ORDER NO. 01-810

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UT 125/PHASE II
RATE DESIGN

In the Matter of the Application of	)	
QWEST CORPORATION for an	)	ORDER
Increase in Revenues.	)	

DISPOSITION: RATES APPROVED

INTRODUCTION

Procedural Background

By Order No. 00-190, the Commission adopted a stipulation between Qwest Corporation (Qwest) and Commission Staff (Staff) in resolution of Phase I of this docket, the revenue requirement phase. In the stipulation, Qwest agreed to reduce its annual revenues by $64.2 million, based on August 1997 billing units. *See* Appendix A to Order No. 00-190. Phase II of this docket establishes the rate design for the stipulated revenue requirement.

On November 15, 2000, Qwest filed Advice No. 1849, replacing in their entirety the earlier filed Advice No. 1806 and Transmittal No. 99-014-PL. On March 19, 2001, Qwest filed a modified portion of Attachment B, entitled "Revised UT 125 Rate Spread." These filings represent Qwest's rate design proposal to reduce annual revenues by $64.2 million. Qwest's revised rate design proposal incorporates comprehensive deaveraging of retail rates, consistent with the parameters set in UT 148 (*see* below, Legislation and Commission Decisions Affecting This Docket).

In the rate design phase, as in the revenue requirement phase, Qwest has the burden to demonstrate that its rate design proposal creates rates that are "just and reasonable." ORS 756.040(1), 759.035, 759.180.

After settlement discussions, parties to the rate design phase of the docket identified 13 issues to be resolved in Phase II. Those issues are set out below.

On April 19, 2001, Staff filed its rate design proposal and supporting testimony in response to Qwest's filed rate design proposal. Staff's proposal would reduce Qwest revenues by $64,232,454.

The following parties filed petitions to intervene in this phase of the docket. All petitions were granted.

- Advanced TelCom Group, Inc. (ATG)
- American Association of Retired Persons (AARP)
- AT&T Communications of the Pacific Northwest, Inc. (AT&T)
- Citizen's Utility Board of Oregon (CUB)
- Integra Telecom of Oregon, Inc.
- MCI WorldCom, Inc. (WorldCom)
- Northwest Payphone Association (NWPA)
- Rhythm Links, Inc.
- Telecommunications Ratepayers Association for Cost Based and Equitable Rates (TRACER)
- Unicom
- Verizon Northwest, Inc.

In addition to Staff and Qwest, the following parties filed direct and/or rebuttal testimony on April 10 and May 3, 2001:

- ATG
- AARP
- AT&T
- NWPA
- WorldCom

A hearing was held in this matter on May 29-June 1, 2001. The following attorneys entered appearances:

- For ATG and NWPA, Brooks Harlow
- For AARP, Robert Manifold
- For AT&T, Mark Trinchero
- For Qwest, Lawrence Reichman
- For Staff, Michael Weirich and Jason Jones
- For WorldCom, Ann Hopfenbeck and Lisa Rackner

The parties submitted two rounds of briefs after the hearing.

Legislation and Commission Decisions Affecting This Docket

The 1999 Oregon State Legislature passed Senate Bill 622 (SB 622), now codified as ORS 759.400 *et seq.* SB 622 introduced a permanent price cap regulation option to replace rate of return regulation for telecommunications utilities that elect that option. Qwest elected the price cap regulation option on November 30, 1999, to be effective on December 30, 1999.

SB 622 authorizes the Commission to define and set rates for basic services for utilities electing price cap regulation. ORS 759.410 provides for maximum prices (price caps) and minimum prices (price floors) for nonbasic services. The current price caps are the rates in place when Qwest elected price cap regulation. However, ORS 759.415 allows the price caps for nonbasic services to be adjusted in a pending rate case. This is, therefore, the Commission's only opportunity to adjust Qwest's price caps. The price floors ensure that a utility's prices will not fall below the sum of the total service long run incremental cost (TSLRIC) of providing the service for the nonessential functions of the service and the price charged to other telecommunications carriers for the essential functions.

Commission Docket UM 731 involves the Oregon Universal Service Fund (OUSF). Qwest was required to make a revenue neutral filing in UM 731. The filing reduced Qwest's revenues by $26.75 million, which amount was offset by OUSF funds. This includes a $15.388 million reduction for basic business access lines and an $11.365 million reduction for miscellaneous business rates. Staff used this revenue neutral filing as the starting point for the rate design proposal in this proceeding.

The Commission's decision in Docket UT 148 also affects this docket. UT 148 involved the deaveraging of wholesale unbundled network elements (UNEs). In order to foster local exchange competition, the Federal Communications Commission (FCC) requires states to establish different rates for UNEs in at least three defined geographic areas within the state to reflect geographic cost differences. FCC Rule 51.507(f). In Oregon, the only element with geographic variability sufficient to warrant deaveraging is the loop. Order No. 00-481 at 7.

The Commission chose to deaverage the loop by grouping wire centers by cost similarity into three zones and by establishing a weighted average loop rate for each zone. *Id.* at 9. The Commission established three zones because three zones adequately accounted for the cost difference between wire centers and three zones would be easier for both customers and telecommunications carriers' sales staff to use than an alternative five zone proposal. *Id.*

The Commission created three deaveraged rate zones. Since Order No. 00-481 issued, Qwest has made rate filings in UM 731 and UT 125. In both dockets, Qwest proposes retail rate deaveraging of certain services because of the wholesale deaveraging accomplished in Order No. 00-481. In these dockets, Qwest uses the term "rate group" synonymously with the Commission use of the term "rate zone" in Order No. 00-481. This order will use the term Rate Group with the same meaning as rate zone.

Staff's rate design proposal incorporates deaveraged network access channels (NACs) for private line service, Centrex services, and residential and business local exchange services consistent with the final order in UT 148, Order No. 00-481.

Finally, Dockets UM 351 and UM 844 set prices for unbundled building blocks and set imputation standards for pricing by telecommunications utilities.

Issues

The overall issue in this proceeding is how to apportion the $64.2 million reduction in revenues agreed to in the stipulation that the Commission adopted in Order No. 00-190. The issues are:

- Issue 1: Switched Access Rate Design
- Issue 2: Private Line Rate Design
- Issue 3: Message Toll Service
- Issue 4: Features (Residential and Business)
- Issue 5: Features (Nonrecurring Charges)
- Issue 6: Listings
- Issue 7: Centrex Plus
- Issue 8: Centrex 21
- Issue 9: Extended Area Service
- Issue 10: Advanced Services
- Issue 11: Business Local Exchange Services
- Issue 12: Residential Local Exchange Services
- Issue 13: Residential Nonrecurring Charges

NONCONTROVERSIAL ISSUES

Several of these issues are not controversial. Staff has noted that it agrees with Qwest's proposal on these issues, and no other party has presented arguments about them. These issues include Issue 4, Issue 5, Issue 6, Issue 8, and Issue 10. AARP mounts only a cursory argument against Qwest's position on Issue 13, so Issue 13 will be included in this group as well. For each issue treated in this section, we find that Qwest has carried its burden to show that the rates it proposes are just and reasonable.

Issue 4: Features (Residential and Business)

Residential Features. Qwest proposes significant price reductions for various primary residential features, for an annual revenue reduction of $5,587,158. Staff agrees with Qwest's proposal. Staff notes that its goal is to align prices for telecommunications services toward cost, as represented by the price floors for each service. Qwest's proposal leaves prices for residential features significantly above their price floors. However, Staff proposes no additional reductions in residential features because Staff is limited to total reductions of $64.2 million. Staff believes that because Caller ID, Call Waiting, and Call Forwarding are popular features, it is reasonable to target them for price reductions, as Qwest has done. Reducing prices for the most popular features will benefit the greatest number of ratepayers.

Staff points out that Qwest's Transmittal No. 2000-005-PL, effective October 1, 2000, grandfathered customers subscribing to the obsolete CustomChoice and ValueChoice services as of September 30, 2000. Staff wishes to leave the grandfathered customers of these services at the total package prices they currently pay. CustomChoice customers currently pay $29.95 for an initial line, plus $26.95 for an additional line. ValueChoice customers pay $23.95 including the line charge.

Staff proposes raising monthly flat rates for residential lines in Rate Group 2 by $1.00 and in Rate Group 3 by $2.00. See Issue 12 below. The Commission has adopted Staff's residential rate design proposal. Staff argues that we should allow Qwest to reduce prices for its grandfathered residential CustomChoice and ValueChoice customers in Rate Group 2 by $1.00 and in Rate Group 3 by $2.00, to keep their rates at the amounts given above.

Resolution. We agree with Staff and Qwest that it is reasonable to target the most popular telecommunications features for price reduction. The reductions proposed by Qwest are adopted. Qwest shall reduce prices for its grandfathered residential CustomChoice and ValueChoice customers in Rate Group 2 by $1.00 and in Rate Group 3 by $2.00.

Business Features. Qwest proposes to reduce prices for various business features by $1,276,230. As with residential features, most business features will remain priced significantly above their price floors, because total reductions in this docket cannot exceed $64.2 million. Qwest has targeted its most popular business features for reduction. Qwest proposes to eliminate 12 business feature packages identified by the following uniform service order codes: NLUB+, NLUY1, NLUY2, ESA, ESR, ET8, ETC, ESG, ESB, ET3, ES3, and ES5. Staff agrees that it is reasonable to allow elimination of these services, but imposes the following conditions. Qwest should be required to contact all affected customers to assist them in migrating to the a la carte purchase of the individual features in their packages or to an alternative feature package. Further, customers should not be required to pay nonrecurring charges because of this migration.

Resolution. Staff's conditions mean that no customer will be economically disadvantaged as a result of the elimination of these business features. We adopt both Qwest's proposal on this issue and Staff's conditions.

Issue 5: Features (Nonrecurring Charges)

Qwest proposes to eliminate nonrecurring charges for residential features, resulting in an annual revenue reduction of $729,744. Staff believes that the differences between the price floor and the tariffed monthly recurring charge for individual residential features and their average product service life are sufficient to ensure that even if Qwest does not recover its costs of initiating service through a nonrecurring charge, it will not be selling these services below the price floor in violation of ORS 759.410.

Resolution. We adopt Qwest's rate design proposal on this issue.

Issue 6: Listings

Qwest proposes to decrease the monthly recurring rates for Nonlisted and Nonpublished Listing services, which decreases annual revenues by $237,196. Qwest's proposal lowers Nonlisted service from $0.50 to $0.35 per month and Nonpublished service from $0.75 to $0.65 per month. Staff supports this proposal.

Resolution. Qwest's proposed rate design for this issue is adopted.

Issue 8: Centrex 21

Qwest proposes modest reductions and a specific rate design for Centrex 21 service. Qwest originally proposed to deaverage Centrex 21 prices for Rate Groups 1 and 2, but not for Rate Group 3. Qwest believes that the price floor requirements of ORS 759.410 would make a deaveraged rate for Rate Group 3 too high to be economically attractive.

Staff's proposal decreases Qwest's annual revenues from Centrex 21 service by $12,411. Staff's proposal is consistent with Qwest's proposal to increase the monthly rates in Rate Groups 1 and 2 to $46.95, which allows Qwest to maintain a proper pricing relationship with Qwest's Business CustomChoice service, grandfathered at a monthly price of $49.95 including the line charge. The Business CustomChoice service includes more features than Centrex 21, so Staff believes that a $3.00 per line price difference is reasonable. Staff's proposal also adopts Qwest's proposal to reduce rates for the 12 to 36 month and the 37 to 60 month rate stabilization contracts in Rate Groups 1 and 2.

Qwest has since agreed with Staff's proposal to establish rates for Centrex 21 service in Rate Group 3, consistent with the price floor requirements of ORS 759.410 and the deaveraging requirements of Order No. 00-481 (UT 148). Rate Group 3 rates will be set to recover annual revenues from the average Rate Group 3 Centrex 21 customers, based on subscription to the service from March 1997 to February 1998. However, Staff and Qwest agree that the new prices will not make economic sense for current Centrex 21 customers in Rate Group 3. Accordingly, Qwest has agreed to contact all Rate Group 3 Centrex 21 customers and migrate them to a less expensive alternative feature package. Eventually, Rate Group 3 will have no Centrex 21 customers. Staff recommends that Qwest not require Rate Group 3 customers to pay nonrecurring charges as a result of the migration to a different feature package.

Resolution. We adopt Qwest's proposal for Centrex 21 service pricing, as modified by Staff. Centrex 21 customers in Rate Group 3 shall not pay nonrecurring charges for their migration to a different feature package.

Issue 10: Advanced Services

Qwest proposes rate reductions for ISDN Basic Rate Service (ISDN-BRS), ISDN Primary Rate Service (ISDN-PRS), Digital Switched Services (DSS), and Direct Inward Dialing (DID).

After correcting the current rates contained in Qwest's initial proposal, Staff's reductions for ISDN-BRS slightly exceed Qwest's proposed reductions. Staff's proposal reduces Single Line ISDN-BRS rates by $100,000 by reducing rates in Rate Group 1 by 6 percent, leaving the current rates for the various terms of service unchanged in Rate Group 2, and increasing rates in Rate Group 3 by approximately $17.00. This increase in Rate Group 3 has no revenue effect, because there are no ISDN-BRS lines in that rate group. Staff's recommendations and corrections to Qwest's proposal are minor. The primary difference between the proposals is that Qwest wishes to raise rates for each term period in Rate Group 2 by approximately $6.00, whereas Staff proposes that the current term period rates remain unchanged. Staff argues that it is inappropriate to raise the rates in Rate Group 2 because the rates are already well above their established price floor and the rates were lowered by approximately $7.00 as recently as November 8, 2000. Qwest agrees with Staff's recommendation on this issue.

Staff agrees with Qwest's proposal to decrease certain ISDN-PRS rates, which results in an annual revenue reduction of $30,000. The proposed reductions will make the relationships between the price floors and the proposed ISDN-PRS rates similar to those for local business access lines.

Finally, Staff agrees with Qwest's proposal to reduce certain DSS rates, resulting in an annual revenue reduction of $200,000. Staff also agrees with Qwest's proposal to reduce rates for DID, resulting in an annual revenue reduction of $300,000.

Resolution. We adopt Qwest's proposed rate reductions for advanced services, as modified by Staff.

Issue 13: Residential Nonrecurring Charges

Qwest proposes to raise the nonrecurring charge for residential service installation from $12.00 to $16.50 to bring the rate closer to the direct cost of the service. The resulting annual revenue increase is $1.4 million. Even at that level, Qwest notes, the rate will still be significantly below cost. Staff recommends that the Commission adopt Qwest's proposal, because it moves rates closer to the established TSLRIC and still remains one of the lowest charges for this service applied by any former Bell Operating Company in the United States.

AARP disputes Qwest's proposal to raise the nonrecurring charge for residential service. AARP makes no specific argument opposing this increase. AARP's general argument is that there is no basis for an increase in basic local residential rates in the context of an overall revenue reduction.

Resolution. We adopt Qwest's proposal without modification on this issue. We note that in the overall rate design, many other rates benefiting residential customers are reduced, such as features, intraLATA toll, and EAS. We have a goal of moving rates toward cost. For below cost rates, such as the rate for residential service installation, this means increasing rates to move them closer to cost. AARP's counterargument is not convincing.

CONTESTED ISSUES

ISSUE 1: SWITCHED ACCESS RATE DESIGN

Background

Switched access is a service Qwest provides to interexchange carriers (IXCs) for the purpose of connecting the IXCs to their end user toll customers via the local switched network. Switched access service has three main parts: local transport, local switching, and the carrier common line charge (CCLC).

The CCLC recovers costs for the portion of the local loop assigned to the intrastate toll/access jurisdiction through the separations process. The CCLC is recognized as an implicit subsidy. In the 1996 Telecommunications Act (Act), Congress directed the Federal Communications Commission (FCC) and the states to eliminate implicit subsidies in rates and make them explicit. All parties testifying in this docket agree that the CCLC should be eliminated.

The Commission has broad discretion in the switched access rate design area. Switched access rate design is largely a matter of public policy.

Party Positions

Staff's proposal results in a $21.8 million dollar annual reduction, lowering Qwest's intrastate switched access revenues by 71.32 percent. Staff's proposal eliminates the CCLC and decreases the average access charge rate per access minute from 2.8 cents to 0.8 cents.

Qwest proposes to reduce its intrastate switched access revenues by $16 million, a 52 percent annual decrease. Qwest also proposes to eliminate the CCLC and reduce the average access charge rate from 2.8 cents per access minute to 1.3 cents.

AT&T/WorldCom propose to reduce Qwest's intrastate switched access revenues by $25.3 million, an 82.7 percent reduction. They urge the Commission to lower Qwest's switched access rates to UM 844 prices, which would make them equivalent to UNE rates. AT&T/WorldCom also recommend eliminating the CCLC and reducing the composite access charge rate to 0.48 cents per access minute. AT&T/WorldCom argue that Qwest's position on Issue 3, Message Toll, must be considered together with its position here, because together a relatively high access rate and a relatively low toll rate reduce competitors' margins unacceptably.

Staff. Staff and Qwest share the overall rate design goal of moving Qwest's intrastate switched access rates closer to the company's lower interstate switched access rates. Staff argues that its own proposal consistently brings Qwest's intrastate and interstate rates closer while Qwest's proposal actually drives certain key interstate and intrastate rates further apart. Staff's proposal also removes the CCLC and aligns the switched access direct trunked transport rate and the private line transport rate.

To move Qwest's intrastate switched access rates closer to Qwest's interstate switched access rates, Staff proposes setting the local transport rates approximately equal to Qwest's current approved interstate access rates, where those rates are above the UM 844 and UT 148 prices. Staff follows the FCC's access charge reform rate design by decreasing the local switching rate by almost 27 percent and including the new access charge elements adopted by the FCC in its local transport rate design. Staff's local transport proposal increases Qwest's total local transport revenues by 10.77 percent. Qwest's proposal increases them by 64.31 percent.

Transport rates are variable by distance. Staff's local transport proposal generates 1.4 percent more intrastate revenue than Qwest's current interstate rates would generate within the UT 125 test period. This slight increase is mainly due to the inclusion of new access charge elements adopted by the FCC in its access charge reform docket, *Access Charge Reform*, CC Docket No. 96-262, FCC Order 97-158 (May 16, 1997), and Staff's desire not to decrease rates below the UM 844 and UT 148 prices. Staff follows the FCC's access charge reform rate design by decreasing the local switching rate by almost 27 percent and including the new access charge elements adopted by the FCC in its local transport rate design. The new elements are End Office Shared Port, Common Transport Multiplexing, Tandem Trunk Port, and End Office Dedicated Trunk Port. Staff proposes to mirror Qwest's interstate rates for these elements.

Staff notes that Qwest's proposal also adds the FCC's new access charge elements and adopts new price elements for them. Qwest previously included the costs for these same new access charge elements in its local switching rate element. Staff is concerned that Qwest's proposal may result in a double recovery for these new access charge elements.

Staff's proposal reduces Qwest's local switching rates by 27 percent, bringing them closer to Qwest's interstate switching rates. Under Staff's proposal, Qwest's local switching rates are approximately 1.95 times greater than Qwest's interstate switching rates. Qwest's proposal increases its local switching rates by almost 32 percent. The resulting local switching rates would be approximately 3.5 times greater than Qwest's interstate switching rates.

The major difference between Staff's proposal and AT&T/WorldCom's is that AT&T/WorldCom want to reduce all switched access rate elements to the UM 844 wholesale price levels. AT&T/WorldCom's proposal would encompass about $25.3 million of the $64.2 million reduction, compared to Staff's $21.8 million reduction. Staff is unwilling to commit more of the $64.2 million rate reduction to switched access rates than it has proposed (about 33.9 percent of the total rate reduction). Other classes of customers should enjoy rate reductions as well, and Staff believes its allocation of the $64.2 million is the fairest and most equitable for all customer groups.

Staff notes that moving Qwest's intrastate switched access rates closer to the company's lower interstate rates would help reduce arbitrage opportunities between the interstate and intrastate jurisdictions. Arbitrage is a potential problem, according to Staff, because IXCs purchase access services from Qwest to originate and terminate toll calls to Qwest end users. The IXCs self report to Qwest the jurisdiction of the traffic through the Percent Interstate Usage (PIU) mechanism. Qwest uses the PIU when billing its access charges and recording the revenues. The actual usage, however, is captured through Qwest's traffic studies. These studies identify the originating and terminating number so that the jurisdictional determination can be made. The IXC has incentive to report usage through the PIU in the jurisdiction with the most favorable rates. The result is a mismatch between usage and revenues. Actual usage may be intrastate but the revenues will be recorded as interstate.

Qwest's intrastate regulation is not based on earnings or rate of return. Thus, Staff believes that with Qwest under a price cap plan in the interstate jurisdiction and intrastate regulation under ORS 759.410, there is little incentive for Qwest to vigorously pursue misreporting problems. Other obligations, however, such as the Oregon Universal Service Fund and various regulatory fees, rely on accurate reporting by jurisdiction. Thus, Staff argues that it is important to decrease arbitrage incentives. Staff notes, however, that decreasing arbitrage opportunities is a secondary goal; its primary goal is to bring Qwest's interstate and intrastate switched access rates into closer alignment.

Staff also notes that its proposal is in line with expected future rate design events proposed by the FCC. The FCC states that it generally intends to move carriers' interstate switched access rates, including Qwest's, closer to cost. *In the Matter of Access Charge Reform*, CC Docket 96-262, FCC 00-193, ¶3 (May 31, 2000). The FCC desires to reduce the interstate switched access rates to levels even lower than today. It is important that the Commission take this chance to align Qwest's higher intrastate switched access rates with its lower interstate rates.

The FCC also declared in a recent Notice of Proposed Rulemaking that:

> There are currently two general intercarrier compensation regimes: (1) access charges for long distance traffic; and (2) reciprocal compensation. We believe it is essential to reevaluate these existing intercarrier compensation regimes in light of increasing competition and new technologies, such as the Internet and Internet-based services, and commercial mobile radio services (CMRS). We are particularly interested in identifying a unified approach to intercarrier compensation – one that would apply to interconnection arrangements between all types of carriers interconnecting with the local telephone network, and to all types

of traffic passing over the local telephone network. *In the Matter of Developing a Unified Intercarrier Compensation Regime,* CC Docket 01-92, FCC 01-132, ¶2 (April 27, 2001).

The FCC has thus declared its intent to remove implicit subsidies in access charges, move the access charges to cost based rates, and align all intercarrier compensation regimes. Staff's proposal moves Qwest's intrastate rates down toward the lower interstate switched access rates. Staff's proposal better aligns the two rate structures and is more consistent with expected FCC future adjustments to the interstate rate structure than Qwest's plan.

As a final matter, Staff observes that in Colorado, AT&T recently began charging its intrastate toll customers $1.25 a month to cover some of AT&T's intrastate switched access costs. AT&T witness Arlene Starr explained that the Colorado monthly charge was implemented because of the high Colorado intrastate access rates as compared to the Colorado interstate access rates. Qwest worries that AT&T may impose a similar charge in Oregon. Staff observes that because its proposal reduces the switched access rates and moves them closer to Qwest's interstate rates, its proposal reduces the likelihood that AT&T may need to impose an intrastate switched access surcharge to cover switched access costs in Oregon.

Qwest. Qwest proposes a 52 percent overall reduction in switched access, including the complete elimination of the CCLC. Qwest's proposal accounts for about 25 percent of the total revenue reduction in this case. Qwest also proposes a restructuring of switched access rates, introducing new local transport rate elements.

Qwest opposes AT&T/WorldCom's request for UM 844 pricing for switched access service. All parties agree that Qwest is not required to unbundle switched access service under the Act or to set prices equivalent to comparable UNE rates. It makes no sense, according to Qwest, to set retail rates at the UM 844 prices, which are price floors.

Qwest's proposal increases local transport revenues by 64.31 percent. Qwest's increase in local transport revenues, much larger than Staff's, arises because Qwest significantly increases the tandem switching rate, a component of tandem switched transport (an element of local transport). As a result, tandem switched transport revenues increase 25.97 percent for Staff, compared to a 91.25 percent increase proposed by Qwest.

In response to AT&T/WorldCom's argument that Qwest's pricing proposal creates a price squeeze[1] or is anticompetitive, Qwest contends that

[1] AT&T/WorldCom and Qwest argue about the definition of "price squeeze." Regardless of the term one applies, AT&T/WorldCom assert that the interplay of Qwest's proposed toll rates with its proposed switched access rates will narrow their gross margin and have anticompetitive effects.

AT&T/WorldCom will have sufficient margin even under its proposal to stay in the intrastate toll market.

Further, Qwest asserts that there is no basis for AT&T/WorldCom's position that toll rate reductions should not exceed switched access rate reductions on a cents per minute basis. This is the core of AT&T/WorldCom's argument. The argument assumes that AT&T/WorldCom will match Qwest's toll price reduction precisely and concludes that if their prices are lowered by an amount greater than the reduction in one item of their cost (switched access), their margin will be less than it currently is.

Qwest also notes that it will be lowering its revenue and thus its margin through the rates established in this proceeding; there is no reason that other IXCs should not do the same. (Qwest notes that the impact on their margins is not as straightforward as AT&T/WorldCom would have the Commission believe. The companies can recover switched access charges through monthly surcharges as well as through increased rates for customers served over switched access.)

Qwest also argues that its proposed switched access rates, even set above economic cost, do not give Qwest a competitive advantage of greater margins. AT&T/WorldCom have not demonstrated that their nonaccess costs are the same as Qwest's, and Qwest contends that the record indicates otherwise. Moreover, according to Qwest, the companies' argument ignores the opportunity cost of Qwest selling a minute of toll when the alternative is that Qwest would recover switched access charges if a competitor provided that toll service. The lost opportunity is a real economic cost to Qwest. Any opportunity for greater margins vanishes, Qwest argues, when one considers the opportunity cost to Qwest of selling toll and forgoing revenue from switched access service.

Qwest asserts, finally, that other IXCs in Oregon may offer both interLATA and intraLATA toll service, but Qwest at this time may not. Thus AT&T/WorldCom may spread their nonaccess costs over a far greater volume of traffic, which gives them a significant cost advantage over Qwest. Moreover, Oregon customers can reach far more telephone numbers through interLATA toll than through an intraLATA toll call. IXCs use their marketing and packaging of interLATA toll products to capture intraLATA toll customers. IXCs are not price regulated, so they can set their rates below cost if they want. They also can introduce rates that specifically recover intrastate switched access charges from their customers. They can impose surcharges, as AT&T did in Colorado. Qwest also contends that IXCs have alternatives to switched access, such as special or dedicated access.

Qwest contends that Staff's proposed decrease in switched access rates is too great. Qwest attacks Staff's rate design because it is based on the goal of avoiding arbitrage in PIU reporting, which Qwest contends is not a problem. Qwest notes that Staff is not aware of any misreporting instances in Oregon. Qwest has a financial incentive to pursue misreporting problems. Moreover, Qwest has available, through Signaling System 7, technology that can track the actual nature of traffic to detect and remedy any misreporting.

Qwest also contends that Staff's proposal to give approximately 32 percent of the revenue reduction to IXCs goes too far. Applying a portion of those revenue reductions to other end user services would result in greater overall consumer benefit.

Qwest responds to Staff's and AT&T/WorldCom's charge that Qwest's proposal may result in double recovery for the new access charge elements. The cost basis for these new rate elements is included in the tandem switching building block and the local switching building block from Qwest's previously approved cost studies. That does not mean double recovery for Qwest. Qwest notes that the building block cost studies were prepared and approved by the Commission before Qwest filed to separate these rate elements in this case. There is no double recovery, according to Qwest.

AT&T/WorldCom. AT&T/WorldCom assert that this issue must be considered together with Issue 3, toll rates. AT&T/WorldCom fear that Qwest's proposal will raise the price of switched access, a necessary input into providing toll service, and drop the price of toll. AT&T/WorldCom will then have to match Qwest's price decrease for toll while paying more for an input into the provision of toll service, switched access. AT&T/WorldCom argue that this proposal (and to a lesser degree, Staff's proposal as well) creates an anticompetitive situation.

AT&T/WorldCom argue that Qwest's proposal to implement larger per minute reductions in retail toll rates than in wholesale switched access rates creates a problem for Qwest's competitors. Qwest's access charges are costs to IXCs that must be recovered by a sufficient margin to offset the various other nonaccess retailing costs IXCs incur in providing retail toll services. To meet the Oregon Legislature's goal of promoting telecommunications competition, AT&T/ WorldCom urge us to set rates for switched access services equal to forward looking economic cost, as determined in UM 844.

AT&T/WorldCom note that Qwest's proposal includes reducing the average intraLATA toll rate per minute by 8.41 cents (Issue 3) and the per minute switched access charge rate from 2.76 to 1.31 cents. For a two ended call, the total access charge would fall from 5.52 cents to 2.62 cents, a drop of 2.9 cents. Where Qwest's retail toll rate drops an average of 8.41 cents, its competitors' switched access rate will fall by only 2.9 cents, effectively collapsing the competitors' margin by 5.5 cents. AT&T/ WorldCom argue that if Qwest's switched access rates were set at economic cost, the UM 844 prices, its proposal to implement larger per minute decreases in retail toll rates would not have an objectionable anticompetitive effect. Then other carriers would have the same input cost Qwest faces for a necessary element of toll service provision.[2] Unless all carriers face the same input costs, AT&T/WorldCom

[2] AT&T/WorldCom argue that Qwest has not entirely removed the CCLC from its rates. Qwest proposes a revenue reduction of $16 million on Issue 1. The CCLC currently generates about $20.4 million in revenues. AT&T/WorldCom argue that the difference, $4 million, has merely been shifted to other access

contend that it will cost competitors more to serve retail toll customers than it costs Qwest to serve the same customers, and anticompetitive effects will occur.

Qwest criticizes the assumption that IXCs will pass through cost reductions. AT&T/WorldCom respond that market forces resulting from significant toll reductions proposed by Qwest, one of the largest intrastate toll carriers in Oregon, would likely force IXCs to lower their toll rates. Qwest also criticizes the assumption that nonswitched access costs will be equal for Qwest and competing IXCs. Evidence introduced by AT&T/WorldCom indicates that nonswitched access costs for IXCs in Oregon could be significantly greater than for incumbent local exchange carriers.

Qwest further argues that IXCs have alternatives to using switched access to carry toll calls for Qwest local service customers. According to AT&T/WorldCom, Qwest produced no evidence that switched access is not an essential function. AT&T/WorldCom concedes that in limited circumstances, alternatives exist. AT&T/WorldCom note that special access is rare, however, and is almost nonexistent for termination of traffic.

According to AT&T/WorldCom, setting switched access at price floors makes sense. The UM 844 rates represent price floors. SB 622 established a pricing range to allow telecommunications utilities to respond to market signals. This flexibility is not needed with regard to wholesale services that are essential components for the provision of competing retail services provided by Qwest's competitors. Qwest has no incentive to reduce the cost of switched access, a fundamental service that its competitors must purchase to compete, to price floors. If switched access services are not set at cost, Qwest will always have a self interested incentive to price such services higher than price floors. Pricing switched access services at cost will promote competition in the market, driving retail service prices toward the price floors. Consequently, AT&T/WorldCom contend, it makes good economic sense for the Commission to set switched access rates at price floors.

Discussion and Resolution

Switched access rate design is largely a matter of public policy. We have considerable discretion in adopting switched access rates.

We believe Staff's proposal is the best balanced and fairest of the three proposals. It brings Qwest's intrastate switched access rates closer to its currently lower interstate switched access rates. This is an equitable development with respect to consumers and serves the goal of moving rates closer to cost, while still keeping them above the price floors. This also addresses the potential problem of misreporting PIUs to the more favorable jurisdiction. Although Qwest assures us that it has every incentive to report correctly, Staff remains concerned about the problem. The rate structure Staff

rate elements and is an implicit subsidy. Because we do not decide this issue in favor of Qwest, we do not address this argument further.

proposes reduces the potential for arbitrage. We note, however, that this is a minor consideration. Our overall consideration is to set price caps so that interstate and intrastate switched access rates are more congruent.

We find that Qwest's proposal moves the interstate and intrastate rates further apart rather than decreasing the difference between them. Qwest's proposal greatly increases the tandem switching rate and would result in an overall 64.31 percent increase in local transport revenues. Qwest's proposal increases its local switching rates by approximately 32 percent as well. We do not believe that this proposal can further competition in telecommunications, which is our goal as well as the goal Congress expressed in the 1996 Telecommunications Act.

AT&T/WorldCom's desire to see switched access rates set at forward looking economic cost is understandable, given the companies' position as Qwest's competitors for intrastate toll traffic. The UM 844 rates include contribution. Thus, adopting them here is not an unreasonable proposal. However, we are reluctant to commit more of the $64.2 million reduction than Staff has proposed to this aspect of rate design.

Moreover, we believe that Staff's proposed rates adequately address AT&T/WorldCom's concerns about reduced margins. Staff's rates are considerably lower than Qwest's proposed rates, and Staff's proposed reductions on Issue 3, which we also adopt, are less than Qwest's. Therefore, the reduced margin that AT&T/WorldCom describes based on Qwest's proposals will be much less serious under Staff's plan.[3]

We note too that Qwest has introduced a number of considerations that make the IXCs' reduced margins both less straightforward and less anticompetitive than AT&T/WorldCom have argued.

Finally, we note that Staff's proposal on this issue better aligns interstate and intrastate access charges in view of anticipated FCC action in its access charge reform docket than Qwest's proposal does.

ISSUE 2: PRIVATE LINE RATE DESIGN

Background

Private line services are a collection of transport services that provide direct connections for customers between two or more locations. There are three basic types of private line service: analog, digital, and DS1. Further, there are four basic elements that comprise a two-point private line service: the network access channel (NAC), channel performance, transport mileage, and optional features and functions.

[3] We note also that the FCC is soliciting comments on the use of unbundled network elements to provide exchange access service. *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Public Notice DA 01-169 (January 24, 2001). If the FCC approves such use, IXCs will be able to forgo purchase of switched access for the lower UNE rates.

Channel performance rates are the main point of difference between Qwest and Staff, the only parties addressing this issue. All private lines require some channel performance element, but channel performance is not an independent function.

Party Positions

Staff. Staff proposes to change rates for various private line services, increasing Qwest's intrastate private line revenues by $0.305 million. Staff's proposal sets rates to cover the UM 844 and UT 148 price floors, reduces channel performance and features and function rates to help offset the two wire and four wire NAC increases, and aligns the private line and switched access transport rates. The proposal offsets analog private line increases with digital decreases, raising the total private line revenues by only 1.63 percent. The offset of analog increase and digital services reduction makes sense, according to Staff, because Qwest customers use both services.

For channel performance, transport mileage, and optional features and functions, Staff recommends setting Qwest's private line rates at approximately 25 percent over the UM 844 UNE prices. Staff chose the 25 percent markup to ensure that when a competitive local exchange carrier (CLEC) orders a private line for resale, the discounted private line rate will be at least equal to the sum of the UNEs required for the equivalent bundled service. This prevents a CLEC from purchasing a private line for resale at a price below the floor set in ORS 759.410(4) (calculated after applying the wholesale discount to the private line rate). Twenty two percent is a common resale discount rate in Qwest's Oregon interconnection agreements.

For the NAC, Staff recommends deaveraging the two wire and four wire NAC termination rates using the deaveraged UT 148 prices, with a 13 to 18 percent markup. Staff chose the lower markup for NACs because the same NAC rates have been significantly increased through UT 148, particularly in Rate Groups 2 and 3. Staff also wishes to avoid rate shock. Staff opposes Qwest's proposal to phase in rates for the NAC in Rate Groups 2 and 3, because that would leave in place prices that are below the price floor for several years. Staff contends that this approach violates the price floor requirements of ORS 759.410.

For analog service, Staff's proposal would increase the two wire and four wire NACs to cover the UT 148 price floors; deaverage the NAC rates into three rate groups; align the transport rates with Qwest's switched access transport rates; and lower most of the channel performance and optional features and functions rates. Staff's proposal would increase Qwest's intrastate analog private line revenues by 12.52 percent. Qwest proposes to increase the rates for these services by 23 percent because of potential cost increases.

Staff notes that its recommended analog rates are based on current evidence of cost and satisfy the requirements of ORS 759.410(4).[4] Staff argues that Qwest's concern about potential cost increases is speculative.

For digital private line service, Staff proposes to increase the Digicom1 and Digital Data service two wire and four wire NAC rates to cover the UT 148 price floors; deaverage the NAC rates into three rate groups; decrease channel performance and features and functions rates for all digital private line services; and align the DS1 monthly transport rates with Qwest's switched access DS1 transport rates. This portion of Staff's proposal would decrease Qwest's total digital private line revenues by 25.46 percent. Finally, for DS1 private line service, Staff proposes a 24.78 percent decrease in DS1 revenues.

Qwest. Qwest argues that Staff's proposal prices the NAC and channel performance element below the price floor. Staff and Qwest agree that the discounted price of a retail service should not fall below the price floor, but only Qwest's proposal realizes this goal, in Qwest's view. Qwest contends that it is appropriate to consider an NAC and a channel performance rate element together in analyzing what the discounted price would be, because neither element purchased independently provides a telecommunications service. Channel performance is also generally increasing in cost. Therefore, Staff's low price level is inappropriate. It makes sense, Qwest argues, to build in a sufficient cushion above the price floor so Qwest will not need to ask the Commission to raise prices later to ensure that the price remains above the required floor (assuming the Commission has the authority to make such adjustments).

Qwest and Staff agree that it is necessary to ensure that the discounted resale price is not below the price floor. It would be inappropriate to require Qwest to resell a finished service at a price below the floor established by ORS 759.410(4). In the case of analog NACs, however, Staff proposes prices based on equivalent UNE prices plus a 13 to 18 percent markup. If a 22 percent discount is applied to this price, the NAC would be sold for resale below the price floor. Qwest proposes to avoid rate shock by phasing in the higher rates for two wire and four wire NAC rates, which are currently below the price floor.

According to Qwest, the price of a two wire NAC in Rate Group 1 plus a common channel performance element (Voice Grade 32 Loop Start Sig – LS) under Staff's proposal would be $24.75. Under Qwest's proposal the price would be $25.40, the difference being due to Qwest's higher channel performance rate. The price floor for

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[4] ORS 759.410(4) provides:

> A telecommunications carrier that elects to be subject to this section and ORS 759.405 may adjust the price for a regulated retail telecommunications service between the maximum price established under this section and a price floor equal to the sum of the total service long run incremental cost of providing the service for the nonessential functions of the service and the price that is charged to other telecommunications carriers for the essential functions. Basic telephone service shall not be subject to a price floor.

these elements combined is $20.96. Qwest's proposed rates are 21 percent above the floor, while Staff's are only 18 percent above. To avoid the situation of Qwest having to resell services at prices below the price floor, Qwest urges us to choose its higher channel performance rates.

Qwest proposes less reduction than Staff for digital private line services, but is willing to accept Staff's proposal.

Discussion and Resolution

Staff and Qwest agree that the wholesale discounted price of a private line, when resold by Qwest to a CLEC, should not fall below the ORS 759.410(4) price floor. The parties do not contend that it is unlawful for a *discounted* NAC to fall below the price floor, but agree that this is a situation to be avoided if possible. Staff's proposal avoids this problem by setting private line rates at about 25 percent above the UM 844 UNE prices, except for certain NAC rates. For the NAC, Staff proposes deaveraged UT 148 prices with a 13 to 18 percent markup.

The NAC price Staff proposes is a problem only if Qwest retains the wholesale discount at 22 percent. However, in two dockets before the Commission, UM 962 and UM 973, Qwest has proposed a wholesale discount rate of 8.59 percent. We do not read ORS 759.410(4) to require that a discounted service be above the price floor. Therefore, we find Staff's proposed NAC prices legally acceptable.

Qwest addresses the NAC problem through two arguments. It proposes, first, to set NAC prices low and then phase in a higher rate over a several year time period. This proposal is not legal, because it would leave NAC rates in place that are below the price floor. It would therefore violate ORS 759.410(4). We reject this proposal.

Second, Qwest argues that the Commission should combine the NAC rates with high channel performance rates to ensure that the combined rate is sufficient (that is, above the price floor) when the elements are resold at a discount. Qwest believes that ORS 759.410(4), which sets the parameters for the price a telecommunications carrier may charge for a "regulated retail telecommunications service," addresses combinations of services as well as individually tariffed elements. Qwest argues that channel performance cannot be used alone, and that it therefore makes sense to combine it with the NAC and consider the two elements together as a telecommunications service. Combined, Qwest argues, the elements meet the price floor test.

We do not accept Qwest's reading of the statute. *See* our discussion of ORS 759.401(4) at Issue 3, Access Charge Imputation, below. The statute speaks of service in the singular. We read the statute to apply to individually tariffed elements, not to combinations of elements.

We note that even if we were to accept Qwest's combined rate theory, there are many combinations of NACs and channel performance. Qwest's combined rate could still allow a combination of rates that is unlawfully priced below the floor. For example, Qwest proposes a price of $17.00 for the low speed data NAC two wire per termination. The imputed price floor for the element is $15.11. A potential Qwest customer could combine that NAC with the channel performance option LS2, priced at $2.64, with an imputed price floor of $5.39. The combination would result in a price ($19.64) below the price floor for the combination of $20.50. We find that each rate element must pass the price floor test under ORS 759.410(4).

Qwest also argues that analog private line rates are increasing and that the price should be set higher for that reason. Staff based its analog price proposal on current cost data. Anything else is speculative. The same argument holds for channel performance. Qwest's higher rates are based on what may happen, not on current costs.

Qwest has accepted Staff's digital private line rate design.

We adopt Staff's proposals on Issue 2.

ISSUE 3: MESSAGE TOLL SERVICE RATE DESIGN

Background

Qwest proposed to reduce Message Toll Service (MTS) by $32 million, almost half of the $64.2 million in rate reductions available in this case. Staff recommends a lower amount, a reduction of $23.4 million. The difference of $8.6 million is due to MTS rate design differences ($2.3 million) and to assumptions regarding MTS price elasticity ($6.3 million).

There are two sets of issues regarding MTS rate design: MTS rates, including Staff's access imputation analysis, and price elasticity.

Generally, Qwest proposes to simplify its MTS pricing structure and reduce prices where appropriate. However, Staff identifies $2.3 million in adjustments to Qwest's proposal.

Most of the MTS rate structure issues are straightforward. We discuss them immediately below. We then address access imputation and elasticity separately. Access imputation determines whether a service is priced above the ORS 759.410(4) price floors; Qwest disputes Staff's and AT&T/WorldCom's reading of the statute. The elasticity adjustment, or stimulation factor, is applied to take into account demand response to lowered prices. Qwest argues against applying the elasticity adjustment; Staff and AT&T/WorldCom are in favor of applying it.

MTS Rate Design

Postalized Rates. Current MTS rates are both distance and time of day sensitive, with different rates for the first minute and subsequent minutes. Qwest has proposed a "postalized" rate schedule that eliminates rate differences by distance band

and by initial and subsequent conversation minute. However, Qwest also proposed separate postalized rate schedules for residential, business, and miscellaneous calls. For residential customers, Qwest proposed postalized rates of 10 cents per minute for daytime calls and 6 cents for evening, night, and weekend calls (hereafter called peak and off peak rates). For business customers, Qwest proposed postalized rates of 12 cents for peak and 10 cents for off peak calls. For all other miscellaneous calls,[5] Qwest proposed postalized rates of 12 cents for peak and 6 cents for off peak calls.

Staff agrees with a postalized standard MTS rate structure but disagrees with the residential, business, and miscellaneous rate distinctions. Staff proposes a single standard postalized rate structure of 11 cents per minute for peak calls and 7 cents per minute for off peak calls. Staff makes this proposal because Qwest's customer class distinction has no relation to costs. Staff asserts that the underlying costs associated with a toll minute do not depend on the local service classification of the caller. Qwest defends its class distinctions based on usage patterns. That is, business calls are generally made during the day and are of short duration; residential calls tend to occur at night and last longer. Staff responds that the usage distinctions can be accommodated through off peak discounts.

Discussion and Resolution. We agree with the move toward postalized toll rates. Abolishing rate differences by distance band and by initial and subsequent conversation minutes is reasonable and serves consumers by simplifying the rate structure for intrastate toll. We will not adopt Qwest's customer class distinctions, however. We believe that Qwest's proposal of different rate structures for residential, business, and miscellaneous calls is overly complex and unrelated to cost. Staff's proposal to set two MTS rates, one for peak time and one for off peak hours, takes into account the different usage patterns of business and residential customers. Staff's proposal is simple and reasonable; we adopt the standard MTS rates of 11 cents per minute for peak calls and 7 cents per minute for off peak calls.

Optional MTS Discount Calling Plans. Qwest proposes to eliminate Toll-PAC; consolidate its discounted Calling Connection Plans from ten to six; eliminate WATSaver; retain and reduce 800 ServiceLine; retain Prime Saver; and extend the 50 percent discount for speech and hearing impaired customers to calling card and operator assisted calls. Staff agrees with these changes by and large but proposes modifications to specific rate plans as set out below. However, Staff and Qwest disagree on the Simple Value plan and the Super Savings plan.

Qwest and Staff agree on Qwest's Wide Area Telecommunications Service (WATS) proposals with the exception of Qwest's 800 Service proposal, which is discussed under the heading *Contested Proposals* below.

[5] Miscellaneous MTS rates include calls requiring operator assistance, credit card billing, or calls for which billing capabilities cannot determine the customer's identification as residential or business.

Staff notes that it centers its proposals regarding MTS on creating a standard rate structure that will provide all customers a reasonably priced toll rate structure without contracts, minimum usage, or other rate or customer class conditions.

Uncontested Proposals. Qwest proposes, and Staff agrees, to eliminate its Business Daytime Connection plan and transfer its customers to the Business Daytime Connection Plus plan. These plans are nearly identical. Qwest proposes, and Staff agrees, to reduce the minimum monthly rate for the Connection Plus plan from $9.00 to $6.00 for the first 60 minutes and to continue rates at 10 cents a minute for every minute thereafter. This proposal gives Connection Plus customers a 33 percent reduction and a lower minimum rate.

Qwest's City Connection plan members are charged a monthly rate of $1.00, which allows them to select the exchange they most frequently call. Calls to that exchange receive a 20 percent discount from standard MTS rates, and calls to other exchanges receive a 5 percent discount. Qwest proposes to retain the discount structure. Staff agrees. The discount rate, applied to Staff's proposed standard MTS rate design, reduces the average revenue per minute (ARPM) from 13.1 cents per minute to 7.4 cents per minute, an average rate reduction of 43 percent.

The rate structures for Qwest's Volume and Tenant Calling Connection are nearly identical except that the Volume Calling Connection plan has a monthly charge of $5.00 for call detail reporting. Customers subscribing to these plans pay a postalized rate of 10 cents per minute plus a volume discount of 10 percent after $50.00 per month and 20 percent after $100 per month. Qwest proposed that the per minute rate be reduced to 7 cents per minute with no change in monthly charge or discount rates. Staff agrees with Qwest's proposal, because it appropriately targets high volume toll customers with progressive discount levels. Staff recommends, and Qwest agrees, that the Volume and Tenant Calling Connection plans should be combined, retaining the monthly charge for call detail reporting. This would reduce and simplify customer options.

The Oregon Value Calling Plan I allows subscribers to pay $6.00 per month minimum for the first 60 minutes and 10 cents a minute thereafter. The rates apply only for off peak calls. For daytime calls, a 5 percent discount from standard MTS rates applies. Qwest proposes to discontinue this plan and transfer business customers to the Business Daytime Connection Plus plan. Qwest would transfer residential customers to standard MTS. Staff agrees that the plan should be discontinued. Staff would simply move all customers to standard MTS, where the off peak calling rate is only 7 cents per minute with no minimum usage. The Business Daytime Connection Plus rate has a $6.00 monthly minimum and a 10 cent per minute off peak rate.

Oregon Volume Calling Plan II customers pay a $14.40 per month minimum for the first 120 minutes and then a peak rate of 16 cents per minute and an off peak rate of 10 cents per minute. Qwest proposes to discontinue this plan and move residential and business customers to standard MTS. Staff agrees. The standard MTS rate schedule will offer reduced rates with no minimum usage. Under Staff's proposed standard MTS rate schedule, the ARPM for Oregon Value Plan II drops from 13.5 cents per minute to 8.5 cents per minute, an average reduction of 37 percent.

Better Deal was a trial service offering during the test year. The service was discontinued on February 17, 1999. Better Deal offered customers a flat monthly rate for unlimited intrastate intraLATA toll calling. The business rate was $149.00 per month; the residential rate was $49.00 per month. The ARPM was 14.5 cents per minute. Staff agrees with Qwest's desire to discontinue this service.

WATS service is bulk toll service priced by the hour. There are two basic types of WATS: OutWATS and InWATS (i.e., 800 Service). WATS can be provisioned with dedicated access lines or over common lines. Dedicated WATS lines can access only the long distance network. They are not classed as basic telephone service and will be deaveraged based on the requirements of UT 148. Common lines are local exchange access lines on which WATS is simply an overlay service.

WATSaver is an OutWATS service using a common line. The hourly rate declines as usage increases; it ranges from $10.50 per hour to $8.25 per hour. The ARPM is 17.5 cents per minute. Qwest proposes to discontinue this service and transfer residential customers to the Super Savings plan, while business customers would migrate to standard MTS. Staff agrees that this service should be discontinued, but recommends that all customers be moved to standard MTS. Staff's proposal for standard MTS would provide a substantial reduction in all WATSaver bands.

Resolution. We adopt Qwest's proposals for the above plans. The proposals are reasonable and fair to customers. Qwest may eliminate Toll-PAC. All WATSaver customers as well as all customers from the Oregon Value Calling Plan I should be moved to standard MTS.

Contested Proposals. Simple Value was introduced on June 24, 1998. Customers subscribing to this plan are charged postalized rates for peak and off peak periods. For residential customers, current rates are 24 cents peak and 9 cents off peak per minute. For business customers, the current rates are 11 cents per minute peak and 8 cents per minute off peak.

Qwest proposes to eliminate the Simple Value plan for residential customers and transfer them to the standard MTS. Qwest also proposes to reduce rates for business customers to 9 cents peak and 6 cents off peak. Staff recommends that the Commission eliminate the entire Simple Value plan and transfer current subscribers to standard MTS. Staff's proposed standard of 11 cents peak and 7 cents off peak accomplishes the same goals as the Simple Value plan, and there is no reason for Qwest to have two nearly identical rate structures. This is particularly true in view of Qwest's stated desire to simplify or eliminate calling plans.

Qwest and Staff also disagree about Qwest's Super Savings calling plan. This plan was introduced on April 1, 1998. Like Simple Value customers, customers under Super Savings are charged a postalized rate but with no peak/off peak differential.

For residential customers, the rate is 10 cents per minute for all distance bands and all times of day. For business customers, the rate is 8 cents per minute all day.

Qwest proposes to reduce the rate for residential customers from 10 cents per minute to 8 cents per minute for calling at all times of day and for all distance bands. The rate for business customers would drop to 6 cents per minute for all times of day and all distance bands.

Staff agrees with Qwest's 8 cent proposal for residential customers but rejects Qwest's 6 cent rate for business customers. Staff proposes an 8 cent rate for both residential and business customers. Staff's recommendation reflects its concern that Qwest's 6 cent business rate, with no other charges or minimum usage requirements, would undermine its entire MTS rate structure. Qwest proposes a 7 cent rate for its Volume Calling Connection plan, 9 cents peak and 6 cents off peak for its Simple Value plan, and the standard MTS rate of 12 cents peak and 10 cents off peak. Staff believes that any rational customer would choose the Super Savings rate over these other options. Qwest plans to offer the Super Savings plan only to its best customers, but the rate is available to anyone who learns about it. Staff also argues that the Super Savings plan fails the imputation test and that the Commission should reject it for that reason as well.[6]

OutWATS uses a dedicated access line and a declining hourly rate based on usage. Before the UM 731 revenue neutral filing effective April 30, 2001, the rate per access line was $25.00 per month. With the UM 731 filing, the access line charge was deaveraged into three rate groups of $23.50, $26.00, and $28.50 per month. The hourly rate ranges from $7.50 per hour to $6.00 per hour (equivalent to 12.5 cents per minute to 10 cents per minute).

Qwest proposes to reduce the Rate Group 3 access line rate from $28.50 to $28.00 per month. It proposes no changes to the hourly toll rates and recommends that OutWATS be grandfathered to end 12 months from the effective date of the Commission's final order in this docket. Staff agrees with the grandfathering but disagrees with Qwest's proposed access line rates. The company's proposed Rate Group 2 and 3 rates are priced below the UNE prices set in UT 148, and thus fail to meet the imputation requirements of ORS 759.410(4). Staff recommends setting the access line rates for Rate Group 2 at $27.50 and for Rate Group 3 at $58.50.

800 Service is an InWATS service that uses a dedicated access line and a declining hourly rate based on usage volume. The called party pays for all incoming toll calls. Prior to the UM 731 revenue neutral filing, the access line rate was $35.00 per month. With the UM 731 filing, the access line rate was deaveraged into three rate groups at $33.50, $36.00, and $38.50 per month. The hourly rate ranges from $10.35 to $7.00 per hour (equivalent to 17.25 cents per minute to 11.67 cents per minute).

[6] The imputation argument is addressed below.

Qwest proposes to reduce access line rates in the three rate groups to $33.10, $35.60, and $37.60 per month. Qwest proposes no changes to the current hourly toll rates and proposes to grandfather the service. Staff recommends grandfathering the service but disagrees with Qwest's proposed rates for Rate Group 3, because the rates are below the UNE prices set in UT 148. Staff proposes instead setting the rates at $26.00, $30.00, and $61.00 per month, in order to meet imputation requirements.

800 ServiceLine is an InWATS service that uses a common line. The 800 telephone number overlays the regular telephone number. The service requires a flat monthly charge of $3.00 per month and an hourly usage rate of $7.20. Qwest proposes increasing the flat monthly charge to $5.00 and reducing the hourly usage rate to $6.00. Staff agrees with Qwest's proposal to reduce the hourly rate but disagrees with the proposed increase of the monthly charge. Qwest contends that the increase is comparable with competitors' recurring rates for 800 ServiceLine and is consistent with the other states in which Qwest operates. Staff notes, however, that the ARPM under Qwest's proposal is 21 cents when the per minute rate is combined with the monthly recurring rate. This ARPM is double that of any of the other MTS proposals except the OutWATS and 800 Service, which will be eliminated a year from the date this order issues. Because of the high ARPM and the fact that 800 ServiceLine will be the only InWATS service offered after the regular 800 Service tariff is eliminated, Staff continues to recommend no increase in Qwest's current monthly charge for 800 ServiceLine.

Discussion and Resolution. We agree with Staff that Qwest's proposed Simple Value plan should be eliminated. Given our adoption of standard MTS rates, the Simple Value plan has no discernible purpose. Eliminating the plan will help Qwest in its goal of streamlining rates.

We adopt Staff's recommendation that the Super Savings Plan should be offered at a flat 8 cents a minute to all customers. We base this decision on our belief that the Super Savings Plan offered at 6 cents a minute would undermine the rate structure for the remainder of MTS. We also find that the Super Savings Plan at 6 cents per minute fails the imputation test of ORS 759.410(4). *See* discussion following this section.

We agree with Staff's modification to Qwest's proposed pricing for the OutWATS access line rates, setting Rate Groups 2 and 3 at $27.50 and $58.50, respectively, to meet imputation requirements. For 800 Service, we also adopt Staff's access line rate proposal, setting prices at $26.00, $30.00, and $61.00 per month for Rate Groups 1, 2, and 3, respectively. We adopt this pricing to lower Rate Group 1 and 2 rates toward cost and to raise Rate Group 3 to pass the imputation test. We deny Qwest's request to raise the monthly rate for 800 ServiceLine from $3.00 to $5.00, based on the high ARPM this service would generate under Qwest's proposal. For the rest we adopt Qwest's proposed pricing.

Access Charge Imputation. Imputation is a regulatory device that imposes a price floor on local exchange services supplied to other providers of telecommunications services. Imputation requires a local exchange carrier to charge itself the same price that others must pay to purchase essential functions from the carrier. Imputation thus prevents a local exchange carrier from creating a competitive advantage for itself by manipulating the price of the components only that carrier can supply. It protects carriers who have no adequate alternatives in the market. Order No. 94-1851 at 3.

In conducting its imputation analysis, the Commission sets a price floor below which price may not fall, to prevent anticompetitive pricing. ORS 759.410(4) sets the price floor "equal to the sum of the total service long run incremental cost [TSLRIC] of providing the service for nonessential functions of the service and the price that is charged to other telecommunications carriers for the essential functions."

In Dockets UM 351 and UM 773, the Commission calculated the TSLRIC for each building block service element. The prices for these service elements were then set in Docket UM 844. The Commission traditionally views all building blocks or elements established in these dockets as essential functions of the service. Order No. 96-188 at 53; Order No. 95-313 at 3, fn 3.

Access imputation, a consideration of the effect of access charges on competitors, arises out of Commission Order No. 89-221 in Docket UT 47. Staff performed an access imputation analysis for current and proposed access service charges, including originating and terminating access charges as well as billing and collection charges associated with Qwest's provision of intraLATA toll service. Staff also included an allowance for uncollectible toll revenue. Access charges are the prices IXCs pay to originate and terminate long distance toll calls on Qwest's local exchange network. Billing and collection charges are the prices that Qwest would charge in IXC for billing and collecting monies from end users on behalf of the carrier.

Staff's imputation analysis is presented at the aggregate ARPM for Qwest's intraLATA toll services, assuming two different methods of toll billing: full minute rounding and six second rounding. Although Staff's imputation analysis is summarized at the aggregate level, the imputed cost results can be compared against the ARPM for each Qwest toll service depending on how the toll conversation minute is measured for billing purposes (whether by the full minute or six second rounding). After making this comparison for each service, Staff concludes that Qwest's standard MTS and each of the discounted calling connection plans pass the imputation test based on Staff's proposed rates for toll and carrier access service.

Qwest performed an imputation test based on the UNE prices set in UM 844. Qwest then compared the ARPM for all toll services combined together to an imputation based price floor. Finally, while Qwest asserts that carrier access service is not an essential service, it specifically declined to pursue that issue in this case. The issue is whether a proper imputation analysis for switched access imputes the TSLRIC or the switched access rates (price) under ORS 759.410(4). Staff asserts that Qwest's tariff rate charged to other carriers for switched access is the proper input under the price floor test of ORS 759.410(4). For purposes of this case, the Commission agrees with Staff.

Staff illustrates the difference between the two approaches with the Super Savings issue. Staff and AT&T/WorldCom each performed imputation tests for Super Savings. Both Staff and AT&T/WorldCom concluded that Qwest's proposed 6 cent Super Savings rate for business customers fails the imputation test. That is, at 6 cents per minute, Super Savings is priced below the imputation price floor. Qwest concludes that Super Savings passes the imputation test if the ARPM for all of its calling plans considered together is above the imputed price floor for all services.

Staff argues that its and AT&T/WorldCom's approach is consistent with ORS 759.410(4), while Qwest's is not. The statute speaks of the sum of all relevant costs for *the* service at issue, not service categories in the aggregate. According to Staff, no reasonable interpretation of the statutory language accommodates Qwest's "average of all services" method.

Staff points out that customers purchasing Super Savings are not concerned about the average price for all of Qwest's calling plans. Customers are concerned only about the price of the particular service they are interested in. The same is true for competitors; they wish to compete in the market against particular calling plans, not the average of all plans. Finally, Staff maintains that Qwest's average of all services method would allow some services that are priced above the price floor to subsidize those priced below the floor. Such cross subsidies are impermissible, according to Staff and AT&T/WorldCom.

Qwest argues that the Super Savings plan passes the imputation test on its own. Qwest argues that an imputation calculation should consider the *cost* for billing and collection rather than the applicable *price*, because billing and collection is not an essential service. Staff and AT&T/WorldCom disagree. Order No. 89-221 treats billing and collection as an essential service. Staff and AT&T/WorldCom argue that billing and collection is to be considered an essential service until the Commission orders otherwise. *See also* Order No. 96-188 at 53.

Qwest disagrees, finally, with Staff's and AT&T/WorldCom's inclusion of access rates for calls originated by independent local exchange carriers (LECs) in their imputation analysis. Qwest argues that the Commission should include only the costs of traffic originated by Qwest.

Staff argues that Qwest must pay access charges and other reasonable compensation to the independent LECs to originate and terminate its toll calls on their local exchange networks. Qwest has no choice but to pay these access charges and other compensation. Qwest may not abandon those toll routes without explicit Commission authority.

Discussion and Resolution. Qwest maintains that the ORS 759.410(4) price floor test should be applied to a generalized group of services rather than to individual services actually offered to customers. Qwest argues on this basis that its ARPM for all toll services be used to determine whether its proposed toll rates are in compliance with ORS 759.410(4).

Qwest cites no legal precedent for applying the statutory imputation test in this manner, and we are aware of none. The language of the statute refers to "the service," as Staff points out; this argues in favor of the imputation test being applied to a single service, not a group of services.

Further, Qwest's proposed application of the imputation test to a group of services makes no economic sense. The Legislature intended the price floor imputation test to prevent unfair pricing that would undermine competition in the market. Customers decide to take service from a particular provider based on individual product rates. Qwest acknowledges that its toll pricing proposal contains numerous pricing plans. Qwest customers pay rates imposed under these individual plans, not an average rate per minute. These individual product rates provide the basis for competition.

We read ORS 759.410(4) to apply to individual services, not to a collection of services, as Qwest advocates.

In maintaining that its Super Savings plan passes the imputation test, Qwest states billing and collection is not an "essential function" of intraLATA service. The sequel to that position is that the cost of the service to Qwest is the imputation input for nonessential functions. The price charged to other carriers is the input for essential functions.

Staff has asserted that until the Commission states otherwise, billing and collection is an essential function. Order No. 89-221. We agree. However, in the case of billing and collection, this issue is moot. Qwest's cost for billing and collection is identified as the price it charges other carriers for the service. *See* Order No. 97-239, Appendix C, page 6, lines 9 and 10. Thus, cost and price for billing and collection are the same for imputation purposes, and they are both set at the price Qwest charges other carriers for billing and collection. As a consequence, Staff and AT&T/WorldCom are correct in stating that Super Savings does not pass the imputation test on its own.

Finally, as stated above, we agree with Staff that Qwest's tariff rate charged to other carriers for switched access is the proper imputation analysis input under the price floor test of ORS 759.410(4).

Price Elasticity and Stimulation of Toll

Background. Qwest's and Staff's MTS revenue proposals differ by $6.3 million due to Staff's application of a price elasticity factor to toll rates. Qwest argues against applying an elasticity factor, while Staff and AT&T/WorldCom support the use of such a factor, although they support different factors. AARP supports Staff's elasticity factor and Staff's position on the test year and the elasticity adjustment.

The following definitions emerge from the record and will be helpful for the discussion of the elasticity adjustment. Price elasticity measures the change in consumer demand when prices change. As prices fall, consumers generally purchase more of a product; when prices increase, consumption tends to fall. The implication of price elasticity for this docket is that when Qwest lowers its MTS rates, demand will increase. The revenue impact that must be calculated is therefore subject to adjustment to take increased demand into account. The price elasticity factor adjusts the revenue reduction to account for increased demand.

Market price elasticity refers to consumers' demand response to a change in the overall market price level (when most or all firms in a market adopt a new price level). A monopoly provider such as Qwest was in the late 1980s and early 1990s essentially constitutes the market itself.

Firm price elasticity refers to the demand response to a price change implemented by one firm, assuming all other firms in the same market hold their prices constant. Firm price elasticity will always be equal to or greater than the market price elasticity.

Demand response refers to the responsiveness of consumer demand to changes in price alone. Demand response is shown as movement along a constant demand curve. Demand shift refers to the response in consumer demand to changes other than in price. These events cause the entire demand curve to shift left/down or right/up and may affect the slope of the curve itself.

Mathematically, price elasticity is measured as the ratio of the percentage change in quantity divided by the percentage change in price. Because this is an inverse relationship (when prices rise, quantity consumed falls and vice versa), price elasticity is expressed with a minus sign. For instance, price elasticity of –0.4 means that for each one percent drop in price, quantity would be expected to increase by 0.40 percent, all else being equal.

In the present case, Staff concluded that a conservative price elasticity for a 40 percent MTS price reduction for Qwest would be –0.3632. Staff calculated that Qwest's MTS toll usage would be stimulated by 14.5 percent. The formula to calculate stimulation of consumer demand is: (price elasticity) x (percentage price change); that is, -0.3632 x –40% = 14.5%. Staff stimulated each MTS service individually based on its proposed price change as expressed in ARPM.

The price elasticity dispute involves several areas. One underlying area of contention is Qwest's desire to use events that happened after the test year and that are not price events, such as increased competition, to modify Staff's and AT&T/ WorldCom's elasticity factors. The other areas are whether an elasticity adjustment is appropriate and, if so, which elasticity factor to use.

Post Test Year Issues. Staff objects to use of post test year information. The parties stipulated to the 1997 test year and the Commission adopted the stipulation in Order No. 00-190. In the stipulation, the parties agreed that Qwest would reduce its Oregon intrastate revenue by $63 million from current rates "based on August 1997 billing units for local services and the minutes of use for the five months preceding and six months following August 1997, for switched access services." Order No. 00-190 at 10. *See also* Order No. 00-190, Appendix A at 5, 14.

Qwest argues for consideration of events that occurred after the test year that caused a demand shift for MTS. These events include increased competition resulting from the introduction of mandatory "1+" dialing parity; new toll calling alternatives arising from new technology (e.g., the Internet; cellular phones); and new extended area service routes. Qwest argues that it is unfair to stimulate the toll test year revenue when its toll revenues are much lower today because of the post test year events.[7]

Staff takes the position that all post test year demand shift events that are not price events (such as the implementation of 1+ dialing parity) are not relevant because they are outside the test year. Staff contends that Qwest wants to have it both ways. With regard to the elasticity adjustment, Qwest argues that its toll volumes and revenues have fallen since the test year. With respect to spreading the $64.2 million reduction, however, Qwest argues that the Commission should ignore the fact that its toll volume is slightly more than half what it was in 1997. Staff argues that if current toll service volumes were used as Qwest demands in its price elasticity argument, Qwest's $32 million toll rate reduction would be cut to only about $16 million. As a consequence, Qwest would need to reduce its rates by another $16 million.

AT&T's Witness Dr. Selwyn also argues that Qwest's lowered toll revenues today are no reason to ignore price elasticity and stimulation. Dr. Selwyn notes that it would be more accurate to substitute current service volumes for the test period quantities for purposes of the revenue impact analysis. This should occur for all of Qwest's services, according to Dr. Selwyn, not just for toll.

But for Qwest's and Staff's agreement on a test year, Staff is not opposed to recognizing that Qwest's toll revenues are much lower today than they were in 1997. However, Staff argues that the Commission should not allow Qwest to identify its toll call service volume declines as a reason to eliminate Staff's price elasticity adjustment. Such events are outside the test year, according to Staff and AT&T/WorldCom, and are not relevant or appropriate for consideration.

Discussion and Resolution. We conclude that events beyond the test year should not be considered in determining whether to apply the elasticity adjustment to the MTS pricing proposal. If, for the sake of argument, we were to move the test period into the current year, we would have to shift the entire base on which the proposed toll

[7] Qwest also makes a subargument that if Staff is going to forecast the revenue effect of price changes through the stimulation factor, Staff should also consider making the forecast as accurate as possible by considering post test year events. Reduction to Qwest's toll rates will occur "within the test year." That is, the toll rate reduction is a "test year event"; it is known and it will happen within the test year. There is no prediction or forecast involved. The elasticity principle measures consumer response to the known price change. The elasticity adjustment is a rate design adjustment that is applied to the proposed rate change to reasonably ensure that the revenue consequences of that change match the revenue requirement determined in the revenue requirement phase of a rate case. We reject Qwest's argument about forecasting.

revenue reduction is calculated. We would also have to substitute current service volumes for all intrastate services for the test period quantities. Changing the test year would mean beginning a new rate case. We reject this outcome as unfeasible and in violation of Qwest's agreement to a 1997 test year. We note that while Qwest may appear to lose as a result of this decision, Qwest wins in not having to spread an additional $16 million of reductions over its toll or other services, as Staff points out.

Use of an Elasticity Adjustment. Qwest disagrees with Staff and AT&T/WorldCom about whether an elasticity adjustment should be applied at all. Staff argues that it always adjusts toll revenues for price elasticity when a major rate change is proposed in a rate case. Here, Staff's proposal reduces Qwest's rates by 40 percent, a major reduction under any interpretation. Staff contends that the elasticity adjustment is a pro forma adjustment that is routine and straightforward.

Qwest argues that toll service volumes are set for the period of March 1997 through February 1998. Qwest claims that applying price elasticity to the toll revenues violates the order and stipulation setting the test year in this proceeding.[8] According to Qwest, application of a stimulation factor conflicts with the requirements of the stipulation that the rate design shall be based on March 1997 to February 1998 billing units. Qwest does not argue that intraLATA long distance service is price inelastic and admits that some customers will place more long distance calls when prices are lowered.

Qwest also argues that it is inappropriate for Staff to make pro forma adjustments during the rate design phase of a case. According to Qwest, pro forma adjustments are made in determining revenue requirement. Adjustments were made in the first phase of the case and cannot be made again. Rate spread should be a relatively straightforward distribution of the revenue reduction among different service groups or customer classes; it is not an opportunity to compound decisions made in the revenue requirement phase.

Staff responds that it did not view the stipulation as changing how parties traditionally perform their rate design work. Elasticity is a measure of consumer response to a price change, and Staff did not view the stipulation's discussion of 1997 billing units as removing its right to perform the required elasticity adjustment to toll. Staff notes that as even Qwest recognizes, the stipulation was not intended to change the basic way Staff conducts the rate design portion of a rate case. In its opening brief, Qwest explains that the stipulation is subject to one clarification: the phrase "August 1997 billing units" does not remove the parties' ability to adjust the toll data for "seasonality." Staff takes this to mean that Qwest recognizes that the stipulation's use

[8] Qwest initially seemed to argue that August 1997 billing units, rather than the March 1997 to February 1998 billing units, were the appropriate volume for toll service. The stipulation and the Order both set the test year as March 1997 to February 1998 for switched access services. Order No. 00-190 at 10; Appendix A at 5 and 14. Both Qwest and Staff extend this provision to toll. In its reply brief, Qwest notes that it does not oppose using the full year's data but does oppose forecasting billing units beyond the test year, that is, adjusting them for elasticity.

of 1997 billing units was not intended to change how the parties traditionally perform their rate design work for toll MOUs. Staff argues that its adjustment for elasticity for the reduced toll rates is consistent with the stipulation.

Staff further maintains that it did not previously perform an elasticity adjustment for toll minutes of use in Phase I of UT 125, contrary to Qwest's assertion. Qwest presents no evidence in support of its assertion. Qwest merely takes out of context Staff's comment that this is one of the pro forma adjustments usually made in a rate case. Staff notes that it always performs its toll stimulation in the rate design portion of a rate case. Staff cannot perform an elasticity adjustment in the revenue requirement portion of a case, because the proposed new rates have not yet been determined. Elasticity measures consumer response to a price change, and that price change is not determined until the revenue requirement phase of a rate case is concluded.

Finally, Qwest suggests that because UT 125 was bifurcated, Staff has somehow stimulated toll twice. Staff contends that bifurcation has nothing to do with how a rate case is constructed. The UT 85 rate case was bifurcated and Staff performed its toll stimulation adjustment in the rate design phase of that case as always. *See* Order No. 89-1807 (UT 85 revenue requirement) and Order No. 90-920 (UT 85 rate design).

AT&T/WorldCom agree that the language of the stipulation and of Order No. 00-190 do not preclude an elasticity adjustment to the billing units. AT&T/WorldCom also agree with Staff that it is appropriate to perform the elasticity adjustment in the rate design phase of the case.

Discussion and Resolution. We agree with Staff and AT&T/WorldCom that the language of the stipulation and of Order No. 00-190 does not preclude an elasticity adjustment. The language "based on August 1997 billing units" implies an ability to modify the billing units, using those units as a starting point, as Qwest notes in its modification of those units for seasonality. No other language in the order or stipulation precludes use of an elasticity adjustment to toll revenue.

The rate design phase of the case is the proper phase for performance of an elasticity adjustment. Demand stimulation cannot be determined until a rate is initially assigned, since the amount of stimulation caused by a rate change depends on the specific rate change. Staff did not stimulate toll revenue twice. Simply because Staff calls this a pro forma adjustment does not mean it necessarily belongs to the revenue requirement phase of the case, and it does not.

Finally, we agree with Staff and AT&T/WorldCom that it is appropriate to perform an elasticity adjustment to Staff's proposed toll rates. Elasticity in this case simply measures consumer response to reduced prices. Elasticity adjustments to toll revenues are a normal part of cases involving major price changes, such as this case. We note that even Qwest does not argue that toll services are price inelastic. We accept the contention of Staff and AT&T/WorldCom that the test year toll customers would have responded to the significant price reductions Staff proposes.

Which Elasticity Factor Should the Commission Use? Having determined that it is appropriate to apply an elasticity adjustment to toll revenue in this case, and that it is appropriate to apply the adjustment in this phase of the case, the question remains which elasticity factor to choose.

Staff proposes a factor of –0.3632. Staff began with Qwest's latest price elasticity study, from 1990, developed for UT 102. Staff characterizes its figure from the study, -0.3632, as conservative (that is, it favors Qwest). Qwest has not updated the study except to check its validity in response to a Colorado EAS expansion. Staff did not conduct its own elasticity study for this case because such studies require large amounts of data that Staff does not possess. Staff did draw on its experience in other cases and performed additional research to conclude that its proposed stimulation factor is reasonable.

Staff reviewed its work in Docket CP 317, the Sprint/United Telephone Company of the Northwest, Inc., primary toll carrier filing that became effective in July 1997 and found that an elasticity factor of –0.364 applied there. Staff also reviewed its work in Docket UT 141, a GTE Northwest, Inc. (now Verizon Northwest, Inc.), rate case. Verizon's 1995 price elasticity study, submitted in UT 141, showed that overall price elasticity for various Verizon states was –0.38 and –0.14 for residential and business toll, respectively. Staff's experience with EAS conversions showed that consumers respond to price reductions when toll rates are replaced by lower EAS rates. In such conversion cases the toll minutes converted to EAS minutes double due to the lower EAS prices.

Staff reviewed price elasticity work performed by the FCC and in other states. Staff reviewed the FCC's analysis of the CALLS Plan, where FCC analysts concluded that the elasticity effect for a change in the average interstate and international toll charge per minute for both business and residential customers was –0.8. This figure is based on an average revenue per minute of 13.5 cents, less than the 14.39 cents per minute for Qwest MTS service today. This elasticity figure is considerably larger than Staff's number.

Staff further reviewed a number of journal articles focusing on intrastate, intraLATA toll. The studies[9] produced elasticity factors ranging from –0.38 to –0.44. Staff concluded, based on its review and research, that an elasticity factor of –0.3632 is in the reasonable range and recommends that it be adopted here. Staff posed an interrogatory to Qwest inviting the company to produce a more current study, but Qwest did not do so.

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[9] Weingarten and Stuck, Business Communications Review 32-34, January 2001 (national study 1983-92), elasticity factor –0.4; Duncan and Perry, Information Economics and Policy 6, 163-178, 1994 (California study 1986-1990), elasticity factor –0.38; Train, Telecommunications Policy 708-713 (Delaware residential study 1985), elasticity factor –0.39; Rappoport and Taylor, Information Economics and Policy 9, 51-70, 1997 (national residential study 1994), elasticity factor –0.44. The authors of the last article note that the conventional view of the intraLATA price elasticity factor is in the –0.3 to –0.4 range.

Staff believes that its use of Qwest's 1990 elasticity study is conservative because the figure Staff proposes is lower than the figures the experts suggest and much lower than the FCC's figure. Staff notes also that the 1990 study is drawn from data collected during the 1980s, when Qwest was essentially a monopoly provider of intraLATA toll. Qwest's firm price elasticity was also the market price elasticity for all practical purposes during the study's time period. Firm price elasticity is always equal to or greater than market price elasticity. By 1997, the test year, the intraLATA market was expanding and becoming more competitive. The –0.3632 figure, a market price elasticity number, is therefore likely to be conservative when compared to the 1997 test year period and Qwest's firm price elasticity. AT&T/WorldCom agree with this analysis. AT&T's expert, Dr. Selwyn, noted that the most conservative approach to an elasticity adjustment is to assume that market elasticity is controlling and not to look at firm elasticity.

AT&T/WorldCom and AARP argue that Staff's elasticity figure is overly conservative in Qwest's favor but is reasonable. AT&T/WorldCom propose a higher price elasticity factor of –0.50 for toll calling volumes, based on a 1995 decision in California.

Qwest presents no price elasticity factor of its own. Qwest opposes imposition of any elasticity factor but argues that should one be applied, the figure should be supported by credible evidence. According to Qwest, parties advocating the stimulation factor rely on studies performed in other eras and for other jurisdictions that are inapplicable to the current Oregon market.

Qwest asserts Staff's position is inconceivable. Staff's argument is that firm and market elasticities were the same in 1990. Now, under competition, firm elasticity is likely to be higher than market elasticity. Therefore, Staff argues, it is conservative to use the market elasticity figure from 1990. Missing from Staff's analysis is any information about market elasticity in 2001 or even 1997. Qwest argues that it is likely that market elasticity in these later years is much lower than it was in 1990 and that firm elasticity today is probably also lower than market elasticity used to be.

Qwest also notes that in 1998, Verizon's elasticity study for UT 141 concluded that an appropriate factor for intraLATA toll stimulation was –0.19. Staff does not explain why the Commission should not use that figure or another lower figure, such as it applied more recently to Verizon (-0.277).

Qwest asserts that Staff's reliance on the FCC analysis of the CALLS Plan is also misplaced. The elasticity figure Staff reports, -0.8, is for interstate and international toll, not intraLATA toll. These are radically different markets, according to Qwest.

AT&T/WorldCom advocate for the stimulation factor the California Public Utilities Commission (CPUC) used in 1994, -0.50. Qwest notes that the CPUC used a stimulation factor of -0.20 in 1998. Qwest maintains that the competitive conditions in California in 1994 were radically different from the conditions in the Oregon market today. Further, the CPUC's decision to adjust the stimulation factor in

1998 "reflected recent market changes." AT&T/WorldCom also assert that the difference between the –0.50 and the –0.20 figures adopted by the CPUC in 1994 and 1998 is due to the "fact that the percentage rate decrease adopted in the 1998 case was much lower than in the 1994 decision." Qwest contends that a rate decrease is not the sole factor that drives price elasticity.

Qwest notes that the FCC and state commissions have determined that in order to be valid an elasticity study must account for cross elastic effects. In *In the Matter of AT&T Communications Tariff No. FCC No. 1; PRO American Optional Calling Plan*, 103 FCC2d 134 (FCC 1985), the FCC rejected AT&T's elasticity study because it failed to account for demand shift from a competitive response.[10]

Discussion and Resolution. We find Staff's elasticity factor reasonable. It is based on study and knowledge of the Oregon telecommunications market and on examination of FCC work and expert research on the subject. We decline to adopt an elasticity factor from California, whether the –0.50 or the –0.20 factor, when we know too little about the background of either of those factors to be convinced they are reasonable and when we have reason to adopt the figure proposed by Staff.

Qwest argues that the elasticity study with which Staff begins is not credible. Staff has argued convincingly that it checked its conclusions from that study against other, more recent work and its results are consistent with the conclusions of experts in the field. We find the evidence credible.

Qwest mounts attacks on each piece of evidence that Staff relies on to fortify its position. However, Staff has supported its position with a number of studies and cases, which have a cumulative effect. Qwest attacks the FCC CALLS Plan study. The FCC CALLS Plan study is not directly relevant to intrastate, intraLATA toll calls, but does provide a parameter by which to judge the reasonableness of Staff's proposed elasticity factor. Qwest questions why the Commission did not use the Verizon proposed or actually employed figure in this case. The Verizon rate case, UT 141, has a different record than this case. We conclude that Staff has convincingly supported its elasticity factor. Finally, Qwest argues that an elasticity study must take cross elastic effects into account. We have rejected this argument above, under Post Test Year Issues.

Qwest could have submitted a new elasticity study and chose not to do so. We adopt Staff's elasticity factor of –0.3632.

[10] AT&T/WorldCom and Qwest engage in a discussion of whether Qwest is asking to be made whole for competitive losses in asserting that the Commission should take cross elastic effects into account. Because we do not take these effects into account, we do not describe this argument.

ISSUE 7: CENTREX PLUS

Background

Centrex was designed to compete with private branch exchange (PBX) service. Rather than having an individual PBX at each customer location, Qwest has programmed a portion of its switching system to mimic a PBX. The Centrex service has three essential components: (1) the network access channel (NAC), a telephone line that connects the customer to the local exchange carrier; (2) the network access register (NAR), a switching function that provides dial tone, connects the customer's lines to phones outside the customer's Centrex system, and can limit the number of lines that have access to the telephone number at any one time; and (3) the switching function that provides system features like speed dialing and call waiting.

For Centrex Plus in Oregon, the three components are bundled as a single service. Line charges are set according to the number of station lines per location. Qwest offers discounts based on the number of lines at a single location. This is a form of volume discount.

Qwest filed its original rate design proposal as Advice No. 1849. Qwest modified the Centrex portion of that proposal in the March 19, 2001, modified portion of Attachment B to that Advice, entitled "Revised UT 125 Rate Spread." Staff did not agree with all of Qwest's modifications of March 19. However, in its opening brief, Qwest states that Staff and Qwest agree on Qwest's proposal for Centrex Plus rates. Although there are two Qwest proposals at issue (Advice No. 1849 and the March 19 modification), we take Qwest's statement to mean that it accepts Staff's selection of Qwest's proposals. ATG is the only other party to address this issue. ATG contests the location pricing aspect of Qwest's volume discount pricing.

Centrex Plus Rates

Because Staff adopts Qwest's originally filed proposal in some instances and the March 19 modification in others, we refer in the following to Staff's proposal. Staff's proposal decreases Qwest's composite annual revenues for Centrex Plus service by $726,284. The components of this reduction are a composite decrease of $459,024 from the Centrex Plus line charge, $209,323 from the Centrex Plus usage charge, and $57,937 from the Centrex Plus Network Access Facility (NAF) charge.

Line Charge. Staff agrees with Qwest's proposal for a composite decrease of $459,024 for Centrex Plus line charges. A customer's Centrex Plus line charge is determined by a price matrix based on three criteria.

First, Qwest assesses the number of lines at one location. The lines are divided into six size categories, also called cohorts: 1-20 lines, 21-50 lines, 51-100 lines, 101-300 lines, 301-500 lines, and over 500 lines. Second, the line charge is based on the geographically deaveraged rate group where the customer's Centrex Plus system is located. Staff used the three Rate Groups established in Order No. 00-481 to apply this criterion to the Centrex Plus pricing matrix. The third criterion for the price matrix is the duration of the contract. Qwest gives pricing discounts for contracts of 12 to 35 months, 36 to 59 months, and 60 months.

Staff supports Qwest's proposal for changes to Centrex Plus line charges and the pricing matrix because the proposal is consistent with Commission rules and orders and with Oregon statutes. Centrex Plus is not a basic service. ORS 759.400; OAR 860-032-0260. As a nonbasic service, Qwest's proposal must meet the price floor requirements of ORS 759.410(4). Staff tested Qwest's proposal to ensure that it did meet the price floor, using the rate groups and NAC price floors approved in Order No. 00-481, and then Qwest's current unbundled network element prices for switching, transport, and other elements of Centrex Plus service besides the NAC. Staff concluded that Qwest's Centrex Plus line charge pricing proposal is consistent with ORS 759.410.

Resolution. We adopt Qwest's and Staff's proposal for a composite decrease of $459,024 for the Centrex Plus line charge.

Usage Charge. Staff's proposal decreases composite annual revenues for Centrex Plus usage charges by $209,323. The Centrex Plus usage charge is a monthly recurring charge per station for Centrex Plus systems that are not blocked. The current tariffed Centrex Plus usage charge is $14.90 per line for the 1 to 20 line cohort, $14.90 per line for the 21 to 50 line cohort, and $3.00 for all cohorts in excess of 50 lines. Staff's proposal replaces this matrix with a standard flat rate Centrex Usage Charge of $4.04 per line, regardless of the Centrex Plus system size.

Staff's proposal is consistent with Qwest's original Centrex Plus usage charges proposal. Qwest's modified proposal increases the Centrex Plus usage charge in order to offset Qwest's proposal to further decrease the Centrex Plus line charge. Staff adopted the March 19 proposal for additional decreases in the Centrex Plus line charge, but Staff proposes to offset the additional Centrex Plus line charge revenue decrease with adjustment to prices for services other than Centrex. Therefore, Staff opposes Qwest's revenue offsets filed on March 19.

Resolution. We adopt Staff's proposal on the usage charge issue. All lines, regardless of the Centrex Plus system size, shall be charged a standard flat usage charge of $4.04. Offsets for this reduction shall be made against services other than Centrex.

NAF Charge. Staff's proposal decreases Qwest's annual composite revenues for Centrex Plus NAF charges by $57,937. Staff's proposed NAF charge is set at Staff's proposed price for a Digital Switched Service trunk ($17.00). For Two Way and In Only service, a price element of $1.36 is added for the Hunting feature inherent in those services. Staff's proposal for monthly Two Way, In Only, and Out Only NAF charges is $18.36, $18.36, and $17.00, respectively.

Staff's proposal is consistent with Qwest's original proposed decreases in NAF charges. In Qwest's March 19 modification, Qwest proposed to increase the NAF charge from its original proposal in Advice No. 1849. This adjustment was made as one of Qwest's proposed pricing elements to offset its proposed additional decrease in the Centrex Plus line charge. Staff has not adopted Qwest's adjustments to the NAF charge that were presented in the March 19 modification.

Resolution. Staff's proposal for Centrex Plus NAF charges is adopted.

Centrex Plus Nonrecurring Charges. In its Advice No. 1849, Qwest did not propose a price for the line identification database (LIDB) charge or the charge for chip in of additional numbers. Staff proposes that there be no tariffed LIDB charge for an initial installation and a $3.50 nonrecurring charge for subsequent changes.[11]

Staff proposes that the $4.25 nonrecurring per line charge for chip in, currently listed in Qwest's tariff but not applied, should be changed to reflect a zero nonrecurring charge for Centrex Plus resellers.

In Order No. 97-480, the Commission ordered that the charge for chip in be an issue in the rate design phase of UT 125. The Commission later stated that it "agrees with the joint petitioners and Staff that the proposed chip in charge contravenes the existing stipulation adopted by Order No. 93-746 and that the stipulation should remain in effect pending a complete investigation of the costs associated with the chip in service." Order No. 98-079 at 3.

Qwest appears to agree with Staff that the current nonrecurring chip in charge should be eliminated. However, Qwest conditions its proposal to eliminate that charge on the Commission's acceptance of Qwest's overall price proposal for Centrex Plus. Qwest asserts that if its proposal is not accepted, Centrex Plus margins may be insufficient to provide cost recovery for the chip in charge, and the assessment of the charge will have to be revisited. Qwest offers no evidence to suggest that cost recovery would be insufficient if the chip in charge is eliminated. Since the Commission ordered that the chip in charge be an issue in this proceeding and Qwest has offered no additional cost information concerning chip in service, Staff recommends that the nonrecurring chip in charge be eliminated whether Qwest's overall Centrex Plus proposal is accepted or not.

Resolution. Staff's proposed rates for the Centrex Plus nonrecurring charges are adopted. Qwest did not provide cost data to support its contention that eliminating the chip in charge would cause its Centrex Plus margins to be insufficient unless the rest of its proposal was accepted. Qwest did not contest eliminating the chip in charge in its briefs. We conclude that it is appropriate to eliminate the chip in charge.

The LIDB charge shall be set at no charge for the initial installation and a $3.50 recurring charge for all subsequent changes. There shall be no chip in charge.

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[11] In Order No. 97-441, the Commission ordered that "the proposed LIDB rate from Transmittal No. 97-037-PL supplemental will go into effect, effective December 5, 1997, subject to refund." The proposed rate from Transmittal No. 97-037-PL supplemental was a nonrecurring charge of $3.50 per line for subsequent changes only. Staff's proposal, which we adopt, makes this rate permanent.

Per Location Pricing

The remaining Centrex Plus issue is whether to change Qwest's volume discounts for a certain number of lines per location (street address). A reseller is permitted to aggregate customers as long as they are at one address. Currently, Qwest offers a discount to a customer at a given location with 50 or more access lines.

Party Positions. Qwest and Staff[12] agree that the current per location pricing scheme should be left in place; ATG argues that Qwest should instead offer volume discounts based on a customer's total lines in service at a Qwest wire center.

Qwest believes that its per location volume discount pricing approach is appropriate because Qwest's costs of serving a customer are reduced as the customer has more lines at a specific location. Qwest argues that its pricing approach for Centrex Plus must also be evaluated in the context in which it was developed, as a competitive alternative to customer owned PBX based systems. Qwest reminds the Commission that that Centrex Plus is a retail product that Qwest markets to retail customers.

ATG's Arguments. ATG does not object to Qwest's volume discounts per se, but only to the location restriction. ATG argues that Qwest's per location pricing scheme was designed to restrict resale and is not justified by cost. According to ATG, the volume discount price break points make sense only when viewed in light of the goal of restricting resale.

According to ATG, discounts should be based on a customer's total lines in service in a Qwest wire center, treating a reseller as one customer, rather than be based on end user volumes at a single location. ATG argues that its recommendation is consistent with Qwest's cost data, will conform tariffs to current laws regarding unreasonable discrimination against resale, and can be accomplished with a revenue neutral restructuring of Centrex rates.

History of Per Location Pricing. ATG maintains that Qwest originally offered volume discounts based on the number of station lines as a way to compete with PBX service, without a per location restriction. When resellers started obtaining volume discounts through aggregating smaller customers at multiple locations, Qwest decided to add the per location pricing requirement because it would thwart resale at the same time it permitted Qwest to continue giving substantial discounts to its largest customers with a large number of station lines at a single location. According to ATG, the record shows that per location pricing was instituted to restrict resellers from obtaining the volume discounts that Qwest already offered to its large customers to compete with PBX.[13]

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[12] Staff supports Qwest's proposal to price lines by location because it is consistent with prior approved tariff terms and conditions and Commission orders. *See* Qwest Tariff, PUC Oregon No. 29 ¶9.1.16.C.2; *see also* Order No. 99-438 at 7.

[13] ATG refers to some confidential exhibits it claims are evidence that per location pricing was intended to restrict resale of Centrex Plus service. Those documents discuss proposals from 1993, well before the Telecommunications Act of 1996, and are not relevant to Qwest's compliance with its resale obligations

In the early 1990s, when per location pricing was instituted in Oregon, the policy of the Commission was to discourage resale in local exchange markets, including Centrex resale. Thus, ATG contends, the Commission took no action against per location pricing when it was first introduced. In the meantime, however, the federal Telecommunications Act of 1996 has set the goal of opening telecommunications markets to competition. ATG alleges that despite this change, Qwest has failed to address a Centrex rate design here that it knew was meant to restrict resale.

Legal Considerations. ATG argues that the FCC has found restrictions on resale to be presumptively unreasonable. *In the Matter of Local Competition Provisions in the Telecommunications Act of 1996*, CC Dockets No. 96-98 and 95-185, *First Report and Order*, 11 FCCR 15499 (1996) (Local Competition Order). There, at 15,971, the FCC stated that:

> It is presumptively unreasonable for incumbent LECs to require individual reseller end users to comply with incumbent LEC high volume discount minimum usage requirements, as long as the reseller, in aggregate, under the relevant tariff, meets the minimal level of demand. The Commission traditionally has not permitted such restrictions on the resale of volume discount offers. We believe restrictions on resale of volume discounts will frequently produce anticompetitive results without sufficient justification. We, therefore, conclude that such restrictions should be considered presumptively unreasonable.

Prohibited restrictions on resale include restrictions on volume discounts, according to ATG. *In the Matter of the Public Utility Commission of Texas, Memorandum Opinion and Order*, 13 FCCR 3460 at ¶220-223 (location restriction on Centrex that prevented resellers from aggregating customers determined to be unreasonable); Local Competition Order at 15,971. As an incumbent local exchange carrier, Qwest has the burden to show that its per location pricing is reasonable. 47 CFR §51.613(b); Local Competition Order at 15,966. State law also prohibits unreasonable restrictions on resale. ORS 759.455(i); (g).

ATG argues that Qwest's per location pricing scheme is a restriction on resale. According to ATG, the per location pricing plan precludes aggregation of multiple end users by resellers to achieve volume discounts comparable to those Qwest offers to its large retail customers. Centrex resellers' customer base consists primarily of small and medium sized businesses. The per location requirement of the retail tariff precludes aggregation of these customers unless they are at a single location. Tying volume discounts to a single location restricts resellers from obtaining volume discounts.

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under the Act. The one document from 1997 relates to Centrex Prime, not an issue here, and the arbitrage referred to is with other Qwest retail services, not competition with resellers.

Cost Justification for Per Location Pricing. ATG believes there is nothing wrong with the pricing structure Qwest has developed, even if it does not align with underlying costs; the problem is the restriction on resale of the discounts. ATG argues that there is no rational basis for Qwest's disparate treatment of costs of serving small and large customers other than to justify a scheme that discriminates against resellers. ATG calls Qwest disingenuous in saying that costs for smaller customers are linked to individual loops since that is how they are actually served. Qwest's witness admitted that smaller customers in multi tenant buildings are served by T-1s in several instances, and admitted that this is the efficient way to serve such a customer on a forward looking basis.[14]

ATG contends that Qwest cannot meet its burden of showing that per location pricing is reasonable and nondiscriminatory. Qwest's witness was unable to justify the price break at 101 lines in terms of efficiencies and economies. ATG argues that the line volumes used in per location pricing bear no relationship to the line volumes for T-1 service.[15] ATG also argues that the cost drivers for the lines between a customer's location and the central office are the density of the plant serving the neighborhood and the length of the plant. Therefore, a line serving a small volume user located in a large office building costs Qwest the same amount on a monthly basis as each Centrex line serving a single customer in the same building. Offering a discount to some customers who take more lines is not cost based and is hence discriminatory.

ATG also argues that lines serving each of the customers in different buildings in a commercial neighborhood are likely to be relatively low in cost and roughly equal in cost because of economies of density.

Qwest uses competition with PBX to justify per location pricing. However, according to ATG, Qwest admits that per location pricing has a negative impact on its competition with PBX. Thus, ATG contends that Qwest does not need to offer per location volume discounts to compete with PBX.

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[14] ATG argues that serving a particular number of lines at a single location cannot justify the volume discounts offered by Qwest. Qwest's own cost studies show that there is a small per line difference between serving 50 or fewer lines by copper loops and 51 and over by T-1s. Yet, ATG argues, Qwest's rate design proposes a discount at a multiple of actual savings.

[15] ATG notes that each T-1 carries 24 voice grade circuits, but Qwest does not offer per location discounts based at 24 line intervals. Technically, a location with fewer than 24 lines can use a T-1 just as efficiently as a location with greater than 50 lines. ATG contends that a 51 line system would be inefficient, since it would use two T-1s with 48 lines and a third T-1 with only 3 lines.
Further, Qwest's volume discounts assume 100 percent fill factors in the prices whether or not applied to a multiple of 24. Under the 51 line scenario a customer would receive the benefit of a larger volume discount by using only 70 percent of the total capacity of the three T-1s, while a 48 line customer would get a much lower discount using 100 percent of two T-1s. The unused portion of the T-1 in the 51 line scenario has not been factored into the price floor. ATG contends that there are no additional cost savings for customers subscribing to over 100 lines, assuming a T-1 technology. Since other Centrex price components are related to switching and are not sensitive to volume and location, ATG concludes that the large discount cannot be justified by other cost savings.

The Centrex Plus features, according to ATG, are provided through software in the central office switch; thus the costs are not tied to the customer's location. Any location based savings would be a saving in transaction costs, which are normally recovered in nonrecurring charges.

ATG also argues that small customers provide a cross subsidy for large customers under the Centrex Plus per location pricing plan, since large customers provide Qwest less net revenue than the same quantity of service provided to small customers.

Effect on Competition. ATG argues that Qwest's market power allows it to impose higher prices on smaller volume users. Smaller customers depend on resellers for competitive alternatives to Qwest. Smaller customers lack the volume to justify the T-1 facilities that make it economical for competitive carriers to serve customers. Because Qwest has market power for Centrex services with respect to small volume users, this price discrimination has an anticompetitive effect. According to ATG, this is an abuse of market power. The volume discount exceeds the level of discounts that would be provided in an effectively competitive market, where discounts are limited to the amounts of cost saved.

ATG also argues that competitors have made limited inroads in Oregon. Resale of all types of lines, including unbundled network platforms, appears to account for fewer than 65,000 lines out of more than a million access lines Qwest has in Oregon. Through its UM 731 revenue neutral filing, Qwest has recently reduced the price of basic business lines. One effect of the reduction is to make it harder for facilities based competitors to enter the market and provide alternatives to Qwest access lines. Another effect is to reduce the potential margins for Centrex resellers, because basic business lines compete with resold Centrex Plus lines. ATG argues that it is important for Centrex Plus lines to be priced appropriately to ensure that all businesses in Oregon have a competitive alternative to Qwest. ATG is aware that Qwest cites figures for growth of resale but argues that those figures would be higher without the per location discount restriction. ATG also argues that the current telecommunications market is much less favorable to competitors than the market in the years Qwest cites.

ATG argues that Qwest's per location scheme is designed to protect Qwest's large customer base through volume discounts and to make resale of Centrex Plus difficult. ATG believes that Qwest continues to pursue strategies to restrict Centrex resale. First, Qwest has proposed in this docket to increase rates for lower Centrex volumes, in order to curtail resale. At the same time, Qwest proposes an even greater discount at 100 and 300 lines to protect its large customer base. Continued use of per location pricing, according to ATG, restricts the ability of resale to constrain Qwest's anticompetitive pricing.[16]

[16] ATG notes that the Washington Utilities and Transportation Commission (WUTC), which investigated per location pricing, found that a similar location pricing structure for Centrex Plus, which bundled lines and features, discriminated against resellers and was an impermissible restriction on resale. We decline to base any portion of our decision on an assertedly "similar" pricing structure.

ATG urges the Commission to order Qwest to make revenue neutral revisions to its Centrex Plus pricing using volume discounts based on the number of lines in a particular wire center rather than at a customer location.

Qwest's Response. Qwest contends that ATG's argument is based on the incorrect assumption that its tariff imposes impermissible restrictions on resale.

History of Per Location Pricing. Qwest denies that it added the per location pricing feature to its Centrex Plus pricing when resellers started obtaining volume discounts through aggregation of smaller customers at multiple locations. On the contrary, Centrex Plus was designed with per location pricing all across Qwest's territory. Per location pricing was not added to thwart resale.

Legal Considerations. Qwest asserts that its pricing structure for Centrex Plus imposes no conditions or additional terms whatsoever on the resale of the product. Any CLEC can purchase Centrex Plus service for resale on the same terms and conditions that Qwest offers the product for sale to its retail customers, except that the CLEC could qualify for an additional discount under 47 USC §251(c)(4). If a CLEC has a customer that qualifies for the per location volume discount, the CLEC would receive that pricing structure and could compete for the customer. The per location volume discount is also available to CLECs that can aggregate smaller customers at one location.

ATG cites the FCC's Local Competition Order for the proposition that certain restrictions on resale are presumptively unreasonable. Qwest counters that the sorts of restrictions that the FCC considered in that order were situations in which a service offered for sale to retail customers would not be made available to resellers on the same terms and conditions.

The FCC stated that it is "presumptively unreasonable for incumbent LECs to require individual reseller end users to comply with incumbent LEC high volume discount minimum usage requirements, so long as the reseller, in aggregate, under the relevant tariff, meets the minimal demand." Local Competition Order at 15,971. Earlier in the same order, the FCC stated that incumbent local exchange carriers "also seek to limit reseller end user eligibility to purchase resold incumbent LEC high volume offerings to those eligible to receive such offerings directly from the incumbent LEC." *Id*. at 15,966. Applied to Centrex Plus service, the FCC would consider it unreasonable for Qwest to extend per location discounts to a reseller only if a reseller's individual end user also qualified for the discount. Qwest's tariff imposes no such restrictions, or any other restriction relating to Centrex Plus resale.

The FCC also addressed volume discounts in the Texas order. It is clear from the discussion in the order that the FCC was addressing a type of resale restriction not found in the Centrex Plus pricing structure (refusal to allow aggregation of end users) and that the FCC did not invalidate as an unreasonable restriction on resale the sort of per location pricing that Qwest offers.

Cost Justification for Per Location Pricing. ATG's challenge to per location pricing rests on the assertion by its expert, Dr. Nina Cornell, that Qwest's proposed volume discounts are not based on costs saved by serving a given customer location in volume. ATG is wrong, according to Qwest. Qwest can use alternative loop technologies to serve customers with 50 or more lines, such as T-1 or higher capacity service instead of copper loops, realizing cost savings through such economies of scale.

Dr. Cornell asserts that Qwest's costs are based on the density of a vicinity or neighborhood, not the number of customers at a given location. This assertion, according to Qwest, is mistaken. Qwest's overall costs of service may be higher in a sparsely populated area than in a densely populated one. However, the cost to serve an access line at a particular customer location may still change depending on the number of lines that a customer subscribes to at the location. The forward looking cost of serving a customer with one or two telephone lines will be based on the cost of individual loops, since that is how such customers are actually served. On the other hand, the forward looking cost of serving a customer with 50 to 300 lines at one location will be based on the most efficient technology, which may be a large copper cable with many pairs, a T-1 circuit delivered over two copper pairs, or a T-1 or a DS-3 circuit delivered over a fiber optic loop. The per line cost of serving such customers is much lower than over an individual copper loop.

Qwest's cost of serving multiple lines at a single location is lower than serving customers at multiple locations. ATG claims that Qwest's witness testified that the most efficient way to serve a specific large customer could be through a T-1, a concentrator system, or a large copper cable; ATG takes this statement as contrary to Qwest's cost study, which assumed use of a T-1 to serve Centrex Plus customers with more than 50 lines at one location. Qwest's cost study is based on the least cost forward looking technology that would serve that customer. Qwest contends that it is not contrary to that study to suggest that in the field there may be more than one efficient way to serve a customer.

ATG's examples of price breaks not divisible by 24 show that some specific service configurations may be more efficient than others, if customers do not later add lines at a location. They do not disprove the general principle that the forward looking cost of service per line decreases with the number of lines at a single location.

ATG also mischaracterizes the testimony in stating that Qwest's witness David Teitzel, "admitted that it was technically feasible and could be efficient to serve a small customer in a dense neighborhood by demuxing a T-1, taking it out of a building on copper loops to a nearby manhole, and splicing it into smaller premise next door." Qwest's witness actually said it was technically possible but not the norm. The witness also noted that he is not an engineer. This testimony does not support ATG's testimony that T-1s can be used economically to serve small customers in dense neighborhoods.

Qwest notes that the Commission is setting rates for Qwest's retail services in this proceeding, so it is appropriate to compare the rates for different retail services, since that is what Qwest's retail customers do. Centrex Plus was developed as a competitive alternative to customer owned PBX systems. Centrex Plus provides features similar to a PBX system, such as intercom dialing and a variety of features, but as a central office based system. A customer considering purchasing a PBX system has a relatively large number of access lines at a given location. Such a customer will compare the cost of a PBX system to Centrex Plus service. PBX systems are cost effective only where there are a large number of access lines at one location. Centrex Plus also offers per location volume discounts as a competitive alternative to PBX systems. Elimination of the per location requirement to obtain the volume discount would distort the pricing relationship of Centrex Plus to its competitive retail alternative. Eliminating the requirement would also destroy the relationship between Qwest's cost of providing the service and the price.

Qwest asserts that there is nothing anticompetitive about its per location discount pricing. Qwest notes that Centrex resellers such as ATG compete with Qwest for the sale of basic business lines with feature packages. Such retail services are priced above the prices that Centrex resellers are able to charge based on the current pricing of Centrex Plus.

Qwest maintains that the per location volume discount does not impede Centrex resale. Centrex resellers compete for small customers with whom they have a significant pricing advantage. If a customer wanted to obtain a comparable level of service from Qwest as from a Centrex reseller, the customer would likely purchase either a basic business line with separate features or with a feature package. The CustomChoice package for business customers includes a line and approximately 20 features for about $55. Centrex customers, including resellers, pay less per line than do basic business service customers with a comparable level of features. Centrex resellers are also able to offer customers both interLATA and intraLATA toll service. Centrex resellers have a significant pricing advantage over Qwest in competing for the small and medium sized business customers. Qwest contends that Centrex resellers such as ATG have been able to leverage their pricing advantage to capture a significant amount of the market for smaller business customers in Oregon.

Qwest cites the following figures as proof that Centrex resellers, including ATG, have successfully captured business customers in Oregon. In December 1995, 16,192 Centrex lines were resold; in December 1996, the number of resold Centrex lines was 25,489; in December 1997, the number was 38,304, and in April 1998, the number rose to 41,138. Qwest asserts that this is a significant level of competition for business customers. Currently, there are approximately 20,000 resold basic lines, excluding Centrex, in Oregon, and competitors have purchased another 50,000 unbundled loops in Oregon.

Qwest urges the Commission to evaluate the significance of the issues ATG raises in Qwest's overall rate design, since no other Centrex reseller has appeared and since ATG itself has expressed to the Commission its intention of converting its resold Centrex lines to ATG facilities rather than pursuing a resale strategy. This growth in Centrex resale occurred under per location pricing. During the time period in question, the Commission ordered Qwest to impose a surcharge of $5.40 per month on each resold

Centrex line. Order No. 98-372. Despite these conditions, Qwest argues that Centrex resale flourished. Qwest contends that there is no basis to assert that per location pricing is anticompetitive.

Qwest believes that CLECs currently do not have the 65,000 lines or fewer that ATG asserts but approximately 120,000 access lines to business customers, representing over 23 percent of the business access lines.

Discussion and Resolution. ***History of Per Location Pricing.*** Although ATG has tried to show that Qwest's introduction of per location pricing had an anticompetitive motive, we consider this issue irrelevant for purposes of the rate case. Here we are deciding whether Qwest's rates are just and reasonable as proposed. Corporate thinking from before the Telecommunications Act does not weigh in that decision, nor does discussion about Centrex Prime, a different service from Centrex Plus.

Legal Considerations. ATG contends that Qwest's per location volume discounts restrict resale in violation of the Telecommunications Act. ATG is mistaken. As Qwest has argued, nothing in its tariff restricts resale of Centrex Plus service. Resellers purchase Centrex Plus service on exactly the same footing as any other purchaser. Again, as Qwest has noted, the passage from the Local Competition Order that ATG cites prohibits refusal to allow resellers to aggregate customers for volume discounts. Qwest does not refuse to allow aggregation of customers. The Texas order also speaks to a prohibition on aggregating customers, which is not the case here. We conclude that Qwest's per location volume discount pricing scheme is not in violation of the Act or FCC orders.

Nor is Qwest's scheme in violation of state law. ORS 759.455(g) prohibits a telecommunications utility from discriminating in favor of itself or an affiliate in the provision and pricing of, or extension of credit for, any telephone service. As noted, Qwest's tariff allows anyone to purchase Centrex Plus service under the same terms and conditions. This is not a provision that discriminates in favor of Qwest or an affiliate. ORS 759.455(i) prohibits the imposition of unreasonable or discriminatory restrictions on network elements or the resale of a telecommunications utility's service. Again, Qwest's tariff contains no such restrictions.

Absent a showing that Qwest's per location volume discount pricing scheme violates the Act, the presumption that Qwest's pricing scheme is unreasonable disappears. ATG mounts a disparate impact argument about the effect of Qwest's pricing scheme, but the scheme is in violation of no law or order.

Cost Justification. As to the impact of the scheme, ATG makes two types of argument. First, ATG contends that the scheme is not cost based. ATG's point is to show that the per location volume discount pricing structure keeps resellers from enjoying the large discounts associated with having 100 customers or more. ATG makes assumptions about Qwest's cost structure that Qwest successfully refutes. ATG goes into considerable detail to attack Qwest's forward looking T-1 based technology for larger users and use of embedded or existing technology for smaller users. We agree with

Qwest that there is nothing amiss about using a mix of actual and forward looking technologies to determine a rate design for a service. Moreover, we note that for larger volume customers Qwest mentions other service delivery options than the T-1 (DS-3, for instance) that may have different divisibility properties; ATG has not addressed this possibility but limits its attack to the T-1 properties. ATG has not shown that line volume at a single location is unrelated to cost.

Effect on Competition. ATG also argues that Qwest's per location volume discount disadvantages resellers. ATG does this by attacking Qwest's figures on competition and resale, but does not show specifically how resellers are disadvantaged by the per location pricing. Qwest's figures show that the market for resale of telecommunications services is far from moribund.[17] ATG has not shown that resellers are actually disadvantaged by per location volume discount pricing.

In terms of its marketing strategy, Qwest has shown that its per location volume discount pricing structure allows it to compete with PBX service. The context for this pricing structure shows it to be a reasonable competitive response on Qwest's part.

We conclude that Qwest's per location volume discount does not violate either federal or state law. It has not been shown to have a deleterious impact on Centrex Plus resellers. The per location volume discounts should be left in place.

ISSUE 9: EXTENDED AREA SERVICE

Background

Extended Area Service (EAS) allows Qwest telephone customers to call nearby telephone exchanges for a monthly flat fee rather than incurring long distance charges per call. Exchanges that have EAS capability are grouped by rate band. Charges vary by rate band and are lowest in the most populous bands. There are currently five rate bands.

EAS service is approved by the Commission after a town has shown that a community of interest exists between it and another town. Qwest offers EAS service on a flat or measured basis. EAS is essentially a replacement for toll service. Once EAS routes are in place, customers have no practical alternative to using EAS service, either measured or flat rated, for their calling.

[17] Qwest proposes a figure of 120,000 for CLEC lines in Oregon. We cannot determine whether these are resold lines or not; hence, we do not know whether this figure directly refutes ATG's assertion of 65,000 resold lines. For our disposition of this issue, this matter is not critical.

Party Positions

Only Staff and Qwest addressed this issue. Qwest proposes a reduction in EAS measured service for residential and business service customers to 3 cents per minute from 5 cents per minute, because the current price is well above cost, as represented by a UM 844 price floor. Staff agrees with this proposal.

Qwest proposes to simplify the EAS pricing structure, reducing the current five price bands to three. Staff also proposes to reduce the number of price bands from five to three, but structures its bands differently. Qwest agrees to Staff's rate band structure. Staff combined Bands A and B into one rate, Bands C and D into one rate, and left Band E at one rate.

Qwest's proposal for reducing EAS rates results in a revenue reduction of $22.718 million.[18] Staff's proposal reduces EAS rates by $11.321 million, approximately half the level proposed by Qwest. Qwest proposes a 57.4 percent reduction for EAS rates; Staff proposes a reduction of 28 percent. The differences between Qwest's and Staff's proposals are a function of the difference between their proposals for residential basic service rates (*see* Issue 12 below). Staff's proposal raises residential rates $10.371 million less than Qwest's and lowers EAS rates $10.442 million less than Qwest's. Staff makes no further argument in support of its position on EAS rate design.

Qwest argues that a significant price decrease for EAS rates is appropriate at this time. Qwest points out that the percentage reduction in EAS service should be comparable to the level of reduction in toll rates, since EAS replaces toll service. Qwest's proposed toll rate reduction is 42.3 percent.

Qwest also argues that in this docket, the Commission has a unique opportunity to rationalize EAS pricing and bring it closer to cost. EAS calling replaces what would otherwise be intraLATA toll calls. The conversion of network facilities to accommodate a new EAS route also imposes costs on carriers like Qwest. Accordingly, the Commission has traditionally viewed EAS rates as a mechanism to keep an incumbent local exchange carrier indifferent, from a revenue perspective, to the conversion. EAS rates have thus been determined based on the net toll revenue that an incumbent local exchange carrier would forgo as a result of the conversion as well as the costs of the conversion. The revenue neutral conversion process has been based on intraLATA toll prices that have been substantially higher than current prices or the toll prices proposed in this case.

Qwest also urges the Commission to use this opportunity of Qwest's last general rate case in Oregon to establish EAS rates that make sense from customers'

[18] Staff notes that Qwest's rate design presented incorrect current EAS flat rates, which resulted in an understatement of Qwest's revenue reduction for EAS of $954,731 and an overstatement of its ISDN-BRS reduction by $176,646. Qwest notes that it does not dispute the Staff calculation, which is hereby accepted. Thus, Qwest's proposed EAS rate reduction is actually $22.718 million, not the $21.8 million figure Qwest used in its briefs.

perspectives and in light of Qwest's entire rate structure. According to Qwest, the Commission need not be concerned with the size of the reduction from previous EAS rates that were established to keep Qwest revenue neutral in an EAS conversion. Implementation of an overall revenue reduction will ensure that Qwest's revenue requirement is met. Adopting Qwest's proposed EAS rates will reduce local service rates for all Oregon customers. Qwest argues that the Commission should adopt its proposal for EAS rates, as amended by Staff's proposed rate band structure, along with Qwest's proposed residential basic service rates.

Discussion and Resolution

Our choice in this issue is whether to raise residential rates by $1.00 in Rate Group 1, $2.00 in Rate Group 2, and $3.00 in Rate Group 3 and lower EAS rates by $22.7 million (Qwest's proposal); or raise residential rates not at all in Rate Group 1, by $1.00 in Rate Group 2, and $2.00 in Rate Group 3, and lower EAS rates by $11.3 million (Staff's proposal). Because we have chosen Staff's proposal for Residential Local Exchange Service, Issue 12, and the issues are linked, we choose Staff's proposal, including Staff's proposed rate band structure, here as well.

ISSUE 11: LOCAL BUSINESS ACCESS SERVICES

Party Positions

In connection with its UM 731 (Universal Service) compliance filing pursuant to Order No. 00-312, effective April 30, 2001, Qwest proposed significant reductions to basic business rates and deaveraging of those rates into rate groups, matching the deaveraging structure that the Commission had ordered for UNE loop rates. Advice No. 1844, acknowledged March 12, 2001.[19] Qwest's proposal here maintains the deaveraged rate structure and introduces a number of other changes in business local exchange service rates, including a further small decrease in those rates. Staff generally agrees with all of Qwest's proposed changes except that Staff proposes that rates for business basic service in Rate Groups 2 and 3 should be the same.

Staff's proposal decreases Qwest's annual revenues for local business access services by $1.3 million. Qwest's proposal decreases them by $1.2 million. Staff agrees with Qwest's original proposal to reduce annual revenues from Public Access Line

[19] In UM 731, Qwest filed reductions in business rates that decrease annual revenues by $15.4 million. In its compliance filing, the company proposed a one party flat simple business (1FB) access line rate of $26.40 per month in Rate Group 1. In effect, Qwest proposed to reduce the simple business access line rate by an average of $4.47 (14 percent) from the current $30.87 rate. Qwest proposes to remove the current distinction between simple and complex business lines by treating them all as 1FB lines. Qwest also proposed to continue to charge a higher rate for PBX lines than for 1FB lines. This reduces the complex line rate to the same level proposed for simple lines, $26.40, a reduction of $8.37 (24 percent) from the current $34.77 rate. Most PBX trunk rates are reduced to $28.40, effectively reducing the rate by $6.37 (18 percent) from the current rate of $34.77.

(PAL) services by $13,000.[20] Staff's proposal eliminates the PAL flat rate with measured usage after 300 calls and reduces PAL rates to equal the Staff proposed one party flat business rates for all three rate groups.

NWPA also joined this issue, arguing that Qwest's, and by implication Staff's, public access line (PAL) rates are inconsistent with the FCC Payphone Orders. NWPA contends that PAL rates are subject to the "new services test," requiring that rates be cost based with a reasonable contribution to overhead.[21]

Staff. Staff's proposal reduces monthly rates for local business access service customers by approximately 2 percent. Business one party flat (1FB) rates for both Rate Groups 1 and 2 drop by 40 cents, and Rate Group 3 rates drop by $2.35, or 8 percent. This reduction makes rates in Rate Group 2 and 3 equal. The total annual revenue effect of these reductions is $1.4 million. Staff proposes to reduce business access line rates because they are too far above the universal service benchmark.

Staff's proposal also reduces monthly recurring rates for flat rate PAL service in all three rate groups by 8 to 20 percent. This proposal makes flat PAL rates equal to the proposed 1FB rates for all three rate groups. Staff also proposes to eliminate the PAL Flat Rate with Measured Usage after 300 calls. The total annual revenue effect of these rate reductions is about $13,000.

Qwest. Qwest and Staff generally agree on Qwest's proposed changes except that Staff proposes that rates for business basic service in Rate Groups 2 and 3 should be the same. Qwest believes that the Commission should not retreat from the extent of deaveraging that it has already approved and should maintain a deaveraging of retail rates that matches the deaveraging of loop rates. The deaveraging of loop rates reflects actual cost differences in the three rate groups. Qwest argues that retaining cost based distinctions among the three rate groups will aid the development of facilities based competition in those areas.

Qwest has proposed a change in the price for PAL service, making the rates for PAL access line service consistent with business line rates. Qwest argues that PAL service is provided to business customers (Payphone Service Providers, PSPs) and is the functional equivalent of business line service.[22] Staff and Qwest agree on Qwest's rate design for PAL services except that Staff proposes the same rates for Rate Groups 2 and 3.

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[20] Qwest filed a revised UT 125 rate spread on March 19, 2001, that differs slightly from its original proposal.

[21] Qwest's Advice No. 1844 reduces PAL rates by $0.3 million, or 14 percent. However, the flat PAL rate is reduced to the same level as 1FB lines, $26.40, a reduction of $8.37 or 24 percent from the current $34.77 rate. This is the service to which PAL subscribers are likely to migrate.

[22] Qwest notes that in Order No. 90-920, Docket UT 85, the Commission found that measured PAL access lines are identical to measured business service lines and should be priced the same.

NWPA. NWPA argues that Qwest's proposed rates for pay telephone access service impermissibly exceed the rates allowable under Section 276 of the Telecommunications Act of 1996.

Payphone Rates and the New Services Test. The FCC issued the Payphone Orders in 1996 and 1997,[23] determining that incumbent local exchange carriers (ILECs) must set their rates for pay telephone access services so as to be cost based, consistent with the requirements of Section 276, nondiscriminatory, and consistent with Computer III guidelines.[24] The Computer III tariffing guidelines incorporate the "new services test." Order on Reconsideration at 163. "The new services test is a cost based test that establishes the direct cost of providing the new service as a price floor. LECs then add a reasonable level of overhead costs to derive the overall price of the new service." *In the Matter of Local Exchange Carriers Payphone Functions and Features*, Mem. Op. & Order, CC Docket No. 97-140, 12 FCC Rcd. 17,996 (1997), ¶ 2 (FCC 97-392, rel. Oct. 29, 1997) (Payphone Features Order). The FCC required ILECs to file studies supporting these costs with state commissions in 1997. Bureau Waiver Order at ¶19.

According to NWPA, Qwest had two duties regarding its PAL rates under the new services test: to file studies showing direct and overhead costs for PAL with the Oregon Commission, and to set PAL rates based on these costs. Qwest did neither and has never, according to NWPA, set its Oregon PAL rates according to the new services test. NWPA believes that Qwest's failure to produce and file cost support data is in itself sufficient for this Commission to reject Qwest's proposed PAL rates.

Qwest has also failed to meet its second duty under the new services test, according to NWPA, which is to calculate its rates based on the appropriate cost data. Instead, NWPA argues that Qwest has set PAL rates according to different criteria and methodologies that have nothing to do with the new services test. For instance, Qwest adds contribution and market driven return costs to its PAL rates. Further, NWPA contends that Qwest sets its PAL rates based on the rates for business local exchange service, whereas there are substantial differences between PAL and business local exchange service and their rates are set by different mechanisms. NWPA would like the Commission to require engineering studies, time and wage studies, and other cost accounting studies from Qwest to comply with the new services test.[25]

CustomNet and the New Services Test. The above arguments apply to access service rates. With respect to payphone features, NWPA argues that these rates

[23] Report and Order, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd. 20,541 (1996) (Report and Order); Order on Reconsideration, 11 FCC Rcd. 21,233 (1996); Order, 12 FCC Rcd. 20,997 (1997) (Bureau Waiver Order); Order, 12 FCC Rcd. 21,370 (1997) (second Bureau Waiver Order).

[24] These four characteristics of rates are what NWPA refers to as the FCC's four part test.

[25] NWPA also argues that it is impermissible to set PAL rates based on business line rates because that would discourage widespread deployment of payphones. NWPA further argues that setting PAL rates at business rates ignores the new services test methodology required by law. We disagree with these contentions; *see* Resolution, below.

should also be set according to the new services test. NWPA focuses its argument on CustomNet, a kind of call screening. Qwest has denied that CustomNet is subject to the new services test, has refused to provide relevant cost data, and, according to NWPA, has set rates for this service according to prohibited criteria.

NWPA argues that the new services test applies to any unbundled features ILECs provide to their own payphone services. Order on Reconsideration at ¶163. Qwest provides CustomNet to its own Basic PAL lines ordered by its payphone division; NWPA concludes that CustomNet is therefore subject to the new services test.

NWPA also argues that usage patterns establish CustomNet as a payphone feature, based on confidential numbers. CustomNet places restrictions on a line to prevent someone charging a long distance call to the payphone number. PSPs order CustomNet because that feature is essential to avoid fraudulent charges, as Qwest's network is currently configured.

NWPA asserts that Qwest has failed to file cost data for CustomNet, although it is a payphone feature. Qwest maintains that it has not prepared cost data because it has not proposed price changes for CustomNet. NWPA argues that this does not excuse Qwest from compliance with the requirements of the Payphone Orders. NWPA argues that the limited cost information available shows that Qwest imposes an enormous overhead loading on CustomNet service.

Discriminatory Rates. Further, NWPA contends that Qwest's pay telephone access service rates are discriminatory. First, NWPA asserts that the rates recover certain interstate costs twice. For each PAL line sold Qwest receives a subscriber line charge (SLC, also called a customer access line charge (CALC) and an end user common line (EUCL)) and a primary interexchange carrier charge (PICC). Qwest has not lowered its proposed PAL rates to reflect that these charges recover nontraffic sensitive interstate costs of PAL service, giving Qwest a double recovery of these costs.

NWPA argues that the FCC has already recognized that ILECs must reduce PAL rates to account for these charges so that ILECs do not recover their costs twice. *In the Matter of Wisconsin Public Service Commission Order Directing Filings,* 15 FCC Rcd. 9,978 (2000) (Wisconsin Order), the FCC directed certain ILECs to demonstrate that in setting their PAL rates they have taken into account other sources of revenue (SLC, PICC, and carrier common line (CCL) charges) that are used to recover the cost of the facilities involved to avoid double recovery. Wisconsin Order at ¶12.

Second, NWPA contends that the nature of these federal charges show that they create double recovery for Qwest. They recover the interstate costs of the local loop that are not traffic sensitive. Qwest's PAL costs are not separated by jurisdiction in this proceeding, so they include both interstate and intrastate local loop costs. By collecting the federal charges plus the PAL rate, Qwest recovers the interstate loop costs twice. The fact that Qwest applies these federal charges equally to local exchange services and PAL is irrelevant, according to NWPA.

NWPA contends that Qwest discriminates against its competitors by collecting interstate costs twice. Thus, it can offer higher payphone commission payments than its competitors. As a result, competing payphone providers are subsidizing Qwest's payphone operations. NWPA urges the Commission to require Qwest to adjust its PAL rates to eliminate this double recovery.

NWPA also argues that Qwest's rates and practices regarding CustomNet are discriminatory, including Qwest's markup and its refusal to disclose cost data. NWPA asserts that these practices discriminate against competitive payphone providers and erode their ability to provide viable competition with Qwest's payphone service.

Public Policy. In addition to the assertion that Qwest's payphone service rates fail to comply with the new services test, NWPA alleges that Qwest's rates are inconsistent with Section 276 of the Act, which states the objectives of increasing competition and widespread deployment of payphones. NWPA contends that Qwest's high CustomNet rates hurt independent payphone providers and undercut these objectives. Further, NWPA asserts that Qwest's rates are not cost based, because they are market driven and contain too much overhead loading.

NWPA concludes that the Commission should reject Qwest's payphone access line and features rates because they do not meet each element of the FCC's four part test. NWPA then proposes two approaches according to which the Commission can set Qwest's payphone access and features rates on the evidence available. We do not discuss these proposals here because we decide this issue against NWPA, but note that one of them suggests using UNEs as a basis for setting payphone service rates.

Qwest's Response to NWPA. ***Payphone Rates and the New Services Test.*** In response to NWPA's arguments, Qwest contends that its payphone rates are cost based and provide a reasonable level of contribution to overhead costs and therefore comply with all federal requirements. Therefore, according to Qwest, the Commission should reject NWPA's arguments that PAL rates should be set equivalent to UNE rates.

PAL, according to Qwest, is a retail service, not a wholesale service. UNE pricing principles therefore do not apply to PAL. However, if a PSP is also a competitive local exchange carrier (CLEC), that provider may obtain the UNEs necessary to provide payphone service at the UM 844 UNE rates, or it may obtain a PAL for resale at prices that reflect a wholesale discount. A provider can also obtain UNE or wholesale rates through another CLEC. It is therefore not necessary, according to Qwest, for the Commission to set the retail price for PAL equal to the UNE price for payphone providers to obtain that level of pricing.

Qwest also maintains that the proposed PAL rates satisfy the new services test. The FCC requires rates for payphone services to be cost based and to comply with the new services test. The new services test establishes the direct cost of providing the new service as a price floor. LECs may then add a reasonable level of overhead costs to derive the price of the service.

NWPA argues that Qwest's level of overhead costs are unknown and that Qwest's proposed PAL rates cannot, for that reason, meet the new services test. Qwest notes that the FCC has relied on cost to price ratios to establish the amount of overhead in rates. *See* Payphone Features Order at ¶6. Qwest states that its proposed rates for flat PAL, PAL message line, and PAL measured services range from 26 percent to 91 percent above their direct costs, as approved by the Commission in UM 773. UM 773 costs are a reasonable approximation of direct costs as that term is used in the new services test, Qwest contends.

As to the level of overhead loading of which NWPA complains, Qwest points out that in the Payphone Features Order, the FCC required an explanation of Bell Atlantic's overhead loadings because it determined that, based on cost/price ratios, the overhead loadings did not appear to be reasonable. The FCC and state commissions have determined that a wide range of overhead loading is reasonable, including overhead loading that results in rates 4.8 times direct costs and 30 percent above direct costs. Payphone Features Order at ¶11 n 39, 13; Petition Filed by the Independent Payphone Ass'n of New York, Inc., Case 99-C-1684, 2000 NY PUC LEXIS 832 (NYPSC Oct. 12, 2000) at 8-9.

Qwest maintains that the studies NWPA asks for are unnecessary burdens. None of the things NWPA lists are necessary to ensure that proposed PAL rates are consistent with the new services test, which requires only a showing that the rates for a service include direct costs plus reasonable overhead. Qwest asserts that neither the FCC nor the state commissions prescribe the type of evidence necessary to determine whether PAL rates satisfy the new services test. Qwest notes that the FCC allowed state commissions to determine whether state tariffs comply with FCC guidelines. *In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Order on Reconsideration, CC Docket No. 96-238, 11 FCC Rcd. 21,233 (FCC 96-439 rel. Nov. 8, 1996), ¶163. Qwest argues that the evidence it submitted demonstrates that its proposed PAL rates are consistent with the new services test.

NWPA charges that Qwest includes impermissible elements in its PAL rates, including market driven return and contribution. NWPA asserts that these elements are inappropriate because PAL rates should be cost based. Qwest contends that cost based does not mean limited to costs. For instance, UNE rates are required to be "based on the cost" of providing the UNE and "may include a reasonable profit." 47 USC §252(d)(1). NWPA's reasoning would price retail PAL service below wholesale UNEs.

According to Qwest, NWPA's interpretation of the law ignores the purpose behind the new services test. *In the Matter of Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Order on Further Reconsideration, CC Docket No. 89-79, 6 FCC Rcd. 4,524 (FCC 91-186 rel. July 11, 1991) (ONA Order), the FCC described the new services test as a "flexible cost based approach to pricing new services." ONA Order at ¶38. The purpose of the new services test is to ensure that "initial prices for 'new' services [are] not unreasonably high." *Id*. at ¶39. The FCC continued:

> Because we believe that the public interest will be served by providing LECs with an adequate incentive to innovate, we conclude that a flexible cost based approach is the best way of controlling both excessive pricing and discrimination. As NYNEX recognizes, a cost based upper bound can preserve carriers' incentives to innovate, if it permits them to earn a return on their total new investment commensurate with the risk they assume. *Id*. at ¶41.

On the basis of the ONA Order, Qwest argues that the Commission has leeway to determine whether Qwest's proposed rates are reasonable under the new services test, including consideration of an appropriate level of contribution or return.

CustomNet and the New Services Test. Qwest next argues that the new services test does not apply to CustomNet, contrary to NWPA's position. Qwest argues that CustomNet is an individual retail tariffed service described in Section 10 of PUC Oregon No. 29, Exchange and Network Services.[26] CustomNet is available to any customer that subscribes to an individual line under a single uniform service order code (USOC); it is not provided exclusively to PSPs. Over 37 percent of the lines with CustomNet serve customers other than PSPs. To price CustomNet in accordance with the new services test for PSPs, Qwest might be required to separate a service that is provided under a single USOC into at least two categories, CustomNet for PSPs and CustomNet for all other customers. This solution would be impractical and is not required under the new services test, which only governs lines and features provided exclusively to PSPs. In the Payphone Features Order at ¶15, the FCC expressly referred to GTE's call screening service as an "unbundled, payphone specific feature." Qwest argues that CustomNet is not payphone specific. It is instead an independent product available to any class of subscriber. Accordingly, the new services test does not apply to CustomNet, according to Qwest. Moreover, Qwest argues that NWPA has failed to provide evidence that any payphone service price is inconsistent with the new services test. Finally, with respect to CustomNet, Qwest states that it provided no cost data for CustomNet in this proceeding because no change is proposed for CustomNet rates.

Discriminatory Rates. Qwest also maintains that NWPA's reliance on the Wisconsin Order is misplaced. That order did not issue from the full FCC, it applies only to the specific LECs in Wisconsin that are named in the order, and a stay of the order has been requested.

Additionally, Qwest argues that its proposed PAL rates are not discriminatory. NWPA claims that collection of federal line charges such as SLC

[26] Qwest requests that we take official notice of this tariff. We do so in accordance with OAR 860-014-0050.

on public access lines is discriminatory because Qwest can use the proceeds from its double recovery to offer higher payphone commission payments than its competitors. The only support for this position, according to Qwest, is NWPA's speculation that Qwest would gain a financial advantage through the ability to offer lower rates and/or higher commission payments than NWPA members. Qwest urges us to disregard this assertion as mere speculation. Qwest notes that it is required to assess the federal charges. Qwest imposes them on all access lines, including lines it provides to its own payphone division. Accordingly, these charges are not discriminatory. Qwest also responds that the application of SLC is exactly the same for local exchange services as it is for PAL services.

Discussion and Resolution

For business access services other than payphone rates, Qwest and Staff propose nearly identical rates and no other party addresses the issues. Staff wishes, however, to set rates in Rate Groups 2 and 3 equal to each other, whereas Qwest wishes to retain three rate groups. Qwest argues that retaining cost based distinctions among the three rate groups will aid the development of facilities based competition in those areas. We agree with Qwest on this issue and adopt Qwest's proposed rates.

Payphone Rates and New Services Test. For payphone service rates, we first address NWPA's arguments that Qwest must set rates consistent with the new services test and the FCC's four part test. We note that the FCC's test requires that payphone rates be cost based, consistent with Section 276 (that is, must encourage deployment of payphones), nondiscriminatory, and consistent with Computer III guidelines (that is, must pass the new services test). The new services test requires that rates be cost based with reasonable overhead. Therefore, the test really states that rates be cost based, nondiscriminatory, and consistent with increasing competition for payphones.

NWPA asserts that in order to comply with the new services test, Qwest must submit studies and cost data. We disagree. We find NWPA's reading of FCC requirements to be overly formal. The FCC requires only that rates be cost based and in compliance with the new services test. The new services test requires a showing that rates for a service include direct costs and reasonable overhead. Beyond that, the FCC has not specified what kind of evidence is necessary to determine whether PAL rates satisfy the new services test.

We conclude that UM 773 costs are a reasonable approximation of direct costs. Qwest has used the UM 773 costs to figure its direct costs. Qwest's rates for payphone services range from 26 percent to 91 percent above direct costs. Like the FCC, we find that the cost to price ratio is sufficient to allow us to infer the overhead on payphone rates. Payphone Features Order at ¶6. Further, we find that this overhead is reasonable. As Qwest has pointed out, the FCC and state commissions have determined that a range of overhead loading up to 4.8 times direct costs is reasonable.

We agree with Qwest's arguments about the meaning of cost based rates. This phrase does not mean that rates must be set at cost. This conclusion renders moot NWPA's arguments about the inclusion of contribution and market driven return. We conclude that Qwest's PAL rates satisfy the new services test. We address the rest of the FCC test below.

CustomNet and the New Services Test. We next address the argument about whether CustomNet is subject to the new services test. We conclude that it is not. CustomNet is a service available to any class of subscriber, as Qwest has pointed out. It is a retail tariffed service that may be purchased by any customer with an individual line under a single USOC. Over 37 percent of the lines with CustomNet serve customers other than PSPs. The new services test applies to payphone specific features;[27] CustomNet is not payphone specific. This conclusion makes it unnecessary to address NWPA's arguments about cost data and overhead for CustomNet.

Discriminatory Rates. We agree with Qwest that we should not rely on the Wisconsin Order, which applied to specifically named ILECs and not to Qwest. Moreover, a stay has been requested on that order. We conclude that the Wisconsin Order is not binding on us.

We reject the remainder of NWPA's argument on the issue of discriminatory rates. Qwest assesses the federal charges on all access lines, including the lines it provides to its own payphone division. This is not discriminatory behavior. NWPA has not provided evidence that Qwest uses the proceeds from its recovery of the federal charges to gain a competitive advantage over NWPA members.

Public Policy. Finally, NWPA argues that Qwest's proposed PAL rates are inconsistent with Section 276 of the Act because they do not increase competition and serve the widespread deployment of payphones. NWPA has not shown that the rates as proposed, which represent an overall reduction of current rates, hinder competition. In fact, evidence in the case shows that the number of payphones operated by NWPA members in Oregon increased approximately 24 percent from 1997 to 2000, when NWPA provided its data request response. The number of payphones operated by NWPA members in 1997 is within 3 percent of the total number of PAL lines recorded in the test year. We reject this argument.

For payphone rates, we adopt Qwest's proposal.

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[27] In the Payphone Features Order, the FCC determined that GTE's selective class of call screening service is subject to the new services test, describing it as a payphone specific feature. At ¶15.

ISSUE 12: RESIDENTIAL LOCAL EXCHANGE SERVICE

Party Positions

AARP, Qwest, and Staff took positions on this issue. Qwest proposes to deaverage residential local exchange rates into three Rate Groups on the same basis that the Commission used to deaverage the loop UNE. Qwest proposes an increase in basic residential rates (currently $12.80) of $1.00 in Rate Group 1, $2.00 in Rate Group 2, and $3.00 in Rate Group 3. Qwest proposes to price the second residential line $1.00 below the price of the initial residential line. Qwest also proposes to increase one party measured residential (1MR) access line recurring rates by $2.2 million (from the current $6.37 per month to $9.50 in Rate Group 1, $10.50 in Rate Group 2, and $11.50 in Rate Group 3). Qwest's proposal on this issue would increase annual revenues by $11.49 million.

Staff proposes deaveraging on the same basis as Qwest. Staff also proposes no rate increase for Rate Group 1 or 1MR, an increase of $1.00 for Rate Group 2, and an increase of $2.00 for Rate Group 3, for an overall revenue increase of $1.12 million.

AARP opposes any increase in basic residential rates.

AARP. AARP argues that no rate increase is appropriate for residential local exchange service in the context of this case. According to AARP, Qwest bases its pricing proposal on the $21.00 benchmark for local service that resulted from Docket UM 731. Staff bases its increase in the UM 844 price floors in combination with consideration of the $21.00 benchmark. AARP contends that both approaches erroneously use the output of cost proxy models that were designed for other purposes, and both associate the outcome of these cost modeling processes with the underlying cost of basic residential service and therefore with the rates charged for basic residential service. AARP argues that neither the $21.00 benchmark nor the UM 844 price floors are appropriate costing mechanisms for ratemaking purposes.

AARP argues that there is no cost basis for an increase in basic local service rates in the face of a $91 million rate decrease.[28] AARP maintains that neither Staff nor Qwest has shown that residential rates, separately or combined, do not cover their costs. Without such a showing, AARP argues, there is no justification for increasing residential basic exchange rates.

AARP argues that the UM 844 price floor is not equivalent to the cost of underlying residential basic exchange rates, because the price floor includes 100 percent of the loop cost. Residential basic service is only one service that Qwest offers, and AARP contends that it is not appropriate to assign all of the loop cost to a single rate

[28] AARP derives this figure by adding the $64.2 million decrease from the stipulation adopted in Order No. 00-190 to the $26.7 million business service rate decrease in UM 731.

element such as the residential basic rate. The costs should be spread across all the services that use the loop.

AARP also contends that that the $21.00 benchmark does not justify raising basic residential rates because it does not measure the cost of a single rate element or service. The benchmark is the output of the FCC Synthesis Model, and Commission Staff adjusted the model only for usage or traffic sensitive costs (local and interstate access). The entire cost of the loop, which includes the fixed or shared costs associated with other services offered by Qwest, is still in the model. AARP contends that the $21.00 benchmark is based on an aggregate that should be allocated among the services carried across the loop, including switched access, vertical services (such as Caller ID), and intraLATA or interstate toll services. The cost results of the benchmark study therefore, according to AARP, do not equate with the price of just one service, residential basic service.

AARP refers to several orders from other state commissions that conclude that loop cost should not be allocated entirely to residential rates.[29] Moreover, according to AARP, the rate should not be measured against the benchmark. The Commission uses the benchmark to determine when specific support for the provision of basic service pursuant to the universal service goals of SB 622 is necessary. It is not a rate setting mechanism.

AARP additionally maintains that there is no legal mandate to raise residential rates to the $21.00 benchmark. The purpose of the universal service fund was to provide explicit support for provision of basic service where the cost of providing basic service exceeds a Commission established benchmark (Order No. 00-265 at 2). SB 622, according to AARP, was also designed to move the telecommunications sectors in the direction of reduced regulation by providing for an alternative form of regulation. The regulatory purpose of the benchmark is not for use in setting rates but instead to determine the amount of explicit support necessary to bridge the gap between price and cost in high cost areas. Even if SB 622 implied that a rate element below $21.00 should be increased, which AARP believes is not the case, the Commission should recognize that the cost model used to arrive at the $21.00 benchmark was not appropriate for ratemaking and that there is no mandate to raise any rate immediately.

The benchmark, according to AARP, is a guideline rather than a mandated target. Using the benchmark to set rates contradicts the universal service and affordability goals of the Act and of UM 731. The goals of the Act include making telecommunications rates affordable and service widespread and promoting or advancing consumer subscribership to telecommunications services. AARP argues that an increase

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[29] *See In the Matter of the Identification of All Subsidies in the Existing Rates of Qwest Corporation*, New Mexico Public Regulation Commission, Utility Case No. 3325 (2000); *U S WEST Communications, Inc., v. Washington Utilities and Transportation Commission, Fifteenth Supplemental Order, Commission Decision and Order Rejecting Tariff Revisions; Requiring Refiling*, Docket No. UT 905200, at 95 (1996), aff'd 949 P2d 1337 (1998); 4 Code of Colorado Regulations 723-30-4.2(a)(iv); FCC 96-98, Docket No. 96-45.

in residential rates, given any income elasticity or price elasticity, will decrease the number of customers subscribing to basic service. Further, AARP contends that the universal service fund does not subsidize residential rates and that there is therefore no reason to raise basic rates to compensate for the loss of a subsidy.

AARP argues that the proposal Staff and Qwest offer results in a net decrease or no increase to the residential class because rate increases for certain services are offset by the elimination of or decrease in rates of other services. However, AARP contends that some customers will experience an increase because they do not purchase the offsetting features or Qwest toll service. The better proposal, in AARP's view, is to ensure a rate decrease, or at least no rate increase, for all customers and not just those that purchase the correct bundle of features and services.

Finally, AARP argues that rates need not be increased to encourage competition for residential customers. According to AARP, there is no competition for residential customers. When competition develops, increasing rates could encourage competition. But at present, competition for residential rates is unlikely in the foreseeable future. Moreover, according to AARP, there is no mandate to deaverage retail rates. In fact, long distance and wireless plans are moving toward flat rates, not deaveraged rates.

Qwest. Qwest contends that its proposed increases in local service rates are mandated by ORS 759.425 and would bring the company into compliance with Section 254 of the Act. Section 254 requires states to use mechanisms that specifically and predictably advance universal service. This has generally been understood to require that subsidies be explicit rather than implicit. ORS 759.425 requires the Commission to establish and implement a universal service fund. ORS 759.425(3)(a) requires that the universal service fund provide "explicit support to an eligible telecommunications carrier that is equal to the difference between the cost of providing basic telephone service and the benchmark."

ORS 759.425(3)(c) provides that "the commission shall seek to limit the difference between the price a telecommunications utility may charge for basic telephone service and the benchmark." In UM 731, Order No. 00-312, at 22, the Commission set the benchmark at $21.00. Qwest lowered its rates for basic business service in a revenue neutral filing in April 2001, and this case presents the first chance for the Commission to implement ORS 759.425(3)(c) with respect to residential service. Qwest urges the Commission to make a modest increase in the rate for residential basic service to start moving that price toward the universal service benchmark. Qwest argues that only its proposal meets the legislative mandate of moving prices for basic service toward the benchmark.

According to Qwest, Staff has failed to examine the relationship between the price for residential basic service and the universal service benchmark. Qwest also believes that Staff's proposals are inconsistent. On the one hand, Staff proposes to reduce rates for business basic service by 40 cents in Rate Groups 1 and 2 and by $2.35 in Rate Group 3, because business basic rates too far exceed the universal service benchmark. Staff also justifies its proposed increase in residential rates for Rate

Groups 2 and 3 because the increase would bring those rates closer to the universal service benchmark. But Staff proposes no increase for residential basic service rates in Rate Group 1, although that group includes over 90 percent of Qwest's residential customers. Instead of examining the relationship between the residential basic service rates and the benchmark in Rate Group 1, however, Qwest argues that Staff focused on the relationship between the current rate and the price floors in ORS 759.410. This focus is in error, according to Qwest, because the price floors do not apply to basic service.

Qwest asserts that AARP performed an incorrect analysis comparing the price for residential basic service to the universal service benchmark. AARP compares not the flat residential basic service rate of $12.80 but rather the sum of all revenues supported by the loop: basic services, EAS, features, access, intrastate toll, and the revenue from the CCL and federal support amounts. Performing that comparison, AARP concludes that the Commission need not adjust the price of residential basic service because it nearly equals the benchmark.

Qwest argues that AARP's analysis is based on an incorrect reading of the statute. ORS 759.425(3)(c) requires the Commission to compare "the price a telecommunications utility may charge for basic telephone service" with the benchmark. As required by ORS 759.425(2)(a), the Commission has defined "basic telephone service" by rule, OAR 860-032-0190. That definition specifically excludes EAS, intrastate toll, and custom calling features, but AARP includes revenue from these nonbasic services in the price for basic service, in comparing the price for basic service with the universal service benchmark.

In response to AARP's contention that there is no competition in the residential local exchange service market, Qwest notes that competitive local exchange carriers serve over 10,000 residential customers in Oregon. Furthermore, Qwest argues that developing competitive alternatives for residential customers is an express goal of the Act. Qwest points out that AARP's expert witness agreed that a higher price for residential service gives competitors a better likelihood of achieving a higher margin, which is important to a competitor entering a market.

Staff. Staff argues for an increase in basic local service rates in Rate Groups 2 and 3 because these rates are below the UM 844 price floor and an increase will move them closer to the benchmark. Staff argues that the Commission should not increase rates in Rate Group 1, nor should it increase 1MR rates, because the present rates exceed the price floor.[30] Staff argues that we should increase the nonrecurring residential line charge because that would move the rate closer to the TSLRIC. Staff

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[30] The Commission has not established price floors for retail services such as 1MR, but Qwest presented a proposed price floor of $16.62 for this service. Staff calculated, using Qwest data, total revenue of $17.44, which includes the $6.37 monthly fixed charge, the $4.35 subscriber line charge (which increased to $5.00 on July 1, 2001), plus $6.72 of monthly usage revenue calculated based in Qwest's exhibit. The average monthly usage revenue is calculated by 224 minutes times 3 cents per minute. This calculation uses the same methodology Qwest has used throughout the case.

acknowledges that the Commission is not required to price basic service above a price floor, according to ORS 759.420(4).

Staff argues that the UM 731 benchmark is only a guideline and that no party suggests that rates should be raised to $21.00 in this proceeding. Staff asserts that its proposal does seek to limit the difference between the price a telecommunications utility may charge for basic telephone service and the benchmark, as ORS 759.425(3)(c) mandates. Staff characterizes the differences among the parties as a disagreement on the appropriate increase in this proceeding. According to Staff, the Commission has discretion to adopt any of the three residential basic rate proposals. The parties simply have different opinions on whether and how far rates should move and in which rate group or groups. Staff urges the Commission to adopt Staff's proposal, because it most appropriately balances the interest of customers with Commission policies and goals.

Discussion and Resolution

ORS 759.425(3)(c) provides that "the commission shall seek to limit the difference between the price a telecommunications utility may charge for basic telephone service and the benchmark." OAR 860-032-0190(2) defines basic telephone service:

> "Basic telephone service" means retail telecommunications service that is single party, has voice grade or equivalent transmission parameters and tone-dialing capability, provides local exchange calling, and gives customers access to but does not include:
>
> (a) Extended area service (EAS);
>
> (b) Long distance service;
>
> (c) Relay service for the hearing and speech impaired;
>
> (d) Operator service such as call completion assistance, special billing arrangements, service and trouble assistance, and billing inquiry;
>
> (e) Directory assistance; and
>
> (f) Emergency 9-1-1 service, including E-9-1-1 where available.

It is clear from the above statute and rule that AARP's arguments about the benchmark are misplaced. First, it is irrelevant how the benchmark is calculated. ORS 759.425 requires us to seek to limit the difference between the price of basic service and the benchmark. Thus, the benchmark is a given and not subject to scrutiny in this proceeding. AARP's comparison of other than basic service elements with the benchmark is also misplaced; the rule above excludes from basic service elements AARP would include in comparing price to benchmark.

AARP's remaining arguments have to do with policy. There is nothing to prevent this Commission from raising residential rates in the context of an overall rate decrease (which, for purposes of this docket, amounts to a revenue reduction of $64.2 million, not $91 million). Since the advent of competitors with the Bell Operating Companies, public utility commissions have had to balance the tasks of promoting competition and keeping residential service rates affordable. These tasks may well involve raising some rates to encourage competition (or to meet a statutory guideline, as in this docket) and lowering others to keep the competitive field level.

AARP has not shown that the rates proposed either by Qwest or by Staff are unaffordable. We note that from January 1984 until March 1993, rates for residential basic service exceeded $12.80, climbing as high as $16.05 in the 1986-87 period. Rates for residential service have not increased since 1993. What Qwest now proposes is an increase of 8 percent in Rate Group 1, 16 percent in Rate Group 2, and 23 percent in Rate Group 3. Staff proposes an increase of 8 percent in Rate Group 2 and 16 percent in Rate Group 3. We do not believe that these increases, the first in nine years, render basic telephone service unaffordable. For those customers to whom the increase presents a hardship, there are options. There are sources of public support, such as the Oregon Telephone Assistance Program, and there is the option of the 1MR rate at $6.37. Moreover, we find that the reductions in EAS prices and vertical services will benefit most ratepayers, such that their overall bill will increase little if at all.

As to AARP's policy argument that there is no competition for residential basic service in Oregon, the record shows that local service competition is beginning here and we wish to encourage it. Raising prices to improve the margin for potential competitors is one way to do so. AARP has not convinced us that we may not raise residential rates in this proceeding.

The next issue confronting us is whether to do so. ORS 759.425(3)(c) directs us to "seek to limit the difference between the price a telecommunications utility may charge for basic telephone service and the benchmark." We considered the meaning of this phrase in Order No. 00-312 (UM 731). In that order, at 22, we stated:

> Use of the phrase "seek to limit," rather than "shall eliminate," is an indication that the legislature understood the flexibility we need, in both time and method, to replace implicit supports with explicit supports as the industry embraces competition. We intend to rebalance telephone rates after this order issues. We will address issues about how rates should be structured in those proceedings. We will seek to minimize the difference between the price for basic telephone service and the benchmark. However, we must keep in mind other considerations, such as the affordability of basic telephone rates – ORS 759.425 (SB 622) also directs us to ensure that basic telephone service is available at a reasonable and affordable rate.

The language of ORS 759.425 is a guideline for our rate setting and leaves us flexibility to meet our goal of affordable basic service as well. For this reason, we elect Staff's proposal, which raises rates in two rate groups and leaves then unchanged in Rate Group 1, the group containing about 90 percent of Qwest's ratepayers. We find that Staff's proposal is well balanced and takes into consideration costs as well as movement toward the benchmark. Thus, we seek to limit the difference between basic service rates and the benchmark by modest increases in less urban rate groups. We note again that ratepayers will benefit in this case from reductions in many other categories. We adopt Staff's local exchange rate proposal in its entirety.

ORDER

IT IS ORDERED that:

1. Advice No. 1849, filed by Qwest on November 15, 2000, including Attachment B and Transmittal No. 2000-007-PL, Revisions to the Access Service Tariff, Private Line Transport Services Tariff, and the Exchange and Network Service Tariff and Price List; and the modified portion of Attachment B filed on March 19, 2001, are permanently suspended.

2. Qwest shall file by October 12, 2001, revised rate schedules consistent with the findings of fact and conclusions of law in this order, to be effective no later than January 1, 2002.

Made, entered, and effective ______________________________.

______________________________	______________________________
Roy Hemmingway Chairman	**Lee Beyer** Commissioner
	______________________________
	Joan H. Smith Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order to a court pursuant to applicable law.