

P-421/EI-89-860 SOLICITING COMMENTS ON SPECIFIC ISSUES, ESTABLISHING REPLY AND SUPPLEMENTAL COMMENT PERIOD, ESTABLISHING FURTHER PROCEDURES, AND EXTENDING DEADLINES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Patrice Vick	Commissioner

In the Matter of Northwestern Bell Telephone
Company's, d/b/a U S West Communications,
Proposed Incentive Regulation Plan

ISSUE DATE: March 16, 1990

DOCKET NO. P-421/EI-89-860

ORDER SOLICITING COMMENTS ON
SPECIFIC ISSUES, ESTABLISHING
REPLY AND SUPPLEMENTAL
COMMENT PERIOD, ESTABLISHING
FURTHER PROCEDURES, AND
EXTENDING DEADLINES

PROCEDURAL HISTORY

On October 31, 1989 the Commission issued its NOTICE OF FILING AND ORDER ESTABLISHING PROCEDURES in the above-entitled matter. That Order notified potentially interested persons that Northwestern Bell Telephone Company, d/b/a U S West Communications (Northwestern Bell or the Company), had filed an incentive regulation plan under Minn. Stat. § 237.625 (Supp. 1989). Since that statute requires incentive plan proceedings to be expedited proceedings, governed by Minn. Stat. § 237.61 (1988), rather than contested case proceedings, governed by Minn. Stat. §§ 14.57 et seq., the Order also set forth the procedural framework the Commission would use to evaluate the proposed incentive plan.

The procedural framework established in the October 31 Order required interested persons¹ to file initial comments on the Company's proposal on or before January 30, 1990. This deadline was subsequently extended to February 28, 1990. The Order provided that the Commission would then conduct a preliminary review of the incentive plan proposal, identify any issues requiring further development, establish a time frame for filing any supplementary comments deemed necessary, and establish procedures and time frames for the remainder of the proceeding.

The following interested persons filed initial comments under the October 31 Order: Northwestern Bell, the Minnesota Department of Public Service, the Residential Utilities Division of the Office

¹ Minn. Stat. § 237.61 (1988) refers to persons participating in expedited proceedings as "interested persons" rather than parties, intervenors, or similar terms.

of the Attorney General, MCI, the Minnesota Independent Coalition, the Minnesota Business Utility Users Council, the Minnesota Cable Communications Association, the Suburban Rate Authority, the Minnesota State Planning Agency, AT&T Communications of the Midwest, Inc., and McCaw Cellular, Inc.

The Commission conducted its preliminary review of the Company's incentive plan proposal on March 14, 1990.

FINDINGS AND CONCLUSIONS

Issues Requiring Further Development

The Commission finds that it needs additional information to determine whether the Company's existing rates are appropriate and whether the proposed incentive plan should be approved. At its March 14 preliminary review of the Company's proposal, the Commission reviewed the interested persons' initial comments in detail and identified issues on which additional information or analysis was necessary. Those issues are set forth in an appendix attached to this Order.

The Commission will request additional comments from interested persons on the issues listed. Those comments, together with any comments on other interested persons' initial filings, will be due on or before April 9, 1990.

The Commission also finds it would be helpful for the Company to file "dry run" incentive plan reports, based on the Company's proposal and its actual 1989 financial results. Such reports would help the Commission evaluate the adequacy of the reporting procedures proposed by the Company and allow any necessary corrections to be made before any approved plan took effect. Dry run reports would clarify the mechanics of the plan, facilitating more informed, focused discussion. Finally, such reports would provide updated information on the Company's financial situation in a readily accessible format. For these reasons, the Commission will require a dry run filing on or before April 2.

Extension of Time for Commission Action

Under Minn. Stat. § 237.625 (Supp. 1989), the Commission must issue its decision on any incentive plan proposal within six months of filing or the proposal is deemed withdrawn. The statute excepts situations in which the Commission and the company have agreed to extend the time for Commission action. The deadline for Commission action in this case has already been extended once, from April 30 to May 30, by agreement of the Commission and the Company. ORDER EXTENDING COMMENT DEADLINE AND REMAINING DEADLINES, this docket, January 26, 1990.

Given the number and the complexity of the issues on which the Commission is requesting

additional comments, the time frames of the January 26 Order may now be inadequate. To ensure interested persons adequate opportunity to prepare meaningful comments, and to ensure the Commission the time necessary for careful examination of the Company's plan, the Commission and the Company have agreed to extend the time for Commission action to June 8, 1990.

Procedural and Scheduling Matters

The extension of time for Commission action results in the reply comment deadline of April 9, discussed above, and an April 23 deadline for filing briefs. Oral argument will begin on May 14, followed by deliberations.

The statute on expedited proceedings, which the Commission is required to use in this case, describes expedited proceedings as follows:

Notwithstanding chapter 14, the commission may conduct an expedited proceeding when authorized under this chapter. In an expedited proceeding, the commission shall give prior notice to interested persons and provide them with an opportunity to present statements of fact and argument and to reply, either orally or in writing or both. In an expedited proceeding, the pleadings must be verified, and oral statements of fact must be made under oath or affirmation. The commission shall make a decision in an expedited proceeding based on the record.

Minn. Stat. § 237.61 (1988).

Expedited proceedings are less formal than traditional contested case proceedings, offer more procedural flexibility, and require more active Commission involvement in determining what form the proceeding will take. The Commission must decide, for example, whether to receive testimony and arguments orally, or in writing, or both.

In this case, the Commission finds oral testimony unnecessary. The record is extensive. All interested persons have been given adequate opportunity, through discovery, comment periods, briefs, and oral argument, to analyze and critique adverse positions. This is not a case in which witness demeanor or face to face confrontation is likely to provide useful information to the factfinder. The Commission will therefore dispense with oral testimony.

The Commission does ask, however, that interested persons making oral argument be accompanied by their expert witnesses, prepared to answer any questions the Commission may have. There will be no cross-examination by interested persons, in keeping with the Commission's decision not to receive oral testimony.

Finally, the Commission would remind interested persons that, under Minn. Stat. § 237.61 (1988), all factual assertions in their comments must be made under oath or by affirmation.

ORDER

1. Comments on interested persons' preliminary filings and on the issues identified by the Commission as requiring further development, listed in the appendix attached hereto, shall be filed on or before April 9, 1990.
2. Interested persons' briefs shall be filed on or before April 23, 1990.
3. The Company shall file "dry run" incentive plan reports, described above, on or before April 2, 1990. If the Company requires more time to prepare such reports, the Company shall notify the Commission and all interested persons as soon as possible.
4. If possible, interested persons shall file their comments on the Company's dry run incentive plan filing with their April 9 comments. Interested persons who cannot meet this deadline shall file such comments no later than the April 23 deadline for filing briefs.
5. If possible, interested persons making oral argument shall be accompanied by their expert witnesses, who shall be prepared to answer questions from the Commission.
6. The deadline for Commission action on the Company's incentive plan proposal is extended to June 8, 1990, by agreement of the Commission and the Company.

7. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Lee Larson
Acting Executive Secretary

(S E A L)

APPENDIX

Issues which require further development before the Commission can determine whether the Company's existing rates are appropriate and whether the proposed incentive plan should be approved are listed below. Definitions of recurring terms precede the list of issues.

Interested persons may refer to previous filings in this docket if the relevant information has already been provided.

ROR -- rate of return

ROE -- return on equity

Baseline ROR or ROE -- the minimum rate of return or return on equity the Company must earn to be precluded from filing a general rate case

Benchmark ROR or ROE -- the ROR or ROE which interested persons define as the focal or reference point around which they determine the no action earnings band.

Threshold ROR or ROE -- the rate of return or return on equity the Company must earn before sharing with ratepayers begins

No Action Earnings Band -- The zone between the baseline ROR or ROE and the threshold ROR or ROE

Absolute ROR or ROE -- the rate of return or return on equity the Company must earn before all further earnings are returned to ratepayers

Level of Earnings

1. Should an overall return or a return on equity be used to measure earnings and determine sharing in NWB's incentive plan?
2. Has NWB provided sufficient evidence that its currently-authorized rate of return is not excessive, and, also, that it is an appropriate benchmark?

3. Does NWB's proposed sharing mechanism properly reflect the relative risks to ratepayers and shareholders?
4. Has NWB provided reasonable evidence that its real required return on equity is 14%?

Capital Structure

5. Has NWB shown that use of actual capital structure, rather than 50%/50% or some other structure, is reasonable?
6. Why does NWB need an equity-heavy capital structure to support its regulated operations?
7. If the actual capital structure is used, should some limit be set on deviations from the current approximately 60%/40% ratio for incentive plan purposes?
8. What should the cost rate for imputed debt be if a hypothetical capital structure or fixed capital structure is used?
9. Are interested persons proposing to use the actual capital structure of Northwestern Bell, U S West Communications, U S West or some other entity?
10. Will the capital structure change during the life of the plan? If so, what effect would changes in the actual capital structure have on the company's earnings and sharing?
11. Why did NWB accept the use of a hypothetical capital structure in the DOD-354 case and oppose the use of a hypothetical capital structure in this case?
12. Has the Department ever recommended the use of an actual capital structure in a Northwestern Bell general rate proceeding? If so, which proceedings and why?
13. What capital structure would be used if Northwestern Bell or its parent corporation was restructured or acquired during the life of the plan?

Modernization

14. Should NWB's proposed modernization program be linked to the proposed Incentive Regulation Plan?
15. Could accelerated rural modernization take place without an incentive regulation plan?
16. What is the relationship, if any, between the Company's proposed rural upgrade plan and the MIEAC proposal?
17. Does the Company propose to upgrade the interexchange facilities serving independent local

exchange telephone company exchanges as part of its proposed plan?

18. Does the record contain a map showing: 1) each of the Company's rural central offices to be upgraded; 2) which interexchange facilities will be upgraded; and 3) which interexchange facilities will not be upgraded under the Company's proposal? If not please provide such a map.
19. Does the record contain a list of the 88 central offices in the order of digital conversion dates? If not, please provide such a list.
20. Does the record contain the number of customers who will receive improved service from the 88 upgraded central offices, the number of miles of interexchange facilities that will be upgraded, and the number of miles of interexchange facilities that will not be upgraded under the Company's proposed plan? If not, please provide such information.
21. How does the cost of the proposed rural upgrade affect the Company's earnings and sharing?
22. How does the 4 year upgrade proposal differ from the Company's prior plans to upgrade its rural facilities?
23. Could the Company accelerate its upgrade plan and modernize its rural facilities in 2 or 3 years rather than 4? How would this be accomplished?
24. Has plant modernization been an issue in prior Company general rate proceedings? If so, which proceedings and how was the issue treated?

Sharing

25. Are the Company's proposed reporting requirements adequate?
26. Has NWB shown that the sharing point of 12.14% threshold rate of return (approximately 14.74% ROE) is reasonable?
27. How much have NWB's actual earnings varied over the last ten years?
28. What is the probability of the Company achieving the threshold level of earnings in each year of the plan?
29. Is an Absolute ROR or ROE appropriate in an incentive regulation environment?
30. Which services will participate and which services will not participate in sharing under the Company's proposal?
31. Would the Company have a greater incentive to be efficient with a system where, for

example, the first 100 basis points of additional earnings were returned to ratepayers, the second 100 basis points of additional earnings were retained by the company, and the third 100 basis points were returned to ratepayers, etc. was adopted?

32. Would the Company have a greater incentive to be efficient if a system where, for example, the first 300 basis points of additional earnings were returned to ratepayers and the Company was able to retain all additional earnings thereafter was adopted?
33. What additional risks, if any, would the Company face under its proposed incentive plan that it would not face under traditional rate of return regulation?

Rate Case

34. Would NWB be allowed to file a rate case during the first two years of an incentive plan under any circumstances?
35. Could interim rates be placed into effect during the first two years of an incentive plan?
36. If NWB earnings fall below the Baseline ROR, should it be allowed to file for 100% of the revenue deficiency or only part?

Pass Throughs

37. Is the Company's proposal to pass-through the effects of Commission decisions which negatively affect the Company's revenues consistent with chapter 237.625, subd. 1 (e)?
38. What is a "Miscellaneous Tariff Filing" as it relates to the Company's proposed Incentive Regulation Plan?
39. What types of cost increases and decreases are possible during the life of the plan and which of these should be passed through to customers as rate changes?
40. Explain what Company-provided post-retirement benefits would be subject to the new accounting standard if it is adopted by the Financial Accounting Standards Board (FASB)? What impact would this accounting change have on the calculation of the Company's earnings?
41. What impact, if any, does the recent retirement plan for U S West employees have on earnings if the proposed standard is adopted? Contrast the impact on earnings with what the effect would be if there had not been an early retirement plan offered.

Cost Savings

42. What measures, including employee layoffs, if any, will the Company take to reduce its costs and improve its efficiencies during the life of the incentive plan?
43. Why is an incentive plan necessary for the Company to implement such cost saving measures?

Quality of Service

44. How should quality of service be monitored under the incentive plan?

Legal

45. Minn. Stat. § 237.625 (Supp. 1989) states in part: "The commission shall reject a plan if it has substantial reason to believe that existing rates are inappropriate." Is the standard "inappropriate" the same as the standard "fair and reasonable" as used in Minn. Stat. § 237.06 (1988)?