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SERVICE DATE

SEP 2 9 1994

NOTE: An important notice to parties about administrative review appears at the end of this order.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	DOCKET NO. UT-911482
Complainant,	)	EIGHTH SUPPLEMENTAL ORDER
vs.	)	FINDINGS OF FACT, CONCLUSIONS OF LAW
INTERNATIONAL PACIFIC, INC.,	)	AND INITIAL ORDER SETTING REVENUE
Respondent.	)	REQUIREMENT, REFUNDS AND ASSESSING PENALTIES
. . . . .	)	

PROCEEDINGS: Commission Staff filed a complaint against International Pacific, Inc. ("IPI" or "company") on January 13, 1992. The complaint, as amended, alleged overearnings by IPI and that the company had failed to keep its books and records according to Commission regulations.

HEARINGS: Following prehearing conferences on February 24, and July 27, 1992, hearings in this case were held in Olympia on July 15 and 16, 1993, along with a telephone conference call on July 20, 1993, September 20, 21 and 22, 1993, November 17 and 18, 1993, and January 21, 1994, before Administrative Law Judge Rosemary Foster of the Office of Administrative Hearings. Briefs were submitted by IPI on May 19 and by Commission Staff on April 27 and July 5, 1994.

APPEARANCES: International Pacific, Inc. was represented by Douglas N. Owens, Attorney at Law, Seattle; Commission Staff was represented by Sally G. Johnston and Steven Smith, Assistant Attorneys General; and Northwest Pay Phone Association (NPPA) by Brooks Harlow, Attorney at Law, Seattle. NPPA intervened in this case but did not participate after the opening session. CSI Pay Telephone Investors Partnership (CSI), a member of the payphone association, was allowed to intervene but did not participate in the hearings.

SUMMARY: The initial order proposed by the Administrative Law Judge finds that the company has failed to keep its books and records according to Commission regulation and imposes an ongoing penalty of $1,000 each day for this violation. The initial order also finds that the company has excess earnings and recommends a 42.7 percent reduction in rates. The initial order requires the company to file tariffs consistent with this earning level. Refunds, with interest, are ordered effective as of the Commission's final order in this docket.

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I. SCOPE OF PROCEEDINGS

A. Procedural History

International Pacific, Inc. (also referred to as "IPI" or "the company") is an Alternative Operator Services ("AOS") provider[1] and a registered telecommunications company.[2] IPI operates in nine other state jurisdictions as well as the interstate jurisdiction.

On January 13, 1992, the Commission issued a complaint against IPI. The complaint included three claims for relief. The first claim for relief was subsequently withdrawn and dismissed by the First Supplemental Order, issued June 12, 1992, in this docket. The two remaining claims are summarized as follows:

> 2. The revenues produced by IPI's tariff rates may be unjust, unfair, or unreasonable in that they may produce greater than reasonable compensation for services provided, in contravention of RCW 80.36.080.
>
> 3. IPI has failed to keep its books and records in accordance with the Uniform System of Accounts as required by WAC 480-120-031, and is therefore subject to a civil penalty of up to $1,000 per day.

Eight days of hearing were held on the two remaining claims.

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[1]An AOS provider is defined as:

> . . . a person providing a connection to intrastate or interstate long-distance services from places including, but not limited to, hotels, motels, hospitals, and customer-owned pay telephones. RCW 80.36.520.

[2]A telecommunications company is defined as:

> . . . every corporation, company, association, joint stock association, partnership and person, their lessees, trustees or receivers appointed by any court whatsoever, and every city or town owning, operating or managing any facilities used to provide telecommunications for hire, sale, or resale to the general public within this state. RCW 80.04.010.

In two related dockets (U-89-2603-P and UT-920546), IPI sought to be classified as a competitive telecommunications company pursuant to RCW 80.36.310 and .320. These petitions were denied in final orders from the Commission dated July 24, 1990, and September 21, 1993, respectively.

A protective order was issued in this case on March 12, 1993. Portions of this record which concern commission fee data from IPI and the AOS industry are covered by several other protective orders. See Docket No. 93-2-00820-9 and Docket No. 93-2-0082107 in Thurston County Superior Court and Docket No. 93-2-00141-8 in Snohomish County Superior Court.

On September 22, 1993, the Fifth Supplemental Order was issued by the presiding officer declaring all the claimed material nonconfidential except information concerning IPI's payments of commissions to aggregators. IPI appealed this order to the Commission and in the Sixth Supplemental Order, issued November 23, 1993, the Commission deferred consideration of the confidentiality issue until its final order in this docket is issued. Under these circumstances, the text of this initial order will be nonconfidential and, where necessary, will refer to issues between the Commission Staff and the company in general terms. The attachments to the initial order will include the confidential information and figures in order to preserve the company's claims of confidentiality for further consideration by the Commission. As of May 19, 1994, the date the company filed its brief, IPI released its claim of confidentiality regarding 1991 data, except for information on "...IPI's commission fees and information that could be used to compute such fees..." See p. 91, Company brief. The company indicated that it would not object to a finding that "...evidence originally admitted as confidential, other than its commission fees and portrayals of revenues and expenses that could be used to calculate such fees, is not confidential trade secret information." Ibid., p. 92-93. The company went on to offer to prepare an inventory of the record to show nonconfidential information that had been received as confidential. The initial order will require that the company prepare such an inventory for the Commission's consideration prior to issuance of the final order. Preparing this inventory will be particularly helpful as it will clear up any doubt as to what remains confidential in the existing record, i.e. if there is some question as to whether a given figure can be used to derive the amount of a commission fee payment, it will be the company that makes the decision whether such a figure is susceptible to deriving information which it claims is confidential.

WAC 480-120-021 defines an alternate operator services company as:

> . . . any corporation, company, partnership, or person other than a local exchange company providing a connection to intrastate or interstate long distance or to local services from locations of call aggregators. The term "operator services" in this rule means any intrastate telecommunications service provided to a call aggregator location that includes as a component any automatic or live assistance to a consumer to arrange for billing or completion, or both, of an intrastate telephone call through a method other than: Automatic completion with billing to the telephone from which the call originated; or completion through an access code used by the consumer with billing to an account previously established by the consumer with the carrier.

B. Background of the Company

International Pacific, Inc., is an alternate operator service company whose corporate offices are located in Spokane, Washington. It has approximately 160 employees. It has been conducting operations in Washington since 1988. In 1991, its Washington intrastate revenues represented 30.2 percent of total company revenues. The company earned over $9 million in revenues in 1991. In 1992, its revenues were approximately $16.5 million. By 1993, company revenues were estimated to be about $23 million.

During 1991, IPI entered into an affiliated relationship with N. A. Degerstrom who owned about 57 percent of IPI's 5,199,709 shares of stock. IPI had an accounts receivable financing contract with Mr. Degerstrom which was terminated in May, 1992. Under the contract, Mr. Degerstrom was to loan to IPI 85 percent of the amount of each invoice issued by IPI. The amount loaned by Mr. Degerstrom was secured, in part, by IPI's accounts receivables which were assigned by IPI to Mr. Degerstrom. This affiliated transaction was never approved by the Commission.

On May 8, 1992, 100 percent of IPI's stock was purchased by a holding company called International Pacific Holdings Corporation ("IPH"), which is also known as "Impact". Forty percent of IPH stock is held by Richard S. Cuissack, 33 percent by Bessemer Venture Partners and the remainder by IPI management including Louis Soumas, IPI's chief executive officer who owns 10 percent of the stock.

C. Description of AOS Service

An AOS company provides an operator service via connection to intrastate or interstate long distance or local

services from locations of call aggregators. WAC 480-120-021 defines a call aggregator as "...a person who, in the ordinary course of its operations, makes telephones available for intrastate service to the public or to users of its premises, including but not limited to hotels, motels, hospitals, campuses and pay telephones. The AOS market can be separated into two broad categories; the pay phone market, including phones located at convenience stores, grocery stores, restaurants, theaters and airports, and telephones found in hotels and motels, sometimes referred to as "hospitality" telephones. Approximately 92 percent of interstate traffic comes from payphones and seven plus percent comes from "hospitality" or hotel-motel traffic. (Exhibit CT-1, p. 9.) About 44 percent of its billable calls in the test year were Washington calls. IPI's Washington operations are a significant portion of IPI's total operations.

A provider of AOS is presubscribed to a specific pay telephone or "hospitality" room. The AOS receives and processes calls originated on the presubscribed telephone. This processing includes checking the payment source, i.e. whether it is by credit card, telephone calling card, or whether it is a collect call or a call billed to a third party. This check assures the validity of the claim for payment. When payment is verified, the call is routed to its destination.

If a caller wishes to use other than the presubscribed provider of AOS services at a given location, the caller may dial a series of numbers in order to gain access to their preferred carrier. When the local exchange company receives such a call, it is routed to the carrier corresponding to the access code transmitted to the local exchange company. This phenomenon, known as "dial around", allows callers to gain access to their preferred carrier rather than relying on the preferred carrier of the owner of the pay phone or the "hospitality" telephone.

Once the call is completed through the AOS provider, data is collected for billing purposes. Each call is rated according to the AOS tariff, charges for the call are calculated and this information is forwarded to the billing agent. IPI offers aggregators rate options from its tariff which include "A" rates, "B" rates, "C" rates, "D" rates, "E" rates and "F" rates. In practice, rate option "C" features the highest rates and it is the schedule most often selected by aggregators. Exhibit CT-1, p. 96. In IPI's case, its billing agent is Zero Plus Dialing, Inc. or "ZPDI". The billing agent has agreements with local exchange carriers and credit card companies to which calls can be charged. The billing agent then forwards the call data to the appropriate company and the local exchange company or credit card company enters the call data on the customer's bill. When the customer pays the bill to the local exchange company, the amount associated

with the AOS call is forwarded to the billing agent who, in turn, sends it to the AOS company.

The owner and operator of a pay phone or a "hospitality" or hotel/motel phone enter into an agreement with an AOS provider for provision of operator service. In the case of IPI, these agreements are verbal, of indefinite duration, and terminable at will by the aggregator. It is relatively simple for an aggregator to change from one AOS to another by simply reprogramming the payphone's computer from a central control point. The size of the commission to be paid to an aggregator at a given location may also vary and may be the subject of bidding for provision of operator services by more than one AOS company.

IPI is one of 53 registered AOS companies providing services in Washington. Exhibit T-17, p. 7. Most of these companies have lower rates for end users because they are governed by the prevailing rate benchmark set in WAC 480-120-141. However, IPI and several other AOS companies are not subject to this rule as the rule was instituted after they filed a tariff with the Commission and started doing business in this state.[3] In addition, local exchange companies such as U S West and GTE, also provide payphone services in Washington. They pay site commissions in the neighborhood of 14 percent.

IPI and its holding company, IPH or "Impact," enjoy a 50 percent share of the independent payphone provider market in Washington. (Commission Staff brief, p. 7.) IPI's rates are higher than those of other AOS companies and it enjoys considerable market power with aggregators as it bids for and pays for sites at a rate or commission fee at a rate higher, often substantially higher, than other AOS companies. Thus, the commission or rates paid for site locations are not cost based.

D. Evidence

1. Commission Staff Witnesses

Commission Staff presented the testimony and exhibits of Robert L. C. Damron, a Revenue Requirement Specialist 5. He testified regarding the company's compliance with accounting rules as well as the determination of IPI's revenue requirement including pro formed results of operations and rate base. Commission Staff also presented the testimony and exhibits of Thomas L. Wilson, a Utility Rate Research Specialist for the Commission. In this capacity, he has worked with the telecommunications industry, including the AOS industry, in Washington since 1986. He presented

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[3]This is because RCW 80.36.110 only allows Commission suspension of changes in tariffs.

the results of a subscriber commission survey of AOS providers in Washington. The results of this study serve as the basis for the Staff's recommended subscriber commission fee adjustment in this case.

Mr. Damron presented evidence regarding the company's compliance with Commission accounting rules, the company's revenue requirements, jurisdictional separations and IPI's actual capital structure and actual cost of capital. He indicated that IPI's rates of return were the highest he had observed during his years providing accounting analysis to the Commission since 1974. He recommended that the Commission adopt a total company approach to rate making in this case because of inadequacies in the company's recordkeeping, accounting and separations procedures. He also recommended rejection of the company's jurisdictional separations and cost studies. He recommended that the Commission adopt IPI's actual capital structure and actual cost of capital. He recommended a reduction in company rates of 42.86 percent based on overearnings during the test year, as well as a refund, with interest, back to the date of service of the complaint. He also indicated that the company was not in compliance with the Commission accounting rule found in WAC 480-120-031. Mr. Damron recommends a penalty assessment for each day the company remains out of compliance.

Mr. Wilson prepared a survey of 26, or approximately one half, of the AOS companies operating in Washington, as well as five LECs which provide AOS-type services. Based on the results of this survey, he recommends that the Commission adopt a benchmark figure of 22.32 percent as the industry average for subscriber commission fees. Application of this benchmark figure to IPI's operations results in substantially lower commission fees and, when combined with Mr. Damron's results of operations, substantially lower rates.

2. IPI Witnesses

IPI presented the testimony of five witnesses. Stephen D. Mean, chief financial and administrative officer of the company, testified concerning company accounting and recordkeeping practices. Sharon Siers, an IPI financial analyst, testified concerning transmission of company computer records.

Three witnesses were retained to appear on behalf of IPI. John T. Wenders, an economist and professor of economics at the University of Idaho, testified regarding the competitive nature of IPI's markets and the inappropriateness of rate of return regulation as applied to IPI. In the alternative, he asserts that if the Commission determines that rate of return regulation is appropriate for IPI, the Commission should not disallow subscriber commission fee payments and it should adopt a cost of capital for

IPI which is consistent with a forward-looking analysis of companies engaged in enterprises of comparable risk.

Lee Olch, senior manager, Ernst & Young Telecommunications Consulting, Seattle, testified concerning IPI's jurisdictional separations study and Commission Staff's critique of that study.

R. Ashley Lyman, associate professor, Economics Department, University of Idaho, Moscow, testified concerning the Staff subscriber commission fee study. He described various statistical and theoretical flaws in the study, including problems with self selection, random sampling, sample size and normal distribution.

IPI presents a variety of arguments regarding the issues raised by the complaint and the instant proceeding. Among other arguments, IPI urges that it was operating at a loss during the test period and therefore cannot be said to have excess earnings, that the Commission cannot use a total company approach to determine IPI's Washington intrastate revenue requirement, that the Commission cannot exclude IPI's properly incurred commission fee expenses, that the Staff's survey of the commission fees of AOS providers in Washington is defective and that the Commission lacks authority to impose penalties against IPI and to require refunds from IPI.

E. Burden of Proof

In an earnings complaint case, the burden of proof is on the moving party, in this instance, Commission Staff, to prove that the effective rates are unreasonable and to show noncompliance as charged in the complaint with the Commission's accounting rule found in WAC 480-120-031.

II. IPI's COMPLIANCE WITH THE COMMISSION"S ACCOUNTING RULES

A. Commission Staff Position

Item 3 of the complaint alleges that "IPI has failed to keep its books and records in accordance with the Uniform System of Accounts as required by WAC 480-120-031, and is therefore subject to a civil penalty of up to $1,000 per day."

In support of its allegation, the Staff offered the testimony of Robert Damron, the Commission Staff accounting witness who, among other things, testified that Staff initiated the investigation and visited the company's headquarter in Spokane in January, 1992, shortly after the complaint was filed. Staff ascertained that IPI's accounting records were not in compliance with the FCC's Part 32, Uniform System of Accounts, as required by

WAC 480-120-031. Staff further determined that IPI had not complied with the Commission's accounting rule. (See Exhibit CT-1, p. 16, Exhibit CT-69, p. 44 and T 728.) Staff did obtain a copy of the company's general ledger at the time of the visit. In addition, after the visit and in preparation for the hearings, IPI responded to data requests propounded by Staff. However, Mr. Damron characterized these responses as in many cases, incomplete, inadequate, or untimely. The differences between the parties over the conduct of discovery led to issuance of a discovery order, (See Second Supplemental Order, Interlocutory Order on Discovery, issued October 8, 1992) a portion of which IPI did not comply with. (See discussion at Section VII, C.) In addition, IPI challenged the Commission's accounting rule which resulted in a finding by the Thurston County Superior Court that "From May 16, 1991 to the present, WAC 480-120-031 was and is valid and enforceable." See Cause No. 92-2-01605-0, Order on Judicial Review of Agency Action and Declaratory Judgment, Conclusions of Law #10, Exhibit 10).

According to Mr. Damron, the company used its own accounting system. Ultimately, Staff propounded Staff Request 109 which states:

> When and if the Company converts its accounting system to comply with the Commission's rules and regulations to keep its books and records in accordance with the Uniform System of Accounts as required by WAC 480-120-031, please notify the Commission Staff by letter that the Company is in compliance so that Staff can visit the company's headquarters to verify compliance.

As of completion of the hearings and filing of briefs, the request remains unanswered. As counsel for IPI noted, "...the fact is that there isn't anything to report." T 351. At T 728, Mr. Mean, the company's chief financial and administrative officer was asked:

> Q. Have you ever kept a general ledger in accordance with 47 CFR, Part 32?
>
> A. No.

In a related docket involving the company's petition for competitive classification, UT-920546, Mr. Soumas, IPI's chief executive, characterized the Commission's accounting requirements as "nonsense". T 221 in Docket No. UT-920546.

IPI has offered several documents which it claims satisfied the requirements of the rule, including a mapping document and portions of its records which it attempted to mold into a Part 32 format. Staff reviewed these submissions and still maintains that the company has not complied with the rule where the

underlying data was not in a USOA format. Staff brief, p. 12. According to Staff, it is important for the records to be kept according to the rule in order to develop a reliable accounting analysis and to discharge the Commission's regulatory function to monitor the AOS industry. (See Exhibit CT-1, p. 18-19). In essence, according to Staff, the receipt of reliable financial information is essential to Staff's performance of its duties and the Commission's exercise of its decisionmaking functions.

Because the company exhibited a flagrant disregard for Commission regulations, the Commission Staff recommended imposition of a penalty of $1,000 per day for each day the company was not in compliance with this rule. This penalty would be imposed as of May 16, 1992, and, as of March 31, 1994, the total amount of the penalty would be $684,000 with an assessment of $1,000 per day for each day after March 31 until the company comes into compliance. Staff also asks that the Commission order the company to come into compliance with the rule, and to order the company to respond to Staff Request 109, and that a copy of its general ledger be provided which would show accounting changes from the company's current system to a 47 CFR, Part 32 system as required by the Commission's accounting rules.

B. Company Position

The company advances the following arguments claiming compliance with Commission accounting rules and challenging the Commission's authority to impose penalties.

First, IPI claims that Staff has not met its burden of proof under RCW 80.04.380 to show clear and convincing evidence to sustain a claim for penalties.

IPI also claims that the Staff has not demonstrated which category, Class A or Class B, IPI belongs in for purposes of application of WAC 480-120-031.

IPI further claims that the accounts it needs to perform its business functions differ from what is required in Part 32; that Part 32 allows use of internal account numbers, which IPI did; that IPI translated these accounts as well as it could to Part 32; that this approach is standard practice in the industry; and that neither Part 32 or the WAC rule require IPI to keep a general ledger according to Part 32.

IPI further contends that it tried to find out what the Commission wanted by way of accounting compliance and was not able to establish what was expected; and that Staff refused to answer an inquiry from IPI (data request No. 24) which would have advised the company which set of accounting rules apply to IPI, and that therefore the state should now be foreclosed from arguing that one

of the two separate systems of accounting rules in 47 CFR Part 32 apply to IPI.

IPI's legal arguments include its assertion that application of the rule of lenity is required in IPI's case. According to IPI, this means that if there is an ambiguity in a penal statute, the ambiguity must be resolved against the state. IPI would apply this provision to the claim for penalties and urge dismissal of the accounting rule violation portion of the complaint.

IPI also claims that no grounds for assessing penalties exist because the provision of subaccounts for particular aspects of IPI's operations requires that they be identified to the controlling account and the record in this case does not establish which accounts are controlling. In addition, IPI claims that the application of the WAC 480-120-031 accounting rule to AOS companies is deficient because it does not prescribe accounts that an AOS should follow.

IPI also asserts that even if the company is subject to a finding of penalties for violation of the rule, no violation can be imposed after January 21, 1994, the last day on which the record was open according to IPI.

IPI also claims that penalizing the company under the circumstances of this case would deny it due process of law because WAC 480-120-031 is unconstitutionally vague. Specifically, IPI claims that nothing in the rule as it existed until April 22, 1993, would keep the company from using GAAP and then providing the required reports after translation to Part 32, a practice which IPI claims was industry wide. IPI also maintains that the rule is vague in lacking a definition of the term "original books of account" and in requiring original books of account to be kept exclusively with account numbers according to Part 32. IPI also claims that neither the rule or Part 32 contains complete coverage of the accounting requirements for an AOS company. IPI notes that WAC 480-120-031 was amended, effective March or April 22, 1993, (See IPI brief, p. 23) to add the requirement that IPI obtain Commission approval prior to using accounting methods not authorized in the rule. According to IPI, this means that the amendment changed the law which previously existed, and therefore, IPI cannot be penalized for failure to obtain Commission approval to use another accounting method for periods of time prior to April 22, 1993, the effective date of the amendment. In addition, IPI claims that the requirement of prior approval does not apply to GAAP adopted in the October 1, 1991, version of the USOA. Since 47 CFR Section 32.12 is claimed by IPI to have been unconstitutionally vague as to the extent that use of GAAP is allowed by the USOA, then IPI may not be penalized for dates after April 22, 1993, for violation of the rule. IPI claims that since application of WAC

480-120-031 would be unconstitutional as to IPI, the claim for penalties should be dismissed.

IPI also claims that penalizing the company under the circumstances of this case would deny the company equal protection of the law. In essence, IPI argues that WAC 480-120-031 is being applied by the state in a discriminatory manner, i.e. against IPI but not other companies who are similarly situated.

Finally, IPI contends that the penalties sought in this case violate the Washington Constitution Art. I, Section 14 provision that "...excessive fines...are prohibited."

C. Staff Response to IPI Legal Arguments Regarding Penalties

In its reply brief, Commission Staff responded to the company's arguments. Staff asserted that the company clearly was not in compliance with the accounting rule.

With regard to IPI's legal arguments, Staff maintained that WAC 480-120-031 is not unconstitutionally vague and is legally valid and enforceable.

According to Staff, IPI is clearly a Class B carrier and it cannot be heard to claim confusion as to what was required to comply with WAC 480-120-031.

Staff asserts with regard to the denial of equal protection argument, that the fact that other carriers may do the same things that IPI has been complained against for doing does not mean the company has been denied equal protection due to the filing and prosecution of this complaint.

Staff downplays IPI's alleged confusion about proper treatment of accounts under Part 32 by pointing out that Part 32 can be adapted to meet a broad range of individual company accounting requirements.

Staff maintains that IPI's noncompliance with the rule did not end on the last day of hearing but has continued on to the date of filing of the Staff's reply brief as there has been no motion to reopen by IPI to show compliance with the rule.

D. Discussion

The evidence and testimony presented during this hearing clearly establish that IPI's financial reports and records do not comport with WAC 480-120-031 and 47 CFR Part 32, that IPI has consistently refused to comply with this requirement, and that IPI will continue to refuse to comply until forced to do so.

The fact that the Part 32 reporting format does not precisely fit the AOS industry does not absolve IPI from its responsibility to maintain its financial accounts, records and reports in a Part 32 format or a Commission approved format which can be readily translated. Part 32 is specifically designed to meet a broad range of individual company accounting requirements. IPI is a regulated telecommunications company, and, as such, is required to keep financial records and render reports in a format which allows the Commission to discharge its regulatory responsibilities. This record does not establish that such a requirement is overly burdensome to IPI, but only establishes that IPI does not wish to be regulated. The record does not support IPI's contention that the company has earnestly attempted to comply as best it could, but instead establishes that IPI has resisted any and all attempts to force IPI to provide meaningful financial data. Commission Staff has proved its case by clear and convincing evidence, rendering IPI's argument regarding the burden of proof standard irrelevant. IPI is clearly a Class "B" carrier as defined by WAC 480-120-031 and 47 CFR Part 32. WAC 480-120-031 requires that a regulated telecommunications company such as IPI keep financial records in accordance with the Federal Communications Commission's Uniform System of Accounts as set forth at 47 CFR Part 32. IPI's financial records simply do not comply with Part 32 requirements. The variations between IPI's records and what is required are fundamental rather than technical in nature. IPI's annual reports filed with the Commission are not in a prescribed USOA Part 32 format. The company's general ledger and supporting financial records, including lotus files, reflect IPI's own accounting system rather than the prescribed format. During the course of this hearing, IPI, in responding to Commission Staff data requests, has at times attempted to mold some responses into a Part 32 format, but the underlying accounting detail was not in the prescribed format, and the company was unwilling or unable to map the detailed information from IPI's system to a Part 32 format. This rendered much of the information useless, and clearly demonstrates the necessity of maintaining financial records in the prescribed format. Part 32 contains some 60 pages of printed material. It provides very specific definitions as to what account numbers will be used for various items of income and expense. It provides detailed definitions and guidelines for almost every conceivable situation a regulated telecommunications company might face. It fully complies with Generally Accepted Accounting Principles (GAAP), and is generally accepted in the industry. The Commission's accounting requirements are not "nonsense" as characterized by IPI's chief executive in a companion case, Docket No. UT-920546. The Commission has statutory responsibility to regulate companies such as IPI. In order to discharge this responsibility, the Commission must have accurate accounting and financial information in a standardized format. WAC 480-120-031 and Part 32 are a reasonable and necessary means of meeting that need.

IPI's refusal to maintain financial records in compliance with WAC 480-120-031 is longstanding, deliberate and ongoing. IPI has been aware of the requirements of the rule for several years, and has simply refused to comply. Commission Staff has on numerous occasions requested and demanded financial reports and records and supporting financial details in a Part 32 format and IPI has refused or failed to comply. IPI has litigated the validity of WAC 480-120-031 and received a Superior Court decision finding the regulation to be legal since May 16, 1991. Still IPI has refused to comply. At the close of this hearing, there was no evidence IPI has any intention of doing so in the future. This refusal has seriously hindered Commission Staff's efforts to gather information for this proceeding, and will make future regulatory efforts difficult or impossible. IPI has demonstrated no cogent reason for refusing to maintain financial records according to a Part 32 format. Indeed, IPI's refusal appears to simply be a part of the company's ongoing efforts to delay and obstruct the regulatory process. A financial penalty of the size and magnitude requested by Commission Staff in this proceeding is a very serious matter and should not be imposed except under the most extreme circumstances. However, there is no real doubt that IPI will continue to refuse to maintain and provide financial records in a Part 32 format or acceptable alternative unless and until forced to do so. So long as IPI can delay and avoid the regulatory process, it will continue to earn substantial profits, as discussed below, at public expense. Under these circumstances, there is no alternative. IPI should be assessed a penalty of $1,000 per day from May 16, 1992, until the company fully complies with the requirements of WAC 480-120-031 and 47 CFR Part 32. This penalty may be ameliorated when and if IPI does comply.

III. ISSUES AND GOVERNING PRINCIPLES

The ultimate determination to be made by the Commission in this case is whether the revenues produced by IPI's tariff rates are unjust, unfair, or unreasonable in that they produce greater than reasonable compensation for services provided in contravention of RCW 80.36.080.[4] These questions are resolved by establishing the fair value of the company's property in service, determining the proper rate of return permitted the company on that property, and then ascertaining the appropriate spread of rates charged various customers to recover that return.

The purpose of a rate proceeding is to develop evidence from which the Commission may determine the following:

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[4]RCW 80.36.080 provides in part: All rates, tolls, contracts and charges . . . for telecommunications companies, for messages, conversations, services rendered and equipment and facilities supplied . . . shall be fair, just, reasonable and sufficient. . .

1. The most appropriate test period, which is defined as the most recent 12-month period, in which income statements and balance sheets are available. The test period is used for the investigation of the company's operations for the purposes of these proceedings;

2. The company's results of operations for the appropriate test period, adjusted for unusual events during the test period and for known and measurable events;

3. The appropriate rate base which is derived from the balance sheets of the test period. The rate base represents the net book value of assets provided by investors' funds which are used and useful in providing utility service to the public;

4. An appropriate rate of return the company is authorized to earn on the rate base established by the Commission;

5. Any existing revenue deficiency or excess; and

6. The allocation of the rate reduction, if any, fairly and equitably among the company's ratepayers.

IV. APPLICABLE STATUTES AND RULES

There are a number of applicable statutes and rules governing the operations of a regulated telecommunications company providing service in Washington. In this case, many of these provisions will be addressed and cited in connection with the particular issue under discussion. However, certain statutes have a bearing on many of the decisions to be made in this case. For example, RCW 80.01.040(3) provides, in part, that it is the Commission's duty to:

> Regulate in the public interest, as provided by the public service laws, the rates...of all persons engaging within this state in the business of supplying any utility service...including...telecommunications companies...

RCW 80.36.080 provides, in part, that:
All rates...of telecommunications companies...

> shall be fair, just, reasonable and sufficient...

The Commission is required to adhere to the just and reasonable rate standard which is mandated by RCW 80.36.140:

> Whenever the Commission shall find, after a hearing had upon its own motion or upon complaint, that the rates...charged...by any...telecommunications company...are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in anyway in violation of the provisions of law, or that such rates...are insufficient to yield reasonable compensation for the service rendered, the Commission shall determine the just and reasonable rates...to be thereafter observed and in force, and fix the same by order as provided in this title.

With respect to alternate operator services companies in general, RCW 80.36.510 through 530 were enacted in 1988 and 1990 to provide for disclosure of rates to consumers, for AOS registration with the Commission, and to make failure to disclose information regarding rates, charges or fees of AOS service a deceptive trade practice. RCW 80.36.510 sets out as part of the legislative finding regarding AOS companies:

> ...that a growing number of companies provide in a non-residential setting, telecommunications services necessary to long distance service without disclosing the services provided or the rate, charge or fee...

V. COMMISSION RATEMAKING PROCEDURES

In investigating the second claim for relief in the complaint, Commission Staff followed the rate of return-rate base approach using an historical test year to measure the company's revenue requirements. The results of the investigation were then tested using the operating ratio approach. Both of these methods have been utilized in many Commission cases as proper methods for determining revenue requirements

In this case, IPI claimed that the ratemaking methods referred to above were not appropriate for IPI. See IPI brief, p. 52. In part, this claim is based on IPI's claimed status as a competitive telecommunications company and/or because rate of return regulation is simply not appropriate for IPI or AOS

companies. (See Prof. Wenders, Exhibit T-42, p.27) IPI's witnesses do not suggest an alternative method of regulation.

These arguments have been reviewed and are hereby rejected. In fact, IPI has been found not to be a competitive telecommunications company in two previous cases. (See Section I B). As an AOS company, it is subject to the Commission statutes and rules governing alternative operator services. The propriety and legality of these statutes and rules cannot be challenged in a hearing before the Commission as the Commission is bound by its statutes and rules. To the extent these arguments have any validity, they must be addressed in another forum or in superior court on appeal. Finally, while IPI has objected to the exercise of jurisdiction and Commission authority over the company, it has not offered any viable alternative to the regulatory format applicable to all AOS companies in Washington. For these reasons, IPI's challenges and objections to the Commission's regulatory process and the instant rate case are rejected.

VI. TEST PERIOD

The twelve months ending December 31, 1991, is the test period to be used in this case. This was the latest period for which data was available when Commission Staff filed its complaint and commenced its investigation in January, 1992. IPI also presented its financial data using a 1991 test period.

VII. THE JURISDICTIONAL SEPARATIONS ISSUE

IPI conducts AOS activities in Washington as well as at least nine other states and on an interstate basis. Jurisdictional separations is the process by which the expenses of providing service are divided among the various state jurisdictions and the federal jurisdiction for ratemaking purposes. Jurisdictional separations are intended to allocate investment and expense to reasonable measures of relative use.

A. Commission Staff Position

Normally a company's Washington revenue requirement is determined based on revenues and expenses associated with providing service in Washington. However, in this case, because the Commission Staff considered IPI's recordkeeping too incomplete and its allocations between the Washington and other jurisdictions too simplistic, Commission Staff proposes that the company's Washington revenue requirement be determined on a total company basis, i.e. the revenue requirement for the total company is determined and then the Washington share is derived as a percentage from the total company figure. Although Staff did offer proposed adjustments to the separations offered by IPI, as an alternative recommendation, Staff still recommends that IPI's separations not be adopted for

purposes of this order as they are inadequate, and to do so would set a poor precedent for other regulated companies as well as not representing a meaningful breakdown of the level of expense attributable to Washington for Washington ratemaking purposes.

In responding to IPI's complaints about use of the total company approach, Staff notes that since IPI did not keep separated results in the 1991 test year, it is virtually impossible to go back and reconstruct such separated results after the fact. Staff also points out that even under the total company approach, the final order will only affect the Washington jurisdiction. Staff also notes that in a ratemaking proceeding before the Federal Communications Commission (FCC) involving IPI, the total company approach was used. (See CC Docket No. 91-330)

As a matter of law, Staff asserts that the Court of Appeals for the District of Columbia in a recent case, Crockett Tel. Co. et. al. v. Federal Communications Commission, 963 F.2d 1564 (D.C. Cir. 1992), held that the states could use residual ratemaking to set intrastate rates. Staff also points out that the Washington Commission has utilized the total company approach to set rates for other companies. See Staff brief, p. 32. As an alternative position, Staff offers adjustment's to IPI's cost study if, as an alternative to the total company approach, IPI's cost study is to be used for ratemaking in this case. See Staff brief, p. 34

B. IPI Position

IPI asserts a number of factual and legal bases in opposition to Staff's use of a total company approach to ratemaking in this case. IPI claims that the state has failed to prove that IPI's rates are excessive.

IPI also asserts that the state lacks a statutory basis to proceed on a jurisdictionally unseparated basis. Specifically, IPI claims that RCW 80.04.250 requires that the Commission determine the fair value for ratemaking purposes of the company's property which is used and useful for service. IPI claims that the state has not in this case valued IPI's property which is used and useful in providing telephone service as required by the statute. IPI rejects the Allied Daily Newspapers case relied upon by Staff as applying RCW 81.04.250, not 80.04.250 which contains the used and useful language. According to IPI, revenues and expenses must be segregated into Washington intrastate amounts in order to avoid an arbitrary result. Under these circumstances, IPI claims that the Staff has not made out a prima facie case that IPI's rates are excessive.

IPI also rejects Staff's reliance on the Crocket case by pointing out that the court in that case was not interpreting RCW

80.04.250, and that there is no "average schedule" in this case derived from comparable AOS companies that can be used as a surrogate for separating interstate and intrastate results. IPI claims that residual ratemaking presupposes a lack of a cost study and in this case, IPI did produce a cost study. IPI also objects to the taking of judicial notice of previous Commission decisions under WAC 480-09-750, the Commission's official notice rule, because the requirements of this rule have not been met. IPI brief, p. 37. IPI further maintains that it is prejudiced by failure of the state to follow its WAC regulation, and also objects because IPI was not a party to these previous cases. IPI goes on to argue that taking official notice in this manner will deny IPI a fair hearing.

IPI also asserts that the orders the Staff seeks to use against the company involved different parties other than IPI and have not been published in an index, as required by RCW 42.17.260(5), available to the public or that IPI had actual timely notice of these orders. See IPI brief, p. 38. Thus, according to IPI, these orders are not precedential on the question of whether unseparated results can be used to determine a company's revenue requirement. IPI argues that the mere fact that total company results were used in an earlier Commission case where the company did not challenge the use of the total company approach does not make such a case a dispositive precedent in the instant complaint case against IPI.

IPI goes on to argue that Staff incorrectly assumed that IPI was the moving party on the "separations" issue, and that Staff was incorrect when it did not ask for the information in Exhibits C-40, response to WUTC DR 301 (Exhibit C-9 data) and C-67 which was Mr. Mean's correction of Exhibit C-40 all of which were related to Exhibit C-9, the underlying workpapers associated with IPI's separations study. IPI asserts that Staff has failed to meet its burden of proof to show that IPI charged excessive rates and therefore, the burden of proof on this issue never shifted to IPI. See IPI brief, p. 39.

As it claims at other points in its brief, IPI asserts that Staff incorrectly argued that documentation of IPI's separations was insufficient. But, according to IPI, it cannot refute this claim due to the page limitation imposed by the presiding officer. IPI also raises this same page limitation argument in connection with Staff's claim that IPI withheld documentation in violation of an order on discovery issued in this docket.

IPI also challenges Staff's criticism of IPI's cost study particularly with regard to treatment of shared use of such items as non operator employee costs. See IPI brief, p. 41. IPI also urges that the state failed to show that IPI's cost study was

unreliable or that IPI was required by regulation to perform a cost study.

IPI argues that the separations figures which were offered by Staff at rebuttal should be disregarded because they were not offered in Staff's case in chief. IPI goes on to claim that these adjustments reflect the bias of Staff witness Damron against IPI and because of this bias, they should be disregarded. IPI also maintains that its billable calls allocator is more accurate than the Staff's proposed minutes of use allocator. IPI also asserts that Staff treatment of IPI's separations factors ignores a significant amount of IPI operating expense. See IPI brief, p. 50.

IPI claims that as it was operating at a loss during the test period, there can be no reduction in its rates. See IPI brief, p. 51. On this basis, the company moves to dismiss the complaint.

IPI claims that rate of return regulation is inappropriate for a company such as IPI which, as an AOS, is not similar to local exchange companies which have traditionally been subject to rate of return regulation. IPI also asserts that as it is operating in a competitive marketplace, imposing regulation is arbitrary.

Finally, IPI claims that imposing a rate reduction will favor IPI's competitors and will not produce a "level playing field" for AOS providers.

The testimony of Lee Olch, a separations expert, was offered to refute the Staff criticisms of IPI's cost study. See Exhibit T-23. Mr. Olch noted the dissimilarity between the types of investment of AOS companies when compared with local exchange companies. Mr. Olch also testified that the FCC allows use of shortcuts, estimates and samples to arrive at accurate separations. On this basis, Mr. Olch defends IPI's use of billable calls as an allocator as well as IPI's cost study which Mr. Olch asserts is preferable to the total company approach used by Staff.

C. Discussion

The total company approach is found to be the appropriate method for setting rates in this case. At one point in this proceeding, counsel for IPI offered to provide the Commission staff with separated Washington results. See Respondent's Response and Objections to Renewed Data Requests of Commission Staff, filed July 16, 1992, in this docket, at p. 8. The presiding officer relied on this representation by IPI's counsel and refers to it at several points in the Second Supplemental Order, Interlocutory Order on Discovery, issued October 8, 1992. At pp. 11 through 13,

the order refers to IPI's offer to provide separated results. At p. 12, the order states:

> It is clear from the record that IPI has deliberately waited until well into this proceeding to make the offer to provide intrastate results... assuming prompt good faith compliance, IPI's belated offer does remove the Commission Staff's stated reason for requesting information regarding interstate and out of state operations.

Based on counsel's representation that the Washington intrastate results would be provided, Staff's request for interstate or out of state results was denied. If intrastate results had been properly performed and provided, and assuming the documentation or work papers had been complete, the whole issue of whether total company results were required could possibly have been avoided. Because the Staff was forced to rely on the documentation provided by IPI, and this documentation was inadequate, (See T-131) the Staff was forced to adopt a total company approach in order to derive the company's revenue requirement. Even after commencement of the case and after discovery should have been complete, it became apparent that not all the workpapers supporting IPI's jurisdictional separations had been supplied. See Staff brief, p. 24. Under these circumstances, the company cannot be heard to complain about use of the total company method, where it is the company's inadequate recordkeeping, use of poor allocation methods and failure to respond or to respond completely to discovery, which necessitated the use of a total company approach.

Use of the 1991 test year has been found to be proper in this case as the time period closest to when the complaint was filed. During 1991, the record establishes that IPI did not keep its books of account, including its general ledger, on a 47 CFR Part 32 basis, or in a format which could be translated. IPI did not, as noted above, honor counsel's promise to provide separated data for Washington operations. The separations procedures and data proposed by IPI must be rejected as being wholly unsuited and inadequate for ratemaking purposes. Given the information available, Commission Staff had no realistic choice except to proceed on a total company basis. Case law and prior Commission practice support use of the total company approach where appropriate, and given the total circumstances of this case, Commission Staff's decision to proceed on a total company basis was entirely appropriate.

In this context, it should also be noted that the record, including exhibits and credible testimony, clearly establishes that IPI had excess earnings during the test year. Finally, it should also be noted that Commission Staff's use of a minutes of use

allocator is more appropriate than the billable calls allocator urged by IPI because minutes of use relates directly to cost causation.

VIII. RATE BASE

A. Introduction

RCW 80.04.250 provides, in part:

> The commission shall have power upon complaint or upon its own motion to ascertain and determine the fair market value for ratemaking purposes of the property of any public service company used and useful for service in this state...

The company and Commission Staff per books rate base figures are found in Attachment A, Table II. Stephen Mean, the company's chief financial and administrative officer, presented adjustments to IPI's ratebase and results of operations. Robert Damron for Commission Staff presented Staff's proposed adjustments to the company's rate base and results of operations.

B. End of Period and Average Rate Base

The company proposes use of an end of period rate base which in essence would set the rate base figure for use in the 1991 test year at the level of IPI's rate base as of December 31, 1991. IPI did not adjust its revenues and expenses to an end of period basis.

Commission Staff proposes use of an average of monthly averages rate base for the 1991 test year. Staff maintains that this is the approach traditionally used by the Commission for ratemaking purposes and that it offers the advantage of accurately reflecting the prospective percentage relationship of net income to rate base which is an objective of the historical test period approach. Staff also claims that use of an end of period rate base without making a comparable adjustment to company revenues and expenses results in a mismatch of revenues and expenses.

After review of the evidence and argument offered by the parties, the average of monthly averages approach will be accepted and adopted for purposes of this order. This approach is consistent with the methodology traditionally employed by the Commission for ratemaking purposes.

C. Adjustment RA-8 Investor-Supplied Working Capital

Commission staff proposes an adjustment to reflect the amount of investor supplied working capital. This adjustment is based on an analysis which identified the amount of total funds provided by investors. It is this amount upon which the company is entitled to a return.

IPI presented a lead-lag working capital analysis. A lead lag study is one method used in the measurement of investor supplied working capital. The study compares the lag in payment of expenses versus when they accrued to the lag in receipt of revenues versus when they are accrued. When expenses have a shorter lag than revenues, it indicates a positive cash working capital, which is a component of investor supplied working capital. Part of IPI's analysis takes into account weekly payment of subscriber commissions to site providers or aggregators. IPI did not supply the workpapers to support its lead-lag analysis.

Staff witness Damron's primary determination of working capital relied on the balance sheet approach. See Exhibit C-57, p. 57. This approach relies on a comparison of average capitalization and average investment during the test period. Mr. Damron's calculation does not include the negative equity capital he testified to related to the cost of money. Nor does it include any adjustment associated with the early payment of commission fees discussed below.

The investor supplied working capital approaches offered by the parties have been reviewed and the lead lag method as revised by Commission Staff will be accepted for purposes of this order. The Staff lead lag calculation in Exhibit C-76 has been modified to reflect the total company income statement in Attachment Table III. This conclusion is based on several factors. First, the company did not supply underlying work papers showing how its analysis was derived. Second, the record does not show that weekly payment of subscriber commissions is a standard industry practice. In addition, there is no indication that end user customers receive any more prompt, expeditious or efficient service as a result of paying subscriber commissions on a weekly basis. See Jewell v. Utils. & Transp. Comm'n, 90 Wn. 2d 775, 585 P.2d 1167 (1978). Third, the weekly payment of subscriber commissions is a business decision by IPI and is not one which end users should be required to finance. Finally, the investor supplied working capital adjustment proposed by Commission Staff properly reflects the amount of working capital required by the company and upon which it is entitled to earn a return.

Typically the Commission has adopted the balance sheet approach proposed by Staff. This initial order is not intended to

indicate disfavor with that methodology, however, due to the questions surrounding the actual and prudent levels of investor supplied capital, this order will adopt the lead lag study as proposed by Staff in this proceeding.

D. Conclusion

Attachment Table II shows the rate base found to be appropriate in this initial order.

IX. RESULTS OF OPERATIONS

A. Introduction

Review of a company's results of operations during the test year is an essential part of determining a revenue requirement which is fair, just and reasonable. In this case, the Commission Staff was forced to rely on financial information supplied by IPI as Staff had no independent source of information on the company's financial operations. As described elsewhere in this order, the company did not utilize the Uniform System of Accounts as required by WAC 480-120-031 but used its own system of accounts. When additional information was requested by data request, this information was sometimes produced, was sometimes complete, and other times was not complete and was not supplemented by the company. See p. 13 of Exhibit CT-1. This incomplete information added to the difficulty of creating fully proformed results of operations. An example of this arose in connection with a request by Staff that the company identify the duties of company non-operator employees and the time they spent providing service to the public. The company responded that it does not keep such records. As a result, the company reported that $677,669 was paid during the test year for non operator salaries and wages plus payroll taxes and other expenses. However, because additional information was not provided regarding these expenses, Staff recommends their disallowance unless the company can come up with more responsive information.

The company's net operating income (loss) per books for Washington intrastate operations for the test period is shown in Table IV of the Attachment to this order. Staff and the company proposed adjustments to the company's operating revenues. The booked results of the company's test period operations must be adjusted to remove amounts which are not representative or which are not properly included within the test period. This type of adjustment is referred to as a "restating actual" adjustment. Additional adjustments are made to test period results to give effect to known and measurable changes which are not offset by other factors occurring during or after the test year. These adjustments are called "pro forma" adjustments. Table IV of the Attachment sets forth the positions of the parties with regard to

Staff's proposed adjustments. Each adjustment will be discussed with reference to the Table IV figures which have been deemed confidential by prior order of the Commission.

B. Adjustment RA-1 Taxes to Actual

Commission Staff makes this adjustment to restate federal income taxes by eliminating the impact of prior year net operating loss carry-forward. The Staff adjustment also applies the prospective tax rate rather than the 1.364 percent assumed by IPI. IPI did not offer an adjustment RA-1, nor did it offer specific testimony contesting this adjustment.

The proposed adjustment RA-1 Taxes to Actual has been reviewed, is found to be proper and will be adopted for purposes of this order.

C. Adjustment RA-2 Reclassify Interest Expense

This Commission Staff adjustment removed interest expense from operating expenses which reclassifies the expense as a financial cost. Interest expense is recovered by the authorized rate of return. IPI also made this adjustment as "Other Interest Expense." The company adjustment removes $169 more than the Staff adjustment. This difference is related to the effect of the billable calls allocator used.

This adjustment is basically uncontested by the parties except for the jurisdiction separations issue which includes the effect of the billable calls allocator. The Staff's approach and figure will be adopted in this case.

D. Adjustment RA-3 Remove Other Income

Both Commission Staff and IPI sponsored an adjustment to remove $600 of "Other Income." The intrastate and total company amounts are the same because the total amount was assigned to Washington Intrastate operations.

The adjustment is uncontested. It has been reviewed and it appears to be proper and should be adopted.

E. Adjustment RA-4 Pro Forma Debt Adjustment

Commission Staff proposes this adjustment as a standard rate case adjustment. According to Staff, where the actual average capital structure and cost rates of debt are proposed to be used as they are in this case, the adjustment has very little impact. IPI does not make this adjustment, but would offer different figures for rate base, the interest rate and the tax rate.

The adjustment methodology proposed by Staff should be accepted and adopted for purposes of this order. The pro forma debt adjustment calculated by Staff in Exhibit C-70, page 12, is based on Staff's calculation of rate base. As this order's determination of rate base is different, Attachment Table VI shows this order's determination of the pro forma debt adjustment.

F. Adjustment RA-5 Reduce Subscriber Commissions

1. Staff proposal

Subscriber commission fees are paid by the AOS to an aggregator or hotel/motel operator to cover, at least in part, the cost of a site location for a pay telephone or a hotel-motel telephone. See description of service at Section I, C, above. In practice, the commission fee payment made by the AOS goes to the aggregator, may well not be related to the actual cost of providing service, and does not affect the quality of service received by the end-user.

The Commission has expressed continuing concern over the size of the commission fee payments and the absence of a relationship between the fee and the cost to provide service at the site. In the Commission's final order in the Payline case, Docket No. UT-911250, Second Supplemental Order, issued July 9, 1992, the Commission considered a proposed tariff increase filed by Payline, another AOS operating in Washington, which would charge Payline customers $1.00 per call to benefit location providers. In rejecting the tariff proposal, the Commission noted that under RCW 80.36.520, the Commission may determine whether AOS company charges are for the public convenience and advantage. In addition, the Commission can determine whether expenditures of a regulated utility are fair, just and reasonable and commensurate with the service, material, supplies and equipment received. See RCW 80.04.310. The Commission stated that it will not approve a location surcharge without a demonstration that the surcharge is required to meet reasonable costs of providing the service. The Commission maintained that such location surcharges are unreasonable to the extent that they exceeded the reasonable costs associated with providing the location. The Commission went on to indicate that it would disallow expenses that are undertaken imprudently by public utilities to the detriment of consumers and that it would reject tariffs that would collect revenues to fund disallowed expenses. In rejecting Payline's tariff, the Commission stated at p. 4:

> The Commission will not let unfettered bidding for locations--at the consumer's expense and with no incentive on the AOS to contain that expense--determine the consumer's charge. WAC 480-120-141 allows location surcharges based

> on the principle that reasonable costs of service must be paid. Here, there is no demonstration of the costs associated with the location.

It is against the backdrop of cases such as the Payline decision and the Commission efforts to address the commission fee problem that the Staff proposes a substantial adjustment to IPI's results of operations to bring down the level of commission fee expenses to an acceptable level for ratemaking purposes.

The Reduce Subscriber Commissions adjustment, proposed by Commission Staff, has the greatest impact of all the proposed adjustments to the company's results of operations in this case. Tom Wilson, a Commission Staff witness, presented a survey of commission fee payments made by other telecommunications companies operating in Washington. The survey included data from 28 companies or approximately one half of the companies competing for the relevant market in Washington. This survey found an average figure for commission fee payments. Mr. Wilson noted that the result of his study is very close to Federal Communications Commission (FCC) estimates for the amount of commission fees paid by smaller operator service providers. Based on this average figure, Commission Staff proposes this adjustment to reflect a benchmark level of subscriber commissions which will be allowed for ratemaking purposes. Staff recommends that the industry average level of subscriber commissions be considered by the Commission as the upper limit that will be allowed for ratemaking purposes in this case. This adjustment is based on the premise that before an expense is properly borne by ratepayers, it must provide a benefit to ratepayers. As witness Damron notes in his testimony, Exhibit CT-1, p. 80:

> For an expense to appropriately be included as an operating expense for ratemaking purposes, the expense must be prudently incurred to the benefit of ratepayers; i.e. it should be "used and useful" in the provision of service. The problem is how to apply this test to subscriber commissions.
>
> Without any cost records, there is no way to verify that the Subscriber Commissions the end-users are being asked to pay are "required to meet reasonable costs of providing the service", or that the Subscriber Commissions are or are not reasonable to cover the costs associated with providing the location.

Because of the level of existing subscriber commissions, the private payphone owner(PPO) or aggregator business has become very

profitable, with a well run PPO earning a substantial return on investment. T 947-952. And as noted in Exhibit C-26, p. 17, "... PPO's have room to receive substantially lower commissions and still have a robust business." According to Staff, the costs of providing service to "hospitality" or hotel/motel customers and payphone customers are basically the same from IPI's standpoint but IPI pays much higher commission fees in the payphone market. See Staff brief, p.54. This is because, according to Staff, the payphone market is less elastic, and therefore the market will bear the higher commission fees which are charged to end users. Staff brief, p. 55.

Staff goes on to propose, as an alternative treatment of the subscriber commission fee, to set the fee at the level of the fee paid in the hospitality market where the market is more elastic and the end-user has more alternatives, such as going to a different motel if the rate is too high. Adopting this proposal would represent a regulatory attempt to duplicate the effects of competition in the marketplace.

Another alternative would be to set allowable subscriber commission fees at zero on the theory that the company did not demonstrate on this record the costs to aggregators of providing locations. See Staff brief, p. 59 and Exhibit CT-1, p. 86.

Staff points out that acceptance of the commission fee adjustment will place IPI in a more competitive position in the aggregator market where now they have a significant advantage because of the high commission fees which they pay. According to Staff, acceptance of this adjustment would benefit other AOS companies whose rates are capped by WAC 480-120-141 by creating a more "level playing field" and allowing them to compete with IPI for market share. IPI claims that reduction of commission fees will put the company out of business. T-252-3. However, the company has the capability according to Staff to quickly adjust its expenses in response to changes in its level of revenues. See Staff brief, p 61 and T 210.

2. IPI's position

IPI's arguments against the proposed adjustment are based on several grounds.

IPI claims that if such a commission fee adjustment is made, it will put the company out of business. See testimony of Stephen Mean, Exhibit T-35.

IPI also offered the testimony of Dr. Ashley Lyman, an economist from the University of Idaho, who critiqued the Wilson commission fee study. He indicated that the results of the survey "might" be biased but found no concrete evidence of such bias.

In addition, IPI offered legal arguments against acceptance by the Commission of Staff's commission fee adjustment. IPI argues that the Commission lacks the legal authority to exclude from IPI's cost of service properly incurred commission fee expenses. See IPI brief, p. 56. IPI cites what it considers legal authority for the proposition that unsupported "policy" bases for excluding a company's actual expenses from ratemaking and therefore artificially reducing its revenue requirement will not be sustained by a reviewing court. See State ex rel Pac. Tel. & Tel. v. Public Service Commission, 19 Wn. 2d 200, 142 P.2d 498 (1943). IPI suggests that these precedents require a regulatory agency to act on evidence and not in an arbitrary manner in exercising its ratemaking function.

IPI claims that the Staff has not shown that IPI's commission fees are unreasonable and, in IPI's view, commission fee expenses are reasonable and prudent and related to its growth. IPI asserts that reviewing courts in Washington may view disallowance of an expense other than for imprudence as arbitrary or capricious or improper on some other ground within the scope of review under the APA. See IPI brief, p. 60.

IPI claims that Staff's alternative proposal to reduce the allowable level of subscriber commissions to the level paid in the hotel/motel market based on this market being considered a competitive market, would be arbitrary, without evidentiary support and overlooks IPI's position that the commission fees in both the "hospitality" or hotel/motel market and the pay phone market are the product of competitive forces. IPI also asserts that Staff has not met its burden of proof with respect to the commission fee adjustment. IPI claims that its expert, Dr. Wenders, testified that lowering prices in a price inelastic market to the level that prevails in the more elastic market will lower societal welfare. Exhibit CT-100, p. 4.

IPI urges that the adjustment is arbitrary, capricious and not supported by substantial evidence and that its acceptance denies IPI due process and equal protection of the law. IPI maintains that there is no proof that the commissions paid by other AOS companies in Washington are just, fair and reasonable for the aggregators served by IPI.

IPI argues that it is unconstitutional for the Commission to exclude IPI's actually paid commission fee expense for ratemaking purposes when the effect will be to enrich IPI's competitors at IPI's expense. IPI contends that it could not have known in 1991 what level of commission fee expense the commission would have considered acceptable for ratemaking purposes.

IPI further claims that the Staff failed to prove that the average commission fee is actually an average of the population

at issue. IPI claims that the Wilson survey is biased because it did not follow the normal distribution associated with a bell shaped curve and that data from intrastate operations, total company operations medians, simple averages and weighted averages were lumped together. IPI maintains that the survey was also biased because a smaller sample of five firms which provided intrastate and total company information was tested to confirm the data in the larger survey performed by Mr. Wilson. In addition, IPI claims that use of the survey is inappropriate because there is no proof that the conditions faced by the survey companies in Washington were the same conditions faced by IPI. Finally, IPI argues that the Staff adjustment is inappropriate because it fails to take into account reductions in revenues which IPI will experience with rates set through this proceeding.

3. Discussion

After careful review of the evidence and argument, the Staff's commission fee adjustment based on the results of the Wilson survey will be accepted. That is not to say that there is not a good argument to be made for setting IPI's allowable commission fee expenses at zero or based on the level of commissions paid on "hospitality" phones based upon the company's failure to demonstrate the actual amount of these expenses. However, in this case, it is fair to assume that IPI does have some costs associated with commission fee expenses but the record does not reflect what they are. These costs include such things as cost of a business line for a payphone which is necessary to maintain the site location. Under these circumstances, adopting the results of the Wilson study will give the company the benefit of the doubt as to these site related expenses while still protecting end use customers from the effects of "unfettered bidding" for locations as described in the Payline case.

The critique by Dr. Lyman of the Wilson study has been reviewed but will not be accepted as he found no evidence of actual bias or other defect which would undermine the results of the survey.

The initial order finds that the Wilson study is supported by the record and is suited for its particular purpose in this case. The study results are unbiased, and reasonable and should be adopted. The results of this study represent a sound basis upon which it is reasonable to find the appropriate level of commission fees for IPI's service based on an industry average for providers of similar service in Washington.

In addition, IPI's legal arguments against the commission fee adjustment have been analyzed and will be rejected for purposes of this initial order. The initial order finds that the reduced level of commission fee expense to be allowed in IPI's

rates is reasonable and is based on the product of Mr. Wilson's industry survey. As such, it is not arbitrary or irrational. Staff has met its burden of proof with respect to this adjustment. IPI's constitutional due process and equal protection arguments are rejected. As noted elsewhere in this order, the Commission lacks jurisdiction to hear constitutional challenges to its rules. Such challenges must be addressed on appeal to superior court. The record establishes that adopting this adjustment will not put IPI out of business but will serve to "level the playing field" in the AOS market and will protect end users from the expenses associated with what the Commission referred to as "unfettered bidding" in the Payline case. If IPI suffers a loss in revenues in the future, its remedy is to come back to the Commission and request a rate increase. Dr. Wenders' market analysis was rejected in the Commission's final order in Docket No. UT-920546, p. 8. and is rejected in this initial order.

Finally, IPI's argument that in 1991 it could not have known what level of commission fee expense would be acceptable for ratemaking purposes is rejected. A comparable argument is addressed in the section on refunds.

G. Adjustment RA-6 Remove A/R Financing

1. Factual circumstances underlying this adjustment

As indicated above in the section I, B of the order describing the company, during 1991, IPI had an affiliated relationship with N. A. Degerstrom. He owned approximately 57 percent of IPI's 5,199,709 shares of stock. IPI had an accounts receivable financing agreement with Mr. Degerstrom which terminated in May, 1992. Under this contract, Mr. Degerstrom loaned to IPI 85 percent of the amount of each invoice issued by IPI. The amount loaned by Mr. Degerstrom was secured, in part, by IPI's accounts receivable which were assigned by IPI to Mr. Degerstrom. This affiliated transaction was not reported to or approved by the Commission.

2. Chapter 80.16. RCW

RCW 80.16.020 requires that companies subject to Commission regulation obtain Commission approval of affiliated arrangements. RCW 80.16.030 allows payments to an affiliated interest to be excluded by the Commission from the accounts of the regulated company unless they are shown to be reasonable. The statute authorizes the Commission to disallow such payment or compensation, in whole or in part, in the absence of satisfactory proof that it is reasonable in amount.

In the proposed Staff adjustment, $59,871 is proposed for removal from the company's operating expenses. Under RCW 80.16.030, the burden is on the company to show the reasonableness of amounts associated with affiliated transactions. In this case, IPI did not produce evidence concerning the reasonableness of these payments. IPI has made the same adjustment in its proposed results of operations analysis. See Exhibit C-53.

The proposed Commission Staff adjustment has been reviewed. It represents a proper application of the statutes to the circumstances of the transaction between IPI and Mr. Degerstrom. The proposed Staff adjustment will be accepted and adopted for purposes of this initial order.

H. Adjustment RA-7 Remove Other Non-operating Expenses

Staff and the company removed certain nonoperating expenses from the company's results of operations. The amount of the adjustment is the same and is uncontested, except for the impact of jurisdictional separations issues. The adjustment as proposed by Staff is accepted for purposes of this order.

Commission Staff also proposed three pro forma adjustments which are discussed below.

I. Adjustment P-1 Increase Rental Expense

Commission Staff proposes this adjustment to give effect to changes in IPI's rental expense. IPI did not offer testimony on this adjustment. The adjustment has been reviewed, is correct, and should be adopted for purposes of this order.

J. Adjustment P-2 Decrease in Network Expenses

This Commission Staff adjustment is proposed to adjust to prospective network unit costs. (See Exhibit CT-1, p. 90 and Exhibit CT-69. IPI suggests that this adjustment is not a proper pro forma adjustment because it reflects growth or volume.

The adjustment has been reviewed and will be adopted for purposes of this order. The adjustment adjusts test period network unit costs to the prospective known and measurable unit cost. The units themselves were not adjusted for growth.

K. Adjustment P-3 Decrease in Billing & Collecting

This adjustment adjusts to the prospective unit cost for billing and collection expenses. IPI did not make such an adjustment to its own results of operations. However, it did not challenge the Staff adjustment.

The Staff adjustment has been reviewed, is found to be proper and will be adopted for purposes of this initial order.

L. Results of Operations Summary

Based on determination of specific adjustments set forth in this section, the initial order finds that the net operating income of the company during the test period, as adjusted, is as set forth in Attachment Table V.

X. RATE OF RETURN

A. Legal Principles

The governing principle for determining rates to be charged by a public utility is the right of the public on the one hand to be served at a reasonable charge, and the right of the company, on the other hand, to a fair return on the value of its property used in service. Establishing just and reasonable rate levels involves a balancing of investor and consumer interests. Federal Power Comm. v. Hope Natural Gas Co., 320 U.S. 591, 64 S. Ct. 281, 88 L Ed 333 (1944).

What is a reasonable rate of return is a question of fact, the determination of which calls for the exercise of common sense and sound judgment. A utility ordinarily is entitled to the opportunity to earn a rate of return sufficient to maintain its financial integrity, attract capital on reasonable terms, and receive a return comparable to other enterprises of corresponding risk. Bluefield Water Works Improvement Co. vs. PSC of West Virginia, 262 U.S. 679 (1923); Federal Power Comm. v. Hope Natural Gas Co., supra. The lowest reasonable rate is one that is not so unjust as to be confiscatory in the Constitutional sense. FPC v. Natural Gas Pipeline Co., 315 U.S. 575, 62 S. Ct. 736, 86 L. Ed. 1037 (1942); Duquesne Light Co. v. Barasch, 488 U. S. 299, 109 S. Ct. 609, 102 L. Ed. 2d 646 (1989).

In this case, IPI did not submit substantial evidence for Commission consideration in determining what should be the proper capital structure and rate of return. Commission Staff did offer some proposals which reflect the company's actual operational structure. However, as will be noted in the following sections, the figures for rate of return and capital structure can vary considerably but do not dramatically affect the company's revenue requirement. As Commission Staff witness Damron stated:

> In examining the cost of capital issue in this case, the Commission should keep in mind that the AOS industry is not a capital intensive industry. One could, therefore, make widely varied assumptions about the cost of capital,

> and this would not have a major impact on the total amount of the company's revenue requirement... ...although Staff is presenting its case on a total company basis, any rate changes from this proceeding will only affect the company's Washington operations. Hence, the Staff does not view the issue of the authorized return as a major dollar issue. See Exhibit CT-1, pp. 36-38.

B. Capital Structure, Cost of Debt, and Cost of Equity

Commission Staff recommended use of an actual capital structure for IPI. (See Exhibit CT-1, p. 43, 44 and 46.) Because IPI had negative equity for the 1991 test period, Staff assumed a zero equity component. This results in a capital structure which is 100 percent debt. Staff also calculated IPI's cost of debt as 11.88 percent. Staff noted that although IPI's stock had been acquired by a holding company in May, 1992, no new equity was infused back into IPI.

Staff also proposed some alternatives to use of the actual capital structure. For example, Staff suggested that if the company was able to lower its debt costs, it could achieve a return higher than the 11.88 percent recommended in this proceeding. Mr. Damron also discussed the effect of allowing rates of return at the 20 and 29 percent levels. In addition, Staff noted that if IPI's investors decide to infuse equity into the company, it could return to the Commission for a new determination of its cost of capital.

The capital structure proposed by Staff has been reviewed and is found to be proper for purposes of the initial order. The Commission Staff figures for capital structure and rate of return are those which are best supported in this record. It is noted that even if the 20 or 29 percent figures discussed by Mr. Damron were to be allowed as an acceptable rate of return, IPI would still be facing a rate reduction of 41.34 percent and 40.30 percent respectively. For these reasons, Staff's recommended capital structure of 100 percent debt and a cost of debt of 11.88 percent will be adopted for purposes of the initial order.

C. Rate of Return Summary

Based on the above decisions with respect to capital structure, and cost of debt, the overall rate of return for purposes of this initial order is found to be 11.88 percent, based upon a 100 percent cost of debt.

XI. TARIFF CONSIDERATIONS AND RATE DESIGN

Commission Staff notes that IPI offers aggregators rate options designated "A" rates, "B" rates, "C" rates, "D" rates, "E" rates and "F" rates. Rate option "C" offers the highest rates. Witness Damron recommends that any rate reduction apply to all of the company's Washington tariffed rates. See Exhibit CT-1, p. 97. Staff also notes that the company's tariff is Exhibit 30 in this docket. Staff points out that a problem exists with regard to application of IPI's current tariff as noted in the previous competitive classification proceeding. In Docket No. UT-920546, in the Fifth Supplemental Order, Commission Decision and Order Denying Petition for Classification, the Commission stated at p. 7:

> IPI's present tariffs appear to allow variance at the whim of the aggregator or the carrier. Rates of that sort are not only highly improper, they are illegal under WAC 480-120-141(10)(c) and appear to violate RCW 80.36.170. The Commission is mystified why the carrier has not brought itself into compliance with the rule in the two years since the rule was adopted.
>
> There are three fundamental problems with such rates. First, it is the carrier or a third party rather than the regulator who establishes the rate to be charged to customers. This allows the possibility of invidious discrimination. Even banded tariffs do not allow discrimination among consumers--the same rate must be applied to all traffic that falls within the defined category, although the rate may vary within the band. When individual variation is permitted in other contexts, as by individual contract, those contracts are between the telecommunications company and the consumer, and the person who pays the rate agrees to the variance from the tariffed or price listed rate level. Here, that decision is made without the consumer's knowledge.
>
> Second, it renders enforcement of compliance much more difficult, as there is no way to tell which rate is the appropriate rate for the carrier to bill. IPI does not even have a written contract with aggregators that defines the rate to be charged.

> The arrangement provides no institutional impediment to a carrier's billing consumers at one rate and reporting another and it renders enforcement subject to the carrier's word as to what is the pertinent rate to be charged.
>
> Third, an optional or variable rate renders the consumer's job of securing information--already hard enough--much more difficult. RCW 80.36.100 requires tariffs to be filed and open to the public; yet with rate options there is no way a person can determine from the tariff what rate should apply to a desired service. When choosing a presubscribed carrier for residential or business service, a consumer can refer to the carrier's tariffs. One purpose of tariffs is to provide just this sort of information to consumers and to regulators. Here, even if the consumer had IPI's tariff in hand, the consumer could not identify the rate to be charged for service.

In its brief at p. 77, IPI argues that Staff has failed to offer rate design evidence of what would produce fair, just and reasonable rates. IPI argues that Staff cannot rely on the findings in the competitive classification proceeding, Docket No. UT-920546, because the state never gave IPI notice that its existing tariffs were at issue in the docket.

After review of the parties' positions, it is found that there is sufficient evidence to address rate design issues in this docket given the fact that the tariff is in the record and Mr. Damron has addressed the subject of how a rate reduction should be distributed among the rate options. With respect to IPI's argument that the IPI tariff was not an issue in Docket No. UT-920546, and therefore findings made about IPI's tariff in that docket are void is rejected as a belated collateral attack on the findings in that proceeding. In point of fact, the ability of the end user to ascertain rates to be charged is a prime concern to the Commission whether it arises in the context of market power as discussed in Docket No. UT-920546 or in this proceeding where IPI will be filing new tariffs to achieve fair, just and reasonable rates which should inform customers and the Commission of the rates to be charged for service. For purposes of this order, the Staff recommendation will be adopted and the rate reduction of 42.72 percent applied equally to all of the company's Washington tariff rates.

XII. REFUNDS AND INTEREST

A. Commission Staff position

Commission Staff recommends imposition of refunds, with interest, back to the date or filing of the complaint, i.e. January 13, 1992. According to Staff, this would help to mitigate the damages to end users or ratepayers resulting from delays in processing of this case. Interest on refunds would be paid at the rate set for customer deposits, i.e. for 1992, 6,16 percent, for 1993, 4.01 percent and for 1994, 3.50 percent.

Staff also notes that because of an anomaly in the Commission's tariff filing statutes which allows examination only of changes in rates,[5] IPI filed its tariff in 1988, but that tariff has not been declared by the Commission to be a "fair, just and reasonable rate." So, in essence, there has been no prior "ratemaking" proceeding for this company. However, in a prior decision regarding the company's petition for classification, the Commission in its final order noted that IPI's present tariffs appear to allow variance of rates at the whim of either an aggregator or the carrier. See XI, Tariff Considerations and Rate Design. The order goes on to note that such rates are illegal under WAC 480-120-141(10)(c) and appear to violate RCW 80.36.170. See Fifth Supplemental Order, Commission Decision and Order Denying Petition for Classification, p. 7, Docket No. UT-920546. Staff claims that since the complaint has been filed, IPI has sought to prolong the proceeding and has contributed very little to the record to assist the Commission in making an informed decision in this case. See Staff brief, p. 15. Commission Staff also cites a number of cases which it claims support its argument on the refunds and interest issue. Staff asserts that if IPI's records are too poorly kept to enable it to identify end-users deserving a refund, alternative treatments are available such as creation of a reserve on the company's balance sheet in the amount of the ordered refund by debiting retained earnings and crediting a refund reserve. Then a negative surcharge could be ordered to be applied to each prospective customer's bill with a debit to the reserve and a credit to operating expenses until the reserve is reduced to zero. See Staff brief, p. 18.

In its reply brief, Staff cites prior legal decisions in Washington involving the Commission that have recognized that the Commission's authority to regulate in the public interest is remedial in nature and that every power necessary for the exercise of the Commission's duties is implied. Commission Staff urges that

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[5]This is because RCW 80.36.110 only allows suspension of changes in tariffs.

the Commission has an ongoing duty to protect the public from unreasonable rates. Staff maintains that the legislature could not have intended that a ratepayer who has been overcharged would have no remedy and that Chapter 80.36 is a remedial statute.

B. IPI Position

IPI advances a number of arguments against imposition of refunds with interest. From a factual standpoint, IPI claims that the financial impact would be such that the company would be put out of business.

IPI also presents legal arguments against imposition of refunds in this case. At p. 77 of IPI's brief, IPI asserts that the state lacks the power to reduce IPI's rates retroactively to the date of filing of the complaint and to order refunds or equivalent transfers of IPI's property to its end user customers.

IPI at this point in its brief as well as at several others, asserts that it has been precluded from presenting all the issues it wishes to raise due to the presiding officer's order limiting the number of pages in its brief. See Seventh Supplemental Order issued June 10, 1994. IPI brief, p. 78. Related to this argument is IPI's contention that it has been denied a fair hearing where the state fails to make out a prima facie case against IPI but attempts to shift the burden of proof to the company. IPI brief, p. 85.

IPI urges that RCW 80.36.140 only authorizes the setting of rates after a hearing and provides that the rates to be set after a hearing are those "thereafter to be observed." IPI contends that the cases cited by Staff in support of its proposed interpretation of RCW 80.36.140 were decided before the legislature revamped the law regarding public service companies in 1945. IPI claims that this 1945 change resulted in a limitation of the duty to regulate in the public interest "...as provided by the public service laws of this state,..." IPI construes the addition of this modifying language to amount to a substantive limit on the Commission's power. IPI reviews a number of cases in various states which interpret language similar to that found in RCW 80.36.140 and concludes that none of these cases allow rates to be set back to date of the complaint.

IPI claims that if RCW 80.36.140 is given effect to allow recovery back to the date of filing of the complaint, such a statute would be unconstitutional as a denial of equal protection of the laws. IPI brief, p. 83.

IPI also claims that allowing recovery of excess earnings back to the date of the complaint would constitute retroactive ratemaking.

IPI argues that Commission Staff allegations that IPI has not assisted in the prosecution of this case, represent an attempt to reverse the burden of proof and to put it on the company. In this regard, IPI moves to dismiss the complaint for failure to make a prima facie case.

IPI also denies that it obstructed the conduct of this proceeding and asserts that it would have been impossible for it to reduce its rates as of the date the complaint was served because it did not know what level of reduction would be required. IPI brief, p. 86. IPI also maintains that the Staff allows other regulated companies more lenient treatment than IPI has been accorded during the prosecution of this case.

Finally, IPI asserts that the Staff's proposed alternative treatments on the refund issue are without support in the record, See Staff brief, p. 18 and IPI brief, p. 87, and that Mr. Mean testified that such a refund to persons who had consumed service after filing of the complaint but before the order would be impossible to implement. IPI also asserts that these alternative proposals for refunds are not sufficiently supported in the record, that IPI does not do customer billing and is not required to keep customer records; that the negative surcharge proposal advanced by Staff as an alternative form of refund violates Art I, Section 16 of the Washington Constitution, because it takes IPI's private property for private use of IPI's prospective customers and that there is no evidence in the record of the financial impact of a refund on IPI. IPI brief, p. 88-90.

C. Discussion

After careful review of the evidence and argument offer on the refund issue, the initial order will order refunds, with interest, effective as of the date of the Commission's final order in this docket. The following discussion addresses IPI's arguments on this issue.

First, IPI has claimed at several points in its brief that it was precluded from presenting all the issues it would raise because of the space limitation imposed by the presiding officer which limited the number of pages in the brief filed by the parties. See Seventh Supplemental Order issued June 10, 1994. Upon review of the case as a whole, it is clear that all parties have had a full opportunity to expound on the issues presented in this docket and IPI's claims of injury due to the space limitation are unfounded. The page limitation imposed upon the parties arises from interpretation of WAC 480-09-736(16) which prescribes a 60 page limit for briefs unless additional pages are allowed by the presiding officer where good cause is shown. In this case, IPI was granted additional pages by the presiding officer to address

confidentiality issues. In this matter of page limits as well as in all other respects, the undersigned believes IPI has had a complete and fair hearing before an impartial agency, the office of administrative hearings. In addition, IPI has been afforded an opportunity for a full and fair hearing in this case. Its comments to the contrary are rejected as without a basis in the record.

Second, IPI maintains that RCW 80.36.140 only allows rates to be set on a prospective basis. RCW 80.36.140 provides, in part, that whenever the Commission finds after a hearing that the rates and charges of a telecommunications company are unjust and unreasonable, the Commission shall determine the just and reasonable rates to be thereafter observed and fix the same by order as provided in this title. For purposes of this initial order, the operative date of assessment of fair, just and reasonable rates should be the date on which the company was finally put on notice as to what fair, just, and reasonable rates are, i.e. the date of the Commission's final order in this docket. This is a reasonable interpretation of the term "thereafter" in RCW 80.36.140. In view of this interpretation of the statute, IPI's arguments regarding retroactivity and constitutionality are not addressed.

IPI complains that Staff's comments regarding IPI's lack of contribution to the record in this case and consequent recommendation that refunds be ordered constitutes an attempt to reverse the burden of proof and to place it on IPI thus denying IPI a fair hearing. IPI's argument has been reviewed and will be rejected along with its motion to strike the complaint for failure to make a prima facie case. The Staff has established a prima facie case and met its burden of proof with respect to the complaint. The burden of proof has not been improperly shifted to IPI in this case. IPI has not been denied a fair hearing with regard to the burden of proof question.

With regard to IPI's argument that it was not treated with the same leniency as other companies regulated by the Commission, this argument is also rejected. The Commission has limited resources and is entitled to take prosecutorial action against any company which its regulates for violation of Commission statutes and rules. The issue then is confined to the actions of that company, not how the Commission deals with other companies which it regulates.

With regard to the alterative methods for refunds suggested by Commission Staff, this initial order simply authorizes refunds and will not address the method by which they are to be implemented. Since the record is really not sufficient to determine how refunds should be implemented, the initial order will direct that the parties confer over the best method and make

appropriate recommendations regarding proper treatment of refunds for Commission consideration in its final order.

XIII. OTHER ISSUES RAISED BY THE COMPANY

A. IPI Motion to Dismiss Complaint

At p. 51 of its brief, IPI moves to dismiss the complaint because of failure of proof by the state and because IPI was operating at a loss during the 1991 test year.

Commission Staff counters that the evidence in this record shows not only that the company is not operating at a loss but has excess earnings during the test year and even greater revenues in 1992 and 1993.

The motion should be denied. The record clearly establishes excess earnings for the 1991 test year.

B. IPI Motion to Dismiss the Claim for Penalties

At p. 25 of the IPI brief, the company, after advancing Constitutional arguments against imposition of penalties against IPI, moves for dismissal of the claim for penalties.

The motion to dismiss is denied. The Commission lacks the authority to consider Constitutional challenges to WAC 480-120-031. Penalties have been found to be appropriate in accordance with the terms of this order. Section II, above.

C. IPI Motion to Strike Commission Staff Brief

IPI's Position

After Commission Staff filed its brief, IPI moved to strike the brief on several grounds. First, IPI claims the Commission Staff offered a revised exhibit "C-75R" in its brief which has not been included in the record in place of Exhibit "C-75" which is part of this record. Exhibit C-75 shows an end of period rate base while C-75R shows an average of monthly average rate base. In addition, IPI claims it has not had an opportunity to cross examine regarding this document and that it would be prejudiced by its consideration as part of this record. Because the Commission Staff brief contains references to Exhibit C-75R, IPI maintains that the "exhibit" and the brief should be stricken.

IPI also claims that Commission Staff has violated WAC 480-09-750, the Commission's rules of evidence provision, and specifically, sub section (2) of the rule which sets forth the requirements for taking official notice. Commission Staff requests that judicial notice be taken that several AOS providers have

significantly reduced rates in recent months. According to IPI, Staff would have notice taken of the reduction to bolster its contention that average commission fees are lower in 1994 than in 1991. IPI further urges that it is prejudiced if judicial notice is taken in the manner proposed by Staff because IPI is denied notice of and an opportunity to contest the material to be noticed. IPI also maintains that by introducing evidence into the record through its brief, Commission Staff has deprived IPI of a fair hearing and, accordingly, Staff's brief should be stricken.

IPI also contends that even under Evidence Rule 201, the judicial notice rule of evidence applicable in Washington courts, Staff's request is still improper because the statement is ambiguous and its meaning subject to reasonable dispute.

IPI also asserts that Staff's proposal for refunds to customers violates IPI's right to a fair hearing and that it has not had an opportunity to be confronted with and to address the refund issue. IPI also questions assertions made in the Staff brief and claims that in making these assertion, Staff Counsel is acting as a witness and an expert witness and, consequently, must disqualify herself.

Commission Staff Response

Commission Staff, in its response, urges that the motion to strike be denied. With regard to Exhibit C-75, Staff claims that the revised exhibit does not contain new information but was supplied in response to a Bench Request by the presiding officer to the parties to submit a statement of their final position with regard to all issues and adjustments in the hearing. Further, Staff claims that its position has consistently been that it advocates use of average of monthly averages rate base. See Exhibit C-69, Rebuttal Testimony of Mr. Damron, p. 46. Therefore, IPI cannot claim prejudice by correction of Exhibit C-75 to reflect an average of monthly averages approach. Staff also notes that the average rate base figure appears in the record in prior exhibits and that IPI had ample opportunity to cross examine Staff witnesses regarding derivation of this figure. Staff also notes that the difference in the recommended rate reduction from 38.84 percent to 39.09 percent, or .25 percentage points, cannot be said to prejudice IPI's position. Finally, Staff urges that its revision to reflect an average of monthly averages approach is merely being done to correct the record.

With regard to Staff's request that official notice be taken that several AOS companies have recently reduced their rates, Staff urges that the Commission may acknowledge any formal action it has taken and that the official notice requirements do not have to be met.

Finally, with regard to IPI's claim that it was denied a fair hearing by Staff's reference in its brief to alternative methods for implementing a refund, Staff notes that the refund question was the subject of prefiled testimony and discussion on the record, and therefore, IPI was not deprived of a fair hearing on the refund issue.

Discussion

The motion to strike the Commission Staff brief is denied. This remedy is too broad for the offenses alleged to have been committed by Commission Staff in its brief.

With respect to the matter of revised Exhibit C-75R, this exhibit is intended to correct the Staff presentation from an end of period to an average of monthly averages rate base. Commission Staff is correct in noting that this position has been consistently advocated by Staff. See Exhibit C-1. In addition, the parties were doing what they had been asked to when they offered a final exhibit as evidence of their final position in this case. IPI is not prejudiced by the average of monthly averages position set forth in Exhibit C-75. In addition, all the numbers which appear in the attachments to Staff's brief are contained in the record. Therefore, the use of average of monthly averages figures for rate base will be treated as a correction and a statement of Staff's final position. The revised exhibit C-75R will not be considered as part of this record.

With regard to the Commission Staff proposal at p. 64 of its brief that judicial notice be taken of the fact that several AOS providers have significantly reduced rates in recent months, the request to notice this proposition will be denied as not in accordance with the Commission rule on judicial notice found in WAC 480-09-750(2). For purposes of this order, the WAC rule is applicable on the subject of judicial notice and IPI's arguments regarding ER 201 will be disregarded.

With regard to IPI's alternative treatments regarding refunds, Staff correctly notes that this matter was raised in prefiled testimony and on the record, with ample opportunity for examination and input by IPI. The argument regarding refunds will be allowed in Commission Staff's brief; IPI's motion to strike will be denied.

Given the rulings made to exclude from consideration the items IPI's motion finds objectionable, the motion to strike the Commission Staff brief should be denied. For purposes of this ruling, Exhibit C-75R will not be considered part of the record and that paragraph at the bottom of p. 64 of Staff's brief which begins "Additionally... and ends at the top of P. 65 with ...tariffed rates." will also not be considered part of the record in this

matter. The ruling on this motion does not affect the outcome of any of the adjustments set out in the body of the initial order.

FINDINGS OF FACT

Having discussed above in detail both the oral and documentary testimony concerning all material matters inquired into, and having stated findings and conclusions, the undersigned administrative law judge now makes the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate findings are incorporated herein by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington vested by statute with authority to regulate rates, rules, regulations, practices, accounts, securities and transfers of public service companies, including telecommunications companies.

2. Respondent International Pacific, Inc. is an Alternative Operator Services (AOS) provider and is a registered telecommunications company in the state of Washington.

3. On January 13, 1992, the Commission issued its Complaint against IPI. It included three claims for relief. On June 12, 1992, following withdrawal of the first claim for relief, it was dismissed in the First Supplemental Order. The two remaining claims for relief are summarized as follows:

> 2. The revenues produced by IPI's tariff rates may be unjust, unfair, or unreasonable in that they may produce greater than reasonable compensation for service provided, in contravention of RCW 80.36.080.
>
> 3. IPI has failed to keep its books and records in accordance with the Uniform System of Accounts as required by WAC 480-120-031, and is therefore subject to a civil penalty of up to $1,000 per day.

4. The twelve-month period ending December 31, 1991 is the appropriate test period to examine for ratemaking purposes in this case. The average rate base used by Commission Staff is the proper method for calculation of the historical test year. The company's use of an end of period rate base approach is rejected.

5. The company's adjusted rate base is properly valued at the amount set forth in Attachment Table II.

6. The appropriate capital structure for ratemaking purposes is 100 percent debt and zero percent equity.

7. The overall rate of return of 11.88 percent on the company's adjusted rate base represents a fair amount which will allow the company to maintain its credit and financial integrity and will enable it to acquire sufficient new capital at reasonable terms to meet its service requirements.

8. The record establishes that excess revenues exist based on an adjusted test period gross annual revenue figure, calculated using the rate of return found appropriate in this initial order.

9. IPI is to file tariff revisions designed to produce a 42.7235 percent rate reduction to apply to all of the company's Washington intrastate tariff rates. The tariff revisions authorized in this order will result in rates which are fair, just, reasonable and sufficient.

10. IPI is found to have been out of compliance with WAC 480-120-031, the Commission rule which requires the company to keep its books and records in accordance with the Uniform System of Accounts. The period of noncompliance exists from May 16, 1992, through at least March 31, 1994, and each day thereafter through the date of the initial order.

11. IPI has intentionally prolonged this proceeding. IPI has been late with and/or not complied with discovery. IPI has provided very little of the necessary information required in this proceeding. These problems have added to the time Commission Staff had to devote to this investigation. In addition, the failure to keep books and records in accordance with Commission regulations lengthens and unduly complicates the Commission's exercise of its regulatory oversight responsibilities. These factors indicate that refunds are appropriate in this case.

12. The Commission Staff's commission fee survey as proposed in Mr. Wilson's rebuttal is accepted and adopted for purposes of establishing a benchmark commission fee level.

13. IPI's jurisdictional separations study should be rejected. In addition, IPI's calculations of jurisdictionally separated results of operations lack reliability, are flawed and should be rejected. Commission Staff's total company approach to deriving IPI's revenue requirements is accepted and adopted for purposes of this initial order as the best available evidence of the proper level of the company's Washington intrastate rates.

14. IPI filed a motion to strike the Commission Staff brief.

15. IPI filed a motion to dismiss the complaint because IPI was operating at a loss during the test year.

16. IPI filed a motion to strike the claim for penalties.

17. CSI owns private payphones. It contracts with site owners, including hotels and restaurants, for pay phone locations. IPI provides operator services for the payphones. CSI has an interest in this matter as the result affects the charges for service paid by site owners. Based upon this interest, CSI was allowed to intervene. CSI also is a member of the Northwest Payphone Association, another intervenor in this case. By letter dated June 8, 1992, Mr. Owens withdrew as counsel for CSI. During the course of the hearings, CSI did not appear.

18. IPI moved to dismiss the complaint for failure to make a prima facie case.

19. During the course of the hearing, considerable evidence was admitted into the record which was subject to the Company's claim of confidentiality. This evidence was related to the company's commission fee schedules and amounts, as well as revenue and expense amounts for 1991, 1992 and 1993. With the passage of time, the company believes that the 1991 test period results has become stale and it no longer wishes to assert its claim of confidentiality over any evidence except IPI's commission fee information and evidence that could be used to compute such fees. IPI has offered to prepare an inventory of the record to show what confidential information it is willing to release. IPI brief, p. 93. The initial order will direct that the company prepare such an inventory at the earliest possible time in order to assist the Commission in addressing the remaining confidentiality issues.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and the parties thereto. The Commission does not have jurisdiction to consider challenges to the AOS regulatory structure found in WAC Chapter 480-120 or to the statutes governing AOS in Washington.

2. The second claim for relief in the Complaint should be granted. Specifically, IPI has failed to keep its books and records in accordance with the Uniform System of Accounts as required by WAC 480-12-031. IPI is subject to a civil penalty of $1,000 per day. Because WAC 480-12-031 was subject to legal challenge and was ultimately partially upheld, the effective date of the penalty runs from May 16, 1992 to March 31, 1994 for a total

civil penalty of $684,000, plus $1,000 each day for each day thereafter until the company evidences full compliance with the rule. IPI's motion to strike the claim for penalties is denied.

3. IPI should be ordered to respond to Staff Request 109 if and when it has achieved full compliance with the rule and to provide to Commission Staff a copy of its general ledger showing the necessary changes from its present accounting system to the Uniform System of Accounts required by WAC 480-120-031.

4. IPI's existing rates and charges for AOS service produce excess revenues which result in unfair, unjust and unreasonable rates. These rates are not reasonable and are not in the public interest. IPI should be ordered to refile tariff revisions in accordance with the terms of this order and reflecting a tariff reduction of 42.7235 percent. The refiled rates will be fair, just and reasonable in accordance with RCW 80.36.080. Refunds for overcharges to end-users resulting in excess revenues will be should be ordered effective as of the date of the Commission's final order in this docket. The parties are directed to confer on and arrive at a plan to implement the refund and to provide this refund plan for Commission consideration in its final order in this docket.

5. IPI's motion to strike the Commission Staff brief should be denied in accordance with the terms of this order. Portions of the Commission Staff brief are stricken in accordance with the terms of this order.

6. The intervenor CSI should be dismissed from this proceeding pursuant to WAC 480-09-430.

7. IPI's offer to prepare an inventory of confidential information which it is willing to release will be accepted and the company is requested to prepare such an inventory as soon as possible so that it may facilitate the Commission's consideration of the remaining confidentiality issues in the final order in this docket.

8. IPI's motion to strike the complaint because the company operated at a loss in 1991 is denied.

9. IPI's motion to strike the complaint for failure to make a prima facie case should be denied.

10. All other motions consistent with the findings and conclusions herein should be granted; those inconsistent therewith shall be denied.

Based on the above proposed findings of fact and conclusions of law, the undersigned administrative law judge makes the following initial order.

ORDER

WHEREFORE, IT IS HEREBY ORDERED That the second and third claims for relief are granted; and

IT IS FURTHER ORDERED That IPI be assessed a civil penalty of $1,000 per day from May 16, 1992 to March 31, 1994, or $684,000, and $1,000 per day after March 31, 1994 until the company comes into full compliance with WAC 480-120-031; and

IT IS FURTHER ORDERED That IPI shall respond to Staff Request 109 at such date when IPI comes into full compliance with WAC 480-120-031 and to provide a copy of its general ledger to Commission Staff showing changes from its present accounting system to the accounting system required by the rule; and

IT IS FURTHER ORDERED That, as IPI's existing tariff rates produce greater than reasonable compensation, IPI file tariff revisions to produce no more than the gross revenues found in this order to be proper for provision of respondent's alternate operator services in the state of Washington; and

IT IS FURTHER ORDERED That all excess revenues collected by IPI as of the date of the Commission's final order in this docket, along with interest at the rates charged for customer deposits, be refunded to end-users with the parties to submit a refund plan for Commission consideration; and

IT IS FURTHER ORDERED That IPI's motion to strike the Commission Staff brief is denied; and

IT IS FURTHER ORDERED That IPI's motion to strike the complaint based on IPI's claim of having operated at a loss in 1991 is denied; and

IT IS FURTHER ORDERED That IPI's motion to strike the claim for penalties is denied; and

IT IS FURTHER ORDERED That IPI's motion to strike the complaint for failure to make a prima facie case is denied.

DATED at Olympia, Washington, and effective this 29th day of September, 1994.

OFFICE OF ADMINISTRATIVE HEARINGS

ROSEMARY FOSTER
Administrative Law Judge

NOTICE TO PARTIES:

This is an initial order only. The action proposed in this order is not effective until a final order of the Utilities and Transportation Commission is entered. If you disagree with this initial order and want the Commission to consider your comments, you must take specific action within a time limit as outlined below.

Any party to this proceeding has twenty (20) days after the service date of this initial order to file a Petition for Administrative Review, under WAC 480-09-780(2). Requirements of a Petition are contained in WAC 480-09-780(3). As provided in WAC 480-09-780(4), any party may file an Answer to a Petition for Administrative Review within ten (10) days after service of the Petition. A Petition for Reopening may be filed by any party after the close of the record and before entry of a final order, under WAC 480-09-820(2). One copy of any Petition or Answer must be served on each party of record and each party's attorney or other authorized representative, with proof of service as required by WAC 480-09-120(2).

In accordance with WAC 480-09-100, all documents to be filed must be addressed to: Office of the Secretary, Washington Utilities and Transportation Commission, 1300 South Evergreen Park Drive S.W., PO Box 47250, Olympia, Washington, 98504-7250. After reviewing the Petitions for Administrative Review, Answers, briefs, and oral arguments, if any, the Commission will by final order affirm, reverse, or modify this initial order.

Note Regarding Attachments to Eighth Supplemental Order

The company claims confidentiality pursuant to the protective order in this case of figures related to computation of commission fee payments. Third Supplemental Order, issued March 12, 1994. IPI brief, p. 92. The attachments and tables are filed with the Commission's official record in this matter at the Records Center, Washington Utilities and Transportation Commission in Olympia, Washington.