

SEP 1998
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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF SOUTH DAKOTA**

IN THE MATTER OF THE ESTABLISHMENT) AMENDED FINDINGS OF
OF SWITCHED ACCESS RATES FOR U S) FACT, CONCLUSIONS OF
WEST COMMUNICATIONS, INC.) LAW, ORDER AND NOTICE
) OF ENTRY OF ORDER
) TC96-107

On June 24, 1996, U S WEST Communications, Inc. (U S WEST) filed for approval by the Public Utilities Commission (Commission) its 1995 switched access cost study. According to the application, the study developed an overall average calculated rate of \$0.066 per minute required to recover the cost of switched access.

On June 27, 1996, the Commission electronically transmitted notice of the filing and the intervention deadline of July 12, 1996, to interested individuals and entities. The following companies were granted intervention on July 30, 1996: Sprint Communications Company L.P. (Sprint); MCI Telecommunications Corporation (MCI); Express Communications, Inc. (Express); AT&T Communications of the Midwest, Inc. (AT&T); Telecommunications Action Group (TAG)¹; and Dakota Cooperative Telecommunications, Inc. (DCT). Express Communications withdrew from the action. The Commission also found that pursuant to SDCL 49-31-12.4, the rate increase should be suspended for 120 days.

A hearing was held on October 9 and 10, 1996, before the Commission. At a regularly scheduled meeting of the Commission on December 9, 1996, Commissioner Schoenfelder moved to reopen the record for the taking of more evidence. The motion was seconded by Commissioner Burg with Chairman Stofferahn dissenting. The hearing was set to continue on March 19, 1997 through March 21, 1997.

On January 15, 1997, AT&T moved the Commission to (1) disapprove the application of U S WEST for an increase in switched access rates and (2) to close this docket. A hearing on this motion was held before the Commission on January 23, 1997. Commissioner Nelson did not participate in these proceedings. At an ad hoc meeting on January 27, 1997, the Commission granted the motion of AT&T.

The matter was appealed to the Sixth Judicial Circuit Court for the state of South Dakota which remanded the matter to the Commission by Order dated May 29, 1997. The Commission received the Order on June 9, 1997. It directed that the remand be consistent with the Court's oral bench decision. The Court directed the Commission to handle the remand forthwith.

A pre-hearing conference was held on July 2, 1997, and a pre-hearing Order on Reopening Record was issued July 3, 1997. This Order rejected Commission staff's testimony in the October 1996, hearing, directed a new staff analysis in the case and certain financial reviews by staff, specified issues which the Commission wanted addressed consistent with its Motion of December 1996, and set forth certain scheduling deadlines, including the hearing date.

¹TAG members include Midco Communications, TCIC Communications, TeleTech, FirstTel, and Tel Serv.

A hearing on the reopened record was held on September 10 and 11, 1997 (second hearing). Commissioner Nelson participated in the pre-hearing conference and the hearing on the reopened record.

The matter was appealed to the Sixth Judicial Circuit Court which, by order dated May 12, 1998, affirmed the decision of the Commission but remanded it with specific instructions that the Commission consider the subject matter contained in Exhibits 154 and 160. The parties and Commission staff stipulated to submit the matter to the Commission without further hearing. The Commission established a briefing schedule and considered the arguments and authorities submitted.

Based on the record in this matter, the Commission makes the following Amended Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

References to the record as appealed to the Circuit Court will be "SR"; incidental references may be made to the transcripts of the pre-appeal proceedings. References to the record developed after that appeal will be to transcripts of various proceedings, exhibit numbers and other documents as are contained in the Commission docket.

I

On June 24, 1996, U S WEST filed for approval by the Commission its 1995 switched access cost study (SR 1). The application indicated that the cost study developed an overall average calculated rate of \$0.066 per minute required to recover the costs of providing switched access. Switched access rates are charges made by U S WEST to other telecommunications companies for access to U S WEST exchanges. The overall average calculated rate was recalculated by U S WEST at \$0.064 by a subsequent filing of another cost study (SR 194).

II

The rate that U S WEST had been charging per minute of use for switched access was \$0.0314. This rate was established by Commission Order in docket TC93-108 (SR 937) which adopted a stipulation between U S WEST and Commission staff (SR 939). This rate was an initial rate and the stipulation allowed for a phase-in of a higher rate at some future time even though a switched access rate of \$0.067 was justified by the cost study filed in that case (second hearing, TR 69). The rate U S WEST charged for switched access continued to be \$0.0314 until June 13, 1997, at which time U S WEST implemented a \$0.064 rate pursuant to SDCL 49-31-12.4 (letter, Lehner to Bullard, May 29, 1997, docket filing).

III

At the hearing before the Commission on October 9 and 10, 1996, U S WEST, through its witness Wayne G. Culp, introduced its cost study into evidence (Exhibit 3, Transcript 10). At the September 1997, hearing, Wayne G. Culp testified that U S WEST was relying upon the same cost study (second hearing, TR 15).

IV

U S WEST's cost study referred to in Finding III, above, was introduced into evidence at the October 1996, hearing by witness Wayne G. Culp as producing an "approximate" switched access rate of \$0.064 (SR194); it was an "estimated" cost (SR 199). Wayne G. Culp again testified at the September 10 and 11, 1997, hearing about the cost study and said that it produced an "estimated" switched access cost of \$0.064 (prefiled testimony, second hearing, Ex. 130, page 2). U S WEST's cost study, as presented and explained by its employee who was responsible for its assembly as an approximation or estimate, is speculative. Wayne G. Culp's testimony relative to U S WEST's cost study and the conclusion of the switched access cost reached in the cost study itself shall be accorded no evidentiary weight.

V

U S WEST sought approval of price regulation pursuant to SDCL 49-31-4.1 in docket TC94-121 (SR 913). Price regulation was sought for noncompetitive services (SR 913). Switched access services are to be determined by price regulation (SR 916-917, paragraph 10 b). Switched access services for residences and businesses are to have ceiling prices (SR 917, paragraph 11). The switched access rules currently in place, ARSD 20:10:27 through 20:10:29, are to be used in setting the ceiling price for switched access charges (SR 931, Order Approving Stipulation, paragraph XXII).

VI

SDCL 49-31-1.4 requires the Commission to determine and consider five factors in setting a fair and reasonable price for noncompetitive services:

1. the price of alternative services;
2. the overall market for the service;
3. the affordability of the price for the service in the market it is offered;
4. the impact of the price of the service on the commitment to preserve affordable universal service; and
5. the fully allocated cost of providing the service.

The Commission makes the following findings regarding these criteria.

VII

The record contains no evidence of the price of an alternative switched access service to that provided by U S WEST; further, long distance providers cannot use switched access services provided by other local exchange companies to originate and terminate traffic in U S WEST's service territory. The record, however, does contain a discussion of by-pass of U S WEST's switches as an alternative to switched access service (SR 903, 905). The record is silent as to any prices charged for by-pass services.

VIII

The overall market for switched access service has many facets; among those in the record, the Commission specifically finds:

- a. Switched access charges by other local exchange companies within South Dakota are:

1. Local Exchange Carrier Association (an association of independent, municipal and cooperative telecommunications companies): \$0.07072042 for originating traffic, \$0.09337 for terminating traffic (effective August 1, 1996);
2. Mt. Rushmore Telephone Company: \$0.087 originating and terminating traffic (effective July 1, 1994);
3. Kadoka Telephone Company: \$0.087 originating and terminating traffic (Docket TC93-033);
4. Dakota Telecommunications Cooperative: \$0.080524 originating traffic and \$0.100024 terminating traffic (Docket TC93-076) (SR653-655).
5. The Commission further considered a synopsis of switched access cost studies submitted to it in Exhibit 154 and concludes that the switched access costs listed on this exhibit (corrected September 8, 1997) show a range from \$0.024182 to \$0.288817 per minute of use.
 - a. Switched access rates established by the Commission for carriers listed in Exhibit 154 are not set through pricing regulation pursuant to SDCL 49-31-1.4.
 - b. Switched access charges (current weighted average rate) which U S WEST charges in some other states it serves:
 1. Montana: \$0.043254;
 2. North Dakota: \$0.063725;
 3. Nebraska: \$0.066832;
 4. New Mexico: \$0.059442;
 5. Wyoming: \$0.0469467 (second hearing, late filed Exhibit 166).
 - c. The trend in Minnesota and throughout the nation has been for such charges to go down (Thurman, second hearing TR 388).
 - d. If U S WEST's rate as filed was to be implemented, the switched access rate U S WEST charges in South Dakota would be one of the ten highest access rates in the nation (Susskind, second hearing TR 521).
 - e. By by-passing U S WEST's switched access service such as through private lines an alternative market exists; by raising switched access rates, switched access customers able to do so may be encouraged to by-pass U S WEST's facilities (SR 905).
 - f. U S WEST has indicated a willingness to take less than the rate filed in its cost study in this docket. In the October 1996, hearing, U S WEST said that it would accept Commission staff's calculated rate of \$0.061 (SR551). In argument before the Court on the appeal in this docket, U S WEST's counsel indicated that U S WEST was willing to accept \$0.055 (hearing of May 16, 1997, TR 8). Further, U S WEST has immediately prior to this docket, accepted a switched access rate significantly less than its cost study justified (Findings II and IX(I)).
 - g. Based on the foregoing and as summarized, the Commission finds that the market for switched access varies depending upon geographical location of the provider of the service, the company providing the service, the presence of customers of

sufficient means to by-pass U S WEST's switches and what U S WEST has indicated it was willing to charge for switched access service.

IX

The Commission finds the following factors to affect the affordability of the proposed switched access charges:

- a. As proposed by U S WEST, the switched access charge would amount to a 107% aggregate increase in access charges to TAG member companies (Susskind prefiled testimony, second hearing, p.3).
- b. If the switched access proposed by U S WEST was implemented and the TAG members did not raise their rates to end users, it would result in a drop of net income to TAG group members, in aggregate, in the amount of 58.1% (Susskind prefiled testimony, second hearing, p.4).
- c. The switched access rate as proposed by U S WEST would result in a monthly increase to reseller Midco's average business customers of \$50 to \$75 (Simmons, second hearing, TR 301).
- d. U S WEST's proposed switched access charge, if implemented, would be a determining factor as to whether reseller Midco could remain in business (Simmons, TR 293).
- e. Reseller FirsTel's majority of business is in South Dakota and its customer base consists of small businesses (Thurman, second hearing, TR 350). The impact of a switched access rate increase will be on FirsTel's customers located in communities other than the larger communities of Sioux Falls and Rapid City, South Dakota (Thurman, second hearing, TR 354).
- f. Access costs have a profound effect on the ability of long distance carriers [resellers] to earn a profit (Susskind, second hearing, TR 628).
- g. The proposed rate would be very burdensome on resellers who pay the switched access charge (Rislov, second hearing, TR 236). Intrastate switched access costs are the single largest cost ingredient to TAG group member companies' retail intraLATA toll product. (Susskind, second hearing, 487).
 1. The percentage of interstate use (PIU) for seven carriers ranged from forty to ninety-seven percent with the average being eighty-one percent (Exhibit 160, filed as confidential). The negative economic effect of an increase of the intrastate switched access rate upon switched access customers of U S WEST would vary among customers depending upon the PIU. The affordability of the switched access charge would vary among U S WEST's switched access customers.
- h. Rate shock is a term used to describe the effect on a utility's customers when a utility implements a significantly increased rate immediately or in a relatively short time span.

- i. U S WEST proposed to implement its switched access rate immediately (Culp, first hearing, TR 44).
- j. The implementation of U S WEST's switched access charge which represents over a 100% increase, or even at a rate which staff reached would constitute rate shock (Rislov, second hearing, TR 218, 249; Simmons, second hearing, TR 304).
- k. U S WEST witness Culp conditionally admitted that a 100% increase in costs for a switched access customer constitutes rate shock (second hearing, TR 71).
- l. U S WEST's switched access rate has been at \$0.0314 since March 30, 1994 (SR 937) and was implemented at that rate as a result of docket TC93-108 as a matter of policy by U S WEST (SR 898).
- m. Sprint Communications Company witness Siplon testified that the proposed switched access rate would represent an increase in switched access charges of approximately 112% to her company (SR 329).
- n. Because of the duration of the contracts which some resellers have with their respective customers, the costs which resellers would incur would be difficult to pass on to their customers (SR 733, 776 through 771 [sic, first hearing, should be TR 232 through 234], 793, 795) although at least one reseller, Midco, is reducing the duration of service contracts it enters into with consumers (Simmons, second hearing, TR 343).
- o. The immediate implementation of a switched access rate as proposed by Commission staff is not in the public interest (Second hearing, Simmons, TR 304).
- p. The immediate implementation of a switched access rate as proposed by U S WEST is not in the public interest (See paragraph q, below).
- q. U S WEST proposed a switched access rate of \$0.064 (Finding IV); Commission staff's switched access rate is \$0.060905 (Best, prefiled, second hearing at p.9). The difference in these rates is \$0.003095.
- r. The Commission concludes that the switched access rate as proposed by either U S WEST or by Commission staff constitutes a substantial increase from the rate U S WEST was charging immediately prior to the time it filed this docket, that the increase is not affordable by negatively affects its affordability to the resellers, that the extent of the negative effect of the proposed switched access rate will vary among U S WEST's switched access customers, that its immediate implementation would constitute rate shock, that to immediately implement such a rate as proposed by either U S WEST or Commission staff is not in the public interest, and that to immediately implement it would constitute an unjust and unfair burden upon switched access customers who subscribe to U S WEST's switched access services and, in turn, their customers.
- s. The Commission finds that the immediate implementation of a switched access rate as proposed by either U S WEST or Commission staff not affordable by to U S WEST's switched access customers.

X

With regard to the impact of the price of the switched access service on the commitment to preserve affordable universal service, and consistent with the statutory definition of universal service at SDCL 49-31-1(11), the Commission finds that, based upon the factors in Finding IX, the switched access charge proposed by either U S WEST or Commission staff will impact the switched access customers and in turn their customers, the end users. Depending upon the ability of the respective switched access customers to absorb those costs, the people of South Dakota may sustain additional expense in obtaining rapid, efficient telecommunications service.

XI

Commission staff made several adjustments to the U S WEST cost study in the process of reaching their own switched access rate. The Commission finds that those known and measurable adjustments as made by Commission staff shall be:

- a. Property taxes paid by U S WEST shall be adjusted to reflect actual test year (1995) amounts of \$630,000 the total state amount or \$433,000 for the intrastate amount (Knadle, second hearing, prefiled at p.2).
- b. AT&T volume purchase rebate should reflect a \$56,000 total state credit or a \$37,000 intrastate credit (Knadle, second hearing, prefiled at p.3).
- c. U S WEST's proposal for interest synchronization should reflect Commission staff's pro forma rate base and rate of return recommendation and be calculated in the same manner as was done by U S WEST (Knadle, second hearing, prefiled at p.4).
- d. U S WEST shall not be allowed to include pension asset (pension funding in excess of pension expense) in the rate base (Rislov, second hearing, prefiled at pp.14,15).
- e. That portion of U S WEST's 1994 federal tax true-up which is short term in nature shall be removed as an adjustment to the rate base (Rislov, second hearing, prefiled at p.16).
- f. Reserve adjustments related to short-term turnaround of estimated versus actual taxes shall be excluded (Rislov, second hearing, prefiled at p.16).
- g. Return on equity shall be 11.5% (Rislov, second hearing, prefiled at p.17).
- h. As otherwise adopted on Schedule B, Sheet W to Commission staff's cost study, the removal of pay phone investment and expense, the corrections to minutes of use, the corrected traffic factors, the removal of the sold exchanges, and other adjustments as detailed on schedule A, sheet W and sheet X filed as part of staff witness Best's testimony shall be adopted (Best, second hearing, prefiled at p.9).

XII

For fully allocated costs, the Commission will consider the cost study with adjustments made by and as verified by Commission staff. This cost study, developed in accordance with the Commission's rules ARSD 20:10:27 through 20:10:29 is based on a fully allocated cost model (SR

1). The switched access charge which the Commission shall consider is \$0.060905 (Best, prefiled, p.9).

XIII

The Commission further finds that U S WEST proposed to implement the switched access rate in this docket on August 1, 1996 (SR 65). The implementation of the rate was suspended for a period of 120 days from the proposed effective date (SR 154). U S WEST of its own volition continued to charge \$0.0314 following the expiration of the suspension of the proposed rate up to the remand of this docket from the Circuit Court to the Commission. Following the remand of this docket to the Commission from the Circuit Court, U S WEST imposed a switched access rate of \$0.064 on June 13, 1997 (See Finding II).

XIV

Based upon all of the factors specified in SDCL 49-31-1.4 and as recited in Findings VIII through XIII, above, the Commission finds that a fair and reasonable per minute price which U S WEST may charge for switched access service in South Dakota, effective on the following dates shall be:

| | |
|------------------|-------------|
| June 13, 1997 | \$0.0364; |
| December 1, 1997 | \$0.0414; |
| June 1, 1998 | \$0.0465; |
| December 1, 1998 | \$0.0515; |
| June 1, 1999 | \$0.0565; |
| December 1, 1999 | \$0.060905. |

XV

The Commission further finds that U S WEST's overall, allowed rate of return for switched access service shall be 9.62% (Best, prefiled, second hearing, p.9)

CONCLUSIONS OF LAW

I

The Commission has jurisdiction over this matter pursuant to SDCL Chapters 1-26 and 49-31 and ARSD Chapters 20:10:27 through 20:10:29, inclusive.

II

This is a contested case under SDCL Chapter 1-26.

III

Pursuant to SDCL 49-31-12.4(3) U S WEST has the burden to prove that its proposed switched access rate is fair and reasonable.

IV

On issues of fact, the Commission may judge the credibility of witnesses and give appropriate weight to the testimony of each of them, including the reasonableness of the testimony when it is considered in the light of all evidence in the case. It may also give appropriate weight to evidence other than testimony which has been received.

V

The determination of the public interest is the function of the Commission and what it views as the public interest may change with, or without a change in circumstances.

VI

This docket as filed by U S WEST for switched access charges is subject to price regulation.

VII

In setting a fair and reasonable price for noncompetitive services, the Commission shall determine and consider five factors which are:

1. the price of alternative services;
2. the overall market for the service;
3. the affordability of the price for the service in the market it is offered;
4. the impact of the price of the service on the commitment to preserve affordable universal service; and
5. the fully allocated cost of providing the service.

VIII

In a price regulation docket, a cost study, developed pursuant to ARSD 20:10:27 through 20:10:28, is but one of five factors set forth in SDCL 49-31-1.4 which the Commission must consider.

IX

The Commission concludes that U S WEST has not met its burden of proof that its proposed switched access price is fair and reasonable.

X

The Commission concludes, based upon the criteria in SDCL 49-31-1.4, that a fair and reasonable per minute of use price which U S WEST may charge for switched access services in South Dakota, effective on the following dates shall be:

| | |
|------------------|-------------|
| June 13, 1997 | \$0.0364; |
| December 1, 1997 | \$0.0414; |
| June 1, 1998 | \$0.0465; |
| December 1, 1998 | \$0.0515; |
| June 1, 1999 | \$0.0565; |
| December 1 1999 | \$0.060905. |

XI

The Commission concludes that amounts charged by U S WEST for its switched access charges which are in excess of those prices established in these Amended Findings of Fact and Conclusions of Law are unfair and unreasonable.

XII

The Commission further concludes that, pursuant to SDCL 49-31-12.4(5), that U S WEST shall refund or credit to its switched access customers an amount representing the difference between the rate which it imposed and billed and the prices which the Commission has herein adopted, with interest on those amounts to be calculated at the Commission staff's recommended and allowed rate of return of 9.62% per annum.

Based upon the foregoing Amended Findings of Fact and Conclusions of Law, it is therefore

ORDERED that a fair and reasonable price for switched access charges shall be as determined in these Amended Findings of Fact and Conclusions of Law; and it is further

ORDERED that U S WEST make a refund or credit to its switched access customers consistent with these Amended Findings of Fact and Conclusions of Law; and it is further

ORDERED that Findings of Fact and Conclusions of Law as proposed by the parties and filed in this docket are hereby refused; and it is further

ORDERED that Amended Findings of Fact and Conclusions of Law as proposed by U S WEST and filed in this docket are hereby refused.

NOTICE OF ENTRY OF ORDER

PLEASE TAKE NOTICE that this Amended Order was duly entered on the 23rd day of September, 1998. Pursuant to SDCL 1-26-32, this Amended Order will take effect 10 days after the date of receipt or failure to accept delivery of the decision by the parties.

Dated at Pierre, South Dakota, this 23rd day of September, 1998.

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| CERTIFICATE OF SERVICE | |
| The undersigned hereby certifies that this document has been served today upon all parties of record in this docket, as listed on the docket service list, by facsimile or by first class mail, in properly addressed envelopes, with charges prepaid thereon. | |
| By: | <u>Delaine Kelbo</u> |
| Date: | <u>9/24/98</u> |
| (OFFICIAL SEAL) | |

BY ORDER OF THE COMMISSION:

James A. Burg
JAMES A. BURG, Chairman

Pam Nelson
PAM NELSON, Commissioner

Laska Schoenfelder
LASKA SCHOENFELDER, Commissioner