

P-430, 421/CP-86-5 ORDER ADOPTING GUIDELINES FOR EXTENDED AREA
SERVICE RATES FOR THE WACONIA, MAYER, COLOGNE, AND NORWOOD
EXCHANGES AND VARYING TIME FOR FILING FOR RECONSIDERATION

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
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In the Matter of the Petition of
Certain Subscribers in the
Waconia Exchange for Extended
Area Service to the
Minneapolis/St. Paul Metropolitan
Calling Area

ISSUE DATE: February 1, 1991

DOCKET NO. P-430, 421/CP-86-5

In the Matter of the Petition for
Extended Area Service from Mayer,
Minnesota to the Minneapolis/St.
Paul Metropolitan Calling Area

DOCKET NO. P-407, 421, 430, 405,
426/CP-88-839

In the Matter of a Commission
Investigation into Extended Area
Service Between Cologne and the
Minneapolis/St. Paul Metropolitan
Calling Area

DOCKET NO. P-430, 421, 407, 405,
426/CI-90-441

In the Matter of a Commission
Investigation into Extended Area
Service Between Norwood and the
Minneapolis/St. Paul Metropolitan
Calling Area

DOCKET NO. P-430, 421, 407, 405,
426/CI-90-442

ORDER ADOPTING GUIDELINES FOR
EXTENDED AREA SERVICE RATES FOR
THE WACONIA, MAYER, COLOGNE, AND
NORWOOD EXCHANGES AND VARYING
TIME FOR FILING FOR
RECONSIDERATION

PROCEDURAL HISTORY

On April 26, 1990, the Minnesota legislature enacted legislation prescribing the standards, timetable, and procedure for establishing extended area service (EAS) in Minnesota. 1990 Minn. Laws Chapter 513, hereinafter referred to as the new EAS statute. Section 1 of that statute is codified as Minn. Stat. § 237.161 (1990).

On June 26, 1990, the Commission issued its ORDER AFTER RECONSIDERATION OF JUNE 20, 1989 ORDER IN LIGHT OF MINNESOTA STATUTE § 237.161 (1990) in the consolidated Metro EAS Case (Docket No. P-421, 405, 407, 430, 426, 520, 427/CI-87-76).¹ In this Order, the

¹ The Procedural History section of the June 26, 1990 Order (Docket No. P-421, 405, 407, 430, 426, 520, 427/CI-87-76) presents a brief summary of Commission action with respect to

Commission applied the new EAS statute to 16 petitions for EAS to the metropolitan calling area (MCA), including a petition from Waconia, the first exchange that is the subject of the current Order. With respect to this exchange, the Commission directed the affected telephone companies to file cost studies and proposed rates for EAS between Waconia and the metropolitan calling area within 45 days.

On July 3, 1990, the Commission applied the new EAS statute to four petitions for EAS to the metropolitan calling area that had not been consolidated into the Metro EAS case. Among those four petitions was one from the Mayer exchange which is the second petition subject to this Order.² With respect to the Mayer petition, the Commission directed the affected telephone companies to file cost studies and proposed rates for EAS between Mayer and the metropolitan calling area within 45 days. Mayer EAS Petition, Docket No. P-407, 421, 430, 405, 426/CP-88-839, ORDER REQUIRING FILING OF COST STUDIES AND PROPOSED RATES (July 3, 1990).

On August 6, 1990, pursuant to its duty under Section 2 of the new EAS statute, the Commission initiated consideration of EAS to the metropolitan calling area for the three metropolitan area exchanges that had not filed EAS petitions to date, including the third and fourth exchanges under consideration in this Order: Cologne and Norwood.³ With respect to Cologne and Norwood, the Commission directed the affected telephone companies to file cost studies and proposed rates for EAS between these two exchanges and the metropolitan calling area within 45 days. Cologne EAS Investigation, Docket No. P-430, 421, 407, 405, 426/CI-90-441, ORDER INITIATING INVESTIGATION (August 6, 1990); Norwood EAS Investigation, Docket No. P-430, 421, 407, 405, 426/CI-90-442, ORDER INITIATING INVESTIGATION (August 6, 1990).

On August 20, 1990, the Commission granted the telephone companies affected by the Waconia EAS petition an extension until September 24, 1990 to file their cost studies and proposed rates. On August 29, 1990, the Commission granted the telephone companies affected by the Mayer EAS petition an extension until October 30, 1990 to file their cost studies and proposed rates.

By September 25, 1990, the companies had filed their cost studies and proposed rates for the Waconia, Cologne, and Norwood exchanges.

Metro EAS petitions prior to the 1990 EAS legislation, including those for the Waconia exchange.

² The other three exchanges were Montrose (Docket No. P-421, 413, 407, 405, 430, 426/CP-88-856) Monticello (Docket No. P-404, 421, 430, 407, 405, 426/CP-89-1039) and Waverly (Docket No. P-413, 421, 430, 407, 405, 426/CP-89-187).

³ The other exchange for which the Commission initiated proceedings on August 6, 1990 to determine whether it will order EAS installed is New Germany, Docket No. P-407, 421, 430, 405, 426/CI-90-440.

By October 30, 1990, the companies had filed their cost studies and proposed rates for the Mayer exchange.

Following its investigation into the cost studies and proposed rates filed by the companies, the Department of Public Service (Department) filed its reports on the Mayer, Waconia, Cologne, and Norwood exchanges on December 31, 1990, January 4, January 4, and January 7, 1991 respectively.

On January 28, 1991, the Commission met to hear oral argument from the parties and then to consider these matters.

FINDINGS AND CONCLUSIONS

I. BACKGROUND: REGULATION UNDER THE NEW EAS STATUTE

The new EAS statute divides telephone exchanges into two groups: metropolitan area exchanges (i.e. those served by a central office located within the seven county metropolitan area⁴) and non-metropolitan area exchanges.

Non-Metropolitan Area Exchanges: Section 1 of the new EAS statute, now codified as Minn. Stat. § 237.161 (1990), requires the Commission to grant petitions for installation of extended area service when three objective criteria have been established. First, the petitioning exchange must be adjacent to an exchange or local calling area to which extended area service is requested. Second, a traffic study must indicate that at least 50 percent of the customers in the petitioning exchange make one or more calls per month to the exchange or local calling area to which service is requested. Third, polling by the Commission must show that a majority of the customers responding to the poll in the petitioning exchange favor its installation, unless all parties including the Commission agree that no polling is necessary.

Metropolitan Area Exchanges: Section 2 of the new EAS statute requires the Commission to undertake a project to expand the metropolitan extended area service local calling area to include each metro area exchange. For these exchanges, no findings of adjacency or adequate traffic need be made, as is the case for non-metropolitan exchanges. Instead, the Commission need only determine the appropriate rates for EAS for these exchanges and then poll subscribers within each exchange to determine whether more than 50% of those responding to the poll desire EAS. If a majority of the subscribers responding to the poll in that exchange support the proposed EAS route, the Commission will require that the affected telephone companies provide it.

⁴ Section 2 of the new EAS statute, 1990 Minn. Laws Chapter 513, defines the "metropolitan area" as consisting of the following counties: Anoka, Carver, Dakota, Hennepin, Ramsey, Scott and Washington.

II. TREATMENT OF THE WACONIA, MAYER, COLOGNE AND NORWOOD EXCHANGES UNDER THE NEW EAS LEGISLATION

The four exchanges that are the subjects of this Order, Waconia, Mayer, Cologne, and Norwood, are all metropolitan exchanges governed by the Section 2 requirements and process. For convenience, these exchanges will be referred to hereinafter as "the petitioning exchanges."

In this Order, the Commission will adopt principles to implement the provisions of Section 2 which will govern the rates for EAS to the MCA for these exchanges. After specific rates are set in a subsequent Order, the Commission will poll the subscribers in each of the petitioning exchanges to determine whether a majority of subscribers favors installation of EAS. In a subsequent Order, the Commission will certify the results of each of the four pollings and order the installation of EAS in any exchange where a majority of subscribers responding to the poll desire it.

III. EAS RATES UNDER THE NEW EAS LEGISLATION FOR THE PETITIONING EXCHANGES: WACONIA, MAYER, COLOGNE AND NORWOOD

A. Rate Issues Relevant To All Four of the Petitioning Exchanges

The principles which will guide the formulation of EAS rates for the four petitioning exchanges emerge from Commission resolution of six main issues:

1. Whether the cost studies currently on file with the Commission provide an adequate basis for setting EAS rates;
2. What stimulation factor should be assumed in setting EAS rates;
3. Whether EAS rates should be set to recover lost access revenues or lost access contribution;
4. Whether EAS rates should be set to recover lost foreign exchange (FX) revenue or lost FX contribution;
5. Whether more than 75% of the costs of providing EAS for the petitioning exchanges should be recovered in the rates adopted for these petitioning exchanges; and
6. What gross receipts tax factor shall be assumed in setting EAS rates.

1. Adequacy of Current Cost Studies

The cost studies filed by the telephone companies serving the petitioning exchanges present the costs and revenues that would be experienced if only that particular exchange was added to the MCA. The companies do not present alternate scenarios of what the costs and revenues would be if one, two, or more of the other petitioning exchanges were added to the MCA. As such, the cost studies do not

present the Commission with a full range of the revenue and cost possibilities that these exchanges are likely to face.

For example, Contel will incur a flat \$10,000 software right-to-use fee if one or all of its several exchanges (Mayer, New Germany, Watertown and Delano) is added to the MCA. If more than one of these exchanges joins the MCA, Contel's software right-to-use fee will not increase \$10,000 per exchange, but will remain the same and be spread among the added exchanges. Nevertheless, in cost studies filed for each of these exchanges, Contel has included the full \$10,000 fee.

Failure to consider the inclusion of other petitioning exchanges in the MCA also underestimates the amount of lost access contribution. For example, United has estimated the access revenue it will lose if its Waconia exchange is added to the MCA and Contel has estimated the access revenue it will lose if its Mayer exchange is added to the MCA. However, neither company indicates in its cost studies the impact on its access revenues if both exchanges are added to the MCA and they lose access revenues that they currently receive from toll calling between these exchanges.

Unfortunately, there is no way to remedy this inadequacy. Once the new additions to the MCA are identified, the cost and revenue impact of those additions on the petitioning exchanges will be known. However, polling determines which exchanges will be added and the rates must be set before polling. The inescapable result is that the rates must be set based on cost studies that do not reflect the exact costs and revenue that will obtain when service goes into operation. Any misalignment of rates occasioned by the inescapable incompleteness of the current cost studies can be adjusted for, as necessary, in a settle up procedure at a later date after the service has been in effect for a period of time. A final issue regarding the adequacy of the cost studies of record in this matter involves the studies that Contel filed for the Cologne, Norwood and Waconia exchanges and the studies filed by Centel for the petitioning exchanges. Contel and Centel's studies indicate that the only costs experienced due to installing EAS would be the loss of access revenue. The studies do not include any estimate of the portion of the central office or outside plant costs of existing facilities that would be transferred from toll service to local service (i.e. EAS) if EAS is ordered for these exchanges.

Directing Contel and Centel to amend their cost studies to include these items would lose valuable time and jeopardize the Commission's goal of ordering the installation of EAS pursuant to the new EAS statute by July 1, 1991. Additionally, the Commission agrees with the companies that there are efficiencies to be gained if the cost of determining the investment required to provide EAS is likely to exceed the cost of that investment. In lieu of requiring that Contel and Centel provide amended cost studies, the Commission finds that the cost/rate calculations provided by the Department which include only lost access contribution will provide a reasonable basis for setting these EAS rates.

2. Proper Stimulation Factor

Minn. Stat. § 237.161, subd. 2 (1990) indicates that EAS rates must be based, among other factors, on the operating costs and actual cost of new facilities constructed to provide EAS, and net book value of existing facilities transferred from another service to EAS. To calculate the amount of facilities and operating costs that will be required to provide EAS in any given exchange, it is necessary to estimate the level of EAS calling that will occur once EAS is installed. With EAS, subscribers will pay a flat EAS rate and be able to call anywhere in the MCA without incurring a per call charge. Once the monthly charge has been paid, the subscriber incurs no additional charges regardless of how many calls to the MCA he makes or how long he talks. Previously, such non-EAS calls were individually charged at toll rates. It is anticipated that the availability of EAS will stimulate subscribers in the newly admitted exchange to increase the number and duration of calls to other exchanges within the MCA. The percentage increase in such calling occasioned by the switch to EAS translates into an EAS stimulation factor. The EAS rate must properly take into account the amount of facilities and operating expenses that will be necessary to accommodate this increased calling.

The percentage by which telephone use will increase in the petitioning exchanges due to EAS is in dispute. The Department predicts that the increase will be 400% and therefore proposes that growth be estimated using a stimulation factor of 5. The telephone companies argue that the increase is more likely to be 600%, which corresponds to a stimulation factor of 7.

The Commission is not convinced that either stimulation factor is more likely to be correct than the other. USWC asserts that the industry standard in planning for growth in such circumstances has been 7, but the only actual study before the Commission (USWC's study of the Isanti exchange) appears to support a 5.5 stimulation factor. It is not clear, however, that either the asserted industry standard or the Isanti study provide a solid basis for accurately predicting EAS stimulated growth in the petitioning exchanges.

It is clear, however, that the consequences of underestimating the growth rate are far more serious than overestimating it. If growth is underestimated, adequate EAS facilities will not be installed and the quality of EAS service will suffer. Although they would be paying higher EAS rates, subscribers would experience busy signals during peak use hours. To correct this situation, telephone companies would have to install additional facilities and seek to recover the costs of those additional facilities through increased rates. Subscribers who voted in favor of EAS at one level of rates would quickly find themselves confronted with an increase in EAS rates. The consequences of the companies' overbuilding the EAS system do not appear as significant. On balance, then, the Commission believes it more prudent to provide an EAS system to

accommodate a 600% increase in demand and will therefore approve rates based upon a stimulation rate of 7.⁵

The Commission seeks to develop a more empirically based approach to the stimulation factor question. The Commission, therefore, will require the companies serving the petitioning exchanges to study the growth in toll traffic between the exchanges they serve and the MCA if EAS is adopted in an exchange they serve. The companies shall propose a study methodology to the Commission for approval. The studies of different exchanges added to the MCA shall be consistent so that the results are comparable.

3. Lost Access Revenues or Lost Access Contribution

Under the traditional telephone network configuration, local exchange companies (LECs) primarily incur costs and receive revenue for providing their subscribers with local telephone service, i.e. telecommunications within the particular exchange. In addition, they provide their subscribers with access to an intraLATA toll carrier whenever the subscriber wishes to place a call to a party in another exchange within the LATA, receiving access revenue for providing that service and usually incurring expenses in the provision of that service. EAS changes that picture significantly. The LEC continues to provide and receive revenue for providing access to toll carriers for toll calls destined for end users outside the newly joined EAS calling area. However, once EAS is installed, the LEC no longer provides this service for toll carriers for calls destined for end users within the newly formed EAS calling area. Instead, the LEC charges its subscribers EAS rates which must cover all or most of the costs associated with providing telecommunications service within the new EAS calling area.⁶ At the same time, the LEC experiences the elimination of costs associated with the service that it no longer provides: access service to toll carriers for calls between its subscribers and end-users in exchanges belonging to the new EAS calling area.

Minn. Stat. § 237.161, subd. 3 requires that the Commission adopt EAS rates that are "income neutral for the telephone company serving the added exchange." The term "income" as used in that statute is "net income," i.e. revenue from providing the service minus the costs of providing that service. Another term for net income is "contribution." Further, when the statute requires EAS rates that leave the telephone company serving the added exchange "income neutral," it means that the company must realize the same amount of net income or contribution from providing EAS as it currently realizes from providing access service. In the context of replacing current telephone arrangements with EAS, therefore, income neutrality for the telephone companies serving the petitioning exchanges is as

⁵ During the 1960s and 1970s, when numerous exchanges were added to the MCA, it is USWC's recollection that a stimulation factor of 7 was used to provide adequate service.

⁶ Minn. Stat. 237.161, subd. 3 (a) (1990) provides for the apportionment of 25% of the cost of providing EAS to the petitioned exchange or exchanges.

follows: revenues received from providing EAS minus the costs of providing that service shall equal the revenues received from providing the access service replaced by EAS minus the costs of providing that service.

Two practical problems have arisen in applying these seemingly clear statutory directives. First, some telephone companies in this matter⁷ propose a complicated reconfiguration of the system that requires careful analysis under the statute. The companies propose to build all new facilities to carry EAS traffic to the MCA and use the circuits that they currently use to carry MCA bound toll traffic to the toll carriers strictly to carry non-MCA bound toll traffic to the toll carriers. They then propose EAS rates that recover both the costs associated with constructing the new circuits as well as the gross revenue (costs and contribution) historically received from the circuits currently used to carry MCA-bound toll traffic. Under this proposal, the companies are effectively transferring the costs of meeting their increased demand for toll calls to non-MCA exchanges to the EAS rate payers. Such a proposal violates the income neutral requirement of the EAS statute. More fundamentally, taking into account the interests of all parties in setting EAS rates as required by Minn. Stat. § 237.161, subd. 3 (b) (1990), the Commission finds that this proposal would unjustly increase the rates paid by EAS ratepayers and would therefore not be "fair and equitable" as required by the statute.

Second, some telephone companies (Centel and Scott Rice) acknowledge that income neutral rates must take into account any reduction in costs due to no longer providing access service to intraLATA toll carriers for MCA-bound toll traffic. However, these companies assert that because their intraLATA toll carrier (USWC) picks up the intraLATA toll traffic at the companies' end offices, they currently have no costs associated with providing access to their intraLATA toll carrier. Consequently, they argue, their EAS rates should not reflect any assumed cost savings but instead should calculate their lost access revenue as equal to lost access contribution. The companies' position is consistent with the Commission's interpretation of income neutrality. The Commission accepts the companies' point of factual clarification and will direct the Department to take this into account in preparing proposed EAS rates consistent with this Order.

4. Lost FX Revenues or Lost FX Contribution

Under the current network configuration, some LECs offer their subscribers foreign exchange (FX) service which allows the subscriber, for a monthly charge, to subscribe to the local calling service of a neighboring exchange. Once EAS is installed, FX becomes superfluous and is no longer offered. The LEC that offers EAS loses any FX revenue that it had prior to EAS. Lost FX revenues are indistinguishable in principle from lost access revenues and will be treated the same. To establish EAS rates that are income neutral, lost revenue from FX as well as any lost costs of providing FX must

⁷ Contel, Centel, Scott-Rice and United.

be taken into account. Consequently, only the lost contribution of FX may be recovered in the EAS rates.

5. Cost Apportionment

Minn. Stat. § 237.161, subd. 3 (a) (1990) requires that when the local calling area to which EAS is sought is the MCA, 75% of the costs must be apportioned to the petitioning exchange and the remaining 25% to the exchange or exchanges to which EAS is sought. At the same time, however, the statute prohibits raising rates within the MCA as a result of the addition of a petitioning exchange until the rates in the petitioning exchange are at least equal to the highest rates in an adjacent exchange within the MCA.

It is unclear at this time whether these two statutory requirements can be met in the rates that the Commission ultimately will adopt for these four petitioning exchanges. Rates implementing the principles chosen by the Commission in this Order are not yet before this Commission. To-date, no party has filed with the Commission rates which incorporate both of the Commission's two main decisions affecting the rates, i.e. that rates shall reflect lost contribution rather than lost revenue and that the stimulation factor used shall be 7 rather than 5.

Should the statutory 75/25 cost apportionment formula conflict with the statutory prohibition against raising MCA rates in certain circumstances, the Commission believes that the prohibition should control. The statute requires the Commission to "consider the interests of all parties when determining a fair and equitable EAS rate." Minn. Stat. § 237.161, subd. 3 (b) (1990). A petitioning exchange presumably benefits more than any other exchange from its inclusion in the MCA. Equity requires, therefore, that the extension of EAS to such exchange not increase the rates of an existing MCA exchange while the petitioning exchange's rates, even with EAS, remain lower than those in the adjacent exchange with the highest rates already in the MCA.

Accordingly, in the event that EAS rates for a petitioning exchange based on a 75% allocation of costs (but otherwise consistent with this Order) would be lower by class of service than the rates charged in the adjacent exchange within the MCA with the highest rates, the Commission will not adopt such rates but instead will apportion up to 100% of the costs of providing EAS to the petitioning exchange until 100% of costs have been allocated to the petitioning exchange or until its EAS rates are equal to or higher by class of service than the highest rates in an adjacent exchange within the MCA, whichever comes first. The Commission will adopt rates that apportion the lowest percent of costs above 75% that is necessary to achieve EAS rates for the petitioning exchange that are higher than the rates in the adjacent exchanges already in the MCA.

6. Recovery of Gross Receipts Tax

Minn. Stat. § 237.161, subd. 2 provides that EAS rates must be based on six components, one of which is recovery of operating expenses.⁸ Taxes paid by a telephone company, including the tax on gross receipts, have traditionally been considered operating expenses.

There is no disagreement among the parties that the telephone companies should be allowed to include payment of a gross receipts tax as a cost element of the EAS rates approved by the Commission. They only disagree regarding the amount of gross receipts tax that should be factored into the EAS rates. Centel and Contel propose that a 1.5% gross receipts tax be used. The Department recommends a 1% gross receipts tax factor.

The Commission's primary concern here is to establish EAS rates that realistically estimate the costs of providing EAS so that subscribers being polled to determine whether they favor EAS are not misled regarding EAS rates. The gross receipts tax payable by the companies in 1991 is 1%. For purposes of calculating EAS rates to appear on the EAS ballot in 1991, therefore, the Commission finds that a 1% gross receipts factor is appropriate.

B. Rate Issue Specific to the Waconia, Cologne, and Norwood Exchanges: EAS Impact Upon OLMS Rates

United currently offers Optional Local Measured Service (OLMS) in its Waconia, Cologne and Norwood exchanges. OLMS is a basic local service offered as an alternative to flat rate service. The basic innovation of United's measured service is that it allows the subscriber to pay for local service on a usage basis, i.e. for the local calls he actually makes. OLMS provides low use customers an opportunity to exercise some control over their telephone charges. The opportunity to save money by using OLMS is substantial and the Commission has found that OLMS is making a positive contribution to the goal of universal service at low cost.⁹

In this Order, the Commission considers for the first time how EAS costs will be apportioned between these two varieties of basic local service: flat rate service and OLMS. The Commission must determine

⁸ The six authorized components for EAS rates are: 1) specific additional cost incurred, 2) operating expenses, 3) actual cost for new facilities constructed specifically to provide for EAS, 4) net book value of existing facilities transferred from another service to EAS, 5) a return on the capital investment associated with installing and providing EAS, and 6) appropriate contribution to common overheads. Minn. Stat. § 237.161, subd. 2 (1990).

⁹ In the Matter of an Investigation into Northwestern Bell Telephone Company's Optional Measured Service Trial Offerings, Docket. No. P-421/CI-90-152, ORDER AUTHORIZING NORTHWESTERN BELL TELEPHONE COMPANY TO OFFER OPTIONAL MEASURED SERVICE AS A PERMANENT SERVICE AND REQUIRING THE FILING OF REVISED RATES (January 10, 1991), at page 5.

how much of the costs of providing EAS to the Waconia, Cologne, and Norwood subscribers United will be allowed to recover in rate increases to Waconia, Cologne, and Norwood's flat rate subscribers and how much United will recover in rate increases to its OLMS customers in these three exchanges.

The EAS statute requires that, after rates are adjusted to cover EAS costs, rates of the residential class must bear the same "relationship" to the rates of the business class as existed prior to the EAS-related rate increases. Minn. Stat. § 237.161, subd. 3 (a) (1990). The Commission does not view the statute as requiring maintenance of the precise mathematical rate ratio between classes. For example, if current residential rates in a petitioning exchange were 48.7% lower than business rates before EAS, they need not be exactly 48.7% lower than business rates after EAS-related increases. Instead, the same rate relationship between the classes may be maintained by new residential rates that are approximately 48.7% lower than business rates.

Rather than taking the ratio between residential rates and business rates and proposing EAS rates that maintain the inter-class rate relationship suggested by this ratio, however, the Department has calculated the ratio between the current flat rate service and the current flat rate portion of the OLMS rate for each of the three classes of service and proposed EAS additives that would precisely maintain those ratios. The defect in the Department's proposal is that instead of focusing on the rate ratios between classes, as required by the statute, it focuses on rate ratios between service offerings within the classes, i.e. the rate ratios for residential flat rate service and the rates for residential OLMS. The statute does not require maintaining intra-class ratios and the Commission will not adopt rates calculated to do so, particularly since they are likely to result in rates that raise OLMS rates sharply and erode the price benefit of the OLMS service option. The Department's method also guarantees recovery of the EAS costs in the flat rate portion of OLMS without consideration of stimulated usage increasing the company's revenues from the usage sensitive portion of the OLMS rate. The Department's proposed rates, therefore, would also violate the income neutral requirement of Minn. Stat. § 237.161, subd. 3 (1990).

The rate proposal offered by United is more promising. United proposes rates to recover the same amount of EAS costs per customer from its OLMS subscribers as it recovers per customer from its flat rate subscribers. United's proposed EAS cost recovery method is illustrated using figures for its Waconia exchange as follows. United proposes an EAS additive of \$15.66 for both residential Flat Rate subscribers and OLMS subscribers.¹⁰ However, United proposes to collect the EAS additive from OLMS subscribers partly through increasing the flat rate portion of the OLMS rate (an additional

¹⁰ The specific figures presented in this paragraph apply only to United's Waconia exchange and, because they do not include all of the principles adopted in this Order, are not the final rates that the Commission will adopt. United proposes to apply the same method of recovery, however, in each of its exchanges.

\$2.00 above the current flat rate \$9.30) and partly through the OLMS usage charge. Under United's proposal, by far the largest portion of the OLMS EAS additive would be recovered through the OLMS usage rate: \$13.66. In projecting recovery of this amount (\$13.66) through the usage charge, United assumes that the addition of EAS will stimulate OLMS usage to a higher level and applies the tariffed usage rates of \$.05 for the first minute and \$.02 for additional minutes to that stimulated usage.

The following is an example of United's initial proposal for the Waconia exchange:

Flat Rates: Residential/Business Class Rate Ratio

Residential-1:	Current rate	\$14.98
	<u>Proposed EAS additive</u>	<u>\$15.66</u>
	New Bundled F/R R-1 Rate	\$30.64
Business-1:	Current rate	\$32.67
	<u>Proposed EAS additive</u>	<u>\$31.32</u>
	New Bundled F/R B-1 Rate	\$63.99

Current inter-class ratio for Flat Rates: Ratio between current F/R R-1 rate and current F/R B-1 rate
 (\$14.98 divided by \$32.67) **.458**

New inter-class ratio for Flat Rates: Ratio between the new F/R R-1 rate and the new F/R B-1 rate
 (\$30.64 divided by \$63.99) **.478**

OLMS Rates: Residential/Business Class Rate Ratios

Residential OLMS:	Current rate	\$9.30
	<u>Proposed EAS additive/recovery</u>	<u>\$15.66</u>
	New OLMS rate/recovery ¹¹	\$24.96
Business OLMS:	Current rate	\$18.14
	<u>Proposed EAS additive/recovery</u>	<u>\$31.32</u>
	New OLMS rate/recovery	\$49.46

Current inter-class ratio for OLMS rates: Ratio between current OLMS Residential rate and current OLMS Business rate
 (\$9.30 divided by \$18.14): **.512**

¹¹ The amount listed here as a "new OLMS rate" is in fact the total recovery United projects it will receive from the increased OLMS flat rate charge and increased usage revenues projected as indicated above.

New inter-class ratio for OLMS rates: Ratio between new OLMS residential rate and new OLMS business rate (\$24.96 divided by \$49.46): **.505**

The Commission will adopt United's approach. As the above-cited inter-class rate ratios indicate, United's proposal maintains the inter-class rate relationship required by Minn. Stat. § 237.161, subd. 3 (a) (1990). Moreover, by collecting EAS costs from OLMS subscribers primarily through usage charges, United's plan preserves OLMS as a viable money-saving alternative for low use subscribers.

C. Rate Issue Specific to the Mayer Exchange: Contel's Rate of Return on Equity

The Commission must determine what rate of return it will authorize Contel to use in calculating its EAS rates. Minn. Stat. § 237.161, subd. 2 describes the rate of return factor as "a return on the capital investment associated with installing and providing the [EAS],...."

Contel calculated its proposed EAS rates using the 14.57% rate of return on equity (ROE) that the Commission approved in the company's last rate case. The Department believes that this figure, which was set over 5 years ago, does not reflect a reasonable cost of equity invested in new equipment. The Department recommends that Contel's EAS rates use the return on equity that Contel accepted in its settlement of the earnings complaint filed by the Department in 1990.

Determination of a company's rate of return is normally made by the Commission in the course of a rate case or other proceeding giving special focus to that issue. Although the Commission may change Contel's rate of return in Docket No. P-407/C-90-906 currently pending before it, the Commission will not prejudge this issue. Instead, the Commission will authorize EAS rates based on the rate of return currently authorized for Contel: 14.57%. In the event of change in the rate of return due to Docket No. P-407/C-90-906, no significant time will be lost due to this decision. Contel has already calculated EAS rates using the stipulated ROE: 12.3%. Therefore, any change in EAS rates which may be required to bring them in line with a new rate of return, if any, may be quickly adopted.

IV. EAS RATE ADDITIVES: EAS RATES FOR EXISTING MCA EXCHANGES

A. Rate Additive Issues Relevant to All Existing MCA Exchanges

As discussed above, the Commission's subsequent Order may establish rates for one or more of the petitioning exchanges that recover at least 75% but less than 100% of the costs of providing EAS to the MCA. The remainder of the costs of providing Metro EAS would then be apportioned, pursuant to Minn. Stat. § 237.161, subd. 3 (a) (1990), to the exchanges to which EAS is requested, i.e. to the MCA exchanges. The Commission will authorize the telephone companies serving the MCA exchanges to increase their EAS rates to cover any such costs. The increases in current Metro EAS rates are referred to

as EAS rate additives. In the current Order establishing the principles that will govern establishment of EAS rates, the Commission will resolve two issues that have arisen regarding the recovery of these 25% remaining costs.

1. Rate Design for EAS Rate Additives

The Commission must decide the rate design that it will adopt for EAS rate additives. Currently, all the telephone companies serving the MCA have established practices for structuring EAS additives. Subscribers in all the exchanges of Centel, Contel, and Scott-Rice pay the same flat rates for metro EAS service by class of service. In United's metro exchanges, however, all subscribers pay the same access line rate, but the EAS additive varies by exchange. In USWC's metro exchanges, subscribers pay different rates depending on which tier they reside in.

The Department objects to United and USWC's variations and proposes that the Commission require all the telephone companies to adopt a flat rate EAS additive. The Department believes that since all subscribers of the current MCA benefit from the inclusion of an additional exchange within the MCA, it is reasonable to require a telephone company's customers to pay the same rate additive, with the only differentiation being class of service.

The Commission will permit the companies to continue their past practice for establishing EAS additives. The Department's recommendation that EAS additives should be flat rated is premature. Normally, the Commission would consider such a recommendation in a rate case or in a similar proceeding. Furthermore, in a separate proceeding, the Commission is examining whether USWC's tier structure is appropriate. The Commission will not prejudge that issue.

2. Rate Additives of Less Than \$.01

The Commission must decide whether it will authorize telephone companies serving the MCA to adopt EAS rate additives of less than \$.01. The EAS statute is clear that affected telephone companies are to be income neutral as a result of installing EAS. The Commission will authorize rounding and the determination of final EAS rate additives after it is determined which of the exchanges will be added to the MCA. Because the additive attributable to any given exchange within the MCA is likely to be quite small, determination of the EAS additive should be done by rounding the EAS additive for each of the exchanges to be added into the MCA to the nearest tenth of a cent (\$.001) and then rounding the total of the EAS additives to the nearest whole cent. In this way Commission policy will be followed and income neutrality achieved.

The Commission will not adopt specific amended EAS rates for the existing MCA exchanges in this Order. Indeed, if the EAS rates for each of the four exchanges must recover 100% of the EAS costs to comply with Minn. Stat. § 237.161, subd. 3 (a) (1990), there will be no EAS additive for subscribers in the existing MCA. Instead, the Commission will require the Department to propose any amended EAS rates that may be necessary for MCA exchanges within 10 days of this

Order. Such proposed rates will be consistent with this Order and the requirements of Minn. Stat. § 237.161 (1990).¹²

B. Rate Additive Issue Specific to Contel's MCA Exchanges: Cost Allocation Due to Addition of Mayer to the MCA

If, pursuant to Minn. Stat. § 237.161, subd. 3 (a) (1990), EAS rates for Mayer are calculated to recover only 75% of the costs of providing this service and Mayer is added to the MCA, Contel proposes no increase in rates for its five MCA exchanges to recover its portion of the remaining costs associated with providing EAS to Mayer. The Department argues that Contel may exempt three of its five MCA exchanges (Mound, Maple Plain and St. Bonifacious) from paying EAS additives to recover its portion of the remaining costs (25%) because these three exchanges already have EAS to Mayer, but should then be required to recover all those costs from its two remaining MCA exchanges, Wyoming and Scandia-Marine.

The Commission finds that Contel's proposal of no EAS rate additives for subscribers in its current MCA exchanges due to the addition of Mayer is "fair and equitable" within the meaning of Minn. Stat. § 237.161, subd. 3 (b). The statute does not require that Contel pass on its share of the 25% costs via EAS additives to its current MCA exchanges. It may choose to absorb those costs. However, if Contel does choose to recover those costs through EAS additives, the statute provides no basis for differentiating between its MCA exchanges. If it wishes to impose any additives to recover these costs, it must allocate the burden of these costs equally on all its MCA exchanges and may not exempt any exchange or exchanges at the expense of others.

This question, of course, will become moot if rates adopted by the Commission for Mayer allocate 100% of the costs of providing EAS to the MCA to the Mayer exchange.

IV. MISCELLANEOUS ISSUES

A. Recovery of the Costs Associated With EAS Polling

Once the EAS rates for the petitioning exchanges are established, the Commission will poll the subscribers in those exchanges pursuant to Minn. Stat. § 237.161 (1990). The Commission, then, will bill the telephone companies serving these exchanges to recover the expenses incurred in the polling as part of the overall regulatory expenses associated with this proceeding. Minn. Stat. § 237.295, subd. 2.

The telephone companies have requested authority to pass on to their subscribers the costs associated with the EAS polling in the form of a one-time surcharge assessed the first month that EAS is provided.

¹² For example, the proposed amended rates must apportion the costs assigned under this Order among customers so that the relationship between the rates for classes of basic local service remains the same. Minn. Stat. § 237.161, subd. 3 (a) (1990).

The statute specifically provides that subscribers shall not bear the postage cost of returning their EAS ballots to the Commission. At the same time, however, the companies are entitled to achieve income neutrality pursuant to Minn. Stat. § 237. 161, subd. 3 (b) (1990). The Commission, therefore, will permit the companies to recover all their non-recurring EAS costs, except the postage necessary to return the EAS ballots to the Commission, through a one-month surcharge. At this time, the Commission will not authorize recovery of a specific amount because the EAS polling costs have not been incurred. The Commission will require the companies to file their proposed one-month surcharge plans with supporting documentation for the amount to be recovered 120 days prior to the date that EAS will be provided. The Department shall have 30 days to submit comments on the companies' plans.

B. Shortening the Reconsideration Period

The Commission has adopted a rule authorizing parties to petition for further hearing, rehearing, vacation or reconsideration of Commission orders. Minn. Rules, part 7830.4100. In part, the Commission's rule requires that petitions for reconsideration be filed within 20 days of the date that the Executive Secretary mails the order to the parties. It further requires that replies to such petitions be filed within 10 days of the date of service of the petition.

On its own motion, the Commission will vary the terms of this rule. The Commission will reduce the time to file petitions for reconsideration from 20 to 10 days and eliminate the filing of replies to such petitions. In varying from the requirements of Minn. Rules, part 7830.4100, the Commission acts pursuant to Minn. Rules, part 7830.4400. Minn. Rules, part 7830.4400 authorizes the Commission to vary a rule when it finds that:

1. enforcement of the rule would impose an excessive burden upon the applicant or others affected by the rule;
2. varying the rule would not adversely affect the public interest; and
3. granting the variance would not conflict with standards imposed by law.

The Commission so finds. As the Procedural History section of this Order reflects, the parties have had adequate time to prepare their cost studies and proposed rates and to brief and argue the issues raised in this proceeding. They will be able to readily identify and articulate any parts of this Order that they may wish the Commission to reconsider. In addition, the issues involved in these dockets are substantially the same as the Commission decided in a related EAS rate order issued January 25, 1991. In such a case, the parties to these present dockets will suffer no harm due to a shorter petition period. The variance will provide greater administrative efficiency in that it will allow the Commission to reconsider the EAS rate guidelines for all eight exchanges, if reconsideration is necessary.

In contrast, the Commission finds that strict adherence to the reconsideration timelines would unnecessarily delay the statutory

process for expanding the metropolitan extended area service local calling area as required by Section 2 of the new EAS statute. Such a delay would jeopardize the Commission's efforts to honor the statutory deadline for such expansion, July 1, 1991. Finally, shortening the reconsideration period will not conflict with standards imposed by law. In such circumstances, the Commission will promote the public interest by shortening the timeline for filing petitions for reconsideration of this Order and eliminate the filing of answers to any such petitions.

ORDER

1. On or before February 4, 1991, telephone companies desiring to do so shall file with the Commission and the Minnesota Department of Public Service (the Department) updated cost information and proposed rates consistent with this Order.
2. On or before February 11, 1991, the Department shall file proposed extended area service (EAS) rates for each of the petitioning exchanges consistent with Minn. Stat. § 237.161 (1990) and the principles established in this Order.
3. On or before February 11, 1991, the Department shall file proposed EAS rates for each of the existing metropolitan calling area (MCA) exchanges reflecting the recovery of whatever costs of providing EAS to the petitioning exchanges are properly allocated to such exchanges, consistent with Minn. Stat. § 237.161 (1990) and the principles established in this Order.
4. Pursuant to findings made in accordance with Minn. Rules 7810.4100, the Commission hereby varies the requirements of Minn. Rule 7810.4100 in the following respects:
 - a. On or before February 11, 1991, any party seeking reconsideration of or other relief from this Order pursuant to Minn. Rules, part 7830.4100 shall file its petition seeking such relief and serve copies of such petition on the parties; and
 - b. No answer to any such petition for reconsideration shall be permitted.
5. No later than 120 days prior to the initiation of EAS in any petitioning exchange, telephone companies that have incurred EAS polling costs may submit a plan to the Commission and the Department for the recovery of such costs in a one-month customer surcharge, together with documentation to verify the amount of such costs incurred. The Department shall submit its comments in response to the non-recurring cost recovery plans within 30 days of receipt.
6. Within 90 days of this Order, the companies shall submit a methodology for studying EAS stimulated growth in call traffic between the petitioning exchanges and the MCA.

7. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)