BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

Case No. TR-85-176

In the matter of Continental Telephone Company of Missouri, headquartered in Wentzville, Missouri, for authority to file tariffs increasing rates for local exchange access line service provided to customers in selected exchanges in the Missouri service area of the company.

APPEARANCES: W.R. England, III, Attorney at Law, Hawkins, Brydon & Swearengen, P.C., P.O. Box 456, Jefferson City, Missouri, 65102, for Continental Telephone Company of Missouri.

Joni K. Ott, Assistant Public Counsel, P.O. Box 7800, Jefferson City, Missouri, 65102, for Office of the Public Counsel and The Public.

Linda K. Malinowski, Assistant General Counsel, P.O. Box 360, Jefferson City, Missouri, 65102, for Staff of the Missouri Public Service Commission.

REPORT AND ORDER

On December 12, 1984, Continental Telephone Company of Missouri (Company or Continental) submitted to this Commission revised tariffs for telephone service rendered in fourteen (14) of its Missouri telephone exchanges. The exchanges affected are: Blue Eye, Branson, Branson West, Cleveland, Fordland, Forsyth, Highlandville, Kimberling City, Mano, Ozark, Peculiar, Reeds Spring, Rockaway Beach and Sparta.

The purpose of the tariff filing was to revise rates in these fourteen (14) exchanges (1) to reflect the fact that as a result of Continental's current construction program in these fourteen (14) exchanges, service would be upgraded from one and four-party service to all one-party service; (2) to establish a uniformly flat rate throughout each exchange and thereby eliminate any zone or mileage charges; (3) to achieve a "revenue neutral" position so that while some customers might experience an increase in their individual rates other customers would experience a decrease in their rates and the overall revenue received by Continental under the revised tariffs would be the same as that received under the existing tariffs. The revised tariffs had a proposed effective date of February 1, 1985 although the rates would not go into actual effect in each exchange until the upgrading was completed in that exchange.

By orders dated January 31 and May 30, 1985, the Commission suspended the proposed effective date to December 1, 1985, unless otherwise ordered by the Commission, to allow sufficient time to determine if the proposed rates were just and reasonable. A procedural schedule was established for the filing of prefiled testimony and for a hearing of the issues. Company and Staff filed their prepared testimony and exhibits as required by the Commission and Continental notified its customers in these fourteen (14) exchanges of the upgrading of services, the proposed rate revision and the hearing scheduled to begin September 19, 1985. On September 10, 1985 and pursuant to Commission directive, representatives of Continental, the Staff and the Public Counsel participated in a prehearing conference. As a result of said prehearing conference it became apparent that there was only one issue to be resolved in this case. Testimony on that issue was taken on September 19, 1985, and the parties filed briefs in accordance with the briefing schedule.

Findings of Fact

Having considered all the competent and substantial evidence upon the whole record, the Missouri Public Service Commission makes the following findings of fact.

There appears to be no disagreement among the parties as to the reasonableness of Company's decision to upgrade these fourteen (14) exchanges to an all one-party system or as to the Company's decision to finance this construction via a loan obtained through the Rural Electrification Administration (REA). There appears to be no disagreement as to the revenue neutrality of the proposed revision of rates.

The issue in this case centers on whether Company should be allowed, as it proposes, to implement a flat-rate tariff for access to local exchange service throughout each exchange among the fourteen (14) exchanges in question and thereby eliminate any zone or mileage charges or whether to maintain, as Staff proposes, a rate differential between the Base Rate Area (BRA) and Outside the Base Rate Area (OBRA). Under Staff's proposal the mileage rates presently charged in these fourteen (14) exchanges would be eliminated and zone charges would be implemented for OBRA customers to reflect the higher cost of providing local exchange service outside the BRA. Public Counsel supports the rate revision proposed by Company in this case.

In support of its proposed, revised rates Company states that as a condition of obtaining financing from REA it was required to provide tariffs which eliminate mileage and zone charges for the lowest grade of service offered. Since the fourteen (14) exchanges have been, or will be, upgraded to all one-party service, Company is required to submit tariffs which eliminate mileage and zone charges entirely in the fourteen (14) exchanges. Company pointed out that, if the Commission requires zone charges in this case, it will jeopardize the Company's obtaining loan money for one-party upgrades in any exchanges where construction is not completed. Where the construction is incomplete the Company will have to change the one-party system to a combination one-party and four-party system or finance the completion with a more expensive, non-REA loan. In addition, the Company offered testimony which indicated that, if the Commission requires zone charges in this case, REA will not allow any Missouri telephone company to borrow REA funds for one-party upgrades unless the systems to be upgraded have, as an alternative, four-party service without zone and mileage charges.

Company states that the upgrading will benefit all customers in the fourteen (14) exchanges by raising their quality of service through reduced noise on the line, improved accuracy and speed of dialing and improved access of customers to each other because all customers will have one-party service; by eliminating the

Company's costs of investigating and solving problems involving party-line complaints; and by the generation of additional revenue through increased toll demands stimulated by access of all the customers to one-party service.

Communities of 1,500 population or less qualify for REA financing. However, REA has provided financing to a company that might serve a community larger than 1,500 population, if that were the only way that people in the rural areas surrounding the town could get service. In the instant case, three (3) exchanges would not be eligible for REA financing, if not for their rural OBRA subscribers. This is because the three (3) exchanges do not meet the rural test under the Rural Electrification Act. Company states that since 51% of the money spent will benefit rural subscribers, all subscriber construction in the three (3) exchanges can be financed with REA funds.

Based on the above considerations, Company feels its proposed flat-rate tariffs are justified since all customers in the fourteen (14) exchanges benefit from the upgrade and from the lower cost of financing the upgrade through a loan sponsored by the REA.

Staff has two (2) major objections to the Company's proposed tariff revision. First, Staff states that the tariffs are inequitable since customers OBRA will experience greater benefits from the upgrade than will BRA customers. BRA customers had one-party service prior to upgrade and the majority of customers OBRA did not have one-party service prior to upgrade. Without zone charges, OBRA customers will pay no more and in some cases less than the BRA customers who will experience less of the upgrade benefit and are less costly to serve.

Second, Staff feels that the REA, by requiring borrowers to have no zone or mileage charges for the lowest level of service in the upgraded exchanges, is engaging in de facto ratemaking in the State of Missouri. Staff states that such de facto ratemaking is beyond the authority of the REA.

The Company responds to these objections of Staff by stating that the REA's loan conditions are not an effort to preempt the Commission's statutory duty to fix rates and frame rate design but are simply a condition of financing. Further, Company disagrees with Staff's charge that the proposed flat-rates are not equitable. Company states that if Staff is trying to recover the cost of service, then its zone charges are too low; if, on the other hand, Staff is trying to send a cost-causer signal, the signal is inappropriate in this situation. Company states that cost-causer signals are useful only where the customer has a choice to go a lesser level of service at a lower cost or reduce his cost by reducing his amount of usage. Since all the fourteen (14) exchanges are, or will be, upgraded to all one-party service, the customers in question have no alternative to the zone charges except termination of service or relocation inside the base rate area.

The Commission has been faced recently with two (2) cases that dealt with zone charges where the company was a borrower from REA. In the matter of Holway Telephone Company, 26 Mo.PSC (NS) 654 (1984) and In the Matter of Le-Ru Telephone Company, TR-84-132 (1984). In both those cases Staff recommended zone charges to reflect the difference in cost between customers inside and outside the base rate area. In both those cases the Commission concluded that the cost of extending service beyond the BRA is not the determinative consideration. Because the rate increase was so substantial in both those cases, the Commission determined that any additional charge would be unreasonable.

In the instant case, there is not the problem of a substantial rate increase with the zone charges as an addition to the increase. Therefore the Staff has asked for a clear directive as to Commission policy on zone and mileage charges, given its rulings in Holway and Le-Ru. In its testimony, Staff asked to know whether the Commission disapproves of zone and mileage charges per se or whether the Commission disapproves of zone and mileage charges because of REA requirements. The Commission can only partially answer the question as posed. The Commission is not against zone and mileage charges per se, nor is it in favor of them regardless of the consequences. The REA requirements are a factor to be considered along with other factors. Where the non-REA factors arguing for such charges are highly persuasive, the Commission will not overrule such charges just to ensure REA funding. Where such charges are clearly inappropriate the Commission will not order them merely to show its independence of the REA.

In this instance, the usefulness of such charges as a cost-related signal is suspect since the OBRA customer cannot choose to go to a less expensive level of service. When the upgrading is finished, the fourteen (14) exchanges involved in this case will offer one-party service only. Further, adopting zone charges in this case could jeopardize some of the remainder of Continental's REA financing as well as any one-party upgrades being proposed for REA financing by other companies. In this case, REA financing is less expensive than other sources of financing which can redound to the benefit of all of Continental's telephone customers. It would be imprudent to jeopardize such cost savings to all of Continental's customers. The company has persuaded this Commission that zone charges are inappropriate in this case.

There is no question that the balancing of the respective interests in this case is made more difficult by the REA's policy of the Rural Electrification Administration concerning zone charges. This Commission is not free to evaluate only the arguments concerning the cost justifications and equitable considerations concerning the application of zone charges in this case. Rather, it must also weigh in the balance the threat of REA money being withdrawn entirely from Continental's upgrade program, if the Commission concludes that zone charges are appropriate outside the base rate area for one-party service, unless the Commission also is willing to see Continental retain or re-establish four-party service without zone charges.

The Rural Electrification Administration witness in this case states that REA does not, and does not believe it can, establish rates or rate design within the State of Missouri. While this may be literally true, it is a point of semantics and not substance. The practical effect of the REA policy is that if REA disagrees with a state regulatory commission's local rate design for a local telephone company based on local costs and local considerations, then REA may withdraw future funding or require a redesign of the upgrade plans of local exchange companies to include four-party service without mileage or zone charges. REA's dollars are not provided to the states for the benefit of rural telephone customers unless the states implement the rate design acceptable to REA, which requires that no zone charges be implemented on the lowest grade of service available in a community. This means that the state regulatory agency has the choice of adopting the rate design conditions which REA has prescribed or foregoing federal dollars which the Congress has determined should be made available to the states for the benefit of rural telephone customers.

This Commission believes that the REA should reassess its national policy with regard to zone and mileage charges. State regulatory bodies are in a better position to assess the unique circumstances of each local exchange within their jurisdiction to determine whether or not zone or mileage charges are in the public interest.

Conclusions

The Missouri Public Service Commission has arrived at the following conclusions.

The Company is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 392, RSMo 1978. The Commission suspended Company's tariffs which are the subject of this proceeding under Section 392.230, RSMo 1978. The burden of proof to show the increased rates are just and reasonable is upon Company. The Commission may consider all facts which in its judgment have any bearing upon a proper determination of the setting of fair and reasonable rates. Based upon the evidence and the findings made above, the Commission has determined that the rates proposed by Company for access to local exchange service in the fourteen (14) exchanges in question are just and reasonable and should be allowed to go into effect.

It is, therefore,

ORDERED: 1. That pursuant to the findings and conclusions made in this Report and Order, the tariffs submitted to the Commission by Continental Telephone Company of Missouri on December 12, 1984, and resubmitted by said Company on September 19, 1985, are approved hereby and may be effective for service rendered on and after November 25, 1985.

ORDERED: 2. That by this Report and Order any objections not ruled upon heretofore are overruled and any outstanding motions are denied.

ORDERED: 3. That this Report and Order shall become effective on the 25th day of November, 1985.

BY THE COMMISSION

Harvey G. Hubbs

Harvey G. Hubbs
Secretary

(S E A L)

Steinmeier, Chm., Musgrave, Hendren
and Fischer, CC., Concur.
Mueller, C., dissents with opinion attached.

Dated at Jefferson City on this 15th day
of November, 1985.

Dissenting Opinion of
Commissioner Allan G. Mueller

Continental Telephone Company
Case No. TR-85-176

I respectfully dissent from the opinion of the majority in this case. It is my opinion that excessive and unreasonable restrictions placed on Continental by the Rural Electrification Administration (REA) through its loan agreement have inhibited this Commission's ability to reach an unbiased decision in this case.

The REA controls the purse strings through its general fund policies, which contain restrictive conditions that effectively conflict with this Commission's authority to set rates and regulate telephone service in the State of Missouri. In response to these restrictions, this Commission has opted to implement a rate design for all one-party service in fourteen (14) of Continental's exchanges which:

1. is contrary to the rate design previously approved for Continental's other one hundred twenty (120) exchanges in Missouri and therefore inconsistent with Company's policies, and
2. increases rates significantly for customers in the base rate area (BRA) who already have one-party service and will not have an upgrade of service because of the project.

With regard to point number two, Continental's four-party local exchange rates outside the base rate area (OBRA) are currently set at a higher rate level than the corresponding one-party base rate area (BRA) local exchange rate. While it may seem unreasonable that a lower grade of service would be at rates priced higher than a higher grade of service, one must surmise that the reason the Company has proposed and the Commission in the past has approved such a plan is because of the higher cost of providing service. Staff testified this is the reason the Company has proposed zone and mileage charges on one-party service in its other exchanges in the past, as recently as last year in its Wentzville toll center.

To ignore cost when considering the rate design for telephone service is diametrically opposed to the current pricing trends in the telecommunications industry.

Furthermore, Continental has not justified, as required by law, the elimination of mileage charges for these fourteen (14) exchanges. The cost relationship of outside plant facilities between the BRA and OBRA, which was performed by the Company, justifies an offset in rates between the BRA and OBRA. Rather than dispute the conclusions of its study, the Company wants the Commission to adopt the common one-party rate design so as not to jeopardize the Company's REA funding. These rates are unreasonable and force the BRA customers to pay for the upgrade in service for the OBRA customer.

The resulting rate design is a typical example of what happens when the federal bureaucracy dictates a blanket policy which all states must follow if they are to receive their share of the federal dollar. Blanket enforcement of such a policy totally disregards the impact of that policy in this circumstance. There must be an exception in this circumstance in order to be fair to ratepayers of Continental. In this case we see REA policy resulting in BRA customers, a minority, burdened with most of the cost for upgrading that portion of a telephone system which serves OBRA customers. This is unfair and inequitable.

In this case the Commission had the opportunity to hear testimony and ask questions of Company witness Mr. John Arnesen, the assistant administrator of the REA telephone division. In my opinion, Mr. Arnesen did not give a clear, definite answer as to whether or not the telephone company is precluded from receiving REA funds if the Missouri Commission orders one-party service with zone or mileage charges for OBRA customers. All of his yes and no answers were qualified in such a way that the precise policy of REA is unclear to me. Ms. Malinowski tried several times to get Mr. Arnesen to respond with a simple yes or no, however she gave up in vain (Transcript, page 71). Throughout his testimony and cross-examination, Mr. Arneson never states unequivocally that the REA will not lend money for a one-party upgrade allowing zone charges.

Mr. Arnesen's rebuttal testimony (Exhibit 6, page 6) states:

"I suspect company officials might find it difficult to explain to a rural customer why they may have to pay 50%, 100%, and possibly more for one-party service compared to the four-party rate if the cost differential is only 14.6%."

Nowhere in this case does the Staff recommend a 50%, 100%, or more rate increase for one-party service as compared to four-party service. However, I would challenge Company officials and Mr. Arnesen to explain to the 71 BRA customers in the Blue Eye exchange why they must pay 26% more for their existing one-party service, while the 1,241 OBRA four-party customers will only have to pay 4% to receive upgraded one-party service.

Mr. Arnesen (Testimony, page 6) tries to compare zone and mileage charges in an urban-suburban environment using an example of his newly-purchased home in the Washington, D.C area. He states that he is approximately four airline miles from the central office and is at the edge of the exchange boundary and pays no mileage or zone charges. That may be the case in Washington, D.C. However, let me remind the Commission that Southwestern Bell charges three different rates for premium flat rate service in the St. Louis area. The center zone, which is the City of St. Louis, pays \$11.60 per month. The first tier, the suburb of Webster Groves, pays \$12.10 per month and the second tier, the Kirkwood suburb, pays \$12.75 per month. These three areas are within 5.8 miles of one another. There are also three zone rates in the metropolitan St. Louis area for standard measured service, two-party measured service, and two-party flat rate service. Standard measured service also has distance and time charges based on mileage in the metropolitan St. Louis area. Therefore, it is not unusual for there to be zone charges in the metropolitan areas in the State of Missouri.

Mr. Arnesen, throughout his testimony and cross-examination, repeatedly points out the possibility of the Commission allowing zone charges for OBRA one-party service if the Company would provide for rural four-party service at a flat rate. In my opinion, this policy of the REA borders on stupidity. By requiring four-party service the Company would be taking a step backwards in telecommunications business. Both the Company and Staff testified as to the advantages of one-party service. These include eliminating party line disputes, eliminating many long distance billing problems, reducing maintenance costs by 41%, reducing field visits and elimination of party line CPE. In my opinion this REA policy tells state regulators, "if you do not do it our way, we're going to punish the Company and the ratepayers."

Finally, in my opinion, the result of this rate design on the Continental customers in these fourteen (14) exchanges is not in the public interest. Is it fair to increase the existing one-party residential customer rates, say in Branson, $2.15, from $8.20 to $10.35, while increasing the existing four-party residential rates in Branson $0.70, from $9.65 to $10.35? Isn't the four-party customer the one who will receive the improved telephone service by the upgrade to one-party service?

Mr. Paul Pederson of Staff testified and no one refuted him, that the multiline customers who would be upgraded to one-party service, would receive the greatest benefits. These benefits include one hundred percent access to the network, elimination of party line disputes, privacy, the elimination of long distance billing problems and toll fraud, the elimination of ringer changes in telephone sets, and the customer would be provided with options of alarm circuits, usage pricing, data computer circuits, customer premise equipment compatibility and automatic answering devices.

The Company and Public Counsel have argued that there are "shared" benefits such as less noise on the line while dialing, accuracy in dialing, less maintenance and therefore less cost to the Company. Is it logical that the "shared" benefits received by the existing one-party BRA customers are worth more ($2.15 increase in rates) than the combined benefits, that is, the physical upgrade plus shared benefits received by the four-party customers outside the BRA (only a $.70 increase)? I think not.

Normally, one would suspect in this situation that the majority of the telephone customers would be in the base rate area. However, in this case we find the exact opposite. In all fourteen (14) exchanges, there are 8,736 BRA customers and 15,007 OBRA customers. The most dramatic example of this is the Blue Eye exchange which has 71 BRA customers and 1,241 OBRA customers. It seems unfair and inequitable to place the burden of an upgrade of the entire system on the BRA customers who receive very little benefit. In all but four (4) of the exchanges, the one-party BRA customer will receive a 26% increase in telephone rates while the four-party OBRA customer will receive one-party service or increases ranging from 2% to 7%. Also, in each exchange, if you are outside the base rate area by one-half mile or more and have one-party service, at the present time you will receive a rate reduction. The amount of this reduction will increase as one moves farther away from the base rate area. In order to illustrate this gross inequity, I have attached a map of the Branson exchange. At the present time, a one-party customer who is eight miles from the base rate area pays $45 ($8.20 base rate plus $36.80 mileage charge) for telephone service. Under the Company tariff, this customer will pay $10.35 which is 23% of his original charge or a 77% rate reduction. On the other hand, a residential one-party customer in the base rate area will see his rate increase from $8.20 to $10.35, an increase of 26%.

It appears to me that the dictates of the REA are the true motivations behind this Commission's decision. No one has offered competent or substantial evidence which would justify the elimination of the current rate design preserving a cost relationship between the OBRA and BRA customers. The evidence is uncontroverted that an all one-party upgrade is in the public interest. The Company's proposal is unjustified and inequitable and does not send the proper message to all customers that costs and benefits should be shared.

Respectfully submitted,

Allan G. Mueller

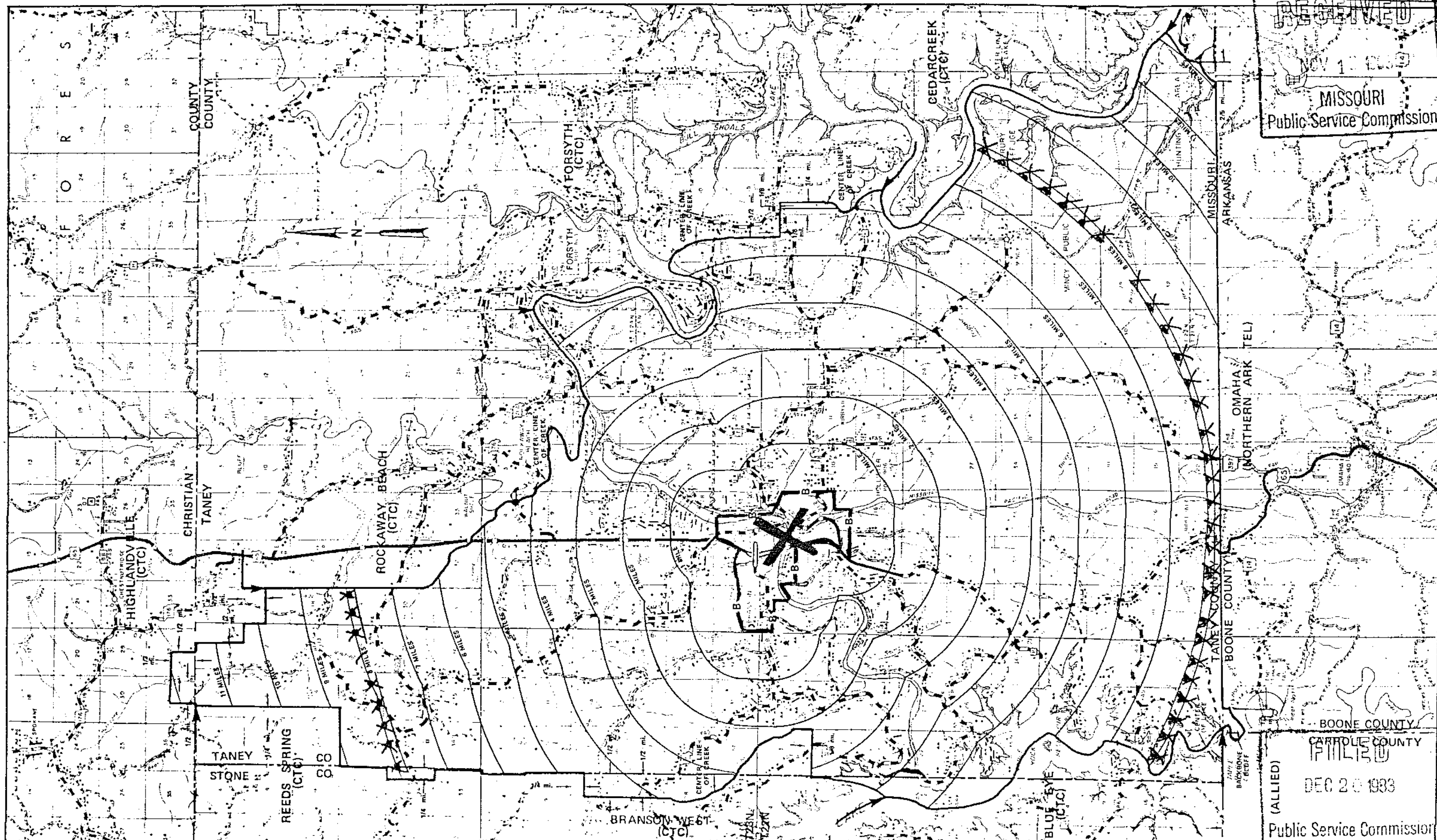
Allan G. Mueller
Commissioner

CONTINENTAL TELEPHONE COMPANY OF MISSOURI

PSC MO. NO. 2
Section A
3rd REVISED SHEET 14
Cancelling 2nd REVISED SHEET 14
Exchange BRANSON
County TANEY, CHRISTIAN & STONE

Legend
Base Rate Area ——B——B——B——
Exchange Boundary ————

EXCHANGE AREA MAP



Issued: NOV 21 1983

F. M. Harlan, Vice President
Wentzville, Missouri

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