

P-421/CI-88-152 P-421/EM-90-370 ORDER DENYING RECONSIDERATION AND
CLARIFYING ORDER

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner
Patrice M. Vick	Commissioner

In the Matter of an
Investigation into Northwestern
Bell Telephone Company's
Optional Measured Service Trial
Offerings

ISSUE DATE: April 19, 1991

DOCKET NO. P-421/CI-88-152

In the Matter of a Proposal by
Northwestern Bell Telephone
Company to Extend Optional
Measured Service to Nine
Exchanges

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ORDER DENYING RECONSIDERATION
AND CLARIFYING ORDER

PROCEDURAL HISTORY

On January 10, 1991, the Commission issued its ORDER AUTHORIZING NORTHWESTERN BELL TELEPHONE COMPANY TO OFFER OPTIONAL MEASURED SERVICE AS A PERMANENT SERVICE AND REQUIRING THE FILING OF REVISED RATES in this matter.

On January 30, 1991, the Department of Public Service (the Department), the Senior Citizen Coalition of Northeastern Minnesota (SCC), and the Minnesota Senior Federation-Metropolitan Region (MSF-MR) each filed a Request for Reconsideration of the Commission's January 10, 1991 Order.

On February 11, 1991, U S West Communications, Inc. (USWC), formerly Northwestern Bell Telephone Company, and the Residential Utilities Division of the Attorney General's Office (RUD-OAG) each filed a Reply to Requests for Reconsideration.

On March 20, 1991, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

In its January 10, 1991 Order, the Commission ended the trial of USWC's Optional Measured Service (OMS) and authorized USWC to offer OMS as a permanent service offering in all the exchanges in which it currently offered OMS on a trial basis and in nine (9)

additional exchanges. In addition, it adopted principles which will control determination of the revised OMS rates in a subsequent filing and directed USWC to file an OMS tariff with the revised rates that would comply with the principles adopted in the Order and which would be based upon updated information regarding OMS access lines and usage.

The requests for reconsideration and clarification raised the following issues:

- 1) Do USWC's OMS rates discriminate against Flat Rate Service (FRS) subscribers in violation of Minn. Stat. § 237.09 (1990)?
- 2) Do USWC's FRS rates subsidize OMS rates in violation of either Minn. Stat. § 237.09 (1990) or Minn. Stat. § 237.06 (1990)?
- 3) Do USWC's OMS rates promote the goal of universal service?
- 4) Will the changes in OMS rates authorized by the Commission's January 10, 1991 Order achieve income neutrality for USWC?
- 5) Will the changes in OMS authorized by the Commission's January 10, 1991 Order reduce the difference between the price/cost ratio for OMS and FRS?

No Discrimination

The parties argue that the OMS rates are discriminatory because they recover a lower percentage of the costs of providing OMS than the percentage of costs of providing FRS that FRS rates recover. Under the parties' analysis, rates for services provided to the same class of customers that do not achieve the same contribution levels are *ipso facto* discriminatory.

Minn. Stat. § 237.09 (1990) states:

No telephone company, or any agent or officer thereof, shall, directly or indirectly, in any manner, knowingly or willfully, charge, demand, collect, or receive from any person, firm or corporation, a greater or less compensation for any intrastate service rendered or to be rendered by it than it charges, demands, collects, or receives from any other firm, person, or corporation for a like and contemporaneous intrastate service under similar circumstances.

The Commission rejects the proposition that OMS and FRS are "like and contemporaneous intrastate service[s] [provided] under similar circumstances". The parties urge the Commission to view FRS and OMS as merely as different pricing plans for the same service, local telephone service. To do so would gloss over

significant distinctions. FRS, itself a bundling of two services (access and usage), is paid on a fixed sum basis and provides limitless local service. OMS, on the other hand, provides a very limited local calling ability for a low flat rate and thereafter unbundles the access service from usage service and charges only for the usage service, i.e. on a per call basis. The Commission finds that these services are distinct in terms of purpose, operation, appearance and effect upon customers. Such distinctions are substantial and adequately differentiate FRS from OMS so that they are not "like" as that term is used in the discrimination statute. To illustrate the distinctiveness of these services: it is inconceivable that an OMS customer could be provided and billed for FRS (and vice versa) and not notice the difference.

Perhaps even more fundamentally, the Commission is not convinced that the discrimination statute requires identical price/cost ratios between all services within a class of customers that the Department apparently seeks. The statute does not refer to price/cost ratios at all, but aims at preventing a more obvious phenomenon, different pricing for essentially the same service to similarly situated customers.

The wisdom of rejecting price/cost ratio studies as governing OMS rates is reinforced by the fact that it is not possible to do a proper price/cost comparison between FRS and OMS. The appropriate price/cost comparison between OMS and FRS would compare the individual price for the access service and the usage service to the incremental cost of providing each such service.¹ Currently, such a cost recovery comparison cannot be made between OMS and FRS because while OMS unbundles these two distinct services, access and usage, and gives a price for each, FRS maintains these services in a bundled state and does not indicate which part of the rate is attributable to access and which part is attributable to usage. Since no delineation is made between access and usage in FRS rates, it is impossible to do an accurate access and usage cost recovery analysis for FRS. Even if the price of FRS usage were delineated so that it could be compared with the OMS usage rate, no valid cost recovery comparison could be made between OMS and FRS because OMS usage rates are based upon the long run incremental cost of a minute of use while FRS usage is residually priced and based upon the average usage of all customers.

¹ The proper comparisons would be: 1) the price of OMS access divided by the incremental cost of providing that service compared to the price of FRS access divided by the incremental cost of providing that service; and 2) the price of OMS usage divided by the incremental cost of providing that service compared to the price of FRS usage divided by the incremental cost of providing that service.

No Subsidization

The parties have also raised the issue of subsidization as part of their discrimination argument, asserting that since FRS rates recover a larger percentage of FRS costs than OMS rates recover of OMS costs FRS is subsidizing OMS. The Commission finds their contention to be without merit.

First, for the reasons discussed previously, the price/cost comparisons relied on by the Department to reveal the alleged subsidization of OMS by FRS are flawed and cannot be relied upon to prove the first premise of their argument, that FRS subscribers in fact bear a greater cost recovery burden than OMS subscribers.

More importantly, the parties' argument regarding subsidization calls for a closer examination of the nature of subsidization in the context of utility rates. Even assuming what the Department studies fail to show, i.e. that FRS subscribers bear a greater cost recovery burden than OMS subscribers, analysis FRS of rates and OMS rates does not reveal that FRS rates subsidize OMS rates.

In USWC's most recent rate case, both residential FRS and OMS were treated as residual services and their rates were residually set. Theoretically, non-residually set rates are set in a rate case before the rates for residual services. The rates for non-residual services customarily are, and in USWC's most recent rate case were, set well above the cost of providing these services. Once the rates for the non-residual services are set and the revenue for such rates is projected, the revenue projected from such services is subtracted from the company's revenue requirement, thereby establishing the amount of revenue that must be recovered from the residual services in order to meet the company's revenue requirement. Rates for the residual services are then designed, not to recover their costs, but merely to recover the balance of the company's revenue requirement.

In setting rates, the revenues of all services taken together must produce the company's revenue requirement. The revenue requirement equation is satisfied regardless of which services produce what revenue as long as the revenues of all services taken together produce the required revenue. To the extent that non-residual services are priced above cost, therefore, the residual services can be priced below-cost and still produce the company's revenue requirement. The above-cost rates for non-residual services, in effect, make below-cost rates for residual services possible. In the case of USWC's 1981 rate case it may be that the average rates for all its residual services were priced below the cost of providing these services. To the extent that they actually do so, the rates of the non-residual services may be said to subsidize the rates of the residual services.

Looking closer, it is clear that subsidization in the context of the revenue requirement equation can only occur between services when one service generates revenue above cost and therefore has excess revenue to "share" with any other service. Unless a service generates revenue above cost, therefore, it can not be said to subsidize any other service.

There is no showing that FRS generates revenue above cost. Since FRS is a residually priced service, it was not purposely priced to generate revenue in excess of cost and the lack of cost data for FRS makes it impossible to determine what portion of its incremental cost its rates actually recover. Accordingly, there is no basis for viewing FRS as generating income in excess of cost, the prerequisite to being in a position to subsidize any other service.

Universal Service

In its January 10, 1991 Order, the Commission states that information on the demographics of OMS users suggests that OMS is making a positive contribution to the goal of universal service at low cost. The parties dispute the validity of this conclusion.

The Department - The Department's discussion of the universal service issue arises in the course of its examination of the OMS rates for discrimination. According to the Department, the current OMS rates offer different prices for like services offered under similar circumstances and, hence, may only be approved if they promote a valid non-cost factor such as universal service.

As indicated earlier, the Commission does not find that FRS and OMS are "like" services, and hence, it is not necessary to consider the remaining parts of the Department's discrimination analysis, including its position on universal service.

Senior Citizen Coalition - The SCC opposes the Commission's decision to authorize OMS as a permanent service. In disputing the basis of the Commission's decision to approve OMS as a permanent service, SCC argues that the case has not been made that OMS has contributed much to universal service.

First, promotion of universal service was an additional rather than the dispositive reason for approving OMS. Even without contributing to universal service, OMS' support of other goals was adequate to justify its place as a permanent service offering. Therefore, even if the Commission were to find that OMS did not contribute to universal service at all, this would not require reversal of the Commission's Order.

Moreover, the Commission continues to believe that OMS contributes to universal service in its own way. Since the introduction of OMS in 1983, the population of very low income and near low income persons in Minnesota has increased, increasing the number of persons at risk for loss or lack of telephone service. The Commission is aware that current telephone assistance provided by the legislature for low income persons is limited in scope.² It is axiomatic that prices affect consumer behavior and that consumers forgo goods and services whose prices exceed their perceived value. In these circumstances, it is not unreasonable to assume that there are persons who are receiving telephone service today who would not if this low cost alternative were not available.

Given the number of current and potential low-income telephone subscribers not assisted by TAP and TACIP, the Commission finds that it is prudent to have in place a workable and popular low cost telephone service such as OMS. Having such an alternative in place provides a necessary safety net telephone service in support of universal service in Minnesota. The Commission believes that no empirical study is necessary to establish that, for an undetermined number of Minnesotans, the price difference between flat rate service and local measured service makes the difference between purchasing telephone service and going without it.³

Income Neutrality

The Department notes that because this is a rate design proceeding, income neutrality must be maintained. The Department believes that the Order allows USWC to increase its rates for OMS without a corresponding decrease in FRS, thereby leaving USWC with increased income. To correct this problem, the Department

² The Telephone Assistance Program (TAP) is restricted to subscribers who meet certain household income limits and are at least 65 years of age or are disabled. Minn. Stat. § 237.70 (1990). The Telecommunication Access for Communication-Impaired Persons (TACIP) fund provides equipment and services to facilitate telecommunications by communication-impaired persons. The TACIP fund does not provide a low cost alternative to basic flat-rate service but makes that service and long-distance service accessible to communications-impaired persons. Minn. Stat. § 237.52 (1990).

³ The legislature has adopted a similar protective measure when it enacted legislation conditioning the expansion of the metropolitan calling area on the availability of local measured service or another low cost alternative to flat rate service. Minn. Stat. § 237.161, subd. 1 (c) (1990).

proposes that the Commission decrease FRS rates to offset the increase in OMS rates.

The Department correctly points out that income neutrality is required in this rate design case. However, the Commission's January 10, 1991 Order approved a rate structure in which increases in the OMS access charge are offset by decreases in the OMS usage charge to produce income neutrality within OMS itself. Therefore, there is no need to lower FRS rates to achieve income neutrality for USWC.

Price/Cost Ratios

The Department sought clarification of the discussion in the Commission's Order regarding the reduction of the price/cost ratio for OMS and FRS. The Department argued that the ordered rate adjustments within OMS accomplished neither a reduction nor the elimination of the difference in the price/cost ratios between OMS and FRS.

Based on the inadequacies in the Department's price/cost ratio argument noted earlier, the Commission finds that there is no sound basis for determining whether a difference in the price cost ratios between OMS and FRS actually exists. Accordingly, it is appropriate to clarify that the overall OMS rate structure authorized in the January 10 Order is justified not because of its impact upon price/cost ratios but simply because it will yield OMS rates that are in better alignment with incremental cost and will, hence, give more accurate price signals to OMS subscribers.

Conclusion

The Commission finds nothing to alter its January 10, 1991 Order in any substantive way. OMS has and will continue to serve the public interest and the rate structure authorized for OMS is fair and reasonable.

ORDER

1. The Requests for Reconsideration filed regarding the January 10, 1991 Order in this matter by the Minnesota Department of Public Service (the Department), the Senior Citizen Coalition (SCC), and the Minnesota Senior Federation-Metropolitan Region (MSF-MR) are denied.
2. The January 10, 1991 Order in this matter is clarified to
 - a. recognize that no reliable price/cost comparison can be made between OMS and FRS;

- b. eliminate any reference to the price/cost comparisons in support of the OMS rates authorized in that Order; and
 - c. recognize that by increasing the OMS access rate and by decreasing the OMS usage rates, the authorized rates are in better alignment with incremental cost.
3. The January 10, 1991 Order in this matter, as clarified consistent with Ordering Paragraph 2 of this Order, is affirmed in all respects.
4. Within 45 days of this Order, U. S. West Communications, Inc. (USWC) shall file with the Commission
 - a. updated data on the number of access lines and OMS usage;
 - b. a tariff consistent with this Order and the January 10 Order for the provision of OMS in all the exchanges in which it currently offers OMS on an trial basis and in the nine additional exchanges authorized in the January 10 Order: Baudette, Caledonia, Detroit Lakes, Isanti, Grand Marais, North Branch, Northfield, Roseau, and Warroad; and
 - c) a proposed implementation plan including a proposed effective date for the revised rates and a proposed customer notice.
5. Within 10 days of USWC's compliance filing required by Ordering Paragraph 4, any interested party wishing to submit comments regarding USWC's filing shall do so.
6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)