ORDER NO. 01-1075

ENTERED DEC 20 2001

This is an electronic copy. Attachments may not appear.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UT 125/PHASE II
RATE DESIGN

In the Matter of the Application of QWEST CORPORATION for an Increase in Revenues.	)))	ORDER

DISPOSITION: APPLICATION FOR RECONSIDERATION DENIED

On November 16, 2001, Qwest Corporation (Qwest) filed an application for reconsideration of Order No. 01-810. Qwest asks us to reconsider that portion of the order in which we decided to apply an elasticity factor of –0.3632 to the rate reduction for intraLATA toll service (Order No. 01-810 at 27–34). Qwest argues that the Commission should apply no elasticity factor, because the application of any elasticity factor is an error of law and is not supported by substantial evidence in the record. In the alternative, Qwest urges us to apply an elasticity factor of –0.20, because that would be the factor best supported by the evidence. Qwest contends that good cause exists for further examination of this issue so that the revenue reduction achieved in this case properly matches the amount previously ordered by the Commission.

AT&T Communications of the Pacific Northwest, Inc., and WorldCom, Inc. (AT&T/WorldCom) filed a joint reply in opposition to Qwest's application for reconsideration on December 3, 2001. On the same date, Commission Staff filed its reply in opposition to Qwest's application. On December 11, 2001, Qwest filed a reply to Staff's opposition, addressing Staff's request that the effective date of the UT 125 rates be extended if the Commission's consideration of Qwest's application for reconsideration extends beyond January 1, 2002.[1]

[1] Because we determine that Qwest's application should be denied, and our order issues before January 1, 2002, it is not necessary to consider the parties' arguments about a possible extension of the effective dates for UT 125 rates.

Qwest's argument.[2] *The 1990 study does not support the Commission's decision.* Qwest's core argument is that the Commission's decision to apply an elasticity factor of –0.3632 is an error of law and is unsupported by substantial evidence. That factor derives from a study of 1980s data, when the Oregon intraLATA toll market was not competitive. Qwest asserts that the application of that study to the test year of 1997-98, by which time the market had become very competitive, is factually unsupportable and unreasonable.

Kenneth Bailey, the author of the study from which the elasticity factor of –0.3632 derives, noted that it would be invalid to apply his elasticity factor in a competitive intraLATA toll market. That is because predicting demand response to a price change, while complicated, is relatively easier when there is only one provider. In a fully competitive market like today's determining an elasticity factor is much more complicated, since competitors will respond to the price change, offsetting increased demand for Qwest with the shift to other providers or technologies. Qwest argues that the Commission ignored these fundamental qualifications of the 1990 case study from which its elasticity factor derives.

Qwest argues that since Staff and other parties raised the issue of demand stimulation and asked the Commission to apply an elasticity factor, they are the parties that bore the burdens of persuasion and production on such issues. Qwest cites Oregon Evidence Code (OEC) 305 and 307 in support. Thus, according to Qwest, the fact that it failed to produce a new elasticity study for this docket provides no support for relying on the 1990 study.

The 1990 study was applied in a case (docket UT 102) with a much smaller reduction in toll rates. Qwest argues that the study states that its results may not apply to estimates of demand response when future price changes are well in excess of those experienced in the past. Qwest's expert, Dr. Banerjee, also testified that it would be a mistake to apply the elasticity factor of –0.3632 in this case, given both the significant difference in the size of the rate reduction and the level to which rates are being reduced. Qwest argues that competition is flourishing now and the percentage reduction in its toll rates is 20 times larger than in 1990; therefore, Qwest argues that the 1990 study is out of date and misleading, as its author testified in this case.

[2] Qwest argues that applying the –0.3632 elasticity factor increases the reduction in revenue attributable to the Commission's ordered toll rates by approximately $6.3 million. Qwest urges the Commission, if we grant reconsideration, to undertake further proceedings to determine which rates should be increased to account for the additional $6.3 million of revenue. Qwest does not ask for a stay of the effective date of the Commission's order. If the Commission grants its application, Qwest assures us that it will work with Staff and the other parties to implement new rates as soon as possible. Qwest will ask that those rates have only prospective application. Because we deny Qwest's application for reconsideration, we do not address the issue of redesigning rates further.

Qwest questions the additional research Staff performed to confirm that its proposed elasticity factor was reasonable. Qwest points out that other evidence, which the order does not mention, suggests that any demand response to a change in Qwest's toll rates may be extremely small, since Qwest's toll rates are being reduced from a relatively low level. For instance, one economist has concluded that residential demand for intraLATA toll becomes price inelastic at an average price per minute below fifteen cents"; Qwest's current average rate per minute for toll service is 14.93 cents.

Qwest argues that the recent experience of Verizon argues against any stimulation factor at all. Verizon's 1998 rate case, docket UT 141, resulted in a –0.277 elasticity factor. Qwest showed that Verizon's intraLATA toll revenue in Oregon has dropped by two thirds since it implemented its rate change, as a result of competition. Verizon's experience shows, according to Qwest, that competitive losses can overwhelm any demand response.

To forecast the revenue impact of a price change, the Commission must consider cross elasticity of demand. The Commission also, according to Qwest, mischaracterized the nature of Qwest's arguments regarding the need for an elasticity study in a competitive market to consider the cross elastic effects of competition. Qwest argues that it introduced evidence and authorities that establish that a valid analysis of demand response to a price change in a competitive market requires consideration of the cross elastic effect of shift in demand to other providers, which can offset demand response. Qwest contends that the order in question conflates the need to consider the cross elastic effects of competition with Qwest's argument that in considering those effects the Commission should also consider all recent (that is, post test year) events. Qwest asserts that it was not arguing simply that the Commission should consider post test year competitive developments but that any valid estimate of price elasticity in a competitive market must consider cross elastic effects. Using the study from 1990, according to Qwest, takes no competitive effects during the test year into consideration.

Qwest notes that it presented considerable evidence on how essential cross elastic effects are to an accurate forecast of the revenue impact of a price change. Qwest concludes that the Commission should have tried to predict the demand response to a price change as accurately as possible, looking at demand shift as well as demand response. Qwest supports its position by citing to FCC and state commission orders deciding that a valid elasticity study must account for cross elastic effects (*In the Matter of AT&T Communications Tariff No. F.C.C. No. 1: PRO America Optional Calling Plan,* 103 F.C.C,2d 134 (FCC 1985); *Review of Financial Data as Filed by Wisconsin Bell, Inc.,* 85 PUR4th 406 (Wisc. PUC 1987); *Illinois Commerce Commission v. Illinois Bell Telephone Co. et al.*, Case Nos. 97-0601, 97-0602, 97-0516, 2000 Ill. PUC LEXIS 10, Sec. V.H. (Ill. Commerce Comm., Mar 29, 2000); *Re: Investigation into New England Telephone Company's Cost of Service and Rate Design*, 1994 Me. PUC LEXIS 9 (Me. PUC, April 13, 1994); and *Central Illinois Light Co*., 1982 Ill. PUC LEXIS 21 (Ill. PUC July 1, 1982).

Qwest argues that it also introduced compelling evidence that Verizon experienced a two thirds reduction in intraLATA toll after its 1998 Oregon rate case, calling even the much lower elasticity factor ordered in that case into serious question. In its order, however, the Commission refused to consider events that occurred after the test year and narrowed its consideration of the elasticity factor arguments Qwest made on that basis.

If the Commission continues to order use of an elasticity factor, the factor should be reduced to –0.20, because the evidence better supports that figure. Qwest believes that if any elasticity factor is applied, the evidence that is closest in time to the test year supports an elasticity factor of no more than -0.20. Qwest argues that the record includes evidence from the California Public Utilities Commission (CPUC) proceedings from 1994 and 1998, evaluating price elasticity in the intraLATA toll market in California. The 1998 elasticity factor the CPUC decided on was –0.20, after using -0.50 in 1994, when the market was much less competitive. Qwest argues that this figure derives from the examination of the toll market closest in time to the test year in Qwest's rate case. This figure is also close to the elasticity factor advocated by GTE (now Verizon) in its 1998 Oregon rate case, which as –0.19. GTE's figure was supported by a study GTE performed for the case.

Qwest notes, third, that expert studies in the record, dating from around 1997-98, support an elasticity factor of –0.20.[3] Fourth, the testimony of Dr. Banerjee supports a –0.20 elasticity factor, according to Qwest. Dr. Banerjee testified that the CPUC finding in 1998 "suggests that similar conditions may well exist in other states experiencing vigorous intraLATA long distance competition."

AT&T/WorldCom Reply. AT&T/WorldCom oppose Qwest's application for reconsideration. They argue that Qwest's application fails to state satisfactory grounds for reconsideration as required by ORS 756.561 and OAR 860-014-0095(3) but instead repeats arguments Qwest made at the hearing on this matter. AT&T/WorldCom contend that Qwest has demonstrated no error of fact or law in the order. Instead, Qwest disagrees with the Commission's decision to adopt Staff's proposal for the elasticity factor rather than Qwest's.

AT&T/WorldCom note that Qwest asks the Commission to apply no elasticity factor at all to its toll rate reduction, despite the fact that on average, Qwest's intraLATA toll rates will be reduced by 40 percent. Qwest argues that factors that occurred outside the test year may have caused a demand shift for its intraLATA toll services: mandatory 1+ dialing parity, new toll calling alternatives arising from new technologies, and new extended area service (EAS) routes. AT&T/WorldCom reassert the position the Commission took in its order, that post test year events are irrelevant in this case. Order at 29.

---

[3] Qwest appends to its application the text of a study by Timothy Tardiff that was merely mentioned in a hearing exhibit. The record in this case is closed and will not be reopened to receive the study at this point.

AT&T/WorldCom also answer Qwest's contention that the Commission should make its forecasts of demand response as accurate as possible. AT&T/WorldCom cite to the order's response to this argument, that the toll rate reduction is a test year event, known and happening within the test year, involving no forecast. Order at 29. AT&T/WorldCom also cite the order's response to Qwest's request for accurate prediction: predicting actual revenue impacts would require us to spread the rate reduction over Qwest's current toll service volumes, which would entail a new rate case. Order at 30.

Qwest's application suggests that the Commission failed to consider the impact of competition on toll demand during the test year. AT&T/WorldCom take issue with this suggestion and reviews the order's discussion of Staff's work in support of its recommended elasticity factor. Order at 32.

AT&T/WorldCom note that Qwest relies on Dr. Banerjee's testimony to support its argument that no elasticity factor should be applied. AT&T/WorldCom argue that on cross examination, Dr. Banerjee stated that only one factor had a significant impact on Qwest's toll revenues. That factor was the introduction of intraLATA 1+ presubscription in February 1999. Prior to that point, Qwest's toll minutes were fairly constant, and only after February 1999 did they begin to decline. Thus, AT&T/WorldCom contend, the testimony of Qwest's own witness shows that competitive factors did not significantly affect Qwest's intraLATA toll demand during the test year.

Finally, AT&T/WorldCom address the –0.20 elasticity factor that Qwest proposes in the alternative. Qwest claims that this is the elasticity factor best supported by the evidence. Here, AT&T/WorldCom argue that Qwest is not claiming an error of fact or law. Qwest argues that the Commission should simply have made different findings of fact and conclusions based on the evidence in the record. The Commission fully considered Qwest's evidence regarding the CPUC decision and declined to adopt an elasticity factor of –0.20. Order at 34. AT&T/WorldCom also point out that the CPUC case involved a decrease of only 29 percent, not 40 percent, as here, and that the California intraLATA toll market had been open to competition in 1995, whereas intraLATA 1+ dialing parity began in Oregon after the test year.

Staff Reply. Staff also opposes Qwest's application for reconsideration. Staff argues that Qwest repeats its arguments from the administrative proceeding that any elasticity factor should be canceled out by post test year non price events. Staff contends that in its application, Qwest for the first time raises the argument that the Commission failed to adjust the –0.3632 elasticity factor for competitive market conditions within the test year. Finally, Staff argues against Qwest's assertion that the record supports an elasticity factor of –0.20.

Staff maintains that Qwest fails to show an error of fact or law in the order. With two exceptions, Staff alleges, Qwest's application merely restates its prior arguments from the administrative proceeding. Qwest first attacks the order's reliance on Qwest's 1990 price elasticity study. However, the order considers the parties' arguments and concludes that the study is a valid basis for the elasticity adjustment. Order at 32-34. Qwest presents no new arguments on this point.

Second, Qwest asserts that the Commission erred by not considering post test year effects of competition on the elasticity adjustment. Qwest made this same argument, Staff asserts, in the underlying proceeding. This issue was raised by Qwest in its briefs and answered in Staff's briefs and in the order at 27-34.

Qwest also asserts that the elasticity factor does not account for cross elastic test year market conditions. Staff responds that the order, at 31-34, relies on evidence in the record to account for market conditions during the test year. Further, Staff notes, Qwest's own evidence supports the conclusion that during the test year, competitive market conditions were similar or identical to conditions existing prior to the test year.

Staff points out that Qwest presented no evidence to support a specific cross elasticity adjustment for market conditions during the test year (1997-98). The evidence in the record relating to the test year conditions supports the –0.3632 elasticity factor, according to Staff. This evidence supports neither Qwest's recommended zero elasticity adjustment nor its –0.20 elasticity factor.

Staff notes that even Qwest's expert witness, Dr. Banerjee, conceded that the single most significant event affecting competition for intraLATA toll service was 1+ dialing parity, which did not begin until after the test year, in 1999. Moreover, Dr. Banerjee testified that the five major competitive factors or events he identifies in his testimony have been factors only in the past couple of years, particularly since 1998. Staff concludes that Qwest's evidence shows that the competitive intraLATA toll market during the test year was the same as it had been for an unspecified number of years prior to the test year.

Staff further argues that the Commission should reject Qwest's newly offered support for an elasticity factor of –0.20. Staff takes this to be in the nature of a settlement offer on Qwest's part that should be rejected. Lowering the elasticity factor to –0.20 would result in an offsetting increase to other unspecified services of approximately $2.8 million, Staff points out. Qwest does not address the impacts on other customers that would result.

On the merits, Staff disagrees that the evidence supports a reduction in the elasticity factor. Qwest relies on the 1998 CPUC decision, but Staff contends that AT&T/WorldCom's expert witness, who analyzed the 1994 and 1998 CPUC decisions, concluded that they supported an elasticity factor of –0.50. Qwest also relies on the GTE/Verizon rate case elasticity factor of –0.277 (docket UT 141). During the proceeding, Qwest's only use of this decision was to attack it as too high in view of Verizon's subsequent experience. Staff witness Tom Turner did, on the other hand, analyze the Verizon decision and concluded that in this case, the –0.3632 elasticity factor was appropriate.

As to the Levy and Taylor studies that Qwest also relies on, Staff notes that Qwest did not sponsor them as support for a –0.20 elasticity factor. Qwest took the position that no elasticity factor was appropriate. Thus, Staff contends, Qwest fails to show how the Commission's order erred by adopting a –0.3632 elasticity factor despite the presence of these two studies in the record.

Finally, Staff argues that Dr. Banerjee's testimony focused mainly on the idea that no elasticity factor for intraLATA toll was appropriate. Staff concedes that Dr. Banerjee discussed the 1998 CPUC decision, which adopted a –0.20 elasticity factor, for the sole purpose of refuting testimony by AT&T/WorldCom's expert witness, who proposed a –0.50 elasticity factor. However, Staff maintains that Dr. Banerjee's position as a whole was that no elasticity factor should be applied.

OPINION

Applicable Law. OAR 860-014-0095(3) provides, in part, that:

> "(3) The Commission may grant an application for rehearing or reconsideration if the applicant shows there is:
>
> (a) New evidence which is essential to the decision and which was unavailable and not reasonably discoverable before issuance of the order;
>
> (b) A change in the law or agency policy since the date the order was issued, relating to a matter essential to the decision;
>
> (c) An error of law or fact in the order which is essential to the decision; or
>
> (d) Good cause for further examination of a matter essential to the decision. * * *"

We conclude that Qwest's application for reconsideration fails to identify an error of law in the elasticity factor that we adopted in Order No. 01-810. First, we disagree with Qwest's assertion that Staff and intervenors bore the burden of persuasion and of production on the issue of the elasticity factor. In a general rate case the utility always bears the burden to show that its proposed rates are just and reasonable. ORS 756.040(1), 759.035, 759.180. Qwest filed its case with no adjustment for toll stimulation and hence bears the burden to show that its proposed elasticity adjustment of zero produces just and reasonable rates. Qwest did not persuade us that no elasticity factor was reasonable.

Second, Qwest contends that it was an error to select -0.3632 as an elasticity factor. Qwest's "substantial evidence" test is not appropriate in an application for reconsideration; this is a standard for judicial review of agency findings. Review for substantial evidence is a review of the rationality of the finding in light of all the evidence in the record. "Substantial evidence exists to support a finding of fact when the record, viewed as a whole, would permit a reasonable person to make that finding." ORS 183.482(8)(c) (Court of Appeals), 183.484(5)(c) (circuit court). Even if this were the correct standard for reconsideration, however, there is more than adequate evidence in the record to support the elasticity factor we chose.

Qwest's other arguments against our choice of the –0.3632 elasticity factor reiterate the arguments that Qwest presented in the underlying proceeding. AT&T/WorldCom and Staff have ably refuted these arguments, and we agree with their position that Qwest has not demonstrated that our selection of the factor in question was erroneous. We weighed the evidence presented and chose the factor from the 1990 study based on reasons we gave in the order (at 32-34). We will not repeat our arguments here. Qwest disagrees with the factor we chose, but cannot point to an error in choosing Staff's factor rather than Qwest's preferred position of no elasticity factor adjustment.

Qwest faults the order for not considering events that may have changed the competitive marketplace for intraLATA toll after the test year. We considered and addressed this question in the order, at 29. We were not forecasting revenue impacts but considering revenue impacts for the year 1997-1998. Adjusting for post test year results would render the test year subject to other adjustments, and would, as AT&T/WorldCom point out, necessitate a new rate case.

Qwest believes that we did not consider cross elasticity of demand, that is, competitive events that could cause demand shift, in the test year. As Dr. Banerjee testified, the most significant events, especially 1+ dialing parity, happened after the test year. We did account for market conditions during the test year. Order at 31-34. Qwest does not identify what test year events we failed to consider, or identify these events as part of the record. Qwest's argument on this point fails.

Qwest's pursuit of evidence to support its alternative -0.20 elasticity factor, which it advocates for the first time in this application, is unconvincing and does not constitute grounds for reconsideration. Qwest's expert witness, Dr. Banerjee, did not advocate any elasticity factor. We fully considered the CPUC cases and decided not to rely on them. Order at 34. We also considered the elasticity factor in the GTE/Verizon rate case and the expert studies Qwest cites. We determined that even with those inputs, the appropriate elasticity factor for this company during this test year was –0.3632.

We conclude that although Qwest disagrees with the elasticity factor we chose, it does not show that our choice was erroneous. Qwest's application for reconsideration should be denied.

ORDER

IT IS ORDERED that Qwest's application for reconsideration of Order No. 01-810 is denied.

Made, entered, and effective ______________________________.

______________________________	______________________________
Roy Hemmingway Chairman	**Lee Beyer** Commissioner
	______________________________
	Joan H. Smith Commissioner

A party may appeal this order to a court pursuant to ORS 756.580.