ISSUE DATE: November 6, 2000

DOCKET NO. P-552, 430/CP-98-1148

ORDER ESTABLISHING RATE
ADDITIVES AND REQUIRING FURTHER FILINGS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott	Chair
Edward A. Garvey	Commissioner
Joel Jacobs	Commissioner
Marshall Johnson	Commissioner
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In the Matter of a Petition for Extended Area Service from the Osakis Exchange to the Alexandria Exchange

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ORDER ESTABLISHING RATE ADDITIVES AND REQUIRING FURTHER FILINGS

PROCEDURAL HISTORY

On August 3, 1998, telephone subscribers in the Osakis exchange filed a petition seeking extended area service (EAS) to the neighboring Alexandria exchange. The incumbent local exchange carrier in the Osakis exchange is the Osakis Telephone Company. The incumbent local exchange carrier in the Alexandria exchange is Sprint Minnesota, Inc.

On June 30, 1999, the Commission issued an Order finding that the proposed EAS route met threshold requirements of adjacency and traffic volume. The Order required the incumbent local exchange carriers serving Osakis and Alexandria to determine the costs of installing and operating the proposed EAS route and to file proposed rate additives that would recover these costs. The Commission would then poll Osakis subscribers to determine whether they wanted EAS at those rates.

The companies duly filed their cost studies and proposed rate additives. On May 26, 2000, the Department of Commerce (the Department) filed comments on the companies' filings. The Department recommended accepting the companies' cost calculations as accurate and allocating 75% of the total costs to the Osakis subscribers. The Department also recommended excluding lost access charges, typically included in EAS rate additives, from the cost calculations and rate additives adopted in this case.

Sprint Minnesota, Inc., the Osakis Telephone Company and the Minnesota Independent Coalition, filing jointly, and the Minnesota Telephone Association filed comments opposing the exclusion of lost access charges.

On September 28, 2000, the matter came before the Commission.

FINDINGS AND CONCLUSIONS

I. Factual and Legal Background

Extended area service (EAS) is a service arrangement permitting neighboring telephone exchanges to become a single local calling area with toll-free calling. Current criteria for installing EAS and the procedures for determining and allocating EAS costs were set in 1996 by Commission Orders (the EAS Orders)[1], following an industry-wide fact-finding and policymaking proceeding mandated by the Minnesota Legislature.[2]

A. EAS Criteria

Briefly, current EAS criteria and procedures are as follows:

> (1) A petitioning exchange must be contiguous with the exchange or local calling area to which it seeks EAS.
>
> (2) At least 50% of subscribers in the petitioning exchange must make at least three calls per month to the exchange or local calling area to which EAS is sought.
>
> (3) The companies serving the two exchanges or local calling areas must determine the cost of installing and operating the proposed EAS route and file proposed rate additives to recover these costs.
>
> (4) The Commission must allocate between 50% and 75% of the cost of the EAS route to the petitioning exchange, adopt rate additives based on that percentage, and poll subscribers in the petitioning exchange on whether they want EAS at that price.
>
> (5) If 50% of subscribers responding to the poll vote yes, the EAS route must be installed.

A. Costs and Rates

The EAS Orders adopted the same method of calculating EAS costs as the statute the Orders replaced, and in the same language:

> *Basis of Rates; Costs.*
>
> *For a proposal to install extended area service, proposed rates must be based on specific additional cost incurred, operating expenses, actual cost for new facilities constructed specifically to provide for extended area service, net book value of*

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[1] In the Matter of an Investigation into the Appropriate Local Calling Scope, in Accordance with Minn. Stat. 237.161 (1994), Docket No. P-999/CI-94-296, ORDER REACTIVATING THE PROCESSING OF EAS PETITIONS (October 24, 1995) and ORDER AFTER RECONSIDERATION (February 23, 1996).

[2] Laws 1994, c. 534, art. 1, § 1.

> *existing facilities transferred from another service to extended area service, a return on the capital investment associated with installing and providing the extended area service, and appropriate contributions to common overheads.*
>
> ORDER AFTER RECONSIDERATION, Attachment A, p. 2; Minn. Stat. 237.161, subd. 2, *repealed* by Laws 1990, c. 513, § 3, effective June 1, 1994.

The EAS Orders also adopted the repealed statute's language requiring the Commission to hold local exchange carriers harmless when setting EAS rates:

> *Rates*
>
> . . . .
>
> *The commission shall establish rates that are income neutral for each affected telephone company at the time at which the commission determines the extended area service rates. The commission shall consider the interests of all parties when determining a fair and equitable extended area service rate for a local telephone exchange that is newly included in the extended area service.*
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> . . . .
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> ORDER AFTER RECONSIDERATION, Attachment A, p. 3; Minn. Stat. 237.161, subd. 3 (b), *repealed* by Laws 1990, c. 513, § 3, effective June 1, 1994.

II. The Issue of Lost Access Charges

A. Historical Background

Setting fair and reasonable rates for extended area service has been a conundrum since extended area service began, mainly because converting a "premium" service (long distance) to a basic service (local service) disturbs the complex web of subsidies by which traditional rate-of-return regulation has promoted universal service. To keep local service rates as low as possible – and thereby promote universal service – this and other state commissions have permitted local exchange carriers to charge long distance carriers "access charges" which arguably exceed the actual costs of providing access to the local network.

When long distance routes become local service routes, companies lose these access charges. To keep these companies whole, the Commission has generally built recovery of lost access charges into EAS rate additives.

The main advantage of including these charges in EAS rates has been administrative efficiency. Under rate-of-return regulation the Commission must set rates high enough to give the carrier a reasonable opportunity to earn its revenue requirement, including its authorized rate of return. If the Commission reduces a particular rate or revenue stream, it must increase another rate or revenue stream, or it must initiate a rate case to determine a new revenue requirement and new rates. This regulatory compact is the source of the "income neutrality" requirement in the repealed statute and the Commission's EAS Orders.

Adding lost access charges to EAS rate additives has been a workable approach for two reasons:

(1) it has satisfied the income neutrality requirement (and the commitment to fairness to shareholders which that concept represents under rate-of-return regulation) without the expense and delay of a rate case; (2) it has provided a kind of "rough justice," since the customers causing the loss of the access charges are the same customers paying the EAS rate additives.

Often, however, including lost access charges in EAS rate additives dramatically increases rates. In this case, for example, the cost of the facilities, equipment, and labor necessary to install and operate an EAS route between Osakis and Alexandria is significantly lower than the rate additives proposed by the companies. In fact, the residential and business rate additives for Osakis, using the Department's recommended 75/25 cost allocation, would be $0.46 and $0.62 based on actual costs, but $7.37 and $9.97 based on actual costs plus lost access charges.

B. Emerging Concerns, Positions of the Parties

As the Department of Commerce points out, including lost access charges in EAS rate additives has always carried with it significant inequities. Local service rates are rarely set for a single exchange, but reflect averaged company-wide or area-wide costs. To the extent that they exceed cost, access charges therefore subsidize local rates company-wide. Building lost access charges into EAS rate additives for a specific exchange forces those customers to subsidize local rates company-wide.

Similarly, since petitioning exchanges are often assessed up to 75% of the costs of a two-way EAS route, treating lost access charges as actual costs can force customers in the petitioning exchange to subsidize not just the local rates of customers in other exchanges served by their own companies, but the local rates of customers in other exchanges served by other companies. (The carrier serving the petitioning exchange makes "transfer payments" to the carrier serving the petitioned exchange.)

As discussed above, the high cost of eliminating these inequities (essentially, the cost of a rate case) has generally led to their toleration, and the Commission has generally met the need for income neutrality by building lost access charges into EAS rate additives. The EAS Orders do not specify how the Commission is to achieve income neutrality, however, and the Commission has sometimes used other methods to reach that goal.

There have been earnings investigations, for example, in which the Commission has permitted a company to reduce EAS rate additives in specific exchanges, as opposed to ordering larger company-wide rate reductions.[3] And in at least one Alternative Form of Regulation case, the Commission has permitted a company to reduce EAS rate additives as part of the rate re-balancing

[3] In the Matter of the Petition of the Department of Public Service for a Commission Investigation of the Level of Rates Charged by Contel of Minnesota, Inc. d/b/a GTE Minnesota, Docket No. P-407/CI-96-216, ORDER APPROVING SETTLEMENT AS MODIFIED (August 29, 1996); In the Matter of the Commission Investigation of the Level of Rates Charged by GTE Minnesota, Docket No. P-407/CI-00-270, ORDER ACCEPTING SETTLEMENT AGREEMENT (May 11, 2000).

required to ensure just and reasonable rates at the beginning of the Plan.[4]

The Department of Commerce argued that in this case the traditional inequities associated with including lost access charges in EAS rate additives are exacerbated by the emerging presence of local competition and the absence of rate-of-return regulation. The Department also argued that including lost access charges in EAS rate additives in this case would undermine local competition, which the Commission has a statutory duty to nurture and promote.[5] The Department therefore urged the Commission to use a different method for ensuring income neutrality.

The positions of the parties on this issue are summarized below.

1. The Department of Commerce

The Department of Commerce (the Department) argued that two factors – the emergence of local competition as a central goal of state and federal telecommunications policy and the fact that neither of these two carriers is subject to rate-of-return regulation – require a different approach to income neutrality in this case.

The agency argued that it is anti-competitive to grant companies a perpetual revenue stream replacing overhead and profit unrelated to the cost of the service producing the revenue stream. The agency also argued that, since neither of the carriers involved in this case is subject to rate-of-return regulation, it is feasible to achieve income neutrality through means other than EAS rate additives.

1. Sprint Minnesota, Inc.

Sprint Minnesota, Inc. (Sprint) claimed that excluding access charges from EAS rate additives violated the Commission's EAS Orders and the Alternative Form of Regulation statutes. The company argued that it was unfair and imprudent to disrupt established EAS procedures without a rulemaking or other industry-wide proceeding. The company urged the Commission to suspend action on EAS cases until it had conducted such a proceeding.

2. Osakis Telephone Company and the Minnesota Independent Coalition

The Osakis Telephone Company (Osakis) and the Minnesota Independent Coalition filed joint comments. They opposed excluding lost access revenues from EAS rate additives on the following grounds:

(a) Excluding lost access revenues violates the Alternative Form of Regulation statute and its underlying legislative intent.

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[4] In the Matter of a Petition by United Telephone Company of Minnesota Requesting Adoption of an Alternative Regulation Plan, Docket No. P-430/AR-95-1049, ORDER APPROVING UNITED'S ALTERNATIVE REGULATION PLAN (July 12, 1996).

[5] Minn. Stat. §§ 237.011, 237.16.

(b) Excluding lost access revenues violates the Commission's EAS Orders.
(c) The Commission lacks the authority to exclude access revenues outside of a rulemaking or other industry-wide proceeding.
(d) Excluding lost access revenues is unfair to customers outside the exchanges receiving the EAS service.
(e) Excluding lost access revenues will confuse and mislead Osakis customers about the rate effects of the proposed EAS route.

3. The Minnesota Telephone Association

The Minnesota Telephone Association filed comments urging the Commission to establish a moratorium on processing EAS petitions until it had conducted a rulemaking or other industry-wide proceeding.

III. Commission Action on Lost Access Charges

The Commission agrees with the Department that in this case justice and sound public policy require that EAS rate additives recover only EAS costs and that the income neutrality requirement inherent in the regulatory compact (and explicit in the EAS Orders) be satisfied by other means. This decision is grounded in two concerns.

(1) Neither of the two companies involved in this case operates under traditional, prior-authorization rate-of-return regulation, permitting more creative and equitable approaches to income neutrality;

(2) The perpetual revenue streams that result from including lost access charges in EAS rates undermine state and federal policies promoting competition in local telecommunications markets.

The Commission finds that neither the EAS Orders nor the Alternative Form of Regulation (AFOR) statutes require the inclusion of these costs in EAS rate additives. The Commission rejects the claim that it is inequitable to recover lost access revenues from the general body of ratepayers rather than from the ratepayers in the exchange seeking EAS.

The Commission rejects the claim that it must conduct a rulemaking or a generic industry-wide proceeding before using any means other than EAS rate additives to achieve income neutrality in this case. Finally, the Commission will require additional filings to ensure that Osakis subscribers are fully informed, prior to polling, on the rate effects of installing the proposed EAS route.

These issues will be addressed in turn.

A. The Diminishing Relevance of Rate-of-Return Regulation

Under traditional, prior authorization rate-of-return regulation, a carrier's rates are set by the Commission at amounts designed to provide a reasonable opportunity for the carrier to recover its prudently incurred costs and earn its authorized rate of return. Since carriers are powerless to raise their rates, simple justice requires that the Commission adjust their rates when it takes actions (such as requiring EAS routes) that raise the carrier's costs or reduce its revenues.

In this case, however, both carriers can raise at least most of their rates without Commission permission. Both carriers operate under Alternative Form of Regulation plans, which allow them to raise rates for all but a handful of price-regulated services without Commission approval.[6]

In short, in this case the regulatory compact does not force the Commission to make a choice between building lost access charges into EAS rate additives or initiating two expensive and time-consuming rate cases to make the companies whole. Both companies have a broad range of revenue-raising methods available to them. Of all these methods, surcharging the local service rates of a particular exchange to subsidize the rates of other exchanges (including the exchanges of other companies) is probably one of the worst. The Commission is confident that the companies can find a better way and will support them as they explore other options.

A. Competition in Local Telecommunications Markets

The Commission agrees with the Department that the perpetual subsidies and revenue streams created by including lost access charges in EAS rates undermine state and federal policies opening local telecommunications markets to competition.

First, granting a carrier a permanent right to lost access charges assumes that the company is a monopoly with a stable customer base and a fixed revenue requirement that must continue to be met to serve that customer base. In a competitive market this is no longer true. In a competitive market, a carrier's customer base can shrink or grow, changing its costs and revenues significantly. In fact, these changes in costs and revenues are one of the engines of competition; competition lowers prices in part because companies react to these changes by becoming more efficient. Maintaining a steady stream of revenue to offset losses sustained under circumstances that no longer apply impairs one of competition's most important functions.

Competition is undermined even more effectively by the transfer payments that would occur between Osakis Telephone Company and Sprint under traditional EAS practice. Access charges are largely subsidies to reduce the cost of local service company-wide. There is no policy justification for requiring Osakis, a potential competitor of Sprint, to subsidize Sprint's company-wide prices.

Finally, using regulation to preserve lost revenue streams in competitive markets is unsustainable and inequitable in the long run. It disrupts the cost/price relationship on which competition depends. In its place, it substitutes arcane subsidies that were originally devised to address practical impediments that no longer exist. It distributes unearned advantages and disadvantages to competing carriers based on historical accidents, such as when specific exchanges outgrew their toll-free calling areas and how much a particular company's access charges and toll rates subsidized local service rates.

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[6] Minn. Stat. § 237.76 *et seq.*

For all these reasons, the Commission concludes that, in this case, including lost access charges in the EAS rate additives would violate the Commission's duty to promote competition in local telecommunications markets and to ensure that rates for telecommunications services are just and reasonable.[7]

A. Fairness to Customers in Other Exchanges

Osakis and the Minnesota Independent Coalition argued that it is unfair to recover lost access revenues from the general body of ratepayers rather than the ratepayers in the exchange seeking EAS. These parties claimed that "*[p]reventing an inequitable shift of revenue recovery* from the new EAS customers to other customers is the primary purpose of the policy of including lost access revenues in EAS additives."[8] The Commission disagrees.

First, the Commission has never had a "policy" of including lost access revenues in EAS rate additives. As the historical overview above makes clear, it has had a practice that has evolved in response to practical constraints. Faced with a need to expand local calling areas through EAS *and* a need to make rate-regulated companies whole when state action disrupts their revenue streams, the Commission has generally used EAS rate additives to meet both objectives. As discussed above, the Commission has been aware that this represents "rough justice" at best and has used other methods of achieving income neutrality when they have presented themselves.

Second, there is nothing unfair about spreading the recovery of displaced access charge revenues over a company's general body of ratepayers. Access charges subsidize the basic rates of all ratepayers, on the theory that long distance is a largely discretionary service which can and should be priced to help keep essential local service affordable.[9] This approach rests on the assumption that local service is in fact just that – local – and that every exchange has a local calling area that meets the everyday calling needs of its subscribers.

When this assumption no longer holds true, when everyday calling patterns change to the point that a local calling area must be expanded through extended area service, the new local calling area remains a *local* calling area. There is no policy justification for requiring calls within that area to continue subsidizing company-wide rates.

Furthermore, from a broader perspective, the practice of including lost access charges in EAS rate additives has the perverse effect of penalizing the customers who most need EAS – the more inter-exchange calling being done, the more pressing the need for EAS, the higher the lost access

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[7] Minn. Stat. §§ 237.011, 237.06.

[8] Reply Comments of Osakis Telephone Company and the Minnesota Independent Coalition, page 11, emphasis in original.

[9] Of course, one of the long term goals of state and federal regulators is to make implicit subsidies, such as the access charge subsidy, explicit, and to fund these subsidies in a manner consistent with competitive markets, such as the Universal Service Fund. In the mean time, however, the Commission has to work within the existing paradigm.

charges, and the higher the EAS rate additives.

Clearly, the equities in this case cut in favor of spreading recovery of lost access charges over the general body of ratepayers.

A. Ensuring that Osakis Voters are Fully Informed

Osakis and the Minnesota Independent Coalition pointed out that, since Osakis is a one exchange company, customers in that exchange will have to make up lost access revenues whether they are included in the EAS rate additives or not. The parties argued that failing to include them in the EAS rate additives could confuse and mislead Osakis customers. These customers will base their EAS vote on the rate additives disclosed on the ballot, not realizing that a general rate increase might also be necessary.

The Commission agrees that full disclosure is essential and will require both companies to make filings showing which rates they propose to increase to recover lost access revenues. The Osakis rates will be disclosed on the ballot.

E. The Rulemaking/Generic Proceeding Issue

1. Rulemaking/Generic Proceeding Not Legally Required

Intervening carriers argued that a rulemaking or industry-wide generic proceeding was required in this case for two reasons:

> (1) any decision to abandon income neutrality in EAS cases could only be reached and implemented through a rulemaking or other generic proceeding, since income neutrality was required by the EAS Orders, which were issued after a legislatively-mandated, state-wide generic proceeding; and
>
> (2) the practice of adding lost access charges to EAS rate additives was so firmly established and so closely linked with the EAS process that it could only be changed by rule or generic proceeding.

The Commission disagrees.

The first argument, that the income neutrality requirement could only be changed by a rulemaking or other generic proceeding, is off-point. The Commission is not abandoning income neutrality; it is merely finding that one traditional method of achieving it – including lost access charges in EAS rate additives – is inequitable and contrary to public policy under the facts of this case. The Commission is confident that these two companies can find competitively neutral methods of recouping lost access revenues, and it will expedite its review of any filing they consider necessary for that purpose.

Second, the Commission rejects the notion that adding lost access charges to EAS rate additives has become so closely linked with the EAS process and so much a part of companies' settled expectations that it can only be changed by rule or generic proceeding. Like all quasi-judicial bodies, the Commission has the right and the duty to depart from precedent when the facts of the case make following that precedent unjust, inequitable, or otherwise at odds with its statutory responsibilities. After thorough briefing and deliberation, the Commission has concluded that that is the case here.

For all these reasons, the Commission concludes that it is not legally required to conduct a rulemaking or an industry-wide generic proceeding to exclude lost access charges from the EAS rate additives in this case.

1. Rulemaking/Generic Proceeding Not Required to Ensure Informed Decision-making

Finally, the Commission rejects the claim that whether or not it has the legal authority to depart from past practice, it would be imprudent to do so here without the extensive notice and broad public participation of a rulemaking or generic proceeding. The Commission rejects this claim for two reasons.

First, although the Commission has reached the same decision on lost access charges in several recent cases – and is aware that these decisions may signal an evolution in its approach to EAS rate-setting – in all these cases the Commission has been acting in its quasi-judicial capacity, resolving the case before it on the basis of the facts and the law before it. The Commission has made a considered decision that that is the fairest and most productive way to proceed at this point.

Without the context of a discrete factual situation, the discipline of an actual case, and the focused advocacy of affected parties, EAS issues, always difficult, can become nearly impenetrable. Acting on a case-by-case basis provides the factual groundwork necessary for informed decision-making in this fact-intensive area.

Further, the telecommunications industry is undergoing such rapid change that any global solutions reached in a rulemaking or other lengthy generic proceeding could well be obsolete by the time they are adopted. Meanwhile, individual cases would have been wrongly decided while awaiting a comprehensive resolution of EAS issues.

Finally, the Commission believes that the procedural approach it has taken to recent EAS cases, including this one, combines the most helpful features of generic/rulemaking proceedings with those of traditional case-by-case adjudications. While examining each case on its own facts and merits, the Commission has served notice of these cases to the broadest possible audience and has invited all interested persons to file comments or to become parties.

When the Commission received the Department's recommendations in the Almelund docket,[10] it was obvious that taking those recommendations could have a precedential effect on future EAS cases. The Commission therefore served notice of the Department's comments on all carriers

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[10] In the Matter of a Petition for Extended Area Service from the Almelund Exchange to the Metropolitan Calling Area, Docket No. P-407, 405, 413, 520, 426, 427, 430, 421/CP-97-1237.

authorized to provide local or long distance service within the state.

Also, before this case was heard, the Commission served copies of its staff's briefing papers for this and three related EAS cases (including Almelund) on all persons on the service lists of all four cases. In the same mailing, the Commission served these persons with copies of a staff discussion paper on EAS policy and a legal memorandum on EAS issues from Commission counsel.

These notice procedures have ensured the broadest possible participation in this case and the fullest development of its issues, while retaining the advantages inherent in focusing on its individual facts and equities. The Commission is convinced that these procedures have produced the well-developed and closely-argued record necessary for informed decision-making. And the Commission remains convinced that this problem-solving, quasi-judicial approach is the most effective and appropriate procedural vehicle for this case.

F. The AFOR Statute and Legislative Intent

The Commission also rejects the carriers' claims that the Alternative Form of Regulation (AFOR) statutes require the inclusion of lost access charges in EAS rate additives. First, the language in these statutes is permissive, not mandatory. It permits but does not require local rate increases to cover EAS costs and achieve income-neutrality in EAS cases.[11]

Second, the income neutrality language in the AFOR statutes does not require a specific method of achieving that goal. Like the EAS Orders (and the old EAS statute), it speaks only to income neutrality, not to how income neutrality is to be achieved. As discussed above, the Commission is not abandoning income neutrality; it is merely declining to use one traditional method of achieving it in this case.

Nor does eliminating lost access charges from EAS rate additives violate the *intent* of the AFOR statute. Osakis and the Minnesota Independent Coalition claim that, by including the EAS provisions in the AFOR statutes, the Legislature ratified and essentially codified existing EAS procedures, including the practice of adding lost access charges to EAS rate additives. The language of the statutes follows.

> Other than as authorized in this subdivision, an initial alternative regulation plan must not permit income-neutral rate changes for price-regulated services during the plan except as is necessary to implement extended area service or any successor to that service.
>
> Minn. Stat. § 237.762, subd. 5.

* * * * * * * * * * * * *

> A small telephone company may change rates for local services listed in section

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[11] Minn. Stat. §§ 237.762, subd. 5; 237.773, subd. 3.

237.761, subd. 3 [listed services include both extended area service and local service], at any time, to implement extended area service or any successor to that service on an income neutral basis.

Minn. Stat. § 237.773, subd. 3.

It strains credulity to read this language as requiring the inclusion of lost access charges in EAS rate additives. Not only does the Legislature fail to endorse or otherwise refer to existing EAS procedures – it explicitly acknowledges that EAS may, before the statute sunsets on January 1, 2006, be replaced by another service. The Commission sees no basis for concluding that the Legislature intended to bind the Commission to continue its much-used practice of including lost access charges in EAS rate additives.

A. Conclusion

For all the reasons explained above, the Commission finds that it cannot, consistent with its statutory duties to ensure fair and reasonable rates and to promote competition, permit these companies to include lost access charges in their EAS rate additives.

IV. Cost Allocation Issues

A. The Issue

The Commission has found above that the losses in access charges that these companies will incur if the proposed EAS route is installed are not really costs of the proposed EAS route, but displaced, company-wide, local service subsidies. Since they are not EAS costs, the Commission has found that it would be unreasonable, inequitable, and anti-competitive to factor them into either company's EAS rate additives. Instead, both companies are to address these losses on a company-wide basis, separate from the exchange-specific EAS rate additives.

This means that the only costs left to be allocated between the two companies are what are usually called "facilities costs," the actual costs of installing and operating the EAS route. Under the terms of the generic EAS Orders, between 50% and 75% of the these costs are to be allocated to the petitioning exchange, included in its EAS rate additives, and paid to the company serving the petitioned exchange in the form of "transfer payments." In this case, the Department recommended allocating 75% of the facilities costs to the Osakis exchange.

Upon careful reflection, however, the Commission concludes that allocating Sprint's Alexandria costs to Osakis's subscribers is so anti-competitive in its potential effects that the Commission must not permit it, past practice notwithstanding. The Commission will therefore depart from the terms of the EAS Orders and require each company to bear its own EAS costs.

A. The Anti-Competitive Nature of Inter-Company EAS Subsidies

The Commission has a duty and a commitment to nurture and promote competition in telecommunications. Both Congress and the Minnesota Legislature have found that the public interest requires transforming the telecommunications sector of the economy from the monopoly of the past to a fully functioning competitive market.[12] Allocating another exchange's and another company's EAS costs to the Osakis exchange is inconsistent with that public policy goal. It would undermine competition in at least three ways.

First, it would give Sprint, the incumbent carrier serving Alexandria, a competitive advantage over new entrants seeking to serve Alexandria. Under Commission rules, both Sprint and the new entrants would be required to offer EAS service to Osakis.[13]

The incumbent, however, would have some of its costs offset by transfer payments from Osakis, while the new entrants would have to bear all of these costs themselves. This would clearly place new entrants at a competitive disadvantage.

Second, it would give new entrants seeking to serve the Osakis exchange a competitive advantage over the incumbent carrier. Again, both the incumbent and new entrants would be required to offer Osakis/Alexandria EAS service. The incumbent, however, would have to cover both its own EAS costs and those allocated from Alexandria, while the new entrant would have to cover just its own costs. This would place the incumbent at a competitive disadvantage.

Third, it would work at cross purposes with the Commission's ongoing efforts to promote competition, by disrupting the cost/price relationship on which competition depends. Competition benefits consumers by driving price to cost and by driving cost to its most efficient level, as firms adopt operating efficiencies to compete more effectively. Much of the work required to move telecommunications from a monopoly environment to a competitive one lies in dealing with the subsidies that break this cost/price link.[14]

Allocating Sprint's EAS costs to Osakis would complicate these efforts by embedding in local rates additional subsidies that the Commission would have to undo at a later date.

A. The Legal Standard

Not only would allocating Sprint's costs to Osakis compromise and complicate the Commission's efforts to promote competition, it would be inconsistent with the spirit, if not the letter, of state and federal statutory mandates.

Minnesota law requires the Commission to execute its regulatory duties in light of the overarching state goal of "encouraging fair and reasonable competition for local exchange telephone service in a competitively neutral regulatory manner." Allocating another company's and another exchange's

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[12] Minn. Stat. §§ 237.011, 237.16; Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of title 47, United States Code).

[13] Minn. Rules 7811.0800; Minn. Rules 7812.0800.

[14] Some examples of common, but not universal subsidies, are toll service/local service, high density service area/low density service area, business service/residential service.

EAS costs to Osakis poses clear obstacles to fair and reasonable competition and places the competitive neutrality of this regulatory action in question.

Federal law is even more direct:

> No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.
>
> 47 U.S.C. § 253 (a).

The section goes on to clarify that states retain the power to protect, *on a competitively neutral basis*, state interests in universal service, public safety and welfare, service quality, and consumer protection. The Federal Communications Commission, which is authorized to preempt state action inconsistent with § 253, has taken a relatively narrow view of these exceptions. The agency has found that mechanisms providing support to incumbents while denying support to new entrants may well constitute "barriers to entry," which are subject to preemption under 47 U.S.C. § 252 (d).[15]

Whether or not the EAS cost allocation in this case would survive a legal challenge, the Commission is convinced that it violates the spirit of the law and should be abandoned.

A. The Generic EAS Orders

The generic EAS Orders, which continued the longstanding practice of allocating EAS costs between petitioning and petitioned exchanges, were issued before the passage of the federal Telecommunications Act of 1996 and while Minnesota's local competition policy initiative was in its infancy. The Commission recognized that change was on the horizon and that the procedures established in the Orders would have to evolve with state and federal telecommunications policy:

> While this Order defines the EAS process for now, it is undeniable that the telecommunications industry is in a state of great change. Changes in the provision of and regulatory framework for local service are imminent. It is likely that these changes will also likely require changes in those services closely related to local service, such as EAS. The following examples illustrate the rapidity of these changes
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> - At the time the legislature directed the Commission to conduct an investigation into local calling scopes in 1994, it was not known that the legislature would require and the Commission would initiate a rulemaking on local service competition less than a year later.

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[15] *Western Wireless Corp. Petition for Preemption of Statutes and Rules Regarding the Kansas State Universal Service Fund Pursuant to Section 253 of the Communications Act of 1934*, Memorandum Opinion and Order, File No. CWD 98-90, FCC 00-309 (August 28, 2000).

- There is also legislation at the federal level that would provide for the elimination of the interLATA toll restrictions on the Bell Operating Companies.

Given these changes that are certain to affect the provision of local telecommunications service in Minnesota, it is noteworthy that the process adopted by the Commission in this proceeding will be subject to review and change as the telecommunications industry evolves.

In the Matter of an Investigation into the Appropriate Local Calling Scope, in Accordance with Minn. Stat. 237.161 (1994), Docket No. P-999/CI-94-296, ORDER REACTIVATING THE PROCESSING OF EAS PETITIONS (October 24, 1995), pp. 5-6.

As discussed above, the Commission recognized early on in this and related EAS cases that traditional methods of calculating and allocating EAS costs might collide with emerging legal standards and with its duty to promote competition. To ensure that it was fully informed, the Commission solicited comments on these issues from all carriers authorized to provide local or long distance service within the state. The Commission has carefully considered these comments.

The Commission now concludes that, at least in this case, ordering the inter-company EAS cost subsidies anticipated in the generic EAS Orders would conflict with sound public policy, contravene the public interest, violate the Commission's statutory duty to promote competition, and perhaps conflict with federal law. Based on these compelling circumstances, the Commission will depart from the terms of the EAS Orders and require both companies in this case to bear, and to collect from their own subscribers, their own EAS costs.

The Commission will so order.

ORDER

1. Sprint Minnesota, Inc. and Osakis Telephone Company shall promptly file EAS rate additives reflecting the decisions herein.

2. Sprint Minnesota, Inc. and Osakis Telephone Company shall promptly make individual filings detailing which, if any, other rates they propose to change to recover the lost access revenues excluded from the EAS rate additives in this Order.

3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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