P-407, 421/CP-86-526; P-407, 421/CP-87-219 ORDER APPROVING LOWER COST ALTERNATIVE, COST STUDIES AND RATES FOR POLLING

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Thomas Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

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

ISSUE DATE: February 25, 1993

DOCKET NO. P-407, 421/CP-86-526

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

DOCKET NO. P-407, 421/CP-87-219

ORDER APPROVING LOWER COST ALTERNATIVE, COST STUDIES AND RATES FOR POLLING

PROCEDURAL HISTORY

I. Proceedings To Date

On July 31, 1991, the Commission issued an order in both of these dockets. In each Order, the Commission required the involved telephone companies to refile their cost studies and proposed rates within 45 days of the Order. The Commission also directed the company serving the petitioning exchanges in these dockets (GTE), to file its proposed lower cost alternative to the EAS flat rate at the same time it filed its revised cost studies and proposed rates.

On September 5 and 6, 1991, respectively, Eckles Telephone Company and U S West Communications, Inc. (USWC) requested additional time to complete their cost studies and proposed rates citing the difficulty of developing a uniform traffic study methodology. The Commission granted the requested extension on September 23, 1991.

Between October 15 and 17, 1991, the companies filed their cost studies and proposed rates.

On December 2, 1991, the Department requested additional time to file its report and recommendation due to USWC's recent filing of revised cost studies. In addition to commenting on the companies' cost studies and proposed rates, the Department noted that it would be analyzing GTE's proposed lower cost alternative. The Commission granted the Department's request on January 15, 1992.

On February 20, 1992, the Department filed its reports and recommendations for these two dockets.

On March 9 and 11, 1992, respectively, USWC and GTE submitted replies to the Departments reports and recommendations.

On March 12, 1992, the City Council for the City of Delano filed a Resolution supporting the Department's report and recommendation regarding the Delano petition.

On April 10, 1992, the Commission issued its ORDER REQUIRING REVISED LOWER COST ALTERNATIVE PROPOSAL, COST STUDIES AND PROPOSED RATES. In that Order, the Commission rejected GTE's proposed lower cost alternative to EAS. GTE's proposal was to discount by 50 percent the EAS additive for Lindstrom and Delano subscribers enrolled in the Telephone Assistance Plan. The Commission directed GTE to file a revised lower cost alternative that would be available to all subscribers in the Lindstrom and Delano exchanges at each customer's option.

In its Order, the Commission also required GTE to refile its cost studies using a zero percent gross receipts tax; USWC to refile its cost studies using its revised cost of money figure; USWC to file its EAS revenue requirement both including and excluding its toll contribution from ILEC to ILEC routes; and GTE, USWC, Eckles, Scott-Rice, United and Vista to file two sets of proposed rates: one including and one excluding USWC's toll contribution from ILEC to ILEC routes.

On July 9, 1992, Scott-Rice, Eckles, United and Vista refiled their cost studies and proposed rates in compliance with the April 10, 1992 Order.

On July 10, 1992, USWC refiled its cost studies and proposed rates in compliance with the April 10, 1992 Order.

On July 20, 1992, GTE refiled its proposed lower cost alternative, cost studies and proposed rates as required by the April 10, 1992 Order.

On September 10, 1992, the Department filed its report and recommendations on the telephone companies' filings. The Department disagreed with the cost of money used by USWC in its cost studies and with the lower cost alternative filed by GTE. The Department argued that GTE would over recover its revenue requirement under the proposed GTE lower cost alternative. The Department proposed its own lower cost alternative for subscribers in Lindstrom and Delano.

On September 21, 1992, USWC responded to the Department's comments regarding the USWC cost of money calculations.

On September 30, 1992, GTE filed its comments in response to the Department's report and recommendations. GTE denied that it would over recover its revenue requirement under the lower cost alternative that it had proposed. The company argued that it would under recover its revenue requirement if the Department's proposal was adopted.

On October 2, 1992, the Department filed an addendum to its September 10, 1992 report, making minor revisions to its estimate of rates for the lower cost alternative that it had proposed.

On October 16, 1992, the Department responded to GTE's September 30, 1992 comments. The Department continued to recommend against the lower cost alternative proposed by GTE and for the Department's proposed lower cost alternative.

On October 26, 1992, the Greater Chisago Lakes Area Chamber of Commerce submitted a resolution to the Commission indicating support for the lower cost alternative filed by GTE and rejection of the Department's alternate proposal.

On November 5, 1992, GTE submitted a reply to the Department's October 16, 1992 comments. GTE continued to argue that adoption of the Department's proposal would not leave GTE income neutral.

On November 12, 1992, the city council for Center City submitted a resolution to the Commission urging rejection of the Department's proposal and selection of the GTE proposal.

On December 7, 1992, the Delano city council forwarded a resolution to the Commission endorsing and supporting the recommendations of the Department, including the lower cost alternative proposed by the Department.

On February 16, 1993, the Commission met to consider this matter.

FINDINGS AND CONCLUSIONS

II. Commission Analysis

There are four issues to be resolved in this Order: 1) whether GTE's proposed lower cost alternative to EAS for subscribers in Lindstrom and Delano is appropriate; 2) whether USWC's toll contribution for routes between Lindstrom and Delano and the non-USWC exchanges in the MCA must be included in determining Delano's and Lindstrom's revenue requirements; 3) what EAS rates should be used in polling Lindstrom and Delano subscribers to determine whether there is adequate subscriber support for the EAS proposals; and 4) whether the cost studies and proposed rates filed for the exchanges that are currently part of the metropolitan calling area (MCA) are fair and reasonable.

A. GTE's Lower Cost Alternative

GTE's lower cost alternative to EAS is called the Community Plus Plan (CPP). The CPP would offer one-party subscribers (both residential and business) in Lindstrom and Delano the option of paying a small monthly fee and a per minute charge for their calls into the metro calling area. Calling within Lindstrom and existing EAS areas, and Delano and existing EAS areas, would remain flat-rated.

GTE would charge CPP subscribers in Delano and Lindstrom a flat access charge ($3.85 for residential service and $7.70 for business service) and a per minute usage charge ($.25 discounted to $.125 between 10:00 p.m. and 8:00 a.m). Calls to a CPP subscriber from the MCA would be local calls. As proposed, CPP would be unavailable to seasonal or vacation service subscribers.

Two aspects of GTE's proposed lower cost alternative require discussion. The Department objected that CPP's unavailability to seasonal and vacation service subscribers violated the EAS statute. The Department also alleged that under the proposed rates GTE would over recover, i.e. not remain income neutral as required by the statute.

1. Seasonal and Vacation Rate Customers

The Department stated that in its April 10, 1992 Order in these dockets, the Commission interpreted Minn. Stat. § 237.161, subd. 1 (c) as requiring that the lower cost alternative be available to all customers in the petitioning exchange. GTE responded that its proposal to restrict seasonal and vacation rate customers from subscribing to CPP is based on economic theory and common sense. Seasonal and vacation rate customers have already been provided with a mechanism that passes on cost savings related to traffic sensitive and certain nonrecurring expenses due to these customers' lower usage. Because these customers have already been provided with savings due to their lower usage, it would not make sense to provide further discounts.

The Commission finds that the discounts made available through the current seasonal and vacation rate services are due to cost savings for the provision of calling within existing local calling areas. The lower per month charge for CPP, on the other hand, relates to lower calling volumes for calls into the metro calling area. The two services are separate and customers should not be restricted from subscribing to both. Therefore, the Commission will not approve GTE's proposed restriction on the availability of CPP and will require that it be offered to seasonal and vacation service subscribers, too.

2. Over Recovery Issue

If a lower cost alternative to the EAS must be offered,[1], the rates adopted for EAS, together with the rates adopted for the lower cost alternative service, must be set so that the affected companies will recover the specific additional cost incurred in providing EAS and the lower cost alternative and be maintained income neutral. Minn. Stat. § 237.161, subds. 2 and 3 (b) (1992). The Department alleged that the proposed rates for CPP would allow GTE to realize revenue in excess of its cost because they were calculated 1) assuming an unreasonably low level of usage by CPP customers, and 2) using a lower usage stimulation factor (6.3) than the factor (7) that the Commission approved in the February 1, 1991 Order in the Waconia, Cologne, and Norwood dockets.[2]

To correct these alleged deficiencies, the Department proposed that the Commission assume that a CPP customer has the same usage as the average exchange subscriber's usage and then stimulate that figure by a factor of seven. The resulting stimulated minutes would then be multiplied by the CPP per minute rate. Multiplying the corrected stimulated minutes times GTE's proposed CPP rates projected EAS revenues far in excess of EAS costs. To prevent this over recovery, the Department proposed reducing CPP rates to achieve GTE's revenue deficiency. The Department argued that its proposed method for calculating the stimulated minutes

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[1] The EAS statute requires the telephone company serving any exchange seeking EAS to the metropolitan local calling area in Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington counties (the Minneapolis/St. Paul metropolitan calling area) to offer a lower cost alternative to basic flat-rate EAS service to its customers in the petitioning exchange. Minn. Stat. § 237.161, subd. 1 (c) (1992).

[2] See 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, In the Matter of the Petition for Extended Area Service from Mayer, Minnesota to the Minneapolis/St. Paul Metropolitan Calling Area, In the Matter of a Commission Investigation into Extended Area Service Between Cologne and the Minneapolis/St. Paul Metropolitan Calling Area, In the Matter of a Commission Investigation into Extended Area Service Between Norwood and the Minneapolis/St. Paul Metropolitan Calling Area, Docket Nos. P-430, 421/CP-86-5, P-407, 421, 430, 405, 426/CP-88-839, P-430, 421, 407, 405, 426/CI-90-441, 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 (February 1, 1991). (Hereinafter referred to as the February 1, 1991 Waconia Order.)

must be used in this case because the Commission prescribed this method when considering the Waconia, Cologne, and Norwood EAS petitions.

a. Base Usage Assumption

The Commission does not agree that it is reasonable to assume, as the Department proposed, that a CPP customer will have the same usage rate as the average exchange subscriber. It would appear that customers opting for the lower cost alternative will do so specifically because they make fewer calls per month and will, therefore, benefit from paying a flat access charge and thereafter pay per minute of use. GTE's actual traffic data supports that view, indicating that subscribers making more than 25 calls (based on calls of five minutes during the 8:00 a.m. to 10:00 p.m. time period) per month would be better off subscribing to flat rate EAS and those making less than 25 calls per month would benefit from subscribing to CPP. The Commission finds that the usage level that GTE assumed for CPP customers is more reasonable.

b. Stimulation Factor

The second alleged flaw in GTE's calculation of stimulated minutes was that it deviated from the February 1, 1991 Waconia Order by using a 6.3 stimulation factor. The Department has not provided any evidence that a stimulation factor of 7 is more accurate than GTE's figure, 6.3. The Department advocated the figure 7 in this case based simply on its view that the Commission established 7 as the official stimulation factor to be used in all EAS cases.[3]

The Department's view of the February 1, 1991 Waconia Order is inaccurate. The Waconia Order did not establish a precedent that controls the stimulation factor that must be used in this case. In its Waconia Order, the Commission made it clear that its choice between various proposed stimulation factors was based on the perceived practical effects of choosing one figure over another rather than on hard evidence regarding the scientific accuracy of the chosen figure. The Commission stated:

> 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.

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[3] In the Waconia, Mayer, Cologne, and Norwood dockets, the Department opposed the stimulation factor of 7, arguing strongly that the traffic would only increase 400%. It therefore proposed that growth be estimated using a stimulation factor of 5.

> 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.
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> 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. Waconia EAS Order, ORDER ADOPTING GUIDELINES FOR EXTENDED AREA SERVICE RATES FOR THE WACONIA, MAYER, COLOGNE, AND NORWOOD EXCHANGES AND VARYING TIME FOR FILING FOR RECONSIDERATION (February 1, 1991), p. 9-10.

The Waconia Order did approve use of a stimulation factor of 7, but limited its approval to the dockets it was addressing. The Waconia decision that 7 was a reasonable stimulation factor relied strictly on the circumstances of those dockets. The Commission, acknowledging the less than optimal empirical basis for its choice of 7, initiated a study of the actual stimulation factors resulting from the inclusion of the Waconia, Cologne, Belle Plaine, and New Prague exchanges into the MCA.[4] In the Waconia Order, the Commission was considering EAS rates, not lower cost alternative rates. More important, the stimulation factor under consideration in the Waconia Order was being used to develop estimates of traffic levels that were in turn used to determine the level of new facilities that would be necessary to accommodate the new EAS. In the Waconia setting, the Commission made a practical decision that it was reasonable to use the higher stimulation rate (7) as a hedge against underestimating

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[4] While that study is underway, the results will not be known for several months.

the necessary facilities and endangering the level of service. In this case, the stimulation factor is being used for another purpose, to estimate traffic levels to predict the amount of revenue that GTE will recover from the CPP.

c. Action on Lower Cost Alternative

The Commission will approve GTE's proposed tariff for the Community Plus Plan (CPP) with the removal of the provision that vacation and seasonal rate customers cannot subscribe to CPP. GTE will be required to submit revised tariff pages no later than 30 days prior to the date the service is initially offered.

B. USWC's Toll Contribution

In its September 10, 1992 report, the Department stated its continued belief that IXCs are affected telephone companies for purposes of EAS. The Department recommended that the Commission adopt EAS revenue requirement studies and rates that include USWC toll contribution from ILEC to ILEC routes.

This is not the first time the Commission has encountered the Department's position. In considering the Monticello EAS petition, the Commission examined a situation similar to the current case at hand. The proposed routes were ILEC to ILEC routes which USWC served solely as an IXC. The Commission found that these circumstances were within the scope of the Commission's Hokah Orders.[5] In the Hokah Orders, the Commission found that the term "affected telephone company" in Minn. Stat. § 237.161, subd. 3 (b) (1990) refers solely to the local exchange companies serving the petitioning exchange and the petitioned exchange or exchanges and does not refer to IXCs that carry toll traffic over proposed EAS routes.[6]

The Department did not attempt to distinguish the current case from the Monticello and Hokah cases. Nor did it offer reasons for departing from the precedent adopted in those Orders. The Department merely stated that it held fast to its previous position. In short, therefore, there is no reason offered the Commission not to apply the finding in Hokah and Monticello that Minn. Stat. § 237.161, subd. 3 (b) (1990) refers solely to the local exchange companies serving the petitioning exchange and the

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[5] In the Matter of a Petition for Extended Area Service Between the Monticello Exchange and the Minneapolis/St. Paul Metropolitan Calling Area, Docket No. P-404, 421, 430, 407, 405, 520, 426/CP-89-1039, ORDER REQUIRING REFILED COST STUDIES AND PROPOSED RATES (December 4, 1992), p. 11.

[6] See the Commission's November 21, 1991 and January 29, 1992 Orders in Docket No. P-401/CP-89-951, et al., hereinafter referred to respectively as the Hokah Order and the Hokah Order After Reconsideration or collectively as the Hokah Orders.

petitioned exchange or exchanges and does not refer to IXCs that carry toll traffic over proposed EAS routes. Accordingly, USWC's toll revenue effect for routes between Lindstrom and the non-USWC exchanges in the MCA and Delano and the non-USWC exchanges MCA will not be included in calculating the EAS rates for those routes.

C. EAS Rates for Polling

GTE filed proposed EAS rates that, if adopted, would produce revenue in excess of its revenue requirement in Lindstrom and below its revenue requirement in Delano. These proposed rates fail to meet the statutory requirement that EAS rates adopted for an exchange must be based on specific additional cost incurred to install and provide EAS in that exchange. Minn. Stat. § 237.161, subd. 2 (1992). Such rates also violate the requirement that EAS rates be fair and reasonable. Minn. Stat. § 237.161, subd. 3 (b) (1992).

Based on additional information provided by GTE at the request of the Commission, GTE's proposed rates have been revised to more closely recover GTE's monthly revenue requirements in both Lindstrom and Delano. The revised rates are as follows:

	Flat Rate EAS Additive:	
	Lindstrom	Delano
Residential:	$32.40	$27.50
Business:	64.80	55.00

Taking into consideration the interests of all parties as required by Minn. Stat. § 237.161, subd. 3 (b) (1992), the Commission finds that further delay of these proceedings to refine the rates further (30-45 days according to GTE) is not warranted. The rates shown above are fair and equitable and will be approved to appear on the EAS ballots distributed to Lindstrom and Delano subscribers.

D. Cost Studies and Proposed Rates Filed by LECs Serving the Existing Metro Calling Area

The Commission has reviewed the cost studies and proposed rates submitted by USWC, Eckles, GTE, Scott-Rice, United and Vista for their existing MCA subscribers. The Commission finds these cost studies and proposed rates reasonable and will approve them.

One issue related to USWC's refiled cost studies and proposed rates deserves discussion. The Department objected to USWC's cost of money. The Department asserted that USWC's cost of money was too high given current economic conditions. The Department stated that it conducted a discounted cash flow analysis of USWC and a comparable group of companies. Based on that analysis, the Department recommended that USWC should use a cost of money of 10.24 percent based on an 11.5 percent return on equity (ROE) and an 8.4 percent cost of debt.

The Commission will approve the cost of money that USWC used in its cost studies and proposed rates. The Department proposed a cost of debt that is historic and reflects debt in a past period. Where possible, the cost of debt to be used for future pricing should be the best estimate of the cost of debt during the period in which the product will be provided. The cost of debt used by USWC in its cost studies represents the company's best estimate of the appropriate future cost of debt.

The ROE that USWC used is also preferable to the Department's. USWC's ROE is very close to the 13.5 percent sharing threshold under the incentive plan. If the lower ROE recommended by the Department were used, the lower earnings from EAS routes would not leave USWC income neutral and would reduce any sharing under the incentive plan. The ROE supported by USWC is the company's best estimate of the future ROE.

The Commission has approved these proposed cost of money figures in other EAS dockets (Buffalo, Cambridge, North Branch) and finds no reason to adopt different figures in the Lindstrom and Delano dockets.

ORDER

1. GTE's proposed tariff for the Community Plus Plan (CPP) is approved with the removal of the provision that vacation and seasonal rate customers cannot subscribe to CPP. GTE shall submit revised tariff pages no later than 30 days prior to the date the service is initially offered.

2. USWC toll contribution on ILEC to ILEC routes is excluded from the EAS revenue requirement for Lindstrom and Delano EAS.

3. The cost studies filed by Eckles, GTE, Scott-Rice, United, Vista and USWC are accepted.

4. Subscribers in Lindstrom and Delano shall be polled to determine whether a majority voting in each exchange favor being included in the MCA. The following rates are approved and shall be included in the polling instruments.

	Flat Rate EAS Additive:	
	Lindstrom	Delano
Residential:	$32.40	$27.50
Business:	64.80	55.00

The polling instrument shall also include a description of the CPP service and rates.

5. GTE is directed to cooperate fully with Commission staff and Commission contractors to expedite the polling of Lindstrom and Delano subscribers. As part of this cooperation, GTE shall provide Commission staff and/or Commission contractor upon request with customer lists for the Lindstrom and Delano exchanges and associated information in a timely fashion.

6. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)