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	REPLY OF LEAGUE OF OREGON CITIES TO FRONTIER COMMUNICATIONS NORTHWEST INC.'S OPPOSITION TO THE LEAGUE OF OREGON CITIES' PETITION TO INTERVENE

Notwithstanding Frontier Communications Northwest Inc.'s (Frontier) objection to the League of Oregon Cities' (League) Petition to Intervene (Petition), the Petition should be granted. OAR 860-001-0300(7) reads, in part: "If the Commission or ALJ finds the petitioner has sufficient interest in the proceedings and the petitioner's appearance and participation will not unreasonably broaden the issues, burden the record, or delay the proceedings, then the Commission or ALJ must grant the petition." Here, the League has a demonstrated interest in OAR 860-022-0042, one of the administrative rules that Frontier has requested the Oregon Public Utility Commission (PUC) waive, and the League's participation will not unduly broaden the issues, burden the record, or delay the proceeding.

The League's interest in OAR 860-022-0042 dates back to 1990, when the PUC promulgated the rule. See Attachment A. Because the League was a primary stakeholder in the PUC's initial consideration of the rule, the League has a demonstrated interest in the rule's waiver and the League will bring a historical perspective and understanding that will assist the PUC in resolving issues related to the rule.

The League's interest in this docket is exceedingly limited in scope. As explicitly stated in the League's Petition, it is interested exclusively in Frontier's requested waiver of OAR 860-022-0042. Frontier's assertion that the League's participation will unreasonably broaden the issues to include an examination of the power of cities to receive compensation for the use of its right of ways is simply inaccurate. Frontier also asserts that the League's participation will unreasonably delay the proceedings. However, this proceeding is still in its initial stages. In fact, PriorityOne Telecommunications, Inc.'s Petition to Intervene was granted on February 4, seven days after the League submitted its Petition on January 28, and a pre-hearing conference is scheduled for this Thursday, February 13. Given these facts, and the League's narrow interest in OAR 860-022-0042, it is difficult to see how the League's participation will unduly broaden the issues or delay the proceeding.

Because the League meets the criteria set forth in OAR 860-001-0300(7), its Petition should be granted.

Respectfully submitted,

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

ATTACHMENT A

Position Statement of the League of Oregon Cities and City of Portland,
OPUC AR 218 (May 4, 1990)

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

AR 218

In the Matter of a Proposed Ruling in Connection With Municipal Privilege Tax.	)))	POSITION STATEMENT OF THE LEAGUE OF OREGON CITIES AND CITY OF PORTLAND

The League of Oregon Cities and the City of Portland expect to take the following positions in this matter.

I.

POSITIONS

1. The proposed new rule should not be adopted and OAR 860-22-040 should not be amended. Franchise fees up to 3% of "gross revenues," as defined in OAR 860-22-040(2), should still be treated as utility operating expenses and should remain a part of each telecommunication utility's revenue requirement. The fees should be spread to all ratepayers in accordance with the rate spread and rate design reflected in the rate schedules.

Franchise fees in excess of 3% would still be billed separately and would still be passed on to ratepayers residing in the city charging the franchise fee exceeding 3%. This position is consistent with the position previously agreed and stipulated to by the League, the City of Portland, Pacific Northwest Bell, and other utilities throughout the state.

2. Nothing in ORS 221.505, et seq., which was adopted by the 1989 Legislature, requires the Commission to change the

definition of "gross revenues" now found in OAR 860-22-040.[1]

If the Commission nevertheless determined that OAR 860-22-040 should be amended to change the definition of "gross revenues" from its present definition to the definition of "gross revenues" found in ORS 221.515(2), the amount of gross revenues used to calculate the franchise fees will decrease. If the definition is changed, then the 3% limit should be increased to a percentage that will keep the amount of the franchise fees now treated as an operating expense at the present level. Until the League and the City of Portland receive discovery from the telecommunications utilities, we do not know what that revenue neutral percentage will be.

Attached to this Position Statement is an alternative proposed amendment. As noted, the League and the City of Portland do not believe this amendment should be adopted, but present it for discussion purposes.

II.

REASONS FOR POSITIONS

A. LEGISLATIVE HISTORY

HB 3000 was introduced at the request of US West. In its original form, it sought to pass the full amount of the franchise fees directly on to ratepayers residing in the city charging the

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[1] OAR 860-22-040 defines gross revenues as all "local service revenues." ORS 221.515 imposes a franchise fee cap upon cities of 7% of gross revenues derived from exchange access revenues, but it does nothing more than that.

fees. This original bill never made it out of the House Energy and Environment Committee. Instead, with the input and support of US West, it was amended to read as it did in its final form. The question of how the fees should be treated for ratemaking was entrusted to the Commission to decide.

The Legislature no doubt recognized that ratemaking is very complicated; that isolating one expense from all the other expenses, and forcing one group of ratepayers to pay that expense, could lead to a result that was "inequitable in whole or in part."

The telecommunications utilities' argument that the Legislature has somehow already determined this issue is wrong. Originally, US West did ask the Legislature to determine this issue, but this it refused to do. The Legislature has recognized that the Commission possesses an expertise in ratemaking that the Legislature does not possess and does not have the time to develop. In this sense, the issue is an open one for the Commission to decide.

B. THE STATUTORY PURPOSE OF FRANCHISE FEES ARE STREET RENTAL CHARGES

Under Oregon law, either (1) cities own city streets in trust for the public use; or (2) the abutting property owners own city streets subject to an easement in the public for the use of the streets, and subject to the cities' power to improve and regulate those streets.

Cities cannot permit persons to erect structures on streets

for "private" purposes. Beyond the general right of the public to make use of the streets, no person has the right, without permission from the city, to use a street for the prosecution of the person's private business.

A franchise is that permission -- a franchise is a special privilege granted by a city to a person, which privilege does not belong to the citizens of a city generally, of common right.

Since at least mediæval times, cities have charged fees to persons using city streets for commercial purposes.

In 1862, the Oregon Legislature adopted a law that allowed telegraph companies free use of the roads and highways of the State, without reference to whether they were city streets. Seven months earlier, the Oregon Telegraph Company had been incorporated and was in the process of stringing a telegraph line from Portland to Yreka, California.

In 1901, the Legislature amended the law to specifically provide that cities could determine by contract or ordinance the terms and conditions, including the payment of charges and fees, upon which telegraph companies, telephone companies, and electric companies would be permitted to occupy the streets, highways, or other public property within cities. In amending this law, the Legislature simply recognized the cities' longstanding right to control the use of their streets, and to charge a rent for that use.

At the same time, the law was amended to give telegraph

companies, telephone companies, and electric companies free use of the roads and highways of the State **outside** of cities. This state-granted subsidy to telephone companies made particular sense at that time given that the 56% of the citizens of the State who resided outside of cities had only 4% of the telephones in the State. This part of the law has not changed. ORS 758.010.

In 1931, a new law was adopted to permit a city to collect from every utility operating in a city **without** a franchise, a 5% "privilege tax" for the **use** of the public **streets**, alleys, and highways in the city. ORS 221.450. Pacific Telephone & Telegraph challenged this law in federal court, but lost.

The source of the term "privilege tax," found in HB 3000, no doubt comes from ORS 221.450. As is discussed below, despite the name, the franchise fees are not a "tax."

In 1987, the Legislature adopted ORS 221.415, which reaffirmed the authority of cities to regulate the use of their rights of way.

C. FRANCHISE FEES AS A MATTER OF LAW ARE RENTAL CHARGES AND ARE NOT "TAXES"

Although the new legislation refers to franchise fees as "privilege taxes," the fees are not taxes. ORS 221.515(1) specifies that the cities collect the "privilege tax" from telecommunications utilities "for the **use** of those **streets**, alleys or highways, or all of them, in such" cities. Oregon courts have recognized that such fees are payment of a rental for

the use of the streets; they are not a "tax." A fee, as opposed to a tax, is a charge paid to the government in exchange for a special privilege not enjoyed by citizens generally. (For example, the Forest Service charges grazing fees. No one suggests these fees are taxes.)

The fact that franchise fees are usually calculated as a percentage of gross revenues does nothing to change the character of the fees. The calculation of franchise fees using a percentage of gross revenues has been accepted by the Oregon courts and has been encouraged by the Legislature, ORS 221.450, and by the Commission, OAR 860-22-040. In fact, prior to the adoption of OAR 860-22-040, many cities used a fixed fee rather than a percentage fee.

The idea of using percentage rent provisions has been used in commercial settings for years. Typically, tenants prefer percentage rent clauses because if they experience a business downturn, their rent goes down.

D. RATEMAKING TREATMENT OF FRANCHISE FEES

It should go without saying that rental charges reasonably and necessarily incurred by a utility to provide service to customers are operating expenses, are a part of a utility's revenue requirement, and are collected from ratepayers through rates.

The PUC has considered the issue of how franchise fees should be treated for ratemaking on several occasions. Each time

it has recognized that cities have a legitimate and legal right to charge utilities a franchise fee as a rent for the use of city rights of way. Each time it has recognized that these fees are not different in character from any other operating expense that utilities incur to provide service to ratepayers, and that up to a point, franchise fees should be treated as any other operating expense for ratemaking purposes.

The alternative for a utility to renting a city's rights of way would be to purchase, condemn, or lease utility easements over private property. ORS 759.075. Not only would this be expensive and cumbersome, it would also be recoverable in rates.

The only concern that the PUC has previously expressed is that if the entire amount of franchise fees is treated as a utility operating expense, cities will have a financial incentive to increase the amount of the fees without limit -- the cities knowing that to some extent the fees will be spread to ratepayers residing outside the city.

While this fear is understandable, the League and the City of Portland never believed this fear was real. As a practical matter, the most a city can charge a utility is 5% of gross revenues under ORS 221.450. If a city seeks a franchise fee above that percentage, a utility will have no reason to enter into a franchise agreement with the city. With the adoption of ORS 221.515(1) imposing a cap on franchise fees of 7% of gross revenues derived from exchange access services, this fear is now

even more remote.

Consistent with the PUC's recognition that franchise fees represent a legitimate rental charge for the use of city rights of way, and consistent with these concerns about unlimited fees, the PUC adopted a reasonable compromise. Up to 3%, franchise fees for telecommunications utilities are treated as a utility operating expense. Above 3%, the excess is passed on to ratepayers residing in the city charging the fee. The PUC has been comfortable that at the 3% level, franchise fees are appropriate and justified.

This 3% level became the subject of a stipulation by the League, the City of Portland, Pacific Northwest Bell, and other utilities around the state, and the basis of the current rule. Cities have continued to work with and cooperate with US West since the adoption of the rule. For example, most cities have voluntarily changed the definition of "gross revenues" to exclude revenues from competitive services, a change beneficial to US West. This compromise has worked successfully for over 20 years, and there is no reason to change it now.

E. UNDER THE PROPOSED RULE, TELECOMMUNICATIONS UTILITIES WILL NOT PAY FRANCHISE FEES

Cities in Oregon charge franchise fees to telecommunications utilities, electric utilities (IOUs and PUDs (ORS 221.415)), gas utilities, water utilities (IOUs and city-owned), cable television companies, and railroads.

The effect of the proposed rule will be to decrease

telecommunications utility franchise fees from 3% of gross revenues to 0%. Energy and water utilities, cable TV companies, and railroads will pay rentals for their use of the streets, but telecommunications utilities will not.

Instead, telephone companies will become mere collection agents. The fees will be passed through. City ratepayers will pay the street rental charges even though the phone companies, not city ratepayers, are using the streets; and even though the phone companies must use those city streets to provide service to all customers, not just customers inside cities.

F. TELECOMMUNICATIONS UTILITIES MUST MAKE USE OF CITY STREETS TO PROVIDE SERVICE TO ALL RATEPAYERS

The "touchstone" of ratemaking is the concept that each customer should pay the costs imposed upon the company in providing service to that customer. In the case of telecommunications utilities, franchise fees are among the costs utilities must incur to provide service to customers who reside **inside** cities **and outside** cities. This is true at several levels.

1. Central Offices In Oregon Are Located In Cities

In Oregon, telecommunications networks are set up as follows. The handset on a customer's premises is connected to a central office by the customer's local loop. The local loop is a pair of wires that transports the signal from the customer's premises to the central office. With new technology, more than one customer may share a local loop. (With old technology this

was also true with party lines.)

The switches are located in the central offices. When a call comes in over a local loop, it is switched in the central office toward its destination.

If the call is a local call, within the same exchange, the call is switched to the local loop that serves the recipient customer's handset.[2] If a customer calls the customer's next-door neighbor, the call goes from the customer's handset through the customer's local loop, to the central office where it is switched, and back out on the neighbor's local loop to the neighbor's handset.

In Oregon, virtually all central offices are located within the boundaries of a city. What this means is that if a customer who resides outside of a city wants to call the customer's next-door neighbor, who also resides outside of the city, the customer's call must be routed through a city right of way to the central office, and then back out again through a city right of way to the neighbor's house.

This means that the telecommunications utility is incurring a city's franchise fee as much to provide service to customers

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[2] If a call is an inter-exchange call, then the call is switched to the central office within the exchange where the recipient resides. From that central office, the call is switched to the local loop that serves the recipient's handset. The call may go directly from one central office to the other central office, or it may be transported to a tandem switch or a series of tandem switches, and then on to the other central office.

outside a city as inside a city. It would be inequitable and unjustly discriminatory to impose the responsibility for franchise fees solely onto city ratepayers when the expense is incurred to serve all ratepayers.

2. Commission Policy Strongly Favors Average State-Wide Rates

The Commission has repeatedly recognized that the telecommunications system is a network.[3] The benefit of being a part of the system is the ability to call others and to receive calls from others. The Commission has also recognized that there is a public policy and a statutory policy favoring universal telecommunications service. ORS 759.015. Finally, the Commission has recognized that, in general, a customer should pay the costs imposed on the company of providing service to the customer. These facts and policies do not necessarily operate in the same direction.

In general, the Commission has balanced these issues and resolved them by averaging operating expenses system-wide and state-wide, and by setting rates on an average state-wide basis.

For example, the PUC has eliminated rate groups. Prior to 1983, telephone ratepayers were placed in rate groups according to the number of persons a customer could reach with a local call. This meant that rates were higher in larger exchanges,

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[3] Even if there were no network, the 3% regulatory limit on franchise fees, and the fact that virtually every city franchise fee is at the 3% level, help ensure that franchise fees incurred on a per exchange basis will be relatively uniform throughout the state.

even though the Commissioner recognized that the cost of providing local exchange service to those customers was lower. In 1983, these rate groups were eliminated because the Commissioner recognized that it was unfair to charge customers more when the costs they imposed were less.

Other examples operate the other way. For example, the PUC has adopted state-wide toll rates, even though the evidence suggests the cost of providing that service to rural areas is higher than the cost of providing that service to urban areas. The averaging of toll rates was adopted, in part, in recognition of the policy favoring universal service and the fact that the telecommunications system is a network.

Most recently, PUC Staff has argued in Re Pacific Northwest Bell Tel. Co., UT 85, that suburban mileage charges[4] should be eliminated, and that rates to Harney County ratepayers should be the same as elsewhere, even though the cost of providing that service is much higher.

The League and the City of Portland have no quarrel with the Commission's resolution of these competing policies. The League, in particular, recognizes that there are differences in the cost of providing service to customers in different cities in Oregon, just as there are differences, in general, in the cost of

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[4] Suburban mileage charges are additional charges made to customers who reside outside base rate areas--customers, who live relatively farther from the central offices serving their exchange.

providing service to customers inside and outside cities.

What the League and the City of Portland would quarrel with would be if the Commission began isolating costs, particularly where there is no cost-incurrence basis on which to do so. This would be a giant step backwards. It would be particularly unfair where there is no evidence to suggest that it costs more to serve city ratepayers, and where there is evidence that suggests it is the other way around.

III.

CONCLUSION

Passing franchise fees on solely to city ratepayers, who are not solely responsible for their being incurred, would be inequitable, in whole and in part, to city ratepayers. ORS 759.105. It would be a form of unjust discrimination. ORS 759.260, 759.275. It would undercut well-established Commission policies and ratemaking principles. These fees should otherwise

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be borne by telecommunications utilities as system-wide operating expenses in accordance with existing rules. ORS 759.105.

DATED this 4th day of May, 1990.

ESLER, STEPHENS & BUCKLEY

By: _____
John W. Stephens
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CITY OF PORTLAND
Jeffrey L. Rogers
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By: Benjamin Walters
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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 11th day of February, 2014 at Salem, Oregon.

/s/ Maja K. Haium
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UM 1677

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