory for virtually all services. For consumers to have competitive choice, the USWC network must be opened up at terms that are fair to both USWC and new entrants. A key part of that process is determining the costs and fair prices for USWC's services. This case, the first general rate case involving USWC in over a decade, provides a comprehensive review of the Company's overall operations. As such, it establishes a baseline from which a sustainable competitive market can emerge.

## II. ISSUES

In USWC's filings and in the evidence, several key issues emerged:

### A. Is the Company Entitled to More Revenues?

USWC's general rate increase filing seeks approximately $205 million a year in additional revenues, phased in over four years. It proposed approximately $95 million of that total as an immediate rate increase. After reviewing the Company's operations and making a

---

[3]L. 1985 ch. 450, amended L. 1989 ch. 101, codified in various provisions in chapter 80.36 RCW.

number of factual, technical and legal decisions, the Commission finds that instead the Company is over-collecting approximately $91.5 million per year. The Company will be directed to reduce rates by that amount.

B. Are Residential Rates Priced Below Cost?

Contending that residential rates are heavily subsidized, USWC proposed more than doubling residential rates over 4 years, and charging rural ratepayers significantly more than urban ratepayers. In the final year of the USWC proposal, urban ratepayers would pay $21.85 per month for service and rural ratepayers $26.35. The current statewide average rate for the service is $10.50.

USWC's own cost data -- which supports the cost study relied on by the Commission -- shows that the incremental cost of local service is less than $5 per month. Even if the entire incremental cost of the "loop" -- the facilities needed for the connection between the central office and the consumer's telephone which also carry long distance and specialized services, such as voice mail, as well as local service -- is allocated to the local ratepayer the price covers that cost. There simply is no local service subsidy.

USWC's own data show little cost difference between its rural and urban service territories. The Commission directs the Company to eliminate extended area service surcharges and establish a statewide residential rate of $10.50 per month, the average rate in effect today. The $10.50 rate covers the cost of local residential service and provides a substantial contribution to shared and common costs.

Because USWC is overearning, the Commission is also ordering a number of rate decreases, for business rates, toll service, access service, and hunting service. This approach targets rate reductions to services where the rates are the most above incremental cost.[4] Bringing these rates closer to incremental cost should stimulate demand to the benefit of ratepayers and the Company.

C. Competition

USWC argues that it needs to meet existing and impending competition with sharply higher rates for residential customers, and lower rates for other, more competitive services. While higher local rates simply are not supported by the record in this proceeding, the Commission agrees that the Company needs pricing flexibility to respond to competition when it appears. As a result, the Commission is authorizing the Company to file banded rates for any service it chooses. The rate set in this order will be the top end of the band. The Company may

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[4]Incremental costs of a single service do not include any shared or common costs that the Company is also entitled to recover. Overall, the Company's rates must be set above incremental cost to avoid unlawfully taking its property.

choose any level above incremental cost for the bottom of the band. Within that band USWC may change prices on ten days notice to customers and the Commission -- exactly the same notice as competitors are required to file. This flexibility gives the Company the ability to drop prices where competition requires, while restraining its ability to raise the rates of captive customers.[5] Of course, the Company is always free to propose increases in the rate caps if it can prove increased costs. The Commission retains jurisdiction to review the Company's use of banded rates to assure that they are not used in an improper manner or inconsistent with the terms of this Order.

D. Service Quality

The Commission finds that USWC is providing service that is substantially worse than that which the Company provided only a few years earlier, at the beginning of its AFOR.[6] The Commission's frequent and consistent attempts to achieve improvement in service quality have been unsuccessful. We find major problems with the Company's ability to install service when needed and its ability to provide repair service when needed, caused in part by lack of facilities and in part by restructuring and downsizing.

The Company's inability to meet its basic service obligations hurts individual ratepayers and it hurts the state economy as a whole. This Commission has not micro-managed USWC's re-engineering and restructuring efforts and does not intend to do so. We are concerned with results. To that end, we are ordering the Company to provide customer service guarantee programs and reducing the Company's return on equity by 0.5% to the low end of the reasonable range, to reflect the level of service it is providing and provide incentive for improvement. We also are ordering improved service quality statistics reporting, and disallowing management team and merit awards that are not clearly and directly linked to meeting service quality targets. When the Company can demonstrate that it is providing adequate service, it may petition to lift any or all of these requirements.

The Company has argued that it cannot invest in Washington state because of uncertainty about its future ability to recover its capital investment. Ex. 101-T, p. 13. The record in the case demonstrates this to be unfounded. Under the AFOR (January 16, 1990 to December

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[5]The protection thus accorded captive customers will further the public policy goals enunciated by the Legislature in RCW 80.36.300, especially:

> "(4) Ensure that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of regulated telecommunications companies[.]"

[6]It is unfortunate that the Commission's attempts to reduce the regulatory burdens on USWC appeared to result in the violation of one of the most important conditions for approving an AFOR, that it "[w]ill not result in a degradation of the quality or availability of efficient telecommunications services[.]" RCW 80.36.135(3)(e).

31, 1994),[7] the Company was authorized to earn an attractive 11% rate of return, and it retained excess profits of $77 million. At the same time, it was cutting investment and reducing staffing levels in the state. Instead of re-investing its earnings in Washington State, the Company is generating funds by dis-investing in the state and failing to provide minimum levels of service to the harm of its citizens and economy. In this Order we authorize the Company to recover its proper costs of operating and to earn a market-based rate of return on its investment.

Our order does not give USWC all it wants. Instead it gives the Company what it needs: fair rates based on the Company's actual costs, greatly increased flexibility to lower prices to meet market requirements, and meaningful incentives to improve service quality.

## PART TWO:

## SCOPE OF PROCEEDING

**HEARINGS:** The Commission conducted seven days of public hearings to receive testimony from customers of the Company on the proposed rate increases in Port Angeles, Tacoma, Vancouver, Seattle, Yakima, Spokane, and Olympia. The Commission held sixteen days of evidentiary hearings in Olympia for receipt and cross-examination of testimony and exhibits of the parties to this proceeding. The hearings were held before Chairman Sharon L. Nelson, Commissioners Richard Hemstad and William R. Gillis, and Administrative Law Judges C. Robert Wallis and Terrence Stapleton.

**APPEARANCES:** USWC was represented by Edward T. Shaw, Molly Hastings, and Douglas N. Owens, attorneys, U S WEST, Inc., Seattle, and Sherilyn Peterson and James M. Van Nostrand, attorneys, Perkins Coie, Seattle; Staff of the Washington Utilities and Transportation Commission (Commission Staff) by Steven W. Smith and Gregory J. Trautman, Assistant Attorneys General, Olympia; Public Counsel by Robert Manifold and Donald T. Trotter, Assistant Attorneys General, Seattle; Washington Independent Telephone Association (WITA) by Richard Finnigan, attorney, Vandeberg Johnson & Gandara, Tacoma; GTE Northwest, Inc. (GTE), by Richard Potter, A. Timothy L. Williamson, and Timothy J. O'Connell, corporate counsel, Everett; PTI Communications, Inc. (PTI), by Calvin Simshaw, corporate counsel, Vancouver; Electric Lightwave, Inc. (ELI), by Ellen Deutsch, corporate counsel, Vancouver; AT&T of the Pacific Northwest, Inc. (AT&T), by Daniel Waggoner and Gregory Kopta, attorneys, Davis Wright Tremaine, Seattle, and Susan Proctor, attorney, AT&T, Inc., Denver, Colorado; MCI Communications, Inc. (MCI), by Sue Weiske, corporate counsel, Denver,

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[7]In the "AFOR" program, an alternate form of regulation that the Company and the Commission agreed to in 1990, the Company was freed of some regulatory constraints and allowed to earn and keep in excess of its authorized return in exchange for sharing excess earnings with customers as directed by the Commission. The customers' share largely was applied variously to refunds and to reduce accumulated depreciation.

Colorado, Robert Nichols, Nichols & Hecht, LLC, Boulder, Colorado, and Clyde MacIver, attorney, Miller, Nash, Wiener, Hager & Carlsen, Seattle; Sprint Communications Company L.P. (Sprint) by Lesla Lehtonen, corporate counsel, San Mateo, California; Department of Information Services (DIS) by Roselyn Marcus, Assistant Attorney General, Olympia; Department of Social and Health Services (DSHS) by Leslie Birnbaum, Assistant Attorney General, Olympia; Department of Defense and Federal Executive Agencies (DOD\FEA) by Sheryl A. Butler, trial attorney, Arlington, Virginia; Enhanced Telemanagement, Inc. (ETI), by Gena Doyscher, external affairs director, Minneapolis, Minnesota; Northwest Payphone Association (NWPPA) and Metronet Service Corporation by Brooks Harlow, attorney, Miller, Nash, Wiener, Hager & Carlson, Seattle; American Association of Retired Persons (AARP) by Ronald L. Roseman, attorney, Evergreen Legal Services, Seattle; and, Telecommunications Ratepayers Association for Cost-based and Equitable Rates (TRACER) by Arthur A. Butler, attorney, Ater Wynne, Seattle.

**Procedural History:** On February 17, 1995, USWC filed with the Commission, under Advice No. 2617-T, revisions to its currently effective Tariffs WN U-30, -31,-32, with a stated effective date of March 21, 1995. The intended effect of the tariff revisions is an annual increase in the Company's revenue of approximately $95,301,836 for 1995; $22,602,847 for 1996; $46,785,542 for 1997; and $39,923,697 for 1998; the total annual revenue increase requested, phased in over a four year period, is approximately $204,613,922. On March 8, 1995, the Commission at its regularly-scheduled open public meeting suspended the operation of the tariff revisions pending hearings to determine whether the proposed tariff revisions are fair, just, reasonable, and sufficient.

A March 14, 1995 Notice of Hearing set a prehearing conference for April 6, 1995, at which time procedural aspects of the proceeding were determined, including invoking the discovery rule and establishing a schedule for prefiling and cross-examining testimony. The Commission entered a Protective Order governing the disclosure of proprietary and confidential information in this proceeding on April 24, 1995.

The Commission convened a prehearing conference on October 12, which was continued to October 17 and then to October 19, 1995, to receive oral argument on motions filed by USWC and Commission Staff. At the prehearing conference, USWC orally moved to continue the hearing schedule to permit the parties to engage in settlement discussions. The Company and Commission Staff believed that settlement of some or all issues was possible if the parties were given adequate opportunity to devote sufficient time and resources to mutually beneficial resolution of issues.

An October 19, 1995 Order of the Commission granted USWC's oral motion stating "[w]e continue to believe that those directly affected by the outcome of matters before the Commission are in the best position to protect their own interests through negotiation and alternatives to litigation." The Order was premised upon USWC's agreement to certain conditions which included proceeding with the public testimony hearing on service quality issues in Olympia on November 9; a deadline for filing stipulations or a settlement agreement; extending the

statutory suspension period; and filing supplemental testimony on costing issues.

A January 4, 1996 Order of the Commission resolved the outstanding motions of USWC and Commission Staff. The Commission granted USWC's motions to compel AT&T to respond to data requests and to strike the testimony of AT&T witness Diane Toomey, but denied its requests to exclude certain issues raised by the Northwest Payphone Association and to exclude "yellow pages" revenue from this proceeding. The Commission granted the Staff motion to exclude certain depreciation changes from consideration.

The Commission conducted 16 days of evidentiary hearings, for cross-examination of prefiled testimony and exhibits of the parties, on November 9, 1995, re-convening January 8, 1996, and continuing for 15 days. The Commission was addressed by 52 expert witnesses, whose testimony required approximately 4,200 pages of transcript. The parties were permitted to file separate and simultaneous briefs on rate design issues by February 23, 1996, and revenue requirement issues by March 1, 1996; parties were allowed to file answering briefs no later than five days following each brief deadline. The Commission's Order is due not later than Friday, April 12, 1996.

**Hearings for Public Participation.** The Commission scheduled seven public hearings for receipt of testimony from members of the public as follows: Port Angeles on September 25; Tacoma on September 26; Vancouver on September 27; Seattle on September 28; Yakima and Spokane on October 2; and Olympia on November 9, 1995. The Commission was addressed by nearly 115 individuals and many more attended the hearings to express their position on this proceeding by virtue of their appearance.

The Commission had anticipated the many citizens who spoke in opposition to the level of the proposed rate increases, as well as the several who asked for fair treatment for the Company's needs. What the Commission did not expect was the huge outpouring of citizens decrying the poor service accorded them by USWC. These individuals related their experiences with USWC missing appointments for service installation, in some instances repeatedly, or the complete inability of USWC to deliver facilities to provide any service at all. Others described their experiences with extended delays in restoring service following an outage. Elsewhere in this Order we discuss service failures experienced by Internet entrepreneurs, large companies, and telecommunications company customers of USWC.

With either cause of poor service, customers were frustrated with their experiences attempting to contact USWC and seek information on the status of ordered service or reports of service outage. Many customers described the similar experience of phone calls to USWC being routed to different service centers in USWC's service area, sometimes during the same phone call but each time with multiple calls seeking assistance, from Minneapolis to Salt Lake City to Denver to Phoenix. And often they encountered service personnel who had no record of their service order or request for repair service, no information regarding the nature or cause of delays being experienced for either complaint, and who were themselves frustrated and simply unable to be of assistance.