Service Date: April 21, 1983

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA PSC

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IN THE MATTER OF THE APPLICATION OF THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY (MOUNTAIN BELL) FOR AUTHORITY TO ESTABLISH RATES AND FOR APPROVAL OF GENERIC COST AND RATE DESIGN METHODOLOGY IN CONNECTION WITH THE IMPLEMENTATION OF ITS COM-PREHENSIVE RURAL TELEPHONE PROGRAM (RTIP)	)	DOCKET NO. 82.11.73 ORDER NO. 4950b

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APPEARANCES

FOR THE APPLICANT:

J. Walter Hyer, III, Montana General Attorney, 560 N. Park, P.O. Box 1716, Helena, Montana 59624.

FOR THE PROTESTANT:

James C. Paine, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Calvin K. Simshaw, Staff Attorney, 1227 11th Avenue, Helena, Montana 59620.

BEFORE:

CLYDE JARVIS, Vice-Chairman
HOWARD L. ELLIS, Commissioner
JOHN B. DRISCOLL, Commissioner
DANNY OBERG, Commissioner
THOMAS J. SCHNEIDER, Chairman

FINDINGS OF FACT

PART A

GENERAL

1. On November 1, 1982, Mountain States Telephone and Telegraph Company (hereinafter Mountain Bell or Company) applied to the Commission for authority to increase rates for telephone services in connection with the first year's implementation of its Rural Telephone Improvement Program (RTIP). The Company requested an annual revenue increase of $2,958,000.

2. On November 30, 1982, the Commission granted Mountain Bell an interim annual revenue increase of $1,647,000 unti1 such time that the Commission makes a final determination in this docket.

3. On January 18, 1983, the Commission granted Mountain Bell's Request for Modification of the RTIP original order (Order No. 4839 in Docket No. 80.10.79). The modification granted an extension of the time in which the Company must complete the RTIP, from three years to five years. The Company must complete the RTIP by the end of 1986.

4. On February 4, 1983, the Company filed an Amended Application for authority to increase rates which stated that the full actual revenue requirement effect of the first year construction program is $4,905,600. This amount was updated on February 10, 1983, in the Company's Position Paper to $4,856,300.

5. The Montana Consumer Counsel (MCC) has participated in this Docket on behalf of the consuming public since its inception.

6. Pursuant to an appropriate Notice of Public Hearing, a hearing on this matter was held on February 15-16, 1983, in the conference room in the offices of the Montana Public Service Commission in Helena, Montana.

PART B

REVENUE REQUIREMENT

7. In Docket No. 80.10.79, Order No. 4839 the Commission found 14.03 percent to be an appropriate overall rate of return to be applied to Mountain Bell's investment in the RTIP. This return is significantly higher than the overall rate of return of 11.70 percent allowed in the Company's last general rate case, Docket No. 82.2.8, and represents an incentive rate of return to the Company. In Order No. 4839, Finding of Fact No. 43, the Commission stated:

> The 14.03 percent return is found appropriate assuming the RTIP is completed within the next three years. If for some reason this is not the case, the Commission reserves the right to modify the allowed return.

Although an extension of time for completing RTIP has been granted, one-third of the Program was completed in 1982, and the Commission allows a 14.03 percent rate of return on the 1982 rate base.

8. In Order No. 4839, the Commission directed the Company to develop a cost tracking procedure that would enable the Commission and MCC to scrutinize the Company's claimed expenses. Following the first year's construction season, the Company would file for increased revenues necessary to cover the costs of rural upgrading, completed during that year. The Company, the Commission staff, and the MCC have worked on developing a revenue requirement methodology through three-way meetings. These three-way meetings resulted in agreement and stipulation amongst the participants on all revenue requirement matters except for the issue concerning the accounting for replacing aerial drops with buried drops. The Commission accepts this stipulation with the exception of the Company's calculation of ongoing maintenance expenses.

9. The Company estimates that, or a total state basis, ongoing maintenance will increase by $303,700 annually as a result of the RTIP. This amount is an estimate based on annual unit maintenance costs multiplied by the number of units placed. The Commission finds that this is an unacceptable approach to looking at ongoing maintenance. The plant being replaced through the RTIP is some of the oldest, most unreliable outside plant Mountain Bell has in operation (See Order No. 4839, Part A and Part B). The Commission finds that system wide average unit costs are not appropriate for measuring the maintenance savings that will occur when this plant is retired. It seems unreasonable that replacing very old, problem aerial wire with new state-of-the-art buried cable will result in an increase in ongoing maintenance. The Commission disallows any increase in ongoing maintenance. Given that the installation on new plant should result in lower maintenance costs, the position taken by the Commission in freezing ongoing maintenance is conservative ratemaking treatment. The Commission declines considering ongoing maintenance as a cost of the RTIP. Instead, these costs will be considered on a test year basis within the confines of general rate cases. Removal of the increase in ongoing maintenance costs from the Company's expenses results in an increase in net operating income of $84,661.

10. As noted above, the participants in the three-way meetings held during 1982 did not reach agreement on an appropriate method of accounting for the replacement of an aerial drop wire with a buried drop wire. The Company requested that these costs be recognized as an expense in the year of occurrence. The FCC Uniform System of Accounts (USoA) requires companies to treat as an expense the cost of replacing an aerial drop wire with a buried drop wire. The USoA does have a clause which allows companies to capitalize extensive replacements of the same nature. The Company is of the opinion that this clause would not apply because it defines extensive replacements as a majority of the station connections (drop wires) in an exchange (TR, pp. 152-153).

11. George Hess, testified on this matter on behalf of the MCC. Mr. Hess stated that property that is going to be used for a number of years should be capitalized and its costs recovered over the years in which it renders service. The Company would be

allowed to recover the cost of the property through depreciation charges and allowed to recover a return on the undepreciated portion of its investment. (TR, p. 246) This treatment would require the retirement of aerial drop wires that were replaced. Mr. Hess testified that under Montana Law, only plant used and useful may be included in the rate base. (TR, p. 251) Aerial drop wires that have been replaced are no longer used or useful.

12. The Commission concurs with Mr. Hess. Replacing aerial drop wires with buried drop wires is an extensive replacement that will provide benefits for many years. Therefore, the costs associated with this activity should be allocated to the periods in which the plant is used. The Commission directs the Company to capitalize the costs of placing buried drops and retire aerial drops that are removed. The capitalized investment should be depreciated over the life of the station connections other account - (account 232). This adjustment has the effect of increasing the Company's net operating income by $320,066 and increasing the average rate base by $498,588.

13. In Order No. 4839, the Commission directed the Company to implement RTIP as an effort over and above Mountain Bell's recurring annual construction expenditures and efforts. The Commission reiterates this directive. This Commission fully expects the Company to keep its regular construction activity at pre-RTIP levels during the years 1983 through 1986, when the RTIP will be complete.

14. During the course of the hearings in this docket several large discrepancies between Mr. Fagrelius' testimony and Mr. Cooper's testimony came to the Commission's attention. Mr. Fagrelius testified that 53,000,000 feet of open wire were removed during the 1982 construction season (TR, p. 31). Mr. Cooper testified that some 38,000,000 feet were removed (TR, p. 196). Unexplained variances of this sort are unacceptable to this Commission. The Company is expected in the future to track down variances of this kind and be able to explain them to the Commission.

15. The Commission is also deeply concerned about the cost overruns that occurred in the 1982 construction year. These cost overruns were apparently largely due to engineering problems and large amounts of overtime needed to complete the 1982 program. Mr. Fagrelius testified that as early as April, 1982, it came to his attention that there could be problems in the engineering phase of the RTIP. (TR, p. 74). Mr. Fagrelius also testified

that “into about late July and August we felt quite certain that there was going to be some significant overruns” (TR, p. 85). Mr. Cooper testified that, although he was aware in October or November that there would be cost overruns, the amounts were not quantifiable and he did not incorporate them into filings or status reports. (TR, pp. 169-180.) The January, 1983 status report was the first time the Company indicated to the Commission that the first year of the RTIP could require a significantly

higher revenue requirement. The Commission finds that the Company's status reports during 1982 were sorely deficient in this area. The Commission does not expect any cost overruns in the 1983 program. Because the time in which the RTIP is to be completed has been extended, the scope of the 1983 program has been substantially reduced. Also, MB and its contractors are further along the learning curve. Therefore, the Commission expects the 1983 RTIP to be on time and on budget.

16. Based on the above findings of fact, the Commission finds that Mountain Bell is entitled to additional annual revenues of $4,032,238 as follows:

SCHEDULE 1
MOUNTAIN BELL
MONTANA INTRASTATE
REVENUE REQUIREMENT FOR THE 1982
RURAL TELEPHONE IMPROVEMENT PROGRAM

1.	Rate Base	$16,326,388
2.	Rate of Return - Finding No. 7	.1403
3.	Required Return	2,290,592
4.	Adjusted N.O.I.	(267,873)
5.	Additional N.O.I. Required	2,558,465
6.	Income to Revenue Multiplier	2.0258
7.	Revenue Shortfall	5,182,938
8.	Additional Revenue Generated	(1,150,700)
9.	Revenues Required	$ 4,032,238

The Commission finds that the Company is also entitled to additional revenues to offset the increase in toll settlements that will be triggered as a result of this order. The Company
estimates the additional revenues needed to be $145,800. The Commission finds that Mountain Bell's revenue deficiency, including toll settlement revenues is $4,178,038.

PART C

RATE DESIGN

17. Finding No.16 identifies an authorized net increase in annualized revenues of $4.178 million. Net revenues resulting from Docket No. 82.6.37 (Order No. 4951b, Finding No. 36) and Docket No. 82.2.8 (staff / MBT letter of December 29, 1982) decrease the design revenue increase to 3.786 million. [1]

18. Order No. 4950 authorized interim revenues of $1.647 million recovered residually through Docket No. 82.2.8. [2] The interim leaves an increment of $2.139 million in authorized annual revenues to be reflected in increased rates.

19. Order No. 4839 (Docket No. 80.10.79) contemplated generating net RTIP revenue requirement via some combination of increased zone increment charges and local service rates (Finding No. 70).

20. The series of three-way meetings resulted in a MBT proposal of three alternatives for structuring rates to generate

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[1] $4.178 million less $.384 million CPIW and $.008 million Business Additional Listings.

[2] In terms of exchange services, only, the interim amounted to a uniform 5.46 percent (1.647/30.139) increase.

the MBT proposed additional increase in revenue (see Staff Report, September 14, 1982, and Exh. 17). The three alternatives are:

(1) a uniform 9.02 percent increase to all local service rates;

(2) reasonable increases to all Zone Increment Charges (ZIC) and Zone Construction Charges (ZCC) in combination with a uniform 6.67 percent increase to local service rates; and

(3) the same ZIC and ZCC increases referenced above, a 5.0 percent increase to residential local service rates, and a residual 8.52 percent increase to all nonresidential local service rates. (Exh. 17, pp. 1-3).

21. MBT considers all three alternatives reasonable but prefers the second alternative in that it at least partially recognizes that the RTIP costs reflect an upgrade of service exclusively beyond the Base Rate Areas (TR. pp. 226-227).

22. The Commission finds the third alternative inappropriate in that it would serve to further the existing rate disparity between residential and nonresidential customers. Of the remaining two alternatives, the Commission finds that the second alternative provides a reasonable rural/urban balance [1] and follows the structure contemplated in Order No. 4839.

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[1] Of the $4.178 million net annual revenue requirement, the increased ZIC/ZCC would recover $.75 million, or 17.9%.

23. Schedule 2 provides a summary of the resulting rate and revenue effect.

SCHEDULE 2
Summary of Resulting Rate And
Revenue Effects

Rate Effect

	RT1P			CPIW/BAL [2]	
Sample Rates	Pre Interim	Interim	Final	W/O Wire Maintenance	W/Wire Maint.
lFR($/mo.)	$ 6.16	6.50	6.86	6.78	7.23
lFBl($/mo.)	16.02	16.89	17.84	17.63	18.28
ZICl($/mo.)	4.00	4.00	5.00	--	--
ZCC1($)	40.00	40.00	50.00	--	--

Revenue Effect ($ Millions)

	Interim	Final	CPIW2	Bal[3]	Total
Local Service	1.647	1.391			3.038
ZIC/ZCC		.748			.748
Wire Maint 2		1.389			1.389
Extensions2			-1.005		-1.005
Bus Add. List3				.008	.008
Total	1.647	2.139	.384	.008	4.178

[2] See Order No. 4951b, Finding No. 36 and footnote 1, p. 8.
[3] See Staff/MBT letter of December 29, 1982.

CONCLUSIONS OF LAW

1. Applicant, Mountain States Telephone and Telegraph Company is a corporation providing telephone and other communication services within the state of Montana and as such is a “public utility" within the meaning of MCA S69-3-101.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's Montana operations pursuant to Title 69, Chapter 3, MCA.

3. The rate base adopted herein reflects original cost depreciated values and as such complies with the requirements of Section 69-3-109, MCA, that the value placed upon a utility's property for ratemaking purposes "...may not exceed the original cost of the property."

4. The rate structure authorized by the Commission herein is just, reasonable and not unjustly discriminatory, MCA S69-3-201.

5. The Commission has the authority to inquire into the management of the business of Mountain Bell and is required to keep itself informed as to the manner and method in which the same is conducted, MCA S69-3-106 (1).

ORDER

1. The Mountain States Telephone and Telegraph Company shall file rate schedules designed to produce additional annual revenues of $4.178 million from its Montana Subscribers.

2. The increased revenues authorized herein shall be collected from tariffed services in the manner described in the Findings of Fact contained in this Order.

3. The increased rates authorized herein shall be effective upon the filing and approval of revised tariffs consistent with this order.

4. Mountain Bell is directed to bring information concerning cost overruns to the Commission's attention as soon as it is known that they will occur, even if the amounts involved cannot be quantified.

5. She Commission directs MB, MCC, and the Commission staff to continue to hold three-way meetings throughout 1983. Methodology for determining the 1983 revenue requirement will be discussed at these meetings.

6. All motions and objections made by parties to the Docket not ruled upon in the Findings in this order are hereby denied.

DONE AND DATED this 18th day of April, 1983, by a vote of 5- 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

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Thomas J. Schneider, Chairman

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Clyde Jarvis, Commissioner

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Howard L. Ellis, Commissioner

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John B. Driscoll, Commissioner

_____
Danny Oberg, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider within ten (10) days. See 38.2.4806, ARM.