

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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In the Matter of a School District Extended Area Service Petition Among the Exchanges of Middle River, Greenbush, Strathcona, and Gatzke

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DOCKET NO. P-409, 432/CP-97-1756

**ORDER SETTING EAS RATE
ADDITIVES AND REQUIRING POLLING**

PROCEDURAL HISTORY

On December 10, 1997, telephone subscribers in the Middle River, Greenbush, Strathcona, and Gatzke exchanges filed a petition for School District Extended Area Service (EAS) between these four exchanges. These exchanges make up the Greenbush-Middle River School District, Independent School District No. 2683. The Gatzke exchange is served by Garden Valley Telephone Company (Garden Valley); the other three exchanges are served by Wikstrom Telephone Company (Wikstrom).

On November 16, 1998, the Commission issued its Order Requiring the Filing of Cost Studies and Proposed Rates. Among other things, that Order found that the petition met threshold requirements of adjacency and school district residency. The Order required the incumbent local exchange carriers serving the four exchanges 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 the exchanges' subscribers to determine whether they wanted EAS at those rates.

The companies duly filed their cost studies and proposed rate additives. On February 17, 2000, the Department of Commerce (the Department) filed comments on the companies' filings. In brief, the Department recommended the following action:

- 1. apportioning the facilities costs of the proposed EAS route equally among all affected customers, except to the extent necessary to preserve existing ratios between customer classes;**
- 2. excluding lost access revenues from the cost calculations and rate**

additives adopted in the case.

Garden Valley and Wikstrom filed reply comments opposing the exclusion of lost access revenues from EAS rate additives.

On October 6, 2000, the Minnesota Independent Coalition, whose members include over 80 incumbent local exchange carriers throughout the state, intervened on behalf of its members.

On April 25, 2001, the matter came before the Commission. All parties were present. The Residential Utilities Division of the Office of the Attorney General appeared on behalf of residential ratepayers. Donna Nelson, a member of the Greenbush-Middle River School Board who serves as its legislative liaison, appeared on behalf of petitioners.

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. In non-school district cases, the criteria for installing EAS and the procedures for determining and allocating EAS costs are set forth in Commission Orders¹ issued after an industry-wide fact-finding and policy-making proceeding mandated by the Minnesota Legislature.²

In 1997, the Legislature established separate criteria and procedures for installing EAS between exchanges in the same school district.³ School District EAS petitions are subject to less stringent traffic requirements and broader public support requirements than conventional EAS petitions. Briefly, School District EAS criteria and procedures are as follows.

A. School District EAS Installation Criteria

- (1) A petition for School District EAS must be signed by at least 15% of the subscribers in each exchange, or 600 subscribers in each exchange, whichever is less;

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), ORDER AFTER RECONSIDERATION (February 23, 1996).

² Laws 1994, c. 534, art. 1, § 1.

³ Laws, 1997, c. 59, § 1, as amended by Laws 1998, c. 326, § 1, subd. 2.

- (2) at least 10% of the subscribers in each exchange must be residents of the school district for which EAS is sought;
- (3) each exchange must be contiguous to at least one of the other exchanges for which EAS is sought;
- (4) a majority of the subscribers in each exchange who return their EAS ballots must vote in favor of the proposed route.

B. School District EAS Costs and Rates

The School District EAS statute requires rates to be based on the costs set forth below:

For a proposal to install extended area service under this section, 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 existing facilities transferred from another service to extended area service, and appropriate contributions to common overheads.

Laws 1997, c. 59, subd. 5.

The statute also requires the Commission to use its ratemaking authority to hold local exchange carriers harmless at the same time that it sets EAS 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.

Laws 1997, c. 59, subd. 6.

Finally, the statute requires that all exchanges in a School District EAS route share the costs of the route equally:

The costs of providing extended area service under this section must be apportioned equally among the exchanges identified in the petition. The costs must be apportioned among the customers in each exchange so that the relationship between the rates for classes of basic local service remains the same.

...

Laws 1997, c. 59, subd. 6.

The Commission has interpreted this requirement to mean that all subscribers who benefit from the EAS route should bear equal responsibility for the costs of the route, subject to preserving pre-existing ratios between customer classes (e.g., business, residential, pay phone). The Commission has therefore set rates by determining the total cost of the route for all companies combined and apportioning that total cost between exchanges according to the number of access lines in each exchange. The practical device for equalizing costs is “transfer payments” between the companies.

II. The Issues

A. Historical Background

Setting fair and reasonable rates for extended area service – School District or conventional – has long been a conundrum, 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 revenues. To keep these companies whole, the Commission has traditionally built recovery of lost access charges into both conventional and School District EAS rate additives. The main issue in this case is whether to follow that traditional practice or to exclude lost access charges from the EAS rates on grounds that they are displaced subsidies, not true costs of the EAS route.

B. The Parties’ Positions

1. The Department of Commerce

The Department of Commerce argued that access revenues lost when toll routes become EAS routes are not properly categorized as costs of the EAS route, but as lost subsidies to company-wide costs. Treating these lost revenues as costs and building them into EAS rate additives causes at least two inappropriate transfers of wealth, in the Department’s view.

First, it forces customers of the exchange that is getting EAS to subsidize local rates company-wide, bearing more than their fair share of the cost of the network. Second, since the School District EAS statute requires the Commission to spread the total costs of all affected companies equally among the exchanges, it forces customers 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. (Costs are equalized by “transfer payments” between the affected carriers.)

The Department further argued that treating lost access revenues as costs and building them into the EAS rate structure undermines local competition, which the Commission has a statutory duty to nurture and promote,⁴ by guaranteeing perpetual revenue streams to incumbents.

Finally, the Department argued that since most companies now operate under alternative regulation (which, unlike traditional rate-of-return regulation, permits them to raise most of their rates at will), there is no longer a practical need or a philosophical justification to build lost access revenues into EAS rate additives – companies now have a host of other ways to recoup the access revenues they lose when EAS is installed. The Department therefore urged the Commission to require the companies to develop and file plans for recouping the access revenues they would lose if the proposed EAS route were installed.

2. The Companies and the Minnesota Independent Coalition (MIC)

The companies and the MIC (together, the companies) argued that, subsidies or not, access charges are a mainstay of Minnesota’s local rate structure, including the EAS rate structure. They make indispensable contributions to common costs, common overheads, and reasonable profits. When access charges disappear, new sources of revenue must be found to replace them.

It is by no means clear that it is more fair for these new sources of revenue to come from the general body of ratepayers rather than from the ratepayers served by the new EAS route – the record contains no evidence on how much each exchange contributes to common costs, common overheads, and reasonable profits. And increasing the rates of customers who will not benefit from the new EAS route and who have no vote on the matter is unfair on its face.

The companies also argued that the Alternative Form of Regulation (AFOR) statute⁵ under which Garden Valley operates gives the Company, not the Commission, the right to determine which rates to adjust for EAS costs, and that it explicitly permits the Company to choose to adjust its EAS rates.

They also claimed that as a matter of law and sound public policy, the decision to eliminate access charges from EAS rate additives should only be made in a rulemaking or other industry-wide, state-wide proceeding.

⁴ Minn. Stat. §§ 237.011, 237.16.

⁵ Minn. Stat. § 237.773.

3. The Residential Utilities Division of the Office of the Attorney General (RUD-OAG)

The RUD-OAG argued that the fairest way to ensure the income neutrality required by statute would be to include in the EAS rate additives for these four exchanges the access revenues the companies would lose if the EAS route were installed. The agency claimed that it would be unfair – and unsound as a matter of public policy – to assign responsibility for these revenue losses to customers in other exchanges, because those customers would not benefit from the service to which the losses relate and would have no vote on whether or not the service was installed.

The RUD-OAG argued that there was no evidence in the record for the Department’s claim that including lost access revenues in EAS rates forced EAS customers to subsidize other customers’ rates. It was just as likely, the agency said, that spreading lost access revenue recovery over the general body of ratepayers would force customers in non-EAS exchanges to subsidize the rates of EAS customers.

While EAS exchanges may have high concentrations of toll calling along certain routes, it is plausible that many non-EAS exchanges may have higher total volumes of toll traffic, with correspondingly higher contributions to joint and common costs. Without exchange-by-exchange data on access charge revenues, it is impossible to know.

Finally, the agency stated that, although it opposed transfer payments in conventional EAS cases, it supported them here, because the School District EAS statute requires affected exchanges to equally share the costs of the route.

4. Petitioners

Petitioners stated that they wanted the lowest EAS rates consistent with prompt final action on their petition. They considered the EAS rates including lost access revenues reasonable, and they preferred those rates to protracted litigation and further delay.

III. Commission Action

A. Summary of Commission Action

In recent EAS cases the Department has raised intriguing and important issues about the role of access charges and transfer payments in EAS ratemaking. These issues are complex, and the Commission’s treatment of them has evolved over time. In two recent cases, the unanticipated

consequences of earlier decisions have led the Commission to reconsider and reverse decisions eliminating lost access revenues from EAS rate additives.⁶

Here, too, the Commission finds that including lost access revenues in EAS rate additives is fairer to consumers, more administratively efficient, and sounder public policy, than collecting lost access revenues from the general body of ratepayers.

B. Fairness Issues

First, the Commission agrees with the companies and the RUD-OAG that the relative fairness of collecting lost access revenues from the general body of ratepayers, as opposed to the ratepayers served by the new EAS route, is less than totally clear. The record contains no evidence on how much each exchange served by each company contributes to that company's common costs, common overheads, and reasonable profits – the types of expenses access charges help defray.

It does seem plausible, though, that relieving an EAS exchange of *all* contributions to common costs formerly made by access charges on its new EAS route could shift a disproportionate share of joint and common costs to the remaining exchanges. Without hard data and careful analysis, it is impossible to know.

We do know, however, that customers outside the EAS exchanges derive no benefit from the new EAS route and have no control over whether or not it is installed. Under these circumstances and given these uncertainties, it is more equitable to assign responsibility for the revenue loss to the customers who “caused” it than to the general body of ratepayers.

C. Administrative Efficiency

Second, requiring companies to file plans for recovering lost access revenues from the general body of ratepayers complicates and delays the EAS process, to the detriment of consumers. Reviewing a unique rate increase proposal in the course of every EAS case requires a substantial investment of time and resources; it guarantees delays at the end of an already lengthy process. The Commission is not willing to forfeit the predictability and administrative efficiency of the traditional process without clear evidence that it would result in greater fairness or promote another important public policy objective.

⁶ In the Matter of a Petition for Extended Area Service from the Osakis Exchange to the Alexandria Exchange, Docket No. P-552, 430/CP-98-1148, ORDER GRANTING RECONSIDERATION AND REQUIRING FURTHER FILINGS (April 20, 2001); In the Matter of a School District Extended Area Service Petition Among the Exchanges of Jeffers, Lamberton, Sanborn, and Storden, Docket No. P-551, 570/CP-97-1797, ORDER GRANTING RECONSIDERATION AND REQUIRING FURTHER FILINGS (May , 2001).

D. Competitive Impacts

Of course, the Department contends that excluding lost access revenues from EAS rates would promote the core public policy objective of competition in local telecommunications markets. It would do this by ending the perpetual (and therefore anti-competitive) revenue streams EAS produces and by treating access charges as the subsidies they are (instead of as costs), thereby promoting the cost-based rates on which competition depends.

While the Commission agrees that promoting competition is the most critical task facing telecommunications policymakers, the Commission does not believe that excluding lost access revenues from EAS rate additives will significantly advance that goal. It is transfer payments, not EAS rates that include lost access revenues, that pose the most serious threat to competition. (Transfer payments represent real transfers of wealth between competitors, not just transfers of wealth between customers of a single competitor.)

Although transfer payments will be ordered in this case – because the Legislature has explicitly required them in the limited context of School District EAS to further other important policy objectives – the Commission has consistently eliminated them in recent conventional EAS cases.⁷ The clearest and most harmful anti-competitive effects of traditional EAS ratemaking, then, have already been dealt with.

E. Comprehensive Approach

Finally, while it is true that including lost access revenues in EAS rates may perpetuate hidden subsidies that can impede competition, the Commission believes that that issue is best addressed on a comprehensive, not piecemeal, basis. It is doubtful that addressing access charges in the isolated context of EAS would be more efficient or more successful than addressing them generally in the ongoing proceeding to reform intrastate access charges.⁸

⁷ In the Matter of a Petition for Extended Area Service from the Osakis Exchange to the Alexandria Exchange, Docket No. P-552, 430/CP-98-1148, ORDER ESTABLISHING RATE ADDITIVES AND REQUIRING FILINGS (November 6, 2000), and ORDER GRANTING RECONSIDERATION AND REQUIRING FURTHER FILINGS (April 20, 2001); 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, ORDER AFTER RECONSIDERATION (November 6, 2000).

⁸ In the Matter of a Commission Investigation of Intrastate Access Charge Reform, Docket No. P-999/CI-98-674.

Furthermore, addressing these issues globally, with a wide range of stakeholders actively involved, reduces the chances that any policy shift ultimately adopted will have unintended consequences that undermine its goals. And taking a comprehensive approach also avoids injecting further uncertainty, delay, higher costs, and greater unfairness into the EAS process.

For all the reasons set forth above, the Commission will permit the companies to include lost access revenues in the new EAS rates for these exchanges.

F. Implementation Issues

As discussed above, although the Commission has eliminated transfer payments in recent conventional EAS cases, these payments are required under the School District EAS statute. The Legislature has determined that the benefits of toll-free calling within a school district – and the benefits of spreading the costs of that toll-free calling equally among School District subscribers – outweigh any competing considerations.

The Commission will therefore follow standard School District EAS ratemaking procedures, combining all EAS-related costs and the lost access revenues of both companies and apportioning the total between the exchanges on the basis of the number of access lines in each exchange. Those procedures yield the total EAS rate additives set forth below:

Exchange/Company	1FR	1FB	Payphone
Greenbush (Wikstrom)	\$2.62	\$3.88	\$3.88
Middle River (Wikstrom)	\$2.62	\$3.88	\$3.88
Strathcona (Wikstrom)	\$2.62	\$3.88	\$3.88
Gatzke (Garden Valley)	\$2.62	\$4.15	\$4.15

The Commission will require the companies to separately itemize on customers’ bills and on the EAS ballot the portion of the EAS rate additive that recovers facilities costs and the portion that recovers lost access revenues. This information may be helpful in developing and implementing a universal service funding mechanism, which will replace, with explicit subsidies, subsidies that are now implicit.

The last step in the School District EAS decision-making process is to poll subscribers in the affected exchanges to determine if a majority in each exchange favors installing EAS at the rates proposed. The Commission will proceed to polling. It will also direct the companies to provide the information and cooperation required for a fair and efficient poll.

The Commission will so order.

ORDER

1. The final cost studies filed by the companies are hereby accepted and approved.
2. All subscribers in the Middle River, Greenbush, Strathcona, and Gatzke exchanges shall be polled on whether they favor installing the School District EAS route proposed at the rates approved herein, which are set forth below.

Greenbush Exchange (Wikstrom)

<u>Service</u>	<u>EAS Rates Based on Facilities Cost</u>	<u>EAS Rates Based on Lost Access Revenue</u>	<u>Total EAS Rate</u>
Residence	\$0.23	\$2.39	\$2.62
Business	\$0.35	\$3.53	\$3.88
Payphone	\$0.35	\$3.53	\$3.88

Middle River Exchange (Wikstrom)

<u>Service</u>	<u>EAS Rates Based on Facilities Cost</u>	<u>EAS Rates Based on Lost Access Revenue</u>	<u>Total EAS Rate</u>
Residence	\$0.23	\$2.39	\$2.62
Business	\$0.35	\$3.53	\$3.88
Payphone	\$0.35	\$3.53	\$3.88

Strathcona (Wikstrom)

<u>Service</u>	<u>EAS Rates Based on Facilities Cost</u>	<u>EAS Rates Based on Lost Access Revenue</u>	<u>Total EAS Rate</u>
Residence	\$0.23	\$2.39	\$2.62
Business	\$0.35	\$3.53	\$3.88
Payphone	\$0.35	\$3.53	\$3.88

Gatzke Exchange (Garden Valley)

<u>Service</u>	<u>EAS Rate Based on Facilities Cost</u>	<u>EAS Rate Based on Lost Access Revenue</u>	<u>Total EAS Rate</u>
Residence	\$0.23	\$2.39	\$2.62
Business	\$0.37	\$3.78	\$4.15
Payphone	\$0.37	\$3.78	\$4.15

3. The EAS rate additives approved herein shall be itemized, in polling materials and on subscribers' bills, to show which portion of the additive will recover facilities costs and which portion of the additive will recover lost access revenues.

4. Garden Valley Telephone Company and Wikstrom Telephone Company shall provide cooperation and assistance to Commission staff and Commission contractors during the polling process. Such cooperation and assistance shall include, but need not be limited to, the following:
 - (a) providing usable, deliverable addresses for all access lines in a format and under time frames set by Commission staff;
 - (b) providing proof of the accuracy of customer lists as requested by Commission staff.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

**Burl W. Haar
Executive Secretary**

(S E A L)

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