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September 8, 1999

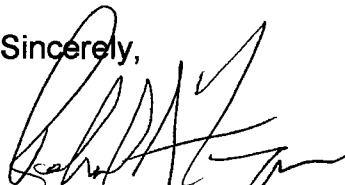
Carole J. Washburn, Executive Secretary
Washington Utilities and Transportation Commission
P. O. Box 47250
Olympia, WA 98504-7250

Subject: Docket UT-971140 Report and Settlement Agreement

Dear Ms. Washburn:

On behalf of the Washington Exchange Carrier Association, I am pleased to enclose for filing the original and nineteen (19) copies of the Report and Settlement Agreement in Docket No. UT-971140. This Report and Settlement Agreement grows out of the discussions between WECA, its member companies and Commission Staff, and others, that were directed to be held by the Commission in its Fifth Supplemental Order in the above referenced docket.

Sincerely,



RICHARD A. FINNIGAN

RAF/rlj
Enclosures as noted

cc: Craig Phillips
WECA Board Members
Mary M. Tennyson
Betty Erdahl
Parties of record

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REPORT AND SETTLEMENT
AGREEMENT
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STATE OF WASH.
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CITY GEN DIV
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Report and Settlement Agreement

Docket No. UT-971140

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September 3, 1999

Carole J. Washburn, Executive Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

Re: Docket No. UT-971140 - Report and Settlement Agreement

Dear Ms. Washburn:

On November 18, 1998, representatives of Commission Staff met informally with Mr. Richard Finnigan, counsel to the Washington Exchange Carrier Association (WECA), to discuss how to proceed in response to the Commission's Fifth Supplemental Order in Docket No. UT-971140 issued on October 30, 1998. Based on that informal meeting, invitations were issued to the parties in UT-971140 to engage in informal discussions. A committee consisting of representatives from WECA, WECA member companies, AT&T Communications of the Pacific Northwest, Inc. (AT&T), US WEST Communications, Inc. (US WEST), GTE Northwest Incorporated (GTE), Sprint Communications Company, L.P. (Sprint), Commission Staff, and the Attorney General's Office have been meeting on a regular basis since November 18. The purpose of this letter is to submit a report and recommended settlement.¹

Issues Discussed

The Commission's Fifth Supplemental Order in UT-971140 directed that the discussions include certain specific items. Chief among these items in terms of the Commission's emphasis is the issue of transition. (See page 18 of the Fifth Supplemental Order.) The Commission also asked the parties to address the following:

- Those items recommended for further investigation in the settlement that resulted in the closing of Docket No. UT-910355
- Corporate overhead and executive compensation
- Use of straight dial equipment minutes
- The "flawed calculation" from Exhibit 213 in Cause No. U-85-23

¹The recommended settlement is offered by Commission Staff and WECA on behalf of itself and its member companies. The other parties to the discussions do not object to the recommended settlement, but are not affirmatively offering the settlement.

The issues that grew out of the dismissal of the complaint in UT-910355 are as follows:

- What process shall determine the return factor to be used in the annual non-traffic sensitive (NTS) and traffic sensitive (TS) access filings
- Whether it is desirable to continue the transition to a 25 percent NTS gross allocator
- Whether prior transition amounts should be reflected in the actual allocator
- Whether the transition should go below a company's actual subscriber line usage (SLU)
- When should the gross allocator shift be completed
- Questions related to the access charge rule, WAC 480-120-047, including issues of filing dates, support data, and the appropriateness of combining traffic and non-traffic sensitive filings

In addition to those items specifically raised by the Commission's Fifth Supplemental Order, the Committee members determined that it would be useful to include additional items in the discussions. These items are as follows:

- The use of actual revenue requirement in filings adjusted for known and measurable changes versus the use of projected revenue requirement
- Investor supplied working capital
- The removal of pay phone expenses from the pool
- The removal of United Telephone Company from the pool
- McDaniel Telephone Company converting from average schedule to a cost company
- The effect of EAS conversions — converting toll minutes to local
- Inclusion of Pend Oreille Telephone Company in the pool process²

²As used above, the term "pool" is used in a generic sense. In later discussion, it may be important to distinguish which of the pools administered by WECA is under discussion — the traditional USF pool, the Carrier Common Line pool, the new interim USF pool, and, in some respects, a new pool of originating CCL rates.

Near the end of the series of meetings, Commission Staff and WECA discussed the standards for entering and exiting WECA pools.

Report Goals

The Commission directed that the parties provide a final report to the Commission concerning the issues identified by the Commission in its Fifth Supplemental Order. Also implicit in the Commission's direction to the parties was a sense of whether the parties felt that the Commission's prior orders in U-85-23 (U-85-23 Orders³) still maintain viability. Having asked the question whether the U-85-23 Orders still maintain viability, it is helpful to discuss some of the objectives accomplished by those orders.

Background

The U-85-23 Orders accomplished a number of objectives. Perhaps the foremost was establishing a universal service mechanism to assist companies with high loop costs compared to the statewide average loop costs (referred to in the report as the "traditional USF"). The traditional USF has the effect of keeping access charges in rural areas lower than they would otherwise be and encouraging competing carriers to provide toll services throughout all parts of the state. Among the benefits of the traditional USF is that it increases customer choice of toll services. The traditional USF mechanism also has the effect of leveling costs between urban and rural areas, thereby promoting comparable toll rates in the rural areas and urban areas.

Beyond establishing the traditional USF mechanism, the Commission's U-85-23 Orders moved the industry from the old separations and settlements system for compensation for the jointly provided intrastate, intraLATA toll service to what was a new "access charge" environment. The Commission's U-85-23 Orders established a rate design for access charges, in part, by including a carrier common line (CCL) rate element. This rate element was subsequently split into recovering a penny per minute of use from originating CCL access minutes and the remainder on terminating CCL access minutes, in order to minimize revenue erosion due to by-pass. The U-85-23 Orders also established a mechanism for calculating originating and terminating traffic sensitive access charges. Further, the U-85-23 Orders confirmed US WEST in the role as designated carrier for intraLATA toll traffic.

Changes in Environment Affecting Discussions

There have been at least two major changes that affect the viability of the U-85-23 Orders. One is the implementation of intraLATA toll dialing parity. This change has

³The term "U-85-23 Orders" includes the Seventeenth, Eighteenth, and Nineteenth Supplemental Orders in that docket.

increased customer choice for intraLATA calling. IntraLATA toll dialing parity was implemented February 8, 1999.

The second major change is the implementation of the Commission's new Access Charge Reform Rule, WAC 480-120-540.⁴ The implementation of this rule occurred in the first part of this year. The Commission substantially modified the rate design aspects of the U-85-23 Orders when it adopted its Access Charge Reform Rule.⁵

Under WAC 480-120-540, the rate design for CCL is changed in that the terminating CCL rate is reduced to zero. In addition, terminating traffic sensitive rates are reduced to a TSLRIC-based cost, or, for many companies, a surrogate of a TSLRIC-based cost is used.⁶ The amount thus eliminated from terminating access rates is then shifted, in whole or part, to new interim universal service rates. The rule allows the amount that is not placed in the interim universal service rate elements to be placed on originating access rate elements. This is a substantial amendment to the rate design established in the U-85-23 Orders. Thus, at least as to terminating access, the rate design aspects of the U-85-23 Orders have been superseded.

These changes in environment had a substantial effect on the direction of the discussions. As a result, some items were found to be rate case specific items which did not need resolution at this time. The product of the discussions is set out below.

Outcome of Discussions

The discussions led to a resolution of the issues fitting for a changed environment. The major issue of transition was addressed. A settlement was crafted around the concept of capping WECA's existing rates.

The Fifth Supplemental Order in UT-971140 anticipated that the WECA companies transition at least \$2 per line per month or justify why no transition is appropriate. The committee believes that WECA and its member companies have complied with the transition requirement by WECA and each member company filing their access charge rates under the new access charge rule, WAC 480-120-540. As noted above, under that rule, each company's terminating access charge rate has been reduced to a TSLRIC level

⁴The Commission's adoption of WAC 480-120-540 is subject to appeal in Thurston County Superior Court Cause No. 98-2-02413-2. However, the effectiveness of the rule was not stayed. The rule is in effect today, and companies have made filings which comply with the terms and conditions of the rule.

⁵To the extent this report describes or characterizes aspects of WAC 480-120-540 as having rate design effects, this description or characterization does not in any way waive any of the WECA member companies' objections to WAC 480-120-540 or the position that what is described as a rate design effect abridges any WECA member company's substantive rights.

⁶Under the Access Reform Rule, companies are allowed to mirror another company's TSLRIC-based rate.

plus a reasonable amount of common and overhead costs (either on a company-specific basis or by use of the rule's alternative to choose a surrogate rate). The amount that was formerly contained in the terminating CCL rate has been transitioned to a separate interim universal service rate. Attached as Exhibit 1 is a calculation demonstrating the effective transition that each company has made in its access charge reform rule filing. While the revenue has not been removed from the access charge bills to interexchange carriers, it has been transitioned from the CCL rate to the interim universal service rate.

WECA, as an entity, is currently administering the funds collected via the "interim" universal service rates that each company charges on terminating access that were formerly in the terminating CCL rate, and is still administering the traditional WECA universal service pool, the originating CCL rate pooling process, and the Pend Oreille rate additive. Under this agreement, WECA will continue to perform these functions, as they are modified by this agreement (e.g., eliminate the Pend Oreille additive).

All parties recommend that the annual WECA filings be discontinued. Except for the specific adjustments described below, the WECA rates should be kept at their current level. We recommend that the Commission no longer require annual industry filings of the type established in the U-85-23 Orders. We reached consensus that the U-85-23 process itself does not have sufficient value to justify the further effort that would be required to resolve the disputed issues. While the process had its value in the years following the divestiture of AT&T, it is no longer optimal or even necessary to establish annual access charge reviews based on a fixed formula. Filings in the future, if any, should be based upon factors specific to individual companies.

In summary, the Committee recommends resolution of the outstanding issues from UT-971140 in the following manner:

- That the Commission accept the analysis set forth in Exhibit 1 to this report that all WECA members have transitioned at least \$2 per line per month in satisfaction of the Fifth Supplemental Order in Docket No. UT-971140.
- That the Commission issue a notice to consider revising or repealing WAC 480-80-047 to terminate the annual access charge report/tariff filing requirement.⁷
- That WECA prepare and file a tariff change to include Pend Oreille Telephone Company in the traditional USF, interim USF and CCL pools on a revenue neutral basis, adjusting the WECA pool rates to reflect that

⁷The repeal of WAC 480-80-047 may qualify for expedited treatment which does not require a CR 101 notice. See RCW 34.05.354. If for some reason repeal of the rate or the requirement is not appropriate, waivers should be granted to the extent the rule applies to WECA and its member companies.

inclusion and the elimination of the separate Pend Oreille rate additive from the WECA tariff and the tariffs of US WEST, GTE, and Sprint.

- That the Commission accept the process described for membership in the pooling process other than traditional USF⁸ as follows:
 - Access charge revenues will be pooled on a voluntary basis, pursuant to contracts signed by the pooling parties and approved by the Commission. It is contemplated that the contracts will be as close as possible to the existing Non-Traffic Service Fund Administration Agreements which are presently in effect, modified to reflect the terms of this settlement agreement.
 - The contract will contain a clause describing that any party to the contract may leave the pool upon reasonable notice to WECA and the Commission.
 - By January 1, 2000, WECA shall establish and file for approval by the Commission mechanisms by which pooled revenue will be allocated among members, rates will be adjusted upon entry or exit of members, and whether the WECA rates are to be adjusted in the future for exogenous regulatory accounting changes and, if so, by what mechanism. It is contemplated that this filing will put into place the mechanisms to govern WECA's activities in the future, and it is not intended that those mechanisms are to be adjusted or reviewed on an annual basis.
 - Any local exchange company may enter the pool upon reasonable notice to WECA and the Commission with the terms of entry described in the WECA mechanisms to be approved by the Commission (see the bullet point immediately above).
 - An exiting company may establish its own originating access charges at a level that will produce revenues equal to those it was receiving from the WECA pool, as long as the total revenue collected by the pool and the exiting company in access charges is not increased as a result of the member's exit, as reflected in the charges established at the time that the exiting company establishes its own originating access charges. Alternatively, an exiting company may file rates that would change its revenue contemporaneous with its withdrawal from

⁸The traditional USF administered by WECA would continue to be administered in accordance with the mechanisms, including the Universal Service Fund Administration Agreements approved by the Commission.

the WECA pool; in the event such filing becomes effective, either upon Commission approval or by operation of law, upon the company's withdrawal from the WECA pool, WECA rates will be adjusted to reflect the net effect of such withdrawal upon the pool. Unless an exiting company that continues to qualify to receive funds from the traditional Universal Service Fund chooses to forego such funds, its withdrawal from any other WECA pool shall not affect its right to receive funds from the traditional Universal Service Fund so long as it continues to qualify to receive such funds. Filings by an exiting company and WECA shall be coordinated to have the same effective date.

- WECA shall continue to perform its functions in administering the pools as described above.
- That the WECA rates remain at their current level (after the Pend Oreille filing described above and after a filing is made to include a new originating rate to reflect the settlements reached over the handling of some companies' access charge reform filings, such as those in Docket No. UT-990413).
- That any company that believes that the revenue it received from WECA is insufficient may remain in the pool and make a tariff filing for a company specific adder. Issues unresolved in this case, such as rate of return, corporate overhead and executive compensation adjustments, jurisdictional separations, etc. may be addressed and resolved in the company's specific adder filing.

In addition to the foregoing, the committee reports that McDaniel Telephone Company has volunteered to convert from an average schedule company to a cost company. Further, the parties have reviewed the issue of the use of straight dial equipment minutes. This appears to be an issue which is primarily a traffic sensitive issue and does not have a material effect on non-traffic sensitive costs. Therefore, the committee concludes that this issue did not need to be addressed at this time.

On the same date as this Report and Settlement Agreement, WECA is filing a supplement to its 1999 annual report that will show that from its view, due to a number of factors, pay phone expenses and the expenses related to United Telephone Company of the Northwest are no longer being recovered by rates administered by WECA.⁹ Given the totality of the settlement set forth in this report, the committee believes that resources are

⁹Just as WECA's member companies do not agree with some of the methodologies used by Commission Staff, Commission Staff does not agree with the methodologies used by WECA for this calculation. However, Commission Staff agrees that in light of this settlement, these issues do not need to be pursued.

best spent in addressing progress in a new environment rather than debating whether access charges need to be modified under standards set forth in the U-85-23 Orders.

Finally, in the course of these discussions, a great deal of time was also devoted to the question of the continuation of US WEST in its designated toll carrier role. US WEST has recently filed a petition related to that subject. Therefore, the committee recommends that US WEST's obligation to provide intraLATA toll service in areas where it is not the incumbent local exchange company be addressed in that docket.

Conclusion

In closing, we have reached an agreement on a way to resolve our differences in the current proceeding without reaching agreement on all of the issues delineated in the Commission's Order.

The committee respectfully requests that the Commission adopt the recommendations set forth above.



RICHARD A. FINNIGAN
Attorney at Law



MARY M. TENNYSON
Senior Assistant Attorney General

RAF/aw

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EXHIBIT 1

WECA TRANSITION TO INTERIM USF

(A) COMPANY	(B) 1998 INTERIM USF SHIFT	(C) ACCESS LINES 12/31/97	(D) TRANSITION PER LINE
ASOTIN	42,335	1,187	\$2.97
CENTURYTEL	7,886,940	162,023	\$3.95
COWICHE	145,590	2,043	\$5.94
ELLENSBURG	1,025,274	23,920	\$3.57
HAT ISLAND	4,042	110	\$3.06
HOOD CANAL	82,814	1,070	\$6.45
INLAND	183,932	2,199	\$6.97
KALAMA	134,733	2,502	\$4.49
LEWIS RIVER	290,977	5,340	\$4.54
MASHELL	213,873	3,129	\$5.70
MCDANIEL	134,296	3,804	\$2.94
PIONEER	87,647	862	\$8.47
ST. JOHN	69,486	634	\$9.13
TENINO	360,543	3,040	\$9.88
TOLEDO	263,557	1,899	\$11.57
WAHIAKUM W.	188,932	1,062	\$14.83
WHIDBEY	1,164,059	11,302	\$8.58
YELM	760,684	10,833	\$5.85
TOTAL	12,839,714	236,959	\$118.90