

P-405/GR-93-2 ORDER MODIFYING SETTLEMENT AGREEMENT

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 Application  
of Vista Telephone Company of  
Minnesota for Authority to  
Increase Its Rates for Telephone  
Service in the State of  
Minnesota

ISSUE DATE: December 14, 1993

DOCKET NO. P-405/GR-93-2

ORDER MODIFYING SETTLEMENT  
AGREEMENT

**PROCEDURAL HISTORY**

**I. INITIAL COMMISSION ACTION**

On March 1, 1993, Vista Telephone Company of Minnesota (Vista or the Company) filed a petition seeking a general rate increase of \$6,463,057, or 18%, effective April 30, 1993. Along with the rate increase petition, Vista filed a proposed interim rate schedule.

On April 8, 1993, the Commission issued two Orders, one accepting the filing as of March 29, 1993<sup>1</sup> and suspending the proposed rates, and the other referring the case to the Office of Administrative Hearings for contested case proceedings. The Office of Administrative Hearings assigned the case to Administrative Law Judge (ALJ) Karl W. Sonneman.

On April 28, 1993, the Commission set interim rates pursuant to Minn. Stat. § 237.075, subd. 3 (1992). Interim rates were authorized as of April 30, 1993, and were set at a level allowing an additional \$5,140,216 in annual revenues.

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<sup>1</sup> The Department of Public Service (the Department) had previously filed comments recommending rejection of the March 1, 1993, filing, because the filing was incomplete. The Department and the Company later agreed that the Company would file a long run incremental cost study on customer-owned coin telephone service, and the 10-month statutory deadline would run from the filing of the cost study. The Company filed its cost study under the agreement on March 29, 1993.

## **II. PROCEEDINGS BEFORE THE ADMINISTRATIVE LAW JUDGE**

### **A. Prehearing Conferences**

ALJ Sonneman held prehearing conferences on April 19, 1993, and August 25, 1993. The following parties were allowed to intervene in the proceedings: the Department of Public Service, represented by Brent Vanderlinden, Special Assistant Attorney General, Suite 1200, NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101-2130; the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), represented by Joan C. Peterson and Gary Cunningham, Special Assistant Attorneys General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, Minnesota 55101; the Department of Administration, represented by Mary Jo Murray, Special Assistant Attorney General, 525 Park, Suite 500, St. Paul, Minnesota 55155; AT&T Communications of the Midwest, Inc. (AT&T), represented by Nancy H. Wittebort, 227 West Monroe Street, Chicago, Illinois 60606; MCI Telecommunications, Inc. (MCI), represented by Amy Klobuchar, Dorsey & Whitney, 220 S. Sixth St., Minneapolis, Minnesota 55402; US WEST Communications, Inc. (US WEST), represented by Richard L. Johnson, 200 S. Fifth St., Room 1800, Minneapolis, Minnesota 55402.

Vista Telephone Company was represented by Richard J. Johnson and Michael J. Bradley, Moss & Barnett, 4800 Norwest Center, 90 South Seventh Street, Minneapolis, Minnesota 55402-4129.

### **B. Public Hearings**

ALJ Sonneman held public hearings to receive comments and questions from non-intervening ratepayers. The public hearings were held in four communities served by Vista: Canby, Edgerton, Fairmont, and Apple Valley, Minnesota. Attendance ranged from two persons at the Edgerton hearing to approximately 12-15 persons at the Fairmont and Apple Valley hearings. The public was generally satisfied with the service received from Vista but had concerns about high rates due to mileage charges in rural areas and high business rates in the metropolitan area.

### **C. A Settlement Agreement Is Filed**

On August 20, 1993, parties to the proceeding submitted a Settlement Agreement to the ALJ and filed the Agreement with the Commission. The Agreement was meant to settle all outstanding issues among the parties. The Settlement Agreement was signed by Vista, the Department, and the RUD-OAG. The Department of Administration, US WEST, AT&T and MCI signed statements that they had reviewed the Settlement Agreement and did not object to the adoption of findings and conclusions by the Commission that are consistent with the Settlement.

On August 31, 1993, the ALJ conducted an evidentiary hearing upon matters related to the Settlement Agreement.

The ALJ submitted the file along with a letter to the Commission on October 25, 1993. In that letter the ALJ reviewed the procedural history of this proceeding and the main elements of

the Settlement Agreement. The ALJ concluded his letter to the Commission by stating that he had found no illegality in the Settlement Agreement.

### **III. PROCEEDING BEFORE THE COMMISSION**

The matter came before the Commission for consideration on November 23, 1993. At the meeting, the Department spoke in favor of the Settlement Agreement on behalf of the parties to the Agreement.

Upon review of the entire record of this proceeding, the Commission makes the following Findings, Conclusions, and Order.

### **FINDINGS AND CONCLUSIONS**

#### **IV. JURISDICTION**

The Commission has general jurisdiction over the Company under Minn. Stat. § 237.02 (1992). The Commission has specific jurisdiction over rate changes under Minn. Stat. § 237.075 (1992). The matter was properly referred to the Office of Administrative Hearings under Minn. Stat. §§ 14.57-14.62 (1992) and Minn. Rules, parts 1400.0200 et seq.

#### **V. FURTHER ADMINISTRATIVE REVIEW**

Under Minn. Rules, part 7830.4100, any petition for rehearing, reconsideration, or any other post-decision relief must be filed within 20 days of the date of this Order. In this case, however, the Commission is on its own motion varying its rule to restrict the time for filing a petition for rehearing to 10 days from the date of the Order (see Section IX below.)

Petitions for rehearing or reconsideration must be filed with the Executive Secretary of the Commission, must specifically set forth the grounds relied upon and errors claimed, and must be served on all parties. The filing should include an original, 13 copies, and proof of service on all parties.

The Commission, in its discretion, may grant oral argument on the petition or decide the petition without oral argument.

#### **VI. VISTA TELEPHONE COMPANY OF MINNESOTA**

Vista came into existence in June, 1991, when Rochester Telephone Corporation purchased the Minnesota properties and operations of Central Telephone Company. Vista is a wholly-owned, second-tier subsidiary of Rochester Telephone Corporation.

Vista serves approximately 92,000 customer access lines in the State of Minnesota.

## **VII. THE SETTLEMENT AGREEMENT**

In its original rate case filing, Vista proposed a rate increase of \$6,463,057. The Company later submitted an updated filing proposing a rate increase of \$6,181,038.

In its direct testimony, the Department recommended that the Commission find a revenue deficiency of \$3,693,803. No other party submitted a proposed revenue deficiency.

In the Settlement Agreement, the parties agreed to a proposed rate increase of \$4,410,563. The ALJ stated that the financial determination included in the Agreement does not present any questions of illegality, and that the financial determination of the settlement revenue deficiency is supported by substantial evidence in the record.

Major issues presented in the Settlement Agreement are as follows:

### **A. Test Year**

Vista proposed an historical test year ending December 31, 1992, based upon 12 months of actual data. No party opposed the Company's test year or offered alternatives. The 1992 historical test year was adopted in the Settlement Agreement.

### **B. Rate Base**

In Vista's final supplemental rate case filing, the Company proposed a rate base of \$66,790,057. The Department recommended a rate base of \$67,064,926. No other party proposed a specific finding on rate base.

In the Settlement Agreement the parties agreed upon a rate base of \$67,322,624. The adjustments to the Company's rate base proposal are primarily due to Financial Accounting Standard (FAS) 106 calculations.

### **C. Operating Income**

In its supplemental filing Vista proposed an operating income of \$3,518,818. The Department's proposed figure of \$4,008,292 was the only alternative submitted.

In the Settlement Agreement the parties agreed upon an operating income of \$3,888,898. Adjustments to the Company's proposal are primarily due to certain increased revenues, and reduced Post-employment Benefits Other than Pensions (PBOP) costs and rate case expenses.

The parties agreed that FAS 106 PBOP expenses would be based upon 1993 estimated costs. After May 1, 1993 (the date interim rates went into effect), FAS 106 PBOP costs would be fully recovered in interim rates. PBOP costs of \$401,481 from January 1, 1993, through April 30, 1993, would be offset against the interim rate refund.

#### **D. Rate of Return**

The parties settled upon an overall rate of return of 9.67%. In arriving at this figure, the parties agreed upon the use of Vista's actual capital structure. The parties also agreed to a return on equity of 11.0%, which was supported by two discounted cash flow calculations using comparable companies.

#### **E. Miscellaneous Rate Design Issues**

##### **1. Consolidation of Two Remaining Outstate Rate Groups**

Vista proposed consolidating its two remaining outstate rate groups into a single outstate rate group. As a result of this consolidation, the Company would have two rate groups-- metropolitan and outstate. There would be no rate impact on the Company's metropolitan exchanges.

No party opposed Vista's consolidation proposal and it was adopted in the Settlement Agreement.

##### **2. Elimination of the Rural Zone and Mileage Band Rates**

Vista proposed eliminating zone and mileage rate additives and recovering the lost revenues through the outstate basic local service rate.

No party opposed Vista's proposal and it was adopted in the Settlement Agreement.

##### **3. Inclusion of Touch Call Service in Basic Service**

Vista proposed eliminating a separate charge of \$1.50 for touch call service and including touch tone as part of basic service. As a result, customers currently paying for the service would receive a rate reduction of approximately \$0.51 per line; customers not currently subscribing would pay approximately \$1.00 for receiving the service in their basic local service. Vista's proposal was adopted in the Settlement Agreement.

##### **4. Inclusion of Belle Plaine in the Metropolitan Calling Area**

Vista proposed that Belle Plaine be added to its metropolitan rate group at a rate consistent with other metropolitan exchanges. The proposal was unopposed and was adopted into the Settlement Agreement.

The ALJ noted that in Docket No. P-405/CP-86-55 Belle Plaine subscribers recently voted for extended area service (EAS) to the metro area pursuant to Minn. Stat. § 237.161. The rates used for EAS balloting are higher than the metro rates proposed in the Settlement.

The ALJ found that a reduction of Belle Plaine's local service rates to equal the Settlement proposed rates for metro exchanges does not violate Minn. Stat. § 237.161.

#### **5. Business/Residential (B/R) Rate Ratio**

Although Vista did not propose a change in the B/R rate ratio, the Company requested that any reduction in its revenue requirement should be used, at least in part, to reduce the B/R ratio. The Department recommended the following changes to the B/R rate ratio:

	<u>Current</u>	<u>Department Proposal</u>
Metro	2.97:1	2.80:1
Outstate	2.26:1	2.26:1

The parties accepted the Department's proposal and incorporated it into the Settlement Agreement.

#### **F. EAS Rates and Rate Design**

This area represented the greatest source of disagreement among the parties before the matter was resolved and incorporated into the Settlement Agreement.

Vista currently has 31 outstate exchanges which adopted EAS under rules in effect prior to the adoption of Minn. Stat. § 237.161. Each of these exchanges has individual EAS rate additives based upon the specific cost circumstances of that exchange. Vista's metropolitan exchanges have a uniform EAS rate additive.

In its rate case filing, Vista proposed residually pricing its EAS rates, leaving the existing rate structure in place.

The Department proposed that the rate differentials between outstate EAS routes be eliminated, and a single outstate EAS rate be developed. Based upon cost averages, the Department suggested a residential outstate rate of \$1.56 and a business outstate rate of \$3.53. The Department explained that Vista has not filed a rate case in over 10 years, and cost information on the outstate routes is out of date. Moving outstate rates to a single level would be consistent with other rate design changes in this case, such as the elimination of multiple outstate rate groups and the elimination of outstate zone and mileage rates.

The parties eventually agreed to the Department's proposal, and it was adopted in the Settlement Agreement. The parties stated that the move to a uniform EAS rate additive in the context of this Settlement Agreement should have no precedential effect on other EAS proceedings.

The ALJ stated at p. 6 of his October 25, 1993 letter to the Commission:

The ALJ has found no illegality in the Settlement Agreement. However, the ALJ also finds that there is no substantial evidence of a material change in costs underlying the outstate extended area service rate elements as determined in the previous rate case. Thus, any change in the rate design of these rate elements must be supported by non-cost factors and policy judgment. The Department of Public Service has offered evidence of non-cost factors to support its proposed rate design. The Commission must determine whether it wishes to change its precedent for outstate extended area service rate design.

#### **G. The Parties' Presentation of the Settlement Agreement**

At the November 23, 1993, hearing, a representative of the Department spoke on behalf of the other parties who had signed or approved the Settlement Agreement. The Department's representative stated that the Settlement Agreement was responsive to the directives of Minn. Stat. § 237.076, the ALJ's preliminary orders, and previous Commission comments regarding the settlement of rate cases. The Department had reviewed Vista's rate case filings and prepared its own rate case testimony prior to the Settlement Agreement. According to the Department, the elements of the Settlement Agreement were supported by testimony, in some cases by two or more witnesses. It was the opinion of the parties that the Agreement resulted in just and reasonable rates and an opportunity for the telephone company to earn a reasonable return on its investment. The parties believed that the terms of the Agreement were fully supported by the record and were in the public interest.

### **VIII.COMMISSION MODIFICATION OF SETTLEMENT AGREEMENT**

Minn. Stat. § 237.076 (1992) governs the Commission's procedure when presented with a negotiated settlement. The statute provides that the Commission may accept the settlement "upon finding that to do so is in the public interest and is supported by substantial evidence." If the Commission does not accept the settlement, it may issue an Order modifying the settlement, subject to the approval of the parties. Parties have ten days from the entry of the Order modifying the settlement, or from an Order disposing of a petition for reconsideration, in which to reject the modified settlement.

The Commission must therefore first examine the proposed agreement to determine if it is in the public interest and is supported by substantial evidence. The Commission finds that the Settlement Agreement, with the exception of the EAS provision, meets these criteria. The Commission will first discuss its findings on the overall Settlement Agreement, considered without the EAS section.

#### **A. Substantial Evidence**

Minn. Stat. § 14.60, subd. 2 directs the Commission to base its decisions upon factual evidence rooted in the record. Throughout

the Settlement Agreement, the parties have cited direct testimony which fully supports the significant elements of the Agreement. The testimony cited in the Agreement, plus the Commission's own independent examination of the record, convince the Commission that the terms of the Settlement Agreement are fully supported by substantial evidence.

#### **B. Reasonable Resolutions of Individual Issues**

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 goal of the process is to serve the public interest. This requires protecting the interests of the Company, the public, and all customer classes, whether or not their interests are vigorously represented. It requires resolving issues within the bounds of acceptable regulatory practice, since future rate structures are built on the foundations established in past rate cases. For these reasons the Commission scrutinizes settlements with care and requires documentation of the reasonableness of the disposition of issues.

Having examined the record in this case, the Commission finds that the resolutions reached by the parties on the issues are just and reasonable. The terms of the Settlement Agreement are within the limits of reason and Commission precedent. The Agreement shows the evidence of good faith negotiations among the parties. The terms should be fair to ratepayers and afford an opportunity for the telephone company to earn a reasonable return on its investments.

The Commission therefore finds that the Settlement Agreement, with the exception of the EAS provision, is in the public interest, is reasonable in its terms, and is supported by substantial evidence. The Commission will turn to an examination of the EAS section of the Settlement Agreement.

#### **C. The EAS Section of the Settlement Agreement**

In its original filing, Vista proposed residually pricing its EAS rates, leaving the existing rate structure in place.

In the Settlement Agreement the parties agreed to the Department's proposal that: 1) the EAS rates mirror the rate ratio relationships of the other local access rates; 2) the rate differential from outstate EAS route to outstate EAS route be eliminated; and 3) a single outstate EAS rate be developed.

The ALJ stated that there was not substantial evidence to support the conclusion that cost relationships have changed materially, a conclusion which would be necessary to support the EAS proposal. On the other hand, rate design involves consideration of both cost and non-cost factors, and the Department supplied non-cost

factors. The ALJ therefore concluded that it is within the Commission's authority to determine that the EAS proposal is justified. The ALJ stated that "he has no basis upon the record here to recommend such a change to the Commission."

The Commission agrees with the ALJ that it is within the Commission's discretion to make a rate design decision based upon non-cost factors. In the area of rate design, the Commission employs its legislative mode of decisionmaking to draw inferences and conclusions regarding the reasonableness of rates. While it is within the Commission's authority to approve the EAS proposal, the Commission finds that it is not the best policy to do so.

The EAS proposal in the Settlement Agreement represents a move from a pricing methodology which is based upon theories of cost towards an averaged pricing methodology. A move away from pricing methodologies based upon theories of cost should not be undertaken without sound reasons. In this case, the non-cost arguments for the EAS proposal do not represent the kind of reasons which would justify such a policy shift.

The Department justified the EAS proposal by stating that it would be consistent with the elimination of outstate zone and mileage rates and with the consolidation of outstate rate groups. These changes, however, are not analogous to the EAS proposal. Zones and mileage bands are innately somewhat arbitrary; the EAS rates, on the other hand, were based upon embedded cost studies from the 1983 rate case. The consolidation of rate groups was the product of Commission directives in the 1981 and 1983 rate cases; no such directive existed for the proposed shift to averaged EAS rates. No persuasive reason has been offered for this significant move.

The timing of such a major policy shift also seems particularly ill-advised in this case. Since the ALJ has stated that substantial evidence for the proposal is lacking, this rate case is a poor venue for a change in EAS procedure. The Commission also notes that the entire issue of EAS in Minnesota has been and will be the subject of intense scrutiny as the 1994 sunset date for the current EAS statute draws nearer. It could be confusing and unproductive to depart from EAS precedent at this time.

Finally, the Commission notes that a modification of the EAS section of the Settlement Agreement should not shed an unfavorable light on this Agreement or on the settlement process in general. On the contrary, the modification procedure was included in Minn. Stat. § 237.076 precisely so that the Commission could reject a section of a settlement agreement while allowing the settlement process to go forward.

Because the Commission does not believe that the EAS proposal is justified by record evidence or by sound public policy, the Commission will modify the Settlement Agreement to exclude the parties' EAS proposal. Under the EAS section as modified by the Commission, the Company's existing EAS rate structure will be maintained for the 31 existing outstate EAS exchanges. The

existing EAS rate additives for these routes will be increased in a manner that will recover the same annual revenue as the EAS rate additives offered in the parties' EAS proposal. The rates in future EAS routes will be determined under the provisions of Minn. Stat. § 237.161.

All other provisions of the parties' Settlement Agreement are accepted as proposed.

#### **IX. Variance to Minn. Rules, Part 7830.4100**

Under Minn. Stat. § 237.075, subd. 2, the Commission must make a final determination in a general rate case within ten months of the initial filing date. Because this rate case filing was accepted as of March 29, 1993, the statutory deadline for the Commission's final Order is January 31, 1994.<sup>2</sup>

If a rate case settlement is modified by the Commission, Minn. Stat. § 237.076 allows a party ten days after the Order modifying the settlement, or after an Order disposing of a petition for reconsideration, in which to reject the proposed modification. If the party rejects the Commission's proposed modification, the matter is referred to the ALJ for further proceedings.

Minn. Rules, part 7830.4100 allows a party to file a petition for rehearing or reconsideration within 20 days of the final Order. Any adverse party is allowed a further ten days in which to file a response.

Given the time constraints of the foregoing statutes and rule, and the realities of a contested case proceeding, the Commission will on its own motion vary its rule to shorten the time allowed to file a petition for reconsideration and to eliminate the time for response to the petition.

Minn. Rules, part 7830.4400 provides that the Commission shall grant a variance when it appears to the satisfaction of the Commission that:

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

In this case, varying Minn. Rules, part 7830.4100 by shortening the time for filing a petition for reconsideration to ten days and by eliminating the time for a response fulfills the

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<sup>2</sup> January 29 and 30, 1994, are Saturday and Sunday, so the deadline is extended to the next working day, January 31, 1994.

requirements for a variance. Allowing the usual time for filing a petition and for responding would impose an excessive time constraint upon the parties, the Commission, and the ALJ. Granting the variance would not adversely affect the public interest; ten days for filing a petition for reconsideration is sufficient in this case, when the issues have been narrowed to the EAS proposal. Finally, granting of the variance would not conflict with standards imposed by law.

The Commission will vary Minn. Rules, part 7830.4100 to allow parties ten days from the date of this Order to file a petition for reconsideration. No responses will be allowed. Any party who rejects the modification should address the scope of the proceedings before the ALJ which that party believes will be necessary.

### ORDER

1. The Commission accepts and adopts the Settlement Agreement filed August 31, 1993, with the following modification: Section II (B) (3) (b) (8) is stricken and the following paragraph is substituted:

The Company's existing EAS rate structure will be maintained for the 31 existing outstate EAS exchanges. The existing EAS rate additives for these routes will be increased in a manner that will recover the same annual revenue as the EAS rate additives offered in the parties' EAS proposal. The rates in future EAS routes will be determined under the provisions of Minn. Stat. § 237.161.

The Settlement Agreement is attached to and made a part of this Order.

2. Within 20 days of the date of this Order, Vista shall file with the Commission for its review and approval and serve on all parties to this proceeding revised schedules of rates and charges reflecting the provisions of this Order. The Company shall include a proposed effective date for the revised schedules of rates and documentation demonstrating that the proposed schedules of rates will generate the level of revenues authorized in this Order.
3. Within 20 days of the date of this Order, Vista shall file with the Commission for its review and approval and serve on all parties to this proceeding a calculation of the proposed interim rate refund and related interest, a proposal for distribution of the refund, and a proposed customer notice explaining the final prospective rates and refund procedures.

4. Comments on any Company filing required under this Order shall be filed within ten days of the Company's service of the filing.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar  
Executive Secretary

(S E A L)