BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1677

In the Matter of the Petition of Frontier Communications Northwest Inc. For Approval of Price Plan Pursuant to ORS 759.255	LEAGUE OF OREGON CITIES COMMENTS

The League of Oregon Cities (League) thanks the Public Utility Commission (Commission) for the opportunity to comment on Frontier Communications Northwest Inc.'s (Frontier) requested partial waiver of OAR 860-022-0042. The League objects to the waiver and requests the Commission's denial of the waiver.

The League objects to the waiver on two primary grounds. First, a state agency lacks authority to waive or suspend a rule unless it has complied with the statutory procedure set forth in ORS 183.335(5). *See Wegroup PC/Architects and Planners v. State*, 131 Or. App. 346, 352-353 (1994) (holding that the Corrections Division's conduct could not waive compliance with applicable public contracting statutes and rules); *see also Harsh Investment Corp. v. State Housing Division*, 88 Or. App. 151, 158 (1988) (a state agency cannot waive a requirement embodied in an administrative rule without complying with ORS 183.335(5)). Because the Commission lacks the authority to waive OAR 860-022-0042 without complying with the statutory procedure required to suspend a rule, the Commission should deny Frontier's waiver request.

Second, the League objects to the waiver because the rule was fully vetted by all interested parties twenty-four years ago and the requested waiver has not enjoyed a similar vetting. In its 1990 order adopting OAR 860-022-0042, the Commission considered the treatment of city charges in utility rates – including the industry assertion that taxes should not be "hidden" in rates – and stated:

> As a practical matter, the tax considered here is only one of a great many taxes imposed on Oregon industry. All those taxes are added to the prices of end products and services sold in this state. The end users, citizens of Oregon, regularly buy those products and services without any accounting of producer taxes. In most cases, where products and services pass through a number of manufacturing, transportation, wholesaling and retailing processes, a pro rata accounting of every tax imposed on every participant probably would be prohibitively expensive to create and too long to read . . . [I]f the utilities are allowed to itemize [municipal taxes and fees] and charge it directly, in its entirety, to municipal ratepayers, the utilities will be in a position of a collection agency for the municipalities, and nothing more. The utilities will not pay any municipal tax, because their municipal customers will pay the entire tax for them.

Proposed Rulemaking in Connection with Municipal Privilege Tax, OPUC AR 218, Order No. 90-1031, pp. 6-7 (June 29, 1990) (Attachment A). The Commission has never wavered from its position that direct assignment of all municipal taxes and fees would inappropriately reduce utilities to a collection agency for municipalities. In addition, the "tax" discussed above – which is a business expense the utilities pay for the privilege of occupying the taxpayers' right of way – falls on the utilities and not its customers. By

waiving the rule and allowing a pass-through, the Commission – which lacks authority to assess taxes – unlawfully converts the nature of the fee into a sales tax on the user of the telecommunications service. Because Frontier has not offered any rationale to alter this long-settled rule for telecommunication utilities and because any potential waiver has not been fully vetted by all interested parties, the Commission should deny Frontier's waiver request.

In conclusion, the League believes that under the current facts there is no authority for the Commission to suspend OAR 860-022-0042. The League also believes that any fundamental policy shift in the application of OAR 860-022-0042 deserves a full vetting and not cursory treatment in a settlement agreement that does not include several of the stakeholders who participated in the initial rulemaking.

/s/ Maja K. Haium
Assistant General Counsel
League of Oregon Cities

ATTACHMENT A

Proposed Rulemaking in Connection with Municipal Privilege Tax,
OPUC AR 218, Order No. 90-1031, pp. 6-7 (June 29, 1990)

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ORDER NO. 90-1031

ENTERED JUN 29 1990

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

AR 218

In the Matter of the Proposed Rulemaking in Connection with Municipal Privilege Tax.	)))	ORDER

DISPOSITION: RULE 860-22-040 ADOPTED;
RULE 860-22-042 ADOPTED AS MODIFIED

Pursuant to a notice of proposed rulemaking issued February 20, 1990,[1] Roger Gerber, Hearings Officer, held a hearing on April 13, 1990, to consider adoption of proposed rules consistent with HB 3000. HB 3000 was enacted into law by the 1989 Oregon Legislature and will be effective on July 1, 1990, as ORS 221.515 and 759.105. These statutes change the taxes and all other fees, compensation and consideration currently paid by telecommunications utilities to municipalities. The proposed rules are: an existing rule, OAR 860-22-040, amended to delete all references to telecommunications utilities; and a new rule, OAR 860-22-042, applicable to telecommunications utilities only. These are attached as Appendix "A."

Prior law generally permitted a privilege tax of up to 5 percent on gross revenues collected for utility service within a municipality. Existing OAR 860-22-040 allows utilities to account for franchise fees or privilege taxes of up to 3 percent as an expense, and include them in statewide telephone rates. Taxes above 3 percent are to be collected only from customers within the municipality and stated separately on bills.

The new statutes permit a privilege tax of up to 7 percent of gross revenues for a telecommunications utility's use of streets, alleys and highways within a municipality. However, gross revenues are narrowly defined as revenues from basic access rates only. This excludes revenues from additional services, intrastate toll, and EAS, which were included under the prior definition.

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[1]The notice was published by the Secretary of State. In addition, it was served on the Commission's telecommunications mailing list.

ORS 759.105 also states that the privilege tax shall be allowed as an operating expense for rate-making purposes, but:

> The cost of such privilege tax or other similar exactions shall be charged pro rata to telephone users within each taxing municipality unless the Public Utility Commission determines on a statewide basis that such pro rata charges would be inequitable, in whole or in part, to city ratepayers or should otherwise be borne as a statewide operating expense by the telecommunications utility.

This means that, unless the Commission determines otherwise, no part of the cost of the privilege tax will be included in a telecommunications utility's statewide rates, as it is under current law for all utilities. Other utilities will continue to include 3 percent of the cost of such taxes in their statewide rates, but, for telecommunications utilities only, the entire tax will be paid by telephone users within the taxing municipality. The tax will be stated as a separate item on municipal users' bills.

At the hearing on April 13, the following entities intervened: League of Oregon Cities, City of Portland, United Telephone Company of the Northwest, U S WEST Communications, GTE Northwest, and Oregon Independent Telephone Association. The parties, including Commission staff, agreed to a schedule for discovery, position statements, evidentiary hearing and briefs. The evidentiary hearing was held on May 23 and simultaneous briefs were filed on June 4, 1990.

Based on the record of this case the Commission makes the following:

FINDINGS OF FACT

The Commission does not normally make findings of fact in rulemaking proceedings. However, in this case the Commission must determine whether or not the pro rata charges proposed in a statute would be inequitable, in whole or in part, to city ratepayers, or should otherwise be borne as a statewide operating expense by telecommunications utilities. Its determination is based in part on the following facts, found on a preponderance of the evidence.

Telecommunications utilities make use of the streets and highways within Oregon's municipalities to provide local exchange service to at least 96 percent of the access lines in the state, and to provide interexchange/toll service to an even

higher percentage of lines. The calls of users located outside municipalities are typically routed over access lines located inside municipalities.

This is true even when rural customers call rural neighbors. Calls are not routed directly between neighbors, because telephones are not connected directly to one another. Telephones are connected to a central office switch. When a customer places a call, the calling signal goes to the switch, which routes the call to the number dialed. Central office switches are typically located in municipalities.

Telecommunications utilities locate central offices in municipalities because municipalities are population centers, where most customers are located. The cost of providing service to each customer is directly related to the length of wire--the "local loop"--between each customer's telephone and a central office switch. By locating these switches close to the majority of customers, the utilities keep most local loops short. This saves substantial costs. If central offices were located in rural areas, local loops from the municipalities--the majority of local loops--would extend for long distances to these rural switches. Costs would be substantially increased.

Of course local loops from rural customers must extend equally long distances to reach switches located in population centers, but there are relatively few customers and local loops in rural areas, so the total number of long local loops, and the costs associated with long local loops, are kept low. Because the local loops to rural customers are long, costs of service to rural customers are high, but they do not pay those costs, because Commission policy favors average statewide rates.[2] This

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[2]ORS 759.015 favors universal service. The Commission effectuates this policy in part by favoring average statewide rates, which reduces toll charges to relatively high-cost non-municipal customers, and increases toll charges to relatively low-cost municipal customers. Pacific Northwest Bell Tel. Co., UF 2955, Order No. 73-447 at 31, 100 PUR3d 82, 107 (1973):

> Generally, it can be stated that the cost to serve higher density population areas is less than the cost to serve low population density areas. To go to a totally cost-oriented ratemaking basis would involve going back to accounting by each exchange or even by customer. In other words, PNB would have to establish a separate set of accounts for each of its many exchanges or customers at considerable cost to the ratepayers. Each exchange

means, in effect, that municipal customers subsidize customers who live outside municipalities.

Just as local calls from non-municipal customers to other non-municipal customers are typically routed through municipalities, the long-distance calls of non-municipal customers are also routed through municipalities, with the frequency of such routing approaching 100 percent. Of course calls from non-municipal customers to municipal customers are always routed through municipalities. Non-municipal customers have a particular interest in calling municipal customers, probably because most people and businesses are located in municipalities.

In sum, because telephone calls are routed through central office switches located in municipalities, non-municipal callers use municipal access lines for almost every call they make. Telecommunications utilities have located their central offices in municipalities to reduce their costs of providing service. Because rates, which are based on costs, are averaged statewide, the result of lower costs is lower rates for everyone. But customers living outside municipalities derive greater cost benefits from this universal telephone service system than those living inside municipalities. Their costs are not only reduced, they are subsidized.

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or customer would have a different rate according to the cost to serve that particular exchange or person. The whole theory of system-wide ratemaking would have to be abandoned. The popular idea presented in this case that everyone is entitled to telephone service at a cost within reason would be impractical. PNB is still a consolidated telephone system in Oregon which has rates set on a system cost basis. A single consolidated accounting system is much less costly to the ratepayers as a whole.

See also In the Matter of Access Provisions and Charges of Telephone Utility Companies in Oregon, UT 5, Order No. 83-869 (1983) at 15-16; In the Matter of Pacific Northwest Bell Tel. Co., UT 85, Order No. 89-1807 at 14; In the Matter of Revenue Transfer from Long-distance Carriers to Local Exchange Customers, UT 42, Order No. 87-405 at 17-19, 82 PUR4th 271, 282-84 (1987); In the Matter of Exchange Carrier Toll Rates, UT 47, Order No. 88-665, 94 PUR4th 309 (1988), recon Order No. 89-221 at 23-24 (1989); In the Matter of IntraLATA Presubscription, UT 52, Order No. 88-666 at 8, 94 PUR4th 329, 334-35 (1988); In the Matter of Rate Design for Telephone Company Carrier Access Charges, UT 45, Order No. 88-664 at 12-13, 94 PUR4th 290, 296 (1988).

The streets, alleys and highways of Oregon's municipalities, over and through which the access lines of the telecommunications utilities run, are real property with economic value. Private owners normally charge for the use of their property, and municipalities are either owners of municipal streets, alleys and highways or they hold them in trust for their citizens. Telecommunications utilities make exclusive use of these streets, alleys and highways, and there does not seem to be any reason why municipalities should not charge, and utilities pay, for that use. Indeed, ORS 221.515(1) states that the privilege tax is "for the use of those streets, alleys or highways . . . ."

The value of that use is hard to quantify, in part because there is no market to determine the value of the streets. Municipal streets, alleys and highways are not bought and sold. The municipalities suggest that the value of their streets can be determined by the value of adjoining property, which is traded on an open market and does have a known value. This is a reasonable approach to valuation, especially as the adjoining property would have little or no value without street access.

Based on reasonable estimates of the value of the streets in Portland and Eugene, the privilege tax provided for in ORS 221.515 and 759.105 represents a reasonable return for the telecommunications utilities' exclusive use.

The amount of usage of municipal access lines by non-municipal customers was not established in this proceeding. Certain information provided by the telecommunications utilities suggests that they may not have any data on this subject, or may not have it in a readily useable form. Without it, or something like it, the benefit accruing to non-municipal customers through their use of municipal access lines cannot be quantified.

Historically, the Commission's rules and orders have provided for inclusion, in statewide rates, of 3 percent of municipal privilege taxes and fees. Consequently, municipal and non-municipal customers alike have paid those taxes and fees; but municipal taxes and fees in excess of 3 percent have been itemized on municipal customers' bills and paid by them alone.

The inclusion, in statewide rates, of 3 percent of municipal privilege taxes and fees, has been based on the Commission's recognition of the average amount of franchise fees negotiated between Oregon cities and utilities, and upon a stipulated agreement between Oregon cities and utilities for

accounting and billing treatment of municipal taxes and fees.[3] This is still the best available evidence of the value of the benefit accruing to non-municipal telephone customers as a result of their use of municipal access lines.

Prior law has provided for a tax of up to 5 percent on a broad base of services. The new statutes, ORS 221.515 and 759.105, provide for a privilege tax of up to 7 percent, but it is narrowly based. The information provided to the Commission in this proceeding shows that, if some part of this tax were to be included in statewide rates, 4 percent on the new narrow tax base would be approximately equal to 3 percent on the prior (and, for all other utilities, still existing) tax base.

DISCUSSION

Dealing first with non-decisive matters, the Commission notes the arguments of the telecommunications utilities, and particularly of U S WEST Communications, that the new laws are "sunshine" statutes intended to reveal the extent of municipal taxes on utilities. Taxes, says U S WEST, should not be hidden in rates.

"Sunshine" may be a laudable goal, but the Commission cannot find any reference to it in HB 3000. As a practical matter, the privilege tax considered here is only one of a great many taxes imposed on Oregon industry. All those taxes are added to the prices of end products and services sold in this state. The end users, citizens of Oregon, regularly buy those products and services without any accounting of producer taxes. In most cases, where products or services pass through a number of manufacturing, transportation, wholesaling and retailing processes, a pro rata accounting of every tax imposed on every participant probably would be prohibitively expensive to create and too long to read.

The Commission concludes that illumination of one tax out of many would only cast it in a false and distorting light.

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[3]OAR 860-22-040, formerly OAR 860-21-040; In the Matter of Exactions Levied upon Utilities by Cities, UF 2620, Order No. 43946 at 5-7 (1967); In the Matter of Exactions Levied upon Utilities by Cities, 17001, Order No. 43377 (1967); In the Matter of Exactions Levied upon Utilities by Cities, UF 2620, Order No. 43223 (1966); In the Matter of Billing Telephone Exchange Subscribers for Certain Taxes, UF 2134, Order No. 36403 (1958).

A second non-decisive matter is the cities' argument that the privilege tax is actually a franchise fee or rent for the use of municipal streets. The cities showed convincingly that Oregon law has historically recognized their right to charge for the use of their streets. Ultimately, this common law right was incorporated into ORS 221.420(2)(a).

But distinguishing the name does not make a difference. The statutes under consideration state that the privilege tax is for the use of municipal streets, alleys and highways. Call it a tax, call it a fee--it is for the use of the streets. Telecommunications utilities make use of those streets for access lines. And non-municipal customers of telecommunications utilities use those lines, and hence municipal streets, almost every time they place a call. If non-municipal customers did not exist, some part of the existing network of municipal access lines would not be needed.

Since non-municipal customers use the lines and, indirectly, the municipal streets; and since they derive great benefit from that use, in the form of lower and indeed subsidized rates, it is only reasonable that they should help pay the utilities' costs for the use of the streets. The pro rata charge proposed in ORS 759.105 clearly would be inequitable to municipal ratepayers. Municipal ratepayers already subsidize the costs of non-municipal ratepayers, so that rates throughout Oregon can be averaged. There is no justification for a further subsidy, so that high-cost non-municipal ratepayers can enjoy lower rates than the low-cost municipal ratepayers who pay the subsidy.

Furthermore, with regard to the use of municipal streets, all utilities are in the same position. They all use the streets. The Commission can find no reason to account for the costs of gas, electric and water utilities in one way, and telecommunications utilities another way, when their circumstances are similar.

Finally, if the privilege tax is indeed "for the use" of municipal streets, as the statute states, it makes no sense that telecommunications utilities should not pay for their use. The utilities, after all, are <u>direct</u> users. Their customers are only indirect users. Yet, if the utilities are allowed to itemize the tax and charge it directly, in its entirety, to municipal ratepayers, the utilities will be in the position of a collection agency for the municipalities, and nothing more. The utilities will not pay any municipal tax, because their municipal customers will pay the entire tax for them.

The Commission concludes that non-municipal ratepayers should help pay the municipal privilege tax. Telecommunications utilities should expense the [illegible] portion of the tax, for inclusion in statewide rates. Since the historic limit on this expense is still the best evidence of legislative equity between municipal and non-municipal ratepayers, the historic limit should be adhered to.

However, the historic limit was 5 percent on a broad tax base. The equivalent limit on the new, narrow base is 4 percent. Four percent should be the maximum municipal tax that can be expensed and included in statewide rates by telecommunications utilities. Any privilege tax in excess of 4 percent should be separately stated on the telephone bills of customers within the taxing municipality, and paid directly by them.

Proposed OAR 860-22-040

The cities argue that OAR 860-22-040 should not be changed; that the new 7 percent limit on a narrow tax base can be regarded as a "cap" on accounting under the existing rule, which applies to the 5 percent limitation on a broad tax base. This would result in two separate calculations. One will do.

Moreover, OAR 860-22-040 refers to all utilities. Statutorily, telecommunications utilities are separately defined. The rules should reflect the statutory separation. References to telecommunications utilities in OAR 860-22-040 should be deleted and the amended rule adopted.

Proposed OAR 860-22-042

Proposed OAR 860-22-042 should be adopted through part (3). Part (4) should be modified as follows:

> (4) The aggregate amount of all privilege, business or occupation taxes, license, franchise or operating permit fees, and other similar exactions, imposed on telecommunications utilities by municipalities, which do not exceed 4 percent, shall be allowed as operating expenses for rate-making purposes and shall not be itemized or billed separately. All such exactions in excess of 4 percent shall be charged pro rata to users of basic local access services within the municipality, and separately itemized on customers' bills, or billed separately.

ORDER NO. 90- 031

ORD

IT IS ORDERED that Rule[illegible] 0 and 860-22-[illegible]. Such rules are adopted in the form attached [illegible] Secretary of State shall become effective upon filing.

Made, entered, and effective JUL 29 1990

Commissioner Katz concurs but is unavailable for signature.
MYRON B. KATZ
Chairman

[illegible] EACHUS
Commissioner

[illegible] Y RYLES
Commissioner

PUBLIC UTILITY COMMISSION OF OREGON

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order pursuant to ORS 756.580.

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CERTIFICATE OF SERVICE

UM 1677

I certify that I have, this day, served the foregoing document upon all parties of record in this proceeding by electronic mail, pursuant to OAR 860-001-0180, to the following parties or attorneys of parties.

Dated this 29th day of January, 2014 at Salem, Oregon.

/s/ Maja K. Haium
Assistant General Counsel
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UM 1677

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