BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Gregory Scott	Chair
Edward A. Garvey	Commissioner
Marshall Johnson	Commissioner
LeRoy Koppendrayer	Commissioner
Phyllis A. Reha	Commissioner

In the Matter of a Petition by Frontier Communications of Minnesota, Inc. Requesting Adoption and Renewal of An Alternative Regulation Plan

ISSUE DATE: May 25, 2001

DOCKET NO. P-405/AR-00-394

ORDER MODIFYING ALTERNATIVE REGULATION PLAN

PROCEDURAL HISTORY

On August 16, 1996, the Commission approved the first alternative form of regulation (AFOR) plan for Frontier Communications of Minnesota, Inc. (Frontier) pursuant to Minnesota Statutes §§ 237.76 through 237.772. That plan (the Current Plan) contained a termination date of October 1, 2000.[1]

On March 31, 2000, Frontier initiated the present docket by filing a Petition for Revised Plan (petition).

On July 14, 2000, the Commission issued its NOTICE OF FILING, ORDER ESTABLISHING PROCEDURES AND ORDER CONVENING SETTLEMENT CONFERENCE (July 14, 2000 Order). The Order provided 80 days for substantive comments on Frontier's plan, and an additional 20 days for reply comments. Also, the Order extended the term of the Current Plan to December 31, 2000.

From July 18 to August 17, 2000, Frontier made a number of filings complying with the Commission's July 14, 2000 Order.

On September 19, 2000, the Minnesota Department of Commerce (the Department) filed comments.

The Commission held public hearings in Burnsville on August 10, Canby and Worthington on August 16, and Fairmont on August 17, 2000. An Administrative Law Judge from the Office of Administrative Hearings conducted the hearings and, on October 16, reported his findings to the Commission.

On October 19 and December 26, 2000, the Commission granted Frontier's requests for extensions to file comments or a settlement, and extended the term of the Current Plan indefinitely.

On March 9, 2001, the Department, Frontier and the Office of Attorney General's Residential and Small Business Utilities Division (OAG-RUD) filed a proposed revised AFOR Plan that they all supported (AFOR Plan).

On March 23, 2001, the Commission solicited further comments on the AFOR Plan, and sought clarification on several questions. Frontier, the Department and the OAG-RUD jointly filed a response on April 10.

On April 19, 2001, Frontier asked the Commission to schedule consideration of the AFOR Plan on May 15, 2001, to coincide with the Commission's consideration of a related docket.

Accordingly, the matter came before the Commission on May 15, 2001. At that hearing, with all the parties present, Frontier, the Department and the OAG-RUD proposed an alternative rate design for use in the event that the Commission modified the AFOR Plan's rate design. No party opposed the proposal.

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[1] In the Matter of a Petition by Frontier Communications of Minnesota, Inc. Requesting Adoption of an Alternative Regulation Plan, Docket No. P-405/AR-95-1048.

FINDINGS AND CONCLUSIONS

I. Substantive Requirements for Alternative Regulation Plans

Minn. Stat. § 237.76 states:

> **The purpose of an alternative regulation plan is to provide a telephone company's customers with service of a quality consistent with commission rules at affordable rates, to facilitate the development of telecommunication alternatives for customers, and to provide, where appropriate, a regulatory environment with greater flexibility than is available under traditional rate-of-return regulation....**

Alternative regulation plans are intended to capture the benefits of emerging competition among local exchange carriers. These plans replace rate-of-return regulation with more flexible pricing procedures. Statutes impose a number of requirements on AFOR plans, including the following:

Carriers operating under alternative regulation must classify all their services as "price regulated," "flexibly priced," or "nonprice regulated." While they may raise or lower rates for some services with minimal regulatory oversight, they may not raise rates for price-regulated services except as expressly provided in the plan.[2] And they may not reduce rates for price-regulated services below long-run incremental cost at any time.

To qualify for alternative regulation a company must demonstrate that its rates and rate design are appropriate in light of the proposed plan.

The company must also demonstrate that it is in substantial compliance with Commission quality
of service rules. It must establish a baseline measure of service quality for the past three years, file periodic service quality reports, and establish remedies and penalties for failure to maintain service quality at levels specified in the plan. It must make a commitment to invest in infrastructure improvements and report on its plans to deploy advanced technology during the life of the plan. Minn. Stat. § 237.761, subd. 8.

II. Procedural Guidelines

Both the AFOR statutes and the Current Plan require consideration of a new AFOR plan six months prior to the expiration of an existing plan. Minn. Stat. § 237.766. Frontier fulfilled these requirements when it filed its proposed revised AFOR plan on March 31, 2000, six months before the term of the Current Plan's termination date of October 1, 2000.

The AFOR statutes also mandate settlement discussions, require broad public notice, encourage public input, and direct appropriate discovery. Minn. Stat. § 237.764. In short, they lay procedural foundations, expecting the Commission to complete the process of constructing workable procedures for examining proposed plans. To assure fulfillment of other procedural requirements, the Commission issued its July 14, 2000 Order specifying public notice, scheduling four public meetings, establishing discovery procedures, and convening a settlement conference. Among other things, that Order extended the comment

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[2] The statutory prohibition on rate increases during the first three years of an AFOR plan does not apply to a revised or renewed plan. Minn. Stat. § 237.766.

period, and extended the term of the Current Plan. In this manner, regulatory continuity was maintained while Frontier's AFOR case was pending.

Minn. Stat. § 237.764, subd. 1(b) directs the Commission to require the petitioning telephone company to provide notice of the proposed plan to its customers, along with a summary description of the plan provisions and the dates, times, and locations of public meetings scheduled by the Commission. The Commission directed Frontier to provide such notice in its July 14, 2000 Order. The Commission finds that Frontier has complied with this Order. See Frontier's supplemental filing (July 18, 2000), compliance filings (July 27, 2000, corrected August 2, 2000), notice (August 7, 2000) and customer notice (August 17, 2000).

Finally, when Frontier arrived at a settlement with the Department and the OAG-RUD, it submitted the agreement to the Commission for review as required by Minn. Stat. § 237.764, subd. 2.

The Commission finds that the procedural requirements prescribed by the AFOR statutes have been fulfilled.

III. Commission Analysis: the Sufficiency of the Proposed Revised AFOR Plan

A settlement, even if endorsed by all parties to this matter, would not make approval of a proposed AFOR Plan automatic. A settlement serves, in effect, as a joint recommendation by the endorsing parties that a company's proposed plan meets all the statutory requirements and should be approved. By statute, however, the Commission is required to review settlements regarding proposed AFOR plans and decide whether it will accept, reject, or modify them.

Accordingly, the Commission has reviewed Frontier's proposed AFOR Plan in light of the requirements of Minn. Stat. §§ 237.76 through 237.772. In this Order, the Commission makes findings of fact and conclusions concerning the appropriateness of the proposed initial rates and proposed plan, pursuant to Minn. Stat. § 237.764, subd. 1(e). Particular statutory requirements warranting comment and findings are as follows:

A. Ratepayer Benefit

Minn. Stat. § 237.764, subd. 1(c) states:

> **The company's petition shall contain an explanation of how ratepayers will benefit from the plan....**

Frontier argues that customers would continue to receive quality services, consistent with Commission rules, at affordable rates. The proposed AFOR Plan would promote competition in Frontier's local service market, protect consumers by ensuring the provision of quality services at affordable rates, and promote universal service goals by compelling and expediting the deployment of advanced telecommunication services to Frontier customers.

The Commission finds that Frontier's assurances are persuasive for reasons detailed in subsequent sections regarding such items as investment commitments, service quality commitments, facilitation of telecommunications alternatives, and regulatory flexibility to facilitate introduction of new services and changes to existing services for customers.

B. Classification of New and Existing Services

Minn. Stat. § 237.761, subd. 1 states:

> **An alternative regulation plan must contain provisions that provide for classification of all telephone services as price regulated, flexibly priced, or nonprice regulated...**

as these categories are defined in statute.

For Frontier's current services, the parties to the settlement recommend continuing to use the Commission-approved classifications from the Current Plan. AFOR Plan IV. The parties agree that any new service should be classified pursuant to Minn. Stat. § 237.761, subd. 7. The AFOR Plan sets for a procedural schedule for objecting to a classification. It also states that the Commission has discretion to challenge a classification on its own motion, and to vary the schedule's time lines. AFOR Plan X.A.

The Commission has reviewed Frontier's service classifications and finds that they comport with applicable statutory definitions provided in Minn. Stat. § 237.761.

C. Reclassification of Services

Minn. Stat. § 237.761, subd. 6 states:

> **An alternative regulation plan may contain provisions allowing for the reclassification of services during the course of the plan upon a showing that the service meets the criteria contained in [statute] and the plan, for the requested classification.**

The proposed AFOR Plan contains a process whereby the Commission or any party may initiate the reclassification. If unopposed, the reclassification would occur within 30 days. The AFOR plan sets forth a procedural schedule for opposing a reclassification, and states that the Commission may vary the schedule's time lines. AFOR Plan IV.B.

The Commission has reviewed the proposed AFOR Plan's reclassification provisions, and finds that they comport with applicable statute.

D. Prices and Revenues

The requirement that an AFOR company justify its earnings levels and rates pursuant to Minn. Stat. § 237.764, subd. 1(c) does not apply to a renewing AFOR company. Minn. Stat. § 237.766. Nevertheless, Frontier joins the other parties in recommending a reduction in certain revenues and rates.

Specifically, Frontier agrees to reduce its annual revenues from price-regulated services by $1.2 million, plus an additional $39,100 for each month of 2001 that the Current Plan remains in effect. Frontier further agrees to reduce its annual revenues from these services by an additional $1.2 million in the plan's second year, and an additional $1.2 million in the plan's third year. These numbers were derived through negotiation, but the Department and the OAG-RUD note that those negotiations were informed by what the parties might expect if they were to conduct a rate case. No one spoke in opposition to this proposal.

If the Commission were to reject this AFOR plan, Frontier would return to rate-of-return regulation under Minn. Stat. Chap. 237. Therefore, it is reasonable for the parties to consider the revenue consequences of such regulation when negotiating an AFOR plan. On the basis of the record as a whole, including the unanimous support for this reduction in revenues and the testimony that the parties considered relevant factors in making their recommendations, the Commission finds this proposed change reasonable.

Additionally, the parties recommended a specific rate design – that is, a description of specific reductions to specific rates designed to produce the desired change in Frontier's revenues described above. Frontier agreed to reduce extended area service (EAS) rates, Metro Business rates (B1, Key and PBX), Metro Residential rates, Metro School rates (B1, Key Trunk and PBX), Outstate Business rates (B1, Key Trunk and PBX), and Outstate School rates (B1,
Key Trunk and PBX). See, for example, Frontier's Exchange-by-Exchange Calculation of the Local Service and Extended Area Service Rate Reductions for the First Year of Frontier's Proposed AFOR (April 10, 2001).

In designing these rates, the parties targeted reductions to those rate categories that typically exceeded their costs, as determined by the Commission-approved HAI cost model.[3] While this rate design may result in prices below costs in certain instances, the parties justified this practice on the grounds of promoting affordability generally.

In the course of the Commission's May 15 hearing on this matter, however, concerns arose. The legislature directs the Commission to balance the goal of affordable rates with the goals of enhanced quality and "the development of telecommunication alternatives for customers...." Minn. Stat. § 237.76. To the extent that the rate design would result in prices that are below cost, it would violate Minn. Stat. § 237.762, subd. 3, and may tend to reduce a competitor's willingness to offer alternatives in Frontier's service area. More specifically, the Commission had previously rejected Frontier proposals to reduce certain rates in certain areas due to concerns about anti-competitive consequences.[4]

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[3]See, for example, In the Matter of the State of Minnesota's Possible Election to Conduct Its Own Forward-Looking Economic Cost Study to Determine the Appropriate Level of Universal Service Support, Docket No. P-999/M-97-909.

[4]**Frontier sought to reduce rates in its Adrian and Edgerton exchanges to respond to competition. The Commission declined to grant a rate reduction with respect to the entire exchange areas because calculations of "exchange-wide revenues would be below the cost estimate for each exchange." Instead, the Commission granted Frontier's request on an interim basis only with respect to the downtown portions of those exchanges. In the Matter of Frontier Communications of Minnesota, Inc. Request to Geographically Deaverage Rates to Reduce Local Service Rates in its Adrian and Edgerton Exchanges, Docket No. P-405/AM-00-367 ORDER GRANTING INTERIM RELIEF (July 27, 2000) (Adrian/Edgerton case).**

Then Frontier asked to reduce rates in its Currie, Lake Wilson and Slayton exchanges to respond to competition. Frontier asked to reduce residential and business rates to $9.99 per month and $19.95 per month respectively. The Department argued that Frontier's proposal would set prices below cost in certain instances. In adopting the

In response to these concerns, the parties proposed a modified rate design. The new rate design is identical to the old one, with the proviso that the prescribed rate reductions would only occur in an exchange to the extent that the average revenues per line exceed the average cost per line. The amount of money saved by limiting these rate reductions would be allocated to further reduce prices in exchanges in which revenues exceeded costs, as the parties may recommend.

While this proposal ameliorates concerns about the rate cut's anti-competitive effects, the computational details are complicated. The Commission acquired data establishing each exchange's average cost per line in a prior docket by employing the HAI cost model.[5] But the Commission lacks similar data regarding Frontier's average revenues per line, disaggregated by exchange and customer class. Rather than incur the cost and delay of gathering Frontier's revenue data, the parties agree – for purposes of targeting rate reductions in this AFOR Plan – that proxy numbers would suffice. Specifically, they agree to assume revenues of $40 per month for residential lines, and $60 per month for business lines.

While the $40 and $60 figures are mere estimates, the parties argue that they're reasonable. First, these estimates conform to data regarding Frontier's average revenues per line in prior dockets.[6] Second, the knowledgeable parties to this docket, representing diverse interests including the public interest and ratepayer interest, support the use of these estimates. Third, the HAI Cost Model identifies few Frontier exchanges with line costs near $40 or $60; in other words, even if these estimates were off by a few dollars, the end result – the list of exchanges in which cost exceeds revenues – would not change.[7]

The Commission has reviewed the proposed AFOR Plan's rate design provisions, and finds that they warrant modification in the interest of avoiding reducing prices below cost and promoting telecommunication alternatives for customers. Frontier should not reduce *business* local or EAS rates in an exchange except to the extent that the exchange's average

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Department's position, the Commission concluded that residential rates in Lake Wilson would fall below cost at any level below $14.36 per month in Lake Wilson. Similarly, the Commission accepted the Department's argument for the Currie exchange that business rates should not be reduced below $21.84 per month, and that no residential rate reduction was warranted at all. <u>In the Matter of the Frontier Communications of Minnesota, Inc. to Geographically Deaverage Rates to Reduce Local Service Rate in Currie, Lake Wilson and Slayton Exchanges</u>, Docket No. P-405/M-00-793 ORDER APPROVING DEAVERAGED RATES (November 1, 2000) (Currie/Lake Wilson/Slayton case).

[5] *Id.*

[6] **See the Adrian/Edgerton case and the Currie/Lake Wilson/Slayton case.**

[7] At the May 15, 2001 hearing, Frontier noted that its Belle Plaine and Madison exchanges each have cost estimates slightly above $40. For purposes of the new rate design formula, Frontier asked that these exchanges be treated as if they had cost estimates of $40. No party opposed Frontier's request. On that basis, and given the imprecision in the revenue estimates generally, the Commission will approve Frontier's request.

cost per line is less than $60 per month. Frontier should not reduce *residential* local or EAS rates in any exchange except to the extent that the exchange's average cost per line is less than $40 per month. That is, for each exchange Frontier should determine the difference between average revenues and average costs per line; that number would constitute the maximum rate reduction for that exchange under the AFOR Plan, Attachment A. Where this modification would cause Frontier to refrain from making a planned rate reduction, the funds that would be saved by Frontier should be allocated to further reduce rates in other exchanges. The parties should jointly decide which rates to reduce.[8]

E. Introduction of New Service

237.761, subd. 7 states:

> **At the time the company first offers a service, it shall file a tariff or price list and the proposed classification for the service under the plan along with a written explanation of why the proposed classification is consistent with this section. New services classified as flexibly priced or nonprice regulated may be offered on one day's notice to the commission and the department. New services classified as price regulated may be offered pursuant to the terms set forth in the plan. A service is not considered a new service if it consists of a repackaging including bundling, unbundling, or repricing of an already existing service. If no interested party or the commission objects to the company's proposed classification within 30 days of the filing of the petition, the company's proposed classification of the service is approved. If an objection is filed, the commission shall determine the classification of the service within 90 days of the filing of the new service.**

These statutory terms are embedded in the proposed AFOR Plan at V (Price-Regulated Services) and VI (Flexibly Priced And Non-Price-Regulated Services). The plan reflects the statutory procedural schedule. It also says that the Commission has discretion to challenge a classification on its own motion, and to vary the schedule. AFOR Plan X.A.

Customers would have the option to decline a new service at no extra charge. AFOR Plan X.B.

The Commission has reviewed the proposed AFOR Plan's new service provisions, and finds that they comport with applicable statute.

F. Prices for New Services

Minn. Stat. § 237.762, subd. 2 states:

> **For services offered by the telephone company for the first time after August 1, 1995, the rates or prices must equal or exceed the total service long-run**

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[8]The precise rates resulting from this formula would depend upon many factors, including customer line counts. See AFOR Plan, Attachment A. The Commission would therefore direct Frontier to make compliance filings to ensure compliance with this provision and Minn. Stat. § 237.762, subd. 3.

incremental cost [TSLRIC] of the service [as TSLRIC is defined in statute].

Frontier is not introducing any new services at present. New services offered during the term of this AFOR Plan will need to comply with this statutory requirement.

G. Rate Changes

Minn. Stat. § 237.766 states:

> **Any revised or renewed plan ... shall contain a mechanism under which a telephone company may reduce the rates for price-regulated services below the initial rates or prices or increase the rates or prices during the term of the revised or renewed plan.**

The proposed AFOR Plan sets forth the procedures for changing rates for various categories of service.

1. Tariff Changes for Price-Regulated Services

Minn. Stat. § 237.762, subd. 3(a) states, in part:

> **An alternative regulation plan must set forth the procedures under which the telephone company may reduce the rates or prices for price-regulated services below the initial rates or prices or thereafter increase the rates or prices during the term of the plan. The rates or prices may not be reduced below the total service long-run incremental cost of providing the service.... Rates for price-regulated services may not be increased unless the company has demonstrated substantial compliance with the quality of service standards set forth in the plan.**

The proposed AFOR Plan would give Frontier flexibility in setting prices for price-regulated services. It would establish a maximum price, called a "Regulated Price," for each service. But as noted above, Frontier would be barred from reducing any price below the incremental cost of service. Minn. Stat. § 237.762. In sum, Frontier would have discretion to set a price for each price-regulated service between a maximum of its Regulated Price and a minimum of its current price or incremental cost, whichever is lower.

The formula for measuring incremental cost is set forth in statute at Minn. Stat. § 237.772. The formula for deriving the Regulated Price is embedded in the proposed AFOR Plan as follows:

Frontier uses its current rates as a starting point. Frontier would then implement its first rate reduction of $1.2 million, plus $39,100 for each month between December 31, 2000 and the effective date of the proposed AFOR Plan, as set forth in AFOR Plan, Attachment A. Generally, it would use the bulk of the discount to reduce EAS rates to specified prices, and use any remaining amount to reduce the other monthly customer charges. The actual rates resulting from this formula would depend upon data from Frontier's December 2000 billing cycle, which is still forthcoming.

Frontier would implement an additional $1.2 million rate reduction on the first and second

anniversaries of the effective date. Specifically, Frontier would reduce monthly customer Regulated Prices, other than EAS charges, based on revenues received from each group. Frontier would have the discretion to accelerate these reductions by up to 12 months.

But in six exchanges where Frontier had already reduced rates to meet competition,[9] the Regulated Prices (that is, the maximum prices) would be equal to the regulated prices in the other exchanges, rather than a price derived from the existing rates in those exchanges. AFOR Plan V.A.

Access rates – the price that another company (such as a long-distance carrier) pays when one of its customers initiates or terminates a call in Frontier's service area – would be capped at current levels. AFOR Plan V.A.3.

The proposed AFOR Plan would also provide for changing regulated rates to reflect exogenous changes. Exogenous changes are government-imposed changes to Frontier's costs or revenues that are either unknown and unforeseeable, or are on a list of known, foreseeable changes having an indeterminate financial effect on Frontier. Frontier would have the right to recover federally-authorized rates or charges. Otherwise, the Commission would have the discretion, upon petition, to authorize changes in regulated rates to reflect exogenous changes. But Frontier could not increase rates to reflect exogenous changes until it was in substantial compliance with the AFOR Plan's quality-of-service requirements. Also, the financial impact of an exogenous change might need to be apportioned among price-regulated, flexibly priced and nonprice-regulated services. AFOR Plan V.B.

The proposed AFOR Plan sets forth a procedural schedule for objecting to a rate change. The Commission would have the discretion to vary the procedural schedule, suspend the rate change, and amend the rate change as a result of a complaint or investigation. AFOR Plan V.C.

2. Changes for Flexibly-Priced Services

Minn. Stat. § 237.762, subd. 6 states:

> **The telephone company shall file price lists with the commission for all flexibly priced or non-price-regulated services. The rate or price for each flexibly priced and non-price-regulated service must be equal to or exceed the total service long-run incremental cost of providing that service. In any proceeding regarding the appropriateness of a rate or price for a flexibly priced or non-price-regulated service, the telephone company has the burden of proving**

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[9] The six exchanges are Adrian, Currie, Edgerton, Lake Wilson, Slayton and Worthington. In the Matter of the Petition of Frontier Communications to Geographically Deaverage Rates to Reduce the Local Service Rate in its Worthington Exchange, Docket No. P-405/M-99-914 ORDER ALLOWING RATE REDUCTION (October 21, 1999); In the Matter of the Petition of Frontier Communications of Minnesota, Inc. to Geographically Deaverage Rates to Reduce Certain Business Rates in its Worthington Exchange, Docket No. P-405/AM-99-1720 ORDER APPROVING REDUCTION OF BUSINESS AND SCHOOL SERVICE RATES IN WORTHINGTON EXCHANGE (March 1, 2000); the Adrian/Edgerton Order; the Currie/Lake Wilson/Slayton Order.

that the rate or price is above the total service long-run incremental cost of providing that service.

The parties agree that Frontier should be able to change rates for flexibly-prices services at any time. Price increases would take effect 20 days after filing a revised price list. Promotions, new services and miscellaneous price-list changes would take effect on the following day, unless Frontier specified otherwise. Price decreases would take effect upon filing.

The AFOR Plan provides a procedural schedule for objecting to a change. It says that the Commission could vary the procedural schedule, and could stay a change to a flexibly-priced service pending investigation. The Commission could also order a refund of a price increase if it finds that the increase violated state law or the AFOR plan. Refunds for violations of Minn. Stat. § 237.06 (Reasonable Rate and Service), however, would be calculated from the date Frontier is notified that a complaint had been filed. AFOR Plan VI.A.

3. Changes for Non-Price-Regulated Services

Regulation of nonprice-regulated services would be similar to regulation of flexibly-priced services. Frontier could change the price of any nonprice-regulated service upon filing, and introduce a new service with one-day notice.

Again, the AFOR Plan provides a procedural schedule for objecting to a change. It says the Commission could vary the procedural schedule, and could stay a change to a flexibly-priced service pending investigation. AFOR Plan VI.B.

4. Pricing Above Cost

Statute requires an AFOR company to maintain prices above incremental cost. Yet Minn. Stat. § 237.772, subd. 2 states:

> **To the extent that this section or the commission may require a company to provide a TSLRIC study, a company may submit a petition to the commission for permission to submit a variable cost study instead of a TSLRIC study. The commission shall grant the petition if the telephone company demonstrates:**
>
> **(1) that a TSLRIC study is burdensome in relation to its annual revenue from the service involved;**
>
> **(2) in the case of an existing service, that the service is no longer being offered to new customers; or**
>
> **(3) if the telephone company shows other good cause.**

The proposed AFOR Plan requires that the price of flexibly priced and non-price-regulated services exceed cost. It also specifies that Frontier need not file a cost study each time it changes rates, initiates a promotion or introduces a new service. Rather, upon an allegation that a change would result in prices below cost, Frontier would respond in ten days by a) agreeing to provide a relevant cost study, b) petitioning the Commission to accept a variable cost study in lieu of the incremental cost study, or c) arguing that the complaint has provided an insufficient factual basis to believe the service is priced below cost. AFOR Plan VI.C.

The Commission has reviewed the proposed AFOR Plan's rate change provisions, and finds that they comport with applicable statute.

H. Deaveraging

Minn. Stat. § 237.771 requires that rates under an AFOR plan must be the same in all geographic locations except for good cause.

The proposed AFOR Plan would permit Frontier to propose a rate reduction in targeted areas for business or residential service, or both, for "good cause." But Frontier would be prohibited from recovering the foregone revenues through increasing rates elsewhere above Regulated Price. The proposed AFOR Plan contains a definition of "good cause," and notes that Frontier may charge non-uniform rates for nonprice-regulated services at any time. Frontier would bear the burden of proof to show "good cause," but if a competitor withholds information relevant to establishing Frontier's cause, the burden may shift to the competitor. AFOR XI.A.

Also, Frontier would be able to seek to pass through local taxes, franchise fees or special surcharges to the customers in the jurisdiction imposing the charges. AFOR Plan XI.B.

The proposed AFOR Plan provides a procedural schedule for objecting to a deaveraging proposal, and says that the Commission may alter the schedule as appropriate. AFOR Plan XI.C.

The Commission has reviewed the proposed AFOR Plan's deaveraging provisions, and finds that they comport with applicable statute.

I. Packages of Services

Minn. Stat. § 237.762, subd. 7 states:

> **This section does not prevent a telephone company from packaging any service classified as price regulated or flexibly priced pursuant to section 237.761, subdivisions 2 to 4, with any other service, or engaging in promotional activities concerning such services, so long as:**
>
> **(1) the company also continues to offer these price-regulated and flexibly priced services as separate stand-alone services at prices required by this section; and**
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> **(2) at the time the packaged offering is introduced, or at the time the package price is subsequently changed, the packaged rate or price may not exceed the sum of the unpackaged rates or prices for the individual service elements or services.**

The AFOR Plan provides for Frontier to sell at one price a combination of services, including price-regulated, flexibly priced, nonprice regulated and non-tariffed services, provided that –

- **the price of the package is not less than the TSLRIC for providing the package, averaged throughout the area in which Frontier offers the package,**

- **if a package contains a price-regulated, flexibly priced or nonprice regulated service, then Frontier will continue to offer the service on a separate, stand-alone basis,**

- **the price of the package may not exceed the sum of the prices for the individual elements or services, and**

- **generally Frontier shall offer any package in all Frontier service areas for which the service elements are available. But Frontier may propose to offer a package in a more limited geographic area to meet competition.**

The AFOR Plan also includes a procedure for investigating whether the package price is less than TSLRIC. AFOR Plan XII.H.

The Commission has reviewed the proposed AFOR Plan's service packaging provisions, and finds that they comport with applicable statute.

J. Discontinuance of Service

Minn. Stat. § 237.767 states:

> **Without the express approval of the commission, a telephone company subject to a plan may not discontinue the provision of a service or basic network function that has been classified as price regulated or flexibly priced.**

Frontier agrees to seek Commission approval before discontinuing a price regulated or flexibly priced service or basic network function. The AFOR Plan sets for a procedural schedule, and says that the Commission may alter the schedule's timelines.

Additionally, Frontier agrees to give customers 30 days notice before discontinuing a nonprice regulated service. AFOR Plan XII.G.

The Commission has reviewed the proposed AFOR Plan's discontinuance provisions, and finds that they comport with applicable statute.

K. Service Quality

Minn. Stat. § 237.765 states:

> **(a) [T]he plan must contain an existing service quality plan or settlement for retail customers approved by the commission or if no such plan or settlement has been approved, the commission shall require:**
>
> **(1) evidence that current service quality substantially complies with commission rules as to justify lessened rate regulation;**
>
> **(2) a baseline measurement of the quality of service levels as achieved by the company during the previous three years, to the extent the data are available, and specific statewide standards for measuring the quality of price-regulated and flexibly priced services provided by the company, including, but not limited to (i) time intervals for installation, (ii) time intervals for restoration or repair of service, (iii) trouble rates, (iv) exchange access line held orders, and (v) customer service answer time;**
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> **(3) provisions for reporting to the commission at least annually the company's performance as to the quality of service standards by quarter for the previous year;**

(4) provisions that index quality of service standards for local residence services to similar standards for local business services;

> (5) appropriate remedies, including penalties and customer-specific adjustments or payments to compensate customers for specific quality of service failures, so as to ensure substantial compliance with the quality of service standards set forth in the plan; and
>
> (6) provisions for informing customers of their rights as to quality of service and how customers can register their complaints regarding service.
>
> (b) Any penalties under paragraph (a), clause (5), shall be returned to customers under a method set forth in the plan.

The proposed AFOR Plan fulfills the requirements of § 237.765.

First, Frontier offers evidence that its service substantially complies with Commission rules. Frontier's petition contains its annual service quality reports for the past three years, filed pursuant to the Current Plan, XII.H., in compliance with Minn. Stat. § 237.765(a)(3).

Second, the proposed AFOR Plan contains specific measures of service quality in the statutorily-prescribed categories -- Time Intervals for Installation, Time Intervals for Restoration or Repair of Service, Trouble Rates, Exchange Access Line Held Orders, and Customer Service Answer Time -- as well as Missed Repair Appointments, and Repeat Troubles. The proposed AFOR Plan has identical service quality provisions for local residence and business services. AFOR Plan XIII.B. Additionally, Frontier agrees to comply with any new, more stringent service quality standards. AFOR Plan XIII.E.

Third, Frontier proposes to report its performance in meeting the quality-of-service standards to the Commission, the Department and the OAG-RUD annually. AFOR Plan XIV.H.1.

Fourth, where Frontier fails to substantially comply with the proposed AFOR Plan service quality standards, Frontier agrees to customer-specific payments and penalties as set forth at XIII.C and D, respectively. The definition of "substantial compliance" appears at XIII.G. But generally no remedies or penalties would accrue if Frontier fails to comply with service quality standards due to circumstances beyond its control. AFOR Plan XIII.F.

Finally, Frontier proposes to notify customers of their rights to service quality remedies, and the manner in which to register complaints, by both bill insert and bill message, annually. Additionally, Frontier will publish a "Consumer Bill of Rights" in its white pages directory. AFOR Plan XIII.I.

The Commission has reviewed the proposed AFOR Plan's service quality provisions, and finds that they comport with applicable statute.

L. Telecommunications alternatives

Minn. Stat. § 237.76 states:

> **The purpose of an alternative regulation plan is ... to facilitate the development of telecommunication alternatives for customers....**

Frontier offers to take a number of steps to facilitate competitive entry:

1. Wholesale Discount

The federal Telecommunications Act of 1996 (the Act) seeks to promote competition in the local telecommunications market by, among other things, compelling incumbent telephone companies to make their retail services available to competing carriers at wholesale rates. 47 U.S.C. § 251(c)(4). This wholesale rate is designed to reflect the incumbent's retail rate less its avoided retail costs. 47 C.F.R. § 51.607 *et seq.* Where an incumbent and a competitor cannot negotiate a mutually acceptable wholesale discount, the Act calls upon the Commission to arbitrate an appropriate amount. 47 U.S.C. § 252.

Frontier agrees to offer its retail services to competitors with a wholesale discount of 17.66 percent. Competitors would retain their right to negotiate a different discount, and to seek Commission arbitration. AFOR Plan IX.

2. Unbundled Network Elements (UNEs)

In the interest of facilitating local competition, the Act permits competitors to lease the use of desired parts of an incumbent's plant ("network elements") at cost, without having to pay for ("unbundled from") undesired parts. 47 U.S.C. § 251(c)(3).

a. Deaveraged Loop Prices

The most expensive aspect of an incumbent telecommunications company's network is its lines, or "loops," connecting the company's plant to customers. The cost of these loops varies in different parts of Frontier's service area. In determining a loops cost, it is possible to consider the cost of all loops averaged throughout Frontier's service area. It is also possible to calculate a "deaveraged" cost, meaning the average cost of a loop throughout some portion of Frontier's service area. To better facilitate competition, regulations direct incumbent telecommunications companies to establish deaveraged prices for unbundled network elements (UNEs) such as loops. 47 C.F.R. § 51.507(f).

Frontier promises to conduct studies to determine deaveraged costs for loops in various parts of Frontier's service area. AFOR Plan VII.A.

b. Unbundled Network Element Platform (UNE-P)

One standard combination of UNEs, providing an entire end-to-end circuit, is called a UNE platform (UNE-P). Frontier promises to draft terms for a UNE-P, containing a specified list of UNEs, and file them with the Commission. Such a "standard offering" of services would then be available for any competitor that wanted to request it. Competitors would still retain their right to negotiate for a different combination of UNEs or a different price, and to seek Commission arbitration. AFOR Plan VII.C.

c. Line Sharing/Line Splitting

A telephone company sends a telephone message by converting the sound of a voice into electromagnetic signals, and transmitting them through a medium such as a telephone line. Just as a standard radio has the capacity to receive many different signals across a range of

the electromagnetic spectrum, a standard telephone line can also transmit signals across a range of the electromagnetic spectrum. Voice communications occupy only a fraction of the total spectrum that a telephone line can transmit. The remaining spectrum can be used for providing other, "advanced" services. This practice of transmitting multiple signals over a single line is called line sharing. As a consequence of this technology, a loop now represents more than one network element.[10]

Frontier promises to draft terms to unbundle the elements of a loop, and to file them with the Commission. Such a standard offering would then be available for a competitor that wanted to lease the use of only a portion of the bandwidth on a loop. Competitors would still retain their right to negotiate for a different arrangement or price, and to seek Commission arbitration. AFOR Plan VII.D.

3. Operational Support Systems (OSS)

In implementing the Act, one source of conflict has been in operational support. Incumbent telecommunications companies encounter logistical hurdles in receiving and processing a competitor's order for services or UNEs in a timely and accurate manner. Competitors complain that the incumbents discriminate in favor of their own retail customers when processing orders, and against the competitors'.

Frontier promises to develop a system whereby a competitor can query Frontier's operational support systems (OSS) and input orders electronically. Such a system would then be available for a competitor that wanted to place an order with Frontier. The system would provide competitors with greater control over their orders, and greater confidence in the orders' accuracy. It would also reduce the opportunities for discrimination by Frontier. AFOR VIII.

4. Rural Exemption Waiver

As noted above, the Act requires an incumbent telephone company to offer to competitors its services at wholesale discounts, and its UNEs at cost, among other things. But a rural telephone company is exempt from some of the obligations of incumbent telecommunications companies, at least until the Commission determines otherwise. 47 U.S.C. § 271(f)(1).

Frontier agrees to waive any claim it may have to a rural exemption under this statute, at least regarding its obligations pursuant to the proposed AFOR Plan. Such a waiver would mean that a competitor could seek to buy Frontier's services at a wholesale discount, or lease Frontier's UNE-P, or use the automated access to Frontier's OSS without first seeking a Commission ruling on the status of any rural exemption claim. AFOR Plan VII.B; VIII.F.

The Commission finds that Frontier's concessions represent a reasonable effort to effectuate the statutory goal of facilitating telecommunications alternatives.

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[10]***In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Common Carrier Bureau (CC) Docket No. 98-147, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, THIRD REPORT AND ORDER IN CC DOCKET NO. 98-147, FOURTH REPORT AND ORDER IN CC DOCKET NO. 96-98 (FCC 99-355).**

M. Investment Commitments

Minn. Stat. § 237.761, subd. 8(a) states:

> **An alternative regulation plan must also include a plan outlining the company's commitment to invest in telecommunications infrastructure improvements in this state....**

The proposed AFOR Plan discusses Frontier's plans for maintaining and improving infrastructure, providing higher-speed, higher-capacity technology, serving Minnesota's public institutions, and enabling competition in the state. A list of specific commitments follows:

In 2001, Frontier promises to --

- ♦ **maintain its central office switches at the latest generic software level.**
- ♦ **begin its three-year plan to build, buy or lease fiber-optic cable to exchanges serving more than 90 percent of its access lines.**
- ♦ **offer point-to-point symmetrical digital subscriber line (DSL) service at speeds of 768 kilobytes per second in all exchanges, provided the requesting customer has a qualifying loop. Frontier would offer the service beginning no later than three months after approval of the Revised AFOR Plan, and no later than 30 days after receiving a customer's request.**
- ♦ **offer asymmetrical DSL (ADSL) service in exchanges serving 75 percent of customers by December 31, 2001.**

In 2002, Frontier promises to --

- ♦ **continue its three-year plan to build, buy or lease fiber-optic cable to its exchanges serving 90 percent of its access lines.**
- ♦ **offer ADSL service in exchanges serving 95 percent of its customers by December 31, 2002.**
- ♦ **file with the Commission and the Department a report on the future of circuit-switched platform, and the merits of migrating to the packed-switched internet protocol-based platform.**

In 2003, Frontier promises to --

- ♦ **complete its three-year plan to build, buy or lease fiber-optic cable to its exchanges serving 90 percent of its access lines.**
- ♦ **ensure that ADSL service is available in all its exchanges by December 31, 2003 (whether by Frontier or some other provider) to the extent warranted by customer demand. Specifically regarding exchanges serving the last five percent of Frontier's customers, Frontier will work with the Department and the OAG-RUD to survey each**

> exchange to determine if sufficient demand exists to justify deployment. Frontier agrees to deploy ADSL in each exchange that 1) can produce a positive net present value for the service within five years, and 2) has at least 30 customers willing to sign a six-month contract for ADSL. Frontier would install the service within six months of determining that sufficient demand exists, provided that Frontier does not pledge to install ADSL in more than three exchanges per month.

The proposed AFOR Plan also lists Frontier's current services and facilities, and its practices regarding deployment of fiber-optic facilities or broad-band capabilities to schools, libraries, technical colleges, hospitals, colleges and universities, and local governments in this state. AFOR Plan III.

The Commission observes Frontier responding to competitive pressures by offering advanced telecommunications services in the state. At the same time, Frontier must also respond to competitive pressures by keeping long-term plans flexible. This is what the Commission would expect of a company facing competition. The Commission appreciates the difficulty of providing a more detailed plan of future investments; changes in technology, competitive conditions and customer demands make long-term projections speculative. The Commission finds Frontier's investment commitments reasonable.

N. Flexible Regulation

Minn. Stat.§ 237.763 states:

> Except as provided in the plan and any subsequent plans, a company that has an alternative regulation plan approved under section 237.764, is not subject to the rate-of-return regulation or earnings investigations provisions of section 237.075 or 237.081 during the term of the plan. ....

The proposed AFOR Plan reflects this language at XII.A.

But this regulatory flexibility is bounded by statute. Section 237.774 states that an AFOR company continues to be subject to state and federal laws except where expressly exempt, and § 237.769 specifies that Commission rules adopted pursuant to Minn. Stat. § 237.16 continue to apply. See also § 237.763 (preserving Commission and Department powers of investigation). The AFOR Plan reflects these ideas at XII.B.

Finally, Minn. Stat. § 237.766 states:

> The plan must ... specify that the telephone company shall maintain records in sufficient detail to facilitate the review.

Frontier promises to retain such detailed records. AFOR Plan XIV. Frontier further agrees to continue to keep its records in the manner prescribed by the Commission. AFOR Plan XII.F.

The Commission has reviewed the proposed AFOR Plan's regulatory flexibility provisions, and finds that they comport with applicable statute.

O. Reporting Provisions

Minn. Stat. § 237.766 states:

> **The plan must specify the reports required of the telephone company for review of the plan....**

Frontier's AFOR Plan contains various reporting provisions.

1. Annual Reports

Minn. Stat. § 237.768 states, in part:

> **[A]n alternative regulation plan may require a telephone company to file with the department an annual report of financial matters for the previous calendar year on or before May 1 of each year on report forms furnished by the department of public service in the same manner as is required of other telephone companies on August 1, 1995.**

Frontier agrees to make such filings. But the parties agree that Frontier need not continue the practice if the legislature relieves AFOR companies of this obligation. AFOR Plan XII.E.

2. Service Quality

Minn. Stat. § 237.765(a) states:

> **[T]he commission shall require ...**
> **(3) provisions for reporting to the commission at least annually the company's performance as to the quality of service standards by quarter for the previous year....**

Frontier promises to provide such report, reflecting monthly data, to the Commission, the Department and the OAG-RUD annually.

Additionally, Frontier promises to report on all customer contacts in specified categories, and all customer complaints received. AFOR Plan XII.H.

3. Reports Prior to Termination

Minn. Stat. § 237.766 also states:

> **Within six months prior to the termination of the plan, the plan must be reviewed by the commission and, with the consent of the company, revised or renewed....**

Frontier proposes to file another revised or renewed AFOR plan six months prior to the expiration of this Plan. Additionally, Frontier promises to provide a report comparing its service quality performance under the AFOR Plan to the Plan's service quality standards. Finally, Frontier promises to report on its infrastructure improvements made during the Plan's term. AFOR Plan XIV.

The Commission has reviewed the proposed AFOR Plan's reporting provisions, and finds them reasonable.

P. Binding Effect on Successor

Frontier proposes that the terms of the approved AFOR be binding even if Citizens Communications Company were to buy Frontier in Docket No. P-407, 405, 3131/PA-00-1109 In the Matter of the Joint Petition of Citizens Communications Company and Global Crossing LTD. for Approval of Sale of Stock. AFOR Plan XII.L.

The Commission has reviewed the proposed AFOR Plan's provisions binding Citizens' successor to the terms of the AFOR, and finds them reasonable.

Q. Plan Duration

Minn. Stat. § 237.766 states:

> **An alternative regulation plan approved by the commission under section 237.764 must remain in force as approved for the term specified in the plan, which must be for no less than three years. Within six months prior to the termination of the plan, the plan must be reviewed by the commission....**

The AFOR Plan specifies that it would remain in force for at least three years. AFOR Plan II. However, the Commission could extend the Plan's term to accommodate the negotiation of a subsequent AFOR plan. AFOR Plan XIV.

The Commission has reviewed the proposed AFOR Plan's term, and finds that it comports with applicable statute.

IV. Commission Action

Minn. Stat. § 237.764 states, in part:

> **Subd. 1(e). The commission shall issue findings of fact and conclusions concerning the appropriateness of the proposed initial rates, where necessary, and the proposed plan, or any modifications to it....**
> **Subd. 2. Any settlement or stipulation must be submitted to the commission, which shall accept or reject the proposal in its entirety or modify it.**

The Commission finds that Frontier's proposed AFOR Plan warrants modification.

As envisioned by the AFOR legislation, Frontier's AFOR Plan should provide it with the regulatory flexibility to be able to position itself more effectively in a competitive environment. The AFOR Plan would enable Frontier to address market developments immediately and more aggressively. Prices for services other than price regulated services could be increased or decreased more readily than without an AFOR Plan. Frontier would be relieved of rate-of-return regulation and earnings investigations during the three-year life of the AFOR plan. The AFOR Plan includes provisions for renewal or modification, subject to Commission approval, beyond the initial term.

The proposed AFOR Plan addresses the requirements regarding earnings level, affordable rates, service quality and investment commitments. The service quality language provides a comprehensive set of service standards, customer remedies, and customer education provisions. In addition, Frontier commits to invest in the plant it uses to serve its customers.

Finally, the rate reductions and limitation on rate increases offered in the plan for essential services make them more affordable to Frontier's customers. But in so doing, it may in some instances unreasonably discourage competitors from offering telecommunications alternatives in Frontier's service area. This would frustrate one of the legislature's goals in adopting the AFOR statutes. The modification discussed above ameliorates these concerns.

Having convened a hearing on Frontier's proposed AFOR Plan, and having reviewed the plan in light of the entire record -- including clarifications obtained at the hearing -- the Commission will modify the proposed AFOR Plan as discussed above at III.D.

ORDER

1. **The Commission modifies the Revised Plan for Alternative Form of Regulation for Frontier Communications of Minnesota, Inc., filed on March 9, 2001, as noted below:**

    A. **Frontier shall determine, for each customer class in each exchange, the difference between the average revenues per line and the average costs per line; that number shall constitute the maximum rate reduction for that customer class in that exchange under the AFOR Plan, Attachment A. Frontier shall refrain from reducing an exchange's *residential* local or EAS rates except to the extent that the exchange's average cost per line is less than the estimated revenue per line of $40 per month. Frontier shall refrain from reducing an exchange's *business* local or EAS rates except to the extent that the exchange's average cost per line is less than the estimated revenue per line of $60 per month. For purposes of this calculation, the average cost per line in the Bel Plaine and Madison exchanges shall be $40.**

    B. **Where clause A would cause Frontier to refrain from making a planned rate reduction, the funds that would be saved by Frontier should be allocated to further reduce rates in other exchanges in which revenues exceed cost. The parties shall jointly decide which rates to reduce.**

2. **Within twelve days of this Order's effective date, Frontier shall make a compliance filing including proposed rates and tariffs implementing the terms of the modified AFOR Plan as they apply during the Plan's first year. Interested persons may comment on the compliance filing within twenty-four days of the Order's effective date. Frontier shall make compliance filings for the Plan's second and third years at least 30 days before of the effective dates of the proposed tariffs.**

3. **Within thirty days of this Order's effective date, the parties shall file any comments on the proposed AFOR Plan as modified.**

4. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

(S E A L)

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