

P-3007/GR-93-1 ORDER APPROVING SETTLEMENT

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner

In the Matter of the Petition of Minnesota Independent Equal Access Corporation for Authority to Increase its Rates for Telephone Service in the State of Minnesota	ISSUE DATE: December 10, 1993
	DOCKET NO. P-3007/GR-93-1
	ORDER APPROVING SETTLEMENT

PROCEDURAL HISTORY

On January 10, 1991, the Commission approved the Minnesota Independent Equal Access Corporation's (MIEAC's) application to provide centralized equal access (CEA) service to interexchange carriers (IXCs) on behalf of any independent local exchange carrier (ILEC) choosing to use MIEAC's services.¹ Several conditions were attached to the Commission's grant of a certificate to MIEAC, including rate caps for the first five years of operation.

For purposes of its cap, MIEAC's first year of operation would be from January 30, 1992 through January 29, 1993. MIEAC's rates for year one were set to recover the revenues allowed by the \$0.0099 per minute of use (MOU) cap.

On March 22, 1993, MIEAC filed a petition seeking a general rate increase of \$833,923 or 25.8 percent.

On April 6, 1993, MIEAC filed comments requesting an alternate process be adopted for the handling of its filing.

¹ In the Matter of the Minnesota Independent Equal Access Corporation's Application for a Certificate of Public Convenience and Necessity, Docket No. P-3007/NA-89-76, ORDER GRANTING CERTIFICATE OF AUTHORITY TO PROVIDE EQUAL ACCESS SERVICE (January 10, 1991).

On May 11, 1993, the Commission issued its ORDER ACCEPTING FILING AND SUSPENDING RATES. In that Order, the Commission accepted MIEAC's filing and approved an alternate process for handling the filing, as requested by MIEAC and agreed to by interested persons.

On May 20, 1993, the Commission issued its ORDER SETTING INTERIM RATES. In that Order, the Commission approved interim rates enabling MIEAC to collect \$833,923 in additional annual revenues.

On July 1, 1993, the Department of Public Service (the Department) and MCI filed direct/initial testimony as provided under the alternate process adopted for this proceeding.

On July 22, 1993, the Commission issued its ORDER GRANTING PARTY STATUS to the Department and MCI.

On August 2, 1993, MIEAC filed rebuttal testimony.

On August 23, 1993, MIEAC and the Department filed a Settlement Agreement. On August 27, 1993, MIEAC filed signature pages to the Settlement Agreement signed by USWC, AT&T, MCI and the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) indicating that they did not object to the Commission adopting findings and conclusions consistent with the settlement. The parties' intent is that the Settlement Agreement resolve all issues relating to this proceeding. Both parties agreed that the resolution of contested issues presented in the settlement does not determine the parties' positions or the resolution of these issues in any future proceeding.

On August 27, 1993, the Commission issued its ORDER GRANTING PARTY STATUS to USWC.

On November 24, 1993, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

I. SETTLEMENT AGREEMENT ACCEPTED AND ADOPTED

The Commission finds that the Settlement Agreement (the Settlement) is supported by substantial evidence, promotes the public interest, and will result in just and reasonable rates. The Commission will accept and adopt the Settlement. A copy of the Settlement is incorporated into this Order by reference. The non-proprietary version of the Settlement is attached to this Order.

In non-ratemaking settlement negotiations it is common for parties to concede some issues to obtain a more favorable resolution of others they value more highly. This is reasonable and appropriate in private disputes, where the goal of the settlement process is to reach a result satisfactory to all

parties. In Commission proceedings, however, the Commission's responsibility is to serve the public interest. This fundamental responsibility does not change when considering the proposed settlement of a rate case. The Commission certainly considers the monetary and administrative efficiency benefits of not subjecting settled issues to a fully contested case treatment. However, the Commission also scrutinizes a proposed settlement to see whether it protects the interests of the Company, the public, and all customer classes. To assure that this objective is achieved, the Commission examines to see that every issue is resolved within the bounds of acceptable regulatory practice. This is particularly important in rate case settlements because resolution of individual issues not only affects rate levels and structures adopted in this proceeding but has implications on future rate levels and rate structures.

The Commission is convinced that the Settlement proposed in this matter meets that standard. Each issue addressed in the Settlement has been resolved within the established parameters of acceptable regulatory practice. Accordingly, the Commission will accept the Settlement.

This is not to say that if the Commission had considered the issues resolved in the Settlement on the merits in a contested context the Commission would have decided these issues the same way that they were settled. The Commission notes that its acceptance of the Settlement in no way provides precedent on how it would resolve the issues contained therein in future rate cases, other than that the Settlement treatment of the issue was within the range of acceptable regulatory practice. In sum, acceptance of the Settlement does not diminish the Commission's discretion in future rate cases to choose other options that fall within the range of reasonable regulatory practice.

II. MAJOR RATE CASE COMPONENTS

A. Revenue Deficiency

Using the capped rate of \$0.0126 per MOU and the annual MOU agreed to in the Settlement (301,605,287), the maximum CEA revenues are \$3,800,227 and the Gross Revenue Requirement is \$3,995,505. These figures are acceptable. Two issues involved in arriving at these figures deserve comment.

1. The Annual MOU

In its petition, MIEAC had proposed a revenue requirement of \$3,882,720, based on the \$0.0126 per MOU revenue cap and total MOU of 308,152,345. In response, the Department proposed adjustments to that MOU figure and in its rebuttal testimony, MIEAC agreed with the Department's MOU adjustments and resulting change in test year rate base and operating income. The Commission finds that the agreed MOU figure is reasonable and well within the range of acceptable regulatory practice.

2. Revenue Conversion Factor

Under the settlement agreement, the revenue conversion factor applied to determine the revenue requirement for CEA is 1.000, as proposed by the Department.

The Department explained in its testimony that MIEAC has generated operating losses since its inception. For tax purposes, it will be allowed to carry forward those operating losses and apply them against future taxable income. Until the tax loss carry-forwards are fully applied to future taxable income, MIEAC will have no liability for income taxes. The Department pointed out that the revenue conversion factor is to provide for the payment of Federal and state income taxes, and argued that, since MIEAC has no Federal or state tax liability at this time, the appropriate revenue conversion factor is 1.000.

MIEAC disagreed with the Department's recommendation to include a revenue conversion factor of 1.000, which would eliminate any recognition of income tax expense in MIEAC's revenue requirement for the test year. MIEAC explained that the operating loss resulted from the Company's operating expenses exceeding capped revenues during the start-up period. Stockholders' equity funded the costs that exceeded the cap and MIEAC argued that stockholders should therefore receive the tax benefits arising from those losses when they are recovered in future periods. The Company further argued that providing ratepayers with the benefits of prior year losses that were funded by stockholders would mismatch the source of funding and the benefits of that funding.

MIEAC also argued that bringing into the test year the tax benefits from prior period losses, without also recognizing those unrecovered losses, would represent an inappropriate application of out of period activity to the test year.

While MIEAC disagreed with the Department's recommendation on this issue, the Company noted that the revenue requirement would exceed the revenues allowed by the cap under either approach. MIEAC indicated it would, therefore, accept the Department's adjustment in the context of this settlement of all issues.

The Commission finds that the parties' resolution of this issue is reasonable and within the range of acceptable regulatory practice.

B. Test Year

MIEAC proposed a 12-month projected test year ending September 30, 1993 and no party objected to the proposed test year. The Commission finds that the Company's proposed test year is reasonable.

C. Rate Base

The average rate base proposed in the Settlement is \$9,889,528. This figure reflects proposed Department adjustments to the Minnesota Equal Access Network Services, Inc. (MEANS)² general allocator, organization costs, accumulated depreciation and amortization, minutes of use (MOU), and cash working capital that had been included in the Company's petition.

MIEAC's petition proposed a rate base of \$9,998,955. In rebuttal testimony, MIEAC indicated that it agreed with the Department's proposed changes to the MEANS general allocator, accumulated depreciation and amortization, MOU and cash working capital, but disagreed with the Department's proposals regarding the reassignment of organizational costs and the revenue conversion factor. The Company indicated, however, that it was willing to accept the Department's adjustments in the context of a settlement of all issues, and because, even if the Department's recommendations were fully adopted, the revenue requirement still exceeds the \$0.0126 per MOU revenue cap.

1. MEANS General Allocator

In its review, the Department determined that MIEAC had omitted some of the expenses used in developing the allocation factor. Correcting the allocator for these omissions reduced test year expenses charged to MIEAC by \$11,298 and also reduced the Cash Working Capital component of rate base by \$200. This correction also impacts the allocation of Building space to MIEAC, resulting in a reduction to test year rate base of \$19,222. MIEAC agreed with the corrections proposed by the Department.

2. Organization Costs

MIEAC proposed that organization costs, which are primarily the costs of obtaining a Certificate of Authority from the Commission, be assigned directly to MIEAC and amortized over 15 years. The Department argued that because the Minnesota Equal Access Facilities Corporation (MEAFCO), the MEANS subsidiary that owns and operates the network plant facilities, was also required to obtain a Certificate of Authority, one-half of the organization costs should be assigned to MEAFCO and then allocated in the same manner as other costs. This change would reduce test year rate base by \$79,306 and would also reduce test year amortization expense by \$5,746.

MIEAC disagreed and argued that the full organization costs should be assigned to MIEAC, since the authority provided to both MIEAC and MEAFCO is directly related to the provision of CEA services by MIEAC. The Company also pointed out that, under the Department's proposal, organization costs not allocated to MIEAC would be allocated to the Minnesota Independent Interexchange Corporation (MIIC), an independent MEANS subsidiary providing

² MEANS is the parent company of MIEAC.

long distance services in Minnesota. Since MIIC obtained its own Certificate of Authority through a process independent of MIEAC, the Company argued that it would be inappropriate to allocate additional organization costs to MIIC.

While MIEAC wanted to note its objection for the record, it indicated its willingness to accept the Department's recommendation in the context of the settlement of all issues. The Company noted that accepting the Department's proposed adjustments would not reduce the revenue requirement below the revenue cap.

Because neither treatment would reduce the revenue requirement below the revenue cap, the Commission need not determine which approach is more appropriate. The agreed upon approach (the Department's) is acceptable because it is within the range of acceptable regulatory practice.

3. Cash Working Capital

The parties agreed that the use of a lead/lag study would not be appropriate for MIEAC at this time, since it has only been fully operational since July, 1992 and that the "15-day method" proposed by the Company would be reasonable. This method assumes an average 15-day delay from service delivery to payment and excludes Depreciation and Amortization Expense, which are considered non-cash expenses.

Both the Company and the Department agreed on the calculation of Cash Working Capital, as corrected for the adjustments proposed by the Department and accepted by MIEAC. The Commission finds that the parties' agreed method is reasonable.

D. Operating Income

The MIEAC operating income statement proposed by the settlement includes revenues under current rates of \$3,166,137, expenses of \$3,156,903 and earnings available for return under current rates of \$9,234. The Commission finds that this income statement is reasonable and will approve it. Three issues involved in arriving at that income statement deserve comment.

1. Affiliated Transactions

During its review of MIEAC's individual leases for the use of network facilities with various Participating Independent Local Exchange Carriers (PILECs), the Department identified an error by MIEAC in recording test year lease expense. The Company had not used the updated monthly lease payment for an amended lease, resulting in an understatement of expense of \$24,193 for the test year. The increased expense also increased the Cash Working Capital component of the rate base by \$994. MIEAC agreed with the adjustments proposed by the Department.

2. Depreciation Expense

MIEAC's filing included depreciation expense and accumulated depreciation based on property lives and salvage values that had not yet been approved or certified by the Commission. On May 7, 1993, the Company filed for certification of its 1993 depreciation rates in which it proposed shorter service lives for the computer and building accounts than had been included in the rate case, and a longer life for the furniture account. These proposed changes, which the Commission accepted and certified in its Order in Docket No. P-3007/D-93-419, resulted in an increase in test year depreciation expense of \$29,652 and a related reduction in Net Telephone Plant of \$14,826. MIEAC agreed with the adjustment proposed by the Department.

3. Minutes of Use (MOU)

In response to a Department information request, MIEAC revised its minutes of use estimate to correct two errors included in its filing. The first involved double counting the MOU growth factor for two telephone companies who would only be participating with MIEAC for a portion of the test year. The second was an error in determining the fraction of the month during which one of the companies would be sending traffic to MIEAC. The net of these two corrections was a reduction in test year MOU of 6,548,032.

The Company's revised estimates of MOU also included two minor errors which increased test year MOU by 974 minutes. The impact of the net reduction in MOU was a reduction in test year revenues of \$63,279.

The reduction in MOU also impacted the separations factor used to allocate individual rate base components and operating expenses between interstate and intrastate operations of the Company. The impact of the slight increase in the intrastate separations factor was a net increase to Telephone Plant in Service of \$2,924 and an increase in operating expenses of \$438. MIEAC agreed with the adjustments proposed by the Department based on the Company's revised MOU estimates.

E. Capital Structure and Return

The overall cost of capital included in the settlement agreement is 8.59 percent. The overall cost of capital was calculated as follows:

<u>MIEAC Capital Structure</u>	<u>% of Capitalization</u>	<u>Average Cost</u>	<u>Weighted Average</u>
Short Term Debt	.0382%	6.0000%	0.0023%
Long Term Debt	62.1609%	6.0916%	3.7866%
Preferred Stock	12.9139%	9.0000%	1.1622%
Common Equity	<u>24.8871%</u>	14.6400%	<u>3.6435%</u>
Total Capital	100.0000%		8.5946%
	=====		=====

The capital structure and return included in the Settlement reflect the Department's acceptance of MIEAC's proposed capital structure, ROE and cost of preferred stock and Department modifications to MIEAC's proposed cost of short term and long term debt.

MIEAC's proposal had included a cost of short term debt of 1.0 percent and a cost of long term debt of 6.6231 percent for an overall cost of money of 8.92 percent. In rebuttal testimony, MIEAC agreed with the changes to the cost of debt proposed by the Department.

Based on its review of the record, the Commission finds that both the capital structure and the rate of return proposed by the parties properly balance appropriate interests within the range of acceptable regulatory practice.

F. Rate Design

The Commission finds that the rate design adopted by the parties results in fair and reasonable rates. Three rate design issues merit discussion:

1. Centralized Equal Access (CEA) Rates

In their settlement proposal, the parties adopt rates for CEA as proposed by the Department:

FG-D	\$0.0113
FG-A, FG-B	\$0.0107
Transport	\$0.0044

These rates are unbundled as required by the Commission's January 10, 1991 ORDER GRANTING CERTIFICATE OF AUTHORITY TO PROVIDE EQUAL ACCESS SERVICE.

The difference between the initial rates proposed by MIEAC and the rates proposed by the Department and adopted in the Settlement reflect Department adjustments to the Company's rate of return, revenue conversion factor, rate base, expenses and forecasted MOU. The rate for FG-A and FG-B also differs between MIEAC and the Department because MIEAC applied the percentage cost difference between FG-A/FG-B and FG-D that had been applied in the docket P-3007/NA-89-76 proceeding whereas the Department applied updated information from MIEAC to recalculate and apply the actual cost difference between the FG-A/FG-B and FG-D services.

2. Switching and Transmission Costs

In the Settlement, the parties correctly agreed that the Commission does not need to determine which accounts are properly included in the switching and transmission cost categories. This agreement was reached because even if all possible accounts are included, the switching and transmission costs are \$0.0084 per MOU. These costs are less than the \$0.0099 per MOU cap the Commission had adopted for switching and transmission costs.

3. Tariff Revisions

Finally, as a part of the Settlement Agreement, the parties agreed that MIEAC should submit in its compliance filing revised tariff language to clarify routing options available to interexchange carriers.

This issue was raised by the Department out of a concern over the way MIIC routes some of its long distance traffic over MIEAC. For calls that originate and terminate in PILEC exchanges, MIIC has opted to have the call switched only by MIEAC. A call routed in this manner does not need to go through the switch of the presubscribed IXC. The Department wanted the MIEAC tariff to make it clear that this option is available to other IXCs.

MIEAC believes that its tariff is clear but indicated in rebuttal testimony that it is willing to work with the Department to clarify its tariff language in this area.

The Commission finds that the Settlement is appropriate on this point. It would be helpful to clarify the tariff language. Therefore, the Commission will direct MIEAC to work with the Department and submit revised tariff language that addresses the concern identified by the Department.

III. INTERIM RATES/REFUNDS

The interim rates, proposed final rates, and proposed test year revenues for CEA and transport services, are shown below:

<u>Service</u>	<u>Interim Rates</u>	<u>Proposed Final Rates</u>	<u>Revenue Units</u>	<u>Proposed Revenues</u>
FG-D	\$0.0112	\$0.0113	301,605,287	\$3,408,140
FG-A/FG-B	\$0.0109	\$0.0107	682,916	7,307
Transport	\$0.0046	\$0.0044	87,787,336	<u>386,264</u>
Proposed Final Revenues				\$3,801,711 =====

While the proposed final revenues for these services slightly exceed the CEA revenue cap of \$3,800,227, the total proposed revenues from all services of \$3,994,849 do not exceed the capped gross revenue requirement of \$3,995,505.

Because both the final revenues and the interim revenues were based on the \$0.0126 per MOU revenue cap, there will be no interim rate refund.

IV. ISSUES FROM EARLIER COMMISSION ORDERS

In the Commission's ORDER APPROVING COMPLIANCE FILING AND REQUIRING ADDITIONAL FILINGS, Docket No. P-3007/NA-89-76 (January 21, 1993), the Commission deferred consideration of

three issues to the current year two rate case filing. The Commission finds that the information submitted by MIEAC in its rate case filing properly responds to the requirements of that Order. The three issues are:

A. General Allocator

In its January 21, 1993 Order, the Commission directed MIEAC to demonstrate how its general allocator is computed in its next general rate proceeding. In his direct testimony filed March 22, 1993, MIEAC witness Loe included a discussion of how the general allocators for allocating residual expenses of MEAFCO and MEANS were developed.

In July 1, 1993 responsive testimony, Department witness Lang proposed an adjustment to the MEANS general allocator to include some expenses used in the development of the factor that MIEAC had inadvertently omitted. MIEAC witness Loe, in August 2, 1993 rebuttal testimony, agreed with the adjustment proposed by the Department.

B. Transport Capacity

In the Commission's January 21, 1993 Order, MIEAC was required to identify in its next rate case its transport capacity, including justification for including all costs of excess capacity in its regulated rate base.

MIEAC witness Juul explained the appropriateness of the size and engineering of the network in his testimony filed March 22, 1993.

No party responded to Mr. Juul's testimony nor is the issue discussed in the Settlement. The Commission finds that this explanation is satisfactory.

C. Switching and Transmission Costs

The January 21, 1993 Order also directed MIEAC to address in its next rate case the issue of what accounts are properly used to calculate switching and transmission costs in years two through five.

MIEAC witness Loe's March 22, 1993 testimony included a calculation of the switching and transmission costs consistent with the requirements of the Commission's January 21, 1993 Order. Under MIEAC's calculations, switching and transmission costs equal \$0.0081 for the test year. This calculation included expense accounts for central office switching and central office transmission, two accounts MIEAC continues to disagree should be included in the switching and transmission cost cap because the majority of expenses in these accounts relate to labor costs.

In his testimony filed July 1, 1993, Department witness Doyle calculated the switching and transmission costs to be \$0.0084. The Department calculations included corrections of mathematical

errors by MIEAC, adjustments to minutes of use, rate of return, the percent intrastate factor and elimination of FG-B minutes.

In rebuttal testimony filed August 2, 1993, MIEAC witness Loe agreed with the Department that there is no need to resolve which accounts must be included in the calculation of the switching and transmission costs because inclusion of all possible accounts does not lead to costs in excess of the \$0.0099 cap.

ORDER

1. The Settlement Agreement proposed by MIEAC and the Minnesota Department of Public Service (the Department) is accepted. Copy attached. Pursuant to this Agreement, MIEAC is hereby authorized to increase gross annual revenues by \$829,368 to produce total annual revenues of \$3,995,505 from Minnesota operations.
2. Within 10 days of this Order, MIEAC shall file with the Commission and serve upon all parties in this proceeding revised schedules of rates and charges, including proposed effective dates that are in accordance with the gross annual revenue requirement authorized in Ordering Paragraph 1 and the rate design decisions contained in the Settlement Agreement.
3. Within 10 days of this Order, MIEAC shall file with the Commission and serve upon parties to this proceeding a proposed customer notice explaining the final prospective rates and noting the proposed effective dates.
4. Within 10 days after MIEAC makes the filings required by Ordering Paragraphs 2 and 3, parties wishing to comment on the Company's filings shall do so.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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