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June 29, 2001

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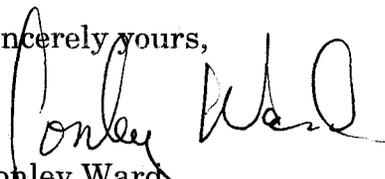
Dear Sir or Madam:

I am enclosing for filing, an original and fifteen copies of Midvale Telephone Exchange, Inc.'s Posthearing Brief in Docket No. T-02532A-00-0512.

I am enclosing a self addressed stamped envelope and a copy of this letter. Please stamp the copy of the letter and return it to me to acknowledge receipt. We do not need a stamped copy of the Brief.

If you have any questions or comments, please give me a call.

Sincerely yours,

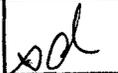

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cc: Lane Williams (with encl.)
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Arizona Corporation Commission
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ATTORNEYS FOR APPLICANTS

BEFORE THE ARIZONA CORPORATION COMMISSION

**IN THE MATTER OF MIDVALE)
TELEPHONE EXCHANGE, INC.'S)
APPLICATION FOR AUTHORITY TO) DOCKET NO. T-02532A-00-0512
INCREASE RATES AND FOR)
DISBURSEMENTS FROM THE ARIZONA)
USF)**

**MIDVALE TELEPHONE EXCHANGE, INC.'S
POSTHEARING BRIEF**

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**MIDVALE TELEPHONE EXCHANGE, INC.'S
POSTHEARING BRIEF**

Midvale's Posthearing Brief 1

STATEMENT OF THE CASE

On July 14, 2000, Midvale Telephone Exchange, Inc. ("Midvale") filed this Application with the Arizona Corporation Commission ("ACC" or "Commission"). The Application employs three alternative revenue requirement scenarios, all based on a calendar 1999 test year. The "Base Case" is a traditional rate increase request for Applicant's existing service territory. The second scenario ("EAS Case") combines the Base Case rate request with pro forma changes reflecting the Applicant's request for authorization of extended area service ("EAS") between its Cascabel exchange and the communities of Benson and San Manuel. Scenario number three combines the first two scenarios with Midvale's application for authority to provide service to approximately 400 potential customers in two new exchanges--Millsite and Silver Bell. The residents of these two areas currently do not have landline telephone service. Finally, Midvale requests funding from the Arizona Universal Service Fund to enable Midvale to continue providing affordable rates in its high cost rural service territory.

All three scenarios request a just and reasonable return on equity for Midvale of 13% and an overall weighted cost of capital of 11.2%. As filed, Midvale's Application requests a revenue increase of \$108,955 in the Base Case. If the Company's EAS request is granted, the necessary increase in revenues is \$144,706 per year. Finally, if both EAS and the request to extend service are granted, the increased revenue requirement becomes \$181,991 per year.

The Application proposes to standardize Midvale's local rates at \$24/month for residential customers and \$32/month for business customers, while reducing Midvale's existing intrastate access charges to a uniform \$.06 per minute. The

Application also proposes to eliminate custom calling charges and to consolidate and revise a number of unused or little used rates and rate categories. These rates would produce a revenue shortfall for Midvale under all three revenue requirement scenarios, and the Applicant requests that the resulting revenue shortfall be made up by annual disbursements from the Arizona Universal Service Fund ("AUSF"). Under the terms of Midvale's original Application, annual AUSF disbursements to Midvale would be \$130,329 in the Base Case, \$225,567 if EAS is granted, and \$221,360 for both EAS and the requested extension of service to Millsite and Silver Bell.

On March 15, 2000, the ACC Staff ("Staff") filed its direct testimony. The Staff proposes a number of adjustments to Midvale's test year rate base, revenues and expenses. Taking all of these adjustments into account, Staff proposes a revenue increase of \$17,391 per year, a 2.38% increase, for the Base Case scenario. See Exhibit S-2, Schedule DWC-1. Staff opposes Midvale's request for EAS, and therefore does not calculate a revenue requirement for the EAS scenario. While Staff supports Midvale's request to serve Millsite and Silver Bell, it rejects Midvale's pro forma adjustments to the test year that incorporate the cost of providing service in these unserved areas. Staff concludes, however, that if the unserved exchanges receive federal USF support and generate non-local revenues in the same amounts as Midvale's existing customer, Midvale could recover the incremental cost of serving the new exchanges at a local exchange rate of \$24 per month for residential customers and \$30 for commercial customers. With regard to rate design issues, the Staff agrees to unify the Company's disparate access charges for its Young and Cascabel exchange on a revenue neutral basis, and it proposes to

limit the increase in local residential rates to \$17.15 per month in the Young exchange.

Midvale filed its rebuttal testimony on April 11, 2001. In its rebuttal testimony, Midvale vigorously disputes the Staff's proposed adjustments to cost of equity and rate case expenses, and strongly disagrees with Staff's argument that the unserved areas could be self supporting at the rates Staff proposes. The Company does, however, agree with a number of the staff's other revenue requirement adjustments, the most important of which deal with accumulated depreciation, depreciation rates, income tax rates and the treatment of deferred taxes. Midvale's witness, Dr. Don Reading then recalculates Midvale's revenue requirement increase in the light of agreed upon Staff adjustments as \$66,789, equivalent to a 9.14% increase in the Base Case. Exhibit A-4 at 18. If EAS and service to Millsite and Silver Bell is authorized, the necessary increase becomes \$224,127, for a total percentage rate increase of 26.65%. *Id.* With respect to rate design issues, Midvale agrees to defer its request for a reduction in access rates if a unified access charge is ordered, and it agrees to reduce its requested residential local exchange rate in Young to \$22 per month.

ISSUES PRESENTED

With the Company's acceptance of the Staff's position on a number of issues, there are only three significant disputed issues remaining:¹

1. What is the proper cost of equity for Midvale?

¹ There is a also an outstanding disagreement between the Applicant and Staff regarding the proper treatment of short term interest expenses, with the Company arguing that the Staff can remove this cost from test year expenses, but the interest rate must then be included in the cost of capital. In view of the *de minimis* amount involved, this Brief does not address this issue.

2. Is Midvale entitled to recover in rates the full cost of preparing and presenting this case?

3. How should the cost of providing service to the unserved territories be funded?

ARGUMENT

I. A just and reasonable cost of equity for Midvale is no less than 13%.

In his direct testimony, Midvale's expert witness, Dr. Don Reading, used three distinct methodologies to determine Midvale's cost of equity--a ("DCF") analysis, a risk premium analysis, and a comparable earnings method. These approaches produce various equity costs ranging from 10.9% to 14.5%. Giving some weight to each of the various methods, Dr. Reading fixes his best estimate of Midvale's cost of equity at 13%. Exhibit 2, Schedule D-4 at 17.

Staff witness Joel Reiker also employs three different methodologies in preparing his estimate of Midvale's cost of equity--a comparable earnings approach, the DCF method, and a capital asset pricing model ("CAPM"). These approaches produce cost of equity results for Midvale ranging from 4.6% to 26.7%. With these results in hand, Mr. Reiker recommends a cost of equity of 11.5%.

Choosing between these two opinions is an admittedly difficult matter. The courts have offered little guidance on this issue, other than to note that a regulatory determination of equity costs "must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts." *Bluefield Waterworks & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 692. For both the expert witnesses and the Commission, the determination of a utility's cost of equity "is a judgment call, enlightened by consideration of all

relevant factors.” *Sun City Water Company v. Arizona Corporation Commission*, 26 Ariz.App. 304, 309, 547 P.2d 1104, 1109, vacated on other grounds 113 Ariz. 464, 556 P.2d 1126 (1976).

In the present case, there are a number of factors that strongly suggest that Mr. Reiker’s analysis contains both technical flaws and errors of judgment. On the technical side, the simple fact is that none of Mr. Reiker’s analytical methods support his ultimate cost of equity recommendation of 11.5%. The summary results for each of Mr. Reiker’s analyses are listed below:

1. Comparable earnings..... 24.3%-26.7%
2. DCF (Dividend growth)..... 4.6%
3. DCF (Sustainable earnings/average)..... 16.5%
4. DCF (Sustainable earnings/spot)..... 16.5%
5. DCF (Earnings growth/average)..... 11.8%
6. DCF (Earnings growth/spot)..... 11.8%
7. DCF (Value Line growth/avg.)..... 15.3%
7. DCF (Value Line growth/spot)..... 15.3%
8. CAPM..... 12.0-13.5%

All parties agree that the comparable earnings results cited by Mr. Reiker are skewed by U S WEST’s abnormally high returns on equity, and that the DCF/dividend growth results are flawed because of the recent rash of dividend cuts in the telecommunications industry. But all the remaining analytical “runs” produce results in excess of Staff’s 11.5% recommendation. Moreover, the raw data for Mr. Reiker’s comparable earnings analysis shows that, even with U S WEST’s

results discarded, the minimum achieved return on equity for his five comparable telecommunications companies during any year in the last five years was 17.3%!

Mr. Reiker attempts to explain these inconvenient results by arguing that the comparable companies used in his analyses are riskier than Midvale because a portion of their investments are in competitive endeavors. Dr. Reading convincingly refuted this argument in his rebuttal testimony:

Q. How do you respond to [Mr. Reiker's] assertions?

A. While I can agree that some comparable companies are operating in competitive or deregulated markets, I cannot agree that companies like BellSouth and SBC Communications are less risky than a small firm like Midvale. In fact, the suggestion is absurd on its face. Mr. Reiker's comparable companies are very large, highly diversified firms which serve some of the largest, most economically stable areas in the country. BellSouth, for example, has 44 million customers, 103,900 employees, revenues of \$26,200,000,000, a market capitalization of \$78,000,000,000, and an A-, "Low Risk" ranking from Standard & Poor's. Midvale, on the other hand, has less than 2000 total customers (638 in Arizona), 32 employees (4 FTEs in Arizona), and under \$3 million in revenue (\$866,000 in Arizona). It is completely unreasonable to view Midvale as less risky than a company like BellSouth.

Exhibit A-4 at 14-15.

Finally, there some reasons to mistrust Mr. Reiker's experience and judgment in financial matters. At the outset of cross examination, Mr. Reiker testified as follows:

Q. (BY MR. WARD) Let me ask you just a few peripheral questions, Mr. Reiker. On page 3 and 4, you discuss the economic prospects at the time for both Arizona and the nation. I assume you would agree with me that in general, prospects are considerably less rosy now.

A. Based on the analysts' forecasts?

Q. Based on the general concern of any number of analysts and economists that we may, in fact, be in a recession, on the verge of a recession.

A. I disagree with you. I do not agree that we're in a recession.

Q. Mr. Reiker, I didn't suggest that I said that. Isn't it true that there are informed and capable people who believe that to be the case?

A. I have read no studies that indicate that we're in a recession right now.

Q. You've read no analyst or economist that has expressed any concern that we may be in a recession in this quarter?

A. Not that I have read.

Tr. At 149. This is nothing more nor less than a confession of complete unfamiliarity with any of the leading financial journals or the business sections of the popular press, all of which have been replete with articles over the last several months about rapidly deteriorating business conditions and recession fears. *See e.g., John Greenwald, Assessing Recession, Time, June 25, 2001, at Y7* ("You don't need an economist to tell you the economy stinks, not with layoffs increasing, energy prices climbing and unsold cars, computers and communications gear piling up."). Similarly, Mr. Reiker could not venture an opinion about Wall Street's current view of small telephone companies. *See Tr. At 152.* This is remarkable considering the fact that the recent telecommunications wreck is one of the most devastating and widely publicized stock market collapses in decades. *See e.g., James K. Glassman, Broadband Failure Has a Political Cause, The Wall Street Journal, June 21, 2001, at A18* (A broad index of publicly traded small telco CLECs have lost 83% of their market value from their peaks).

In short, Mr. Reiker's analytical analysis does not support his recommendation, and there is ample reason to doubt that the judgment he has

brought to bear on the cost of equity issue is well informed. Midvale's request for a 13% cost of equity should be accepted.

II. Midvale is entitled to include \$40,000 in its revenue requirement to recover rate case expenses.

One fact about which there is no dispute in this case is that Midvale's rate case expenses greatly exceed any reasonable relationship to the sums at issue. When Midvale originally prepared its case, it budgeted \$40,000 in rate case expenses, knowing that figure might be a conservative estimate. Exhibit A-2 at 4-5. But by the time Midvale prepared its rebuttal testimony it had already incurred more than \$100,000 in costs, not counting \$41,610 in engineering costs related primarily to the unserved areas request. Exhibit A-2 at 5; Exhibit S-2 at 16. Midvale's General Manager, who has extensive experience in regulatory proceedings in four states, estimated that the final rate case cost to Midvale would surely exceed \$150,000, not counting engineering costs or Midvale's internal costs for management and staff time. Exhibit A-2 at 5.

These expenditures are obviously excessive "for a rate case in which the Company's base case filing requested an increased revenue requirement of only \$108,955 and Staff now recommends a \$17,391 increase." Exhibit A-2 at 5.

According to Mr. Williams,

The biggest single factor in this expenditure has been the cost of responding to the Staff's discovery requests. All told, the Staff served a total of six rounds of written discovery on the Company, totaling more than 115 questions and information requests, most with multiple subparts. Many of these demands required expensive studies by our engineering and cost consultants. A number of others insisted on the production of detailed records and compilations all the way back to the beginning of Midvale's service in Arizona in 1993. In addition, the Staff conducted an onsite audit of the Company's books and records,

and made a number of additional inquiries that used Company time and resources.

Exhibit A-2 at 5-6. In short, Staff conducted the type of exhaustive analysis that would normally be reserved for a multimillion dollar case involving a major utility.²

Notwithstanding its role as the primary cause of Midvale's exorbitant rate case costs, Staff now proposes to reduce Midvale's rate case expense to a three year \$20,000 amortization. Staff offers only two defenses of this reduction. It first argues that \$41,610 of engineering costs "related to the CC&N extension should be capitalized instead of a rate case expense." Exhibit S-2 at 16. It then arbitrarily reduces the remaining costs by nearly two-thirds to \$60,000 on the grounds that this was determined to be a reasonable figure in two previous small telephone company cases. Tr. at 137. No attempt was made to determine the reasonableness of Midvale's costs on an item by item basis. *Id.*

Staff's proposal offends both the law and simple standards of justice. For decades it has been recognized that utilities are entitled to recover reasonable rate case expenses even if the utility ultimately proves unsuccessful on the merits. *See Driscoll v. Edison Light & P. Co.*, 307 US 104, 120 reh. den. 307 US 650 (1939). In the present case, all of Midvale's costs were incurred in response to Commission and Staff requests and rules. Midvale undertook the expansion into Millsite and Silver Bell in response to the Commission's repeated attempts to entice Arizona telephone

² One of the ironies of this case is that, in the end, this herculean labor produced only three significant adjustments to Midvale's revenue requirement--a deferred tax adjustment, a downward revision to Midvale's cost of equity, and a rate case expense disallowance. All other adjustments were either insignificant, favorable to Midvale, or premised on the Staff's blanket refusal to accept pro forma adjustments for EAS and the extension of service to unserved areas. Moreover, two of the three adjustments (cost of equity and rate case expenses) could have been made without any discovery at all.

companies into unserved areas. Its rate case costs are the direct result of Commission imposed filing requirements and the Staff's expansive discovery requests. Despite the fact that all of Midvale's preparation and litigation costs are Commission imposed, Staff now proposes to disallow more than two-thirds of the Company's total costs. This produces an unrecoverable cost for Midvale that is roughly seven times as large as Staff's recommended rate increase.³

Under these circumstances, the Staff's proposed disallowance of the great majority of Midvale's costs is simply unconscionable.⁴ Midvale should be allowed a three year, \$40,000 per year amortization of its rate case expenses. In addition, it should be authorized to capitalize all costs in excess of \$120,000 and include them in the calculation of its costs to serve Millsite and Silver Bell.

III. Midvale must be allowed to recover its cost of serving the unserved areas, and a portion of that recovery must come from the Arizona Universal Service Fund.

For more than half a century, universally available telephone service has been one of the most important goals of the telecommunications industry and its governing regulatory bodies. The preservation and enhancement of universal service is codified in federal law, see 42 U.S.C. 254, and it is an acknowledged goal of the Arizona Corporation Commission. Tr. at 126. Simply put, the goal of universal service is to make telephone service as pervasive as possible, "and to

³ Staff's recommended rate increase is \$17,391. Using Mr. Williams' estimate of total costs, this Staff adjustment implies disallowed engineering and rate case expenses in excess of \$130,000.

⁴ Staff will no doubt argue that it did not disallow the \$41,610 of engineering costs, but instead simply recommended that they be capitalized. The fact is, however, Staff did not include any capitalized costs in its cost projections for the CC&N expansion, thus effectively disallowing the costs in their entirety.

make available, directly or indirectly, the funds necessary to accomplish such a policy.” Morton I Hamburg & Stuart N. Broadman, *Communications Law and Practice* §5.01(1) (1998). In the absence of telephone service, citizens are denied the opportunity to fully participate in the economy and society and, as the testimony of the public witnesses in this case graphically demonstrates, the public health and welfare is placed at risk. Tr. at 9-17.

It is common knowledge in the Arizona telephone industry that the Arizona Corporation Commission has, for a number of years, been seeking a solution to the continuing problem of communities that lack landline telephone service. Tr. at 125. The Commission has collected information about these unserved areas and repeatedly importuned Arizona telephone companies to extend service to the affected communities. This effort has met with little or no success. Tr. at 125-126.

The reason for this lack of success is no mystery to informed observers. Unserved communities in Arizona, or anywhere else, exist because they are not profitable to serve at rates that customers can afford to pay. *Id.* The unserved areas of Millsite and Silver Bell provide a perfect example of this situation. The undisputed evidence is that, in the absence of extraneous universal service funding support, a \$45 local exchange rate would be necessary in these exchanges just to cover Midvale’s incremental cost of providing land line telephone service. Exhibit A-4 at 9.⁵ But for most of the residents of these communities, \$25 per month represents the upper limit of their willingness and, in many cases ability, to pay for telephone service. Tr. at 49.

⁵ Fully allocated costs of service would undoubtedly be considerably higher. Moreover, the \$45 figure assumes that Midvale’s high access charges will be sustainable over time.

There is only one way to break out of this impasse. Telephone companies are businesses, not charitable institutions, and they cannot be required to provide telephone service at a loss. Consequently, high cost unserved areas must be subsidized in some fashion if universal service goals are to be realized. The necessary subsidies can take one of two forms. They can be implicit cross subsidies generated by high charges for other services such as access charges or by rate cost averaging with lower cost service territories. Alternatively, explicit subsidy vehicles such as the federal USF and AUSF can be utilized to partially underwrite service costs.

The Staff's position, while undoubtedly well intended, could not be more perfectly designed to frustrate the extension of universal service to unserved communities. In the present case, Staff first erroneously assumes that federal universal service fund support will be available to bring the rates in Millsite and Silver Bell down to affordable levels. Concurrently, it interprets the Commission's rules and policies in such a way that AUSF support is unavailable to precisely the communities that most need it, i.e., those communities that currently lack telephone service are ineligible for AUSF funding.

These Staff positions are based on fundamental errors of both law and logic. Federal universal service funds cannot be relied upon to underwrite the initial extension of service to unserved communities. The Arizona Universal Service Fund can, and should be, used to make service available, and there are no legal impediments to doing so.

A. Neither Midvale nor the Commission can rely on federal universal service funds to promote service To Millsite and Silver Bell.

One of the most hotly contested issue at the hearings concerned Staff's insistence that any gap in funding Midvale's expansion into the Millsite and Silver Bell exchanges could be offset by federal universal service funds. All parties acknowledge that federal USF support is based on historical data, and thus a new service area is typically ineligible for federal support until its third year of operation. See Exhibit A-4 at 8, Exhibit S-8 at 6; see also *In the Matter of Border to Border Communications, Inc.*, 10 FCC Rcd 5055 (May 4, 1995) (hereafter *Border to Border*) (copy attached as Appendix A). All parties also agree that, in the absence of a waiver of the FCC's USF eligibility rules, Midvale will lose at least \$143,302 over a two year period if it provides service to Millsite and Silver Bell at the Staff's suggested rates. See Exhibit S-8 at 6. But the Staff insists that a waiver of the federal waiting period is a foregone conclusion, and that Midvale will receive federal USF funding at the outset of operations. Tr. at 156-157.

Staff's argument is fatally defective on a number of grounds. In the first place, it assumes without any foundation whatsoever, that the Millsite and Silver Bell exchanges will, on a per line basis, generate the same non-local revenues and federal USF support as Midvale's existing service customers. Exhibit S-4 at 12. But perhaps more to the point, anyone who purports to predict with absolute certainty the outcome of a regulatory commission's decision is making a foolish statement, and this is doubly true when the prediction is for a decision contrary to established rules.

While Midvale is aware of at least one precedent for the waiver of the FCC eligibility rules, that case is distinguishable. In *Border to Border*, the applicant was a newly created utility serving a previously unserved territory, without any cash flow except revenues from the new territory. The *Border to Border* opinion also clearly indicates the FCC would have denied the applicant's request because the applicant had already consented to the initiation of service, but for its fears that the Texas PUC might raise rates or the applicant might terminate service before the end of the two year waiting period. *Border to Border* at 3. Whether the FCC would find the same factors present in Midvale's case is, at best, an open question, and it cannot be denied that there are other FCC orders rejecting requests for relief from the two year waiting period for USF eligibility. See *In the Matter of Fremont Telecom Company*, AAD 97-56, DA 98-127 (1998) (copy attached as Appendix B). Finally, the *Border to Border* applicant clearly did not receive support from the inception of service. There was a one year lag between the filing of the application and the Commission's final order, and the order explicitly denied the applicant's request for retroactive funding. *Border to Border* at 3.

Furthermore, Midvale has ample reason not to trust its fate on such an important matter to the tender mercies of the FCC. On January 16, 1997, Midvale filed a request for a waiver of the FCC cap on its individual USF support payments. The FCC essentially denied this request by inaction. It was not until nearly three years later, after Midvale had refiled its request in a joint filing with other carriers, that it finally secured relief. See *In the Matters of Petitions for Waiver and Reconsideration Concerning Sections 36.611, 36.612, 61.41(c), 69.605(c), 69.3(e)(11) and the Definition of "Study Area" Contained in Part 36 Appendix-Glossary of the*

Commission's Rules, DA 99-1845 (FCC, Sept. 5, 1999) (copy attached as Appendix C).

The Staff's inclusion of federal USF in its calculation of Midvale's revenue requirement for the unserved areas is also impossible to reconcile with its dismissal of Midvale's pro forma adjustments. On the one hand, it rejects pro forma expenses and investments that are certain to take place before Midvale can provide service and receive any revenue at all from the new service exchanges. On the other hand, it accepts with certainty that the FCC will grant a waiver of its general rules, at a time certain, and on the basis of a petition that has not even been prepared, much less filed.

Staff's position on this issue amounts to nothing less than an abdication of its obligation to provide Midvale with a reasonable opportunity to make a fair return on its utility investment. Amazingly, the Staff seems unaware that it has a legal obligation in this regard.

Q. Does the law generally countenance requiring companies to act at less than a reasonable return on their investment for an appreciable period of time?

A. The law? I don't think the law cares whether you make a return or not. I think your shareholders probably do, but the law doesn't really care.

Tr. at 161-162. This view of the law will come as something of a shock to both the Arizona courts and the United States Supreme Court. *See Turner v. Arizona Corp. Com'n*, 195 Ariz. 574, 991 P.2d 804, 807 (Ariz.App.Div. I, 1999) ("The Commission must permit a utility to realize a fair and reasonable rate of return on the owners' capital investment in the utility."); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (The commission must provide "enough revenue not

only for the operating expenses but for the capital cost of the business. These include service on the debt and dividends on the stock.”).

It is possible the Staff feels its actions are excusable because it believes Midvale’s potential loss of more than \$140,000 “is not a big deal when you consider the grander scheme of things.” Tr. At 159. This is of a piece with the Staff’s approach to rate case expenses--the numbers involved are not impressive considering the type of sums usually at issue in Commission proceedings. But the truth is a loss of \$140,000 is roughly equivalent to an entire year’s authorized return from Midvale’s existing Arizona operations. See Exhibit A-4, Schedule 7, P. 8, L.4A. This is a very big deal indeed.

In the end, perhaps none of this matters. In the present circumstances, the only view that really counts is that of Midvale’s management. If it concludes it would be an imprudent business practice for Midvale to stake its fortunes on the FCC, Millsite and Silver Bell will languish without service notwithstanding Staff’s conviction that the gamble is a sure thing.

B. The Commission’s regulations and policies do not prohibit support from the AUSF for the extension of service to Millsite and Silver Bell.

Commission Rule R14-2-1202A provides that AUSF support shall equal the difference between benchmark local exchange rates and “the appropriate cost to provide basic local exchange telephone service. . . net of any universal service support from federal sources.” R14-2-1202B, in turn, defines “appropriate cost” for a small local exchange carrier as “the embedded cost of the incumbent provider.” Staff interprets the term “embedded cost” as synonymous with historical costs without pro forma adjustments. Because Midvale has no recorded historical cost of

providing service to the Millsite and Silver Bell exchanges, it therefore cannot qualify for AUSF distributions under the Staff's interpretation.

There are two fundamental problems with Staff's reading of the rule. In the first place, it ignores the context in which the term "embedded cost" is used. While it is true that embedded cost is sometimes used interchangeably with the term historical cost, it also has another more expansive meaning. In modern telephony, embedded cost is often used as a synonym for the fully allocated costs traditionally used in utility ratemaking, as opposed to the forward looking, incremental costs utilized by the FCC and state commissions in certain proceedings under the Telecommunications Act of 1996. When subsection A and B are read *in para materia* with the remainder of R14-2-1202 it becomes quite clear that the term embedded cost is being used in the latter sense. Subsection C and D of the rule provide that the "appropriate cost" for intermediate and large carriers is not embedded cost but "Total Service Long Run Incremental Cost." In context, embedded cost is a shorthand references to costs traditionally recognized in ratemaking, as opposed to the hypothetical, model driven costs derived from the TSLRIC methodology.

This is in fact the only reading of R14-2-1202 that makes any sense. If the Staff's strict equation of embedded cost with recorded historical cost is adopted, the following absurd consequences necessarily follow:

1. Small carriers could never receive AUSF support for extending service to unserved areas because they have no embedded cost in those areas. This, in turn, means that AUSF support could never be used by small carriers in the very areas where there is a total failure to meet universal service goals. The Commission could not have intended such a ridiculous result, and if it had it would surely have said so in direct terms.

2. Even where support is sought for previously served areas, all pro forma adjustments would have to be stripped from the ratemaking process, and small carriers would have one revenue requirement for ratemaking purposes and another for AUSF purposes. Since the AUSF provides a source of residual funding for the difference between benchmark rates and appropriate costs, any carrier that had a pro forma cost increase removed from appropriate costs under the Staff's interpretation would automatically experience a revenue requirement shortfall.

3. Since TSLRIC is, by definition, a method of projecting costs for a hypothetical, newly constructed network, an intermediate or large carrier who otherwise qualified for AUSF support would automatically receive support based on the projected cost of serving an unserved area, while a small carrier would be barred from receiving support based on projected costs.

Clearly all of these results are irrational, and they fatally undermine Staff's interpretation of R14-2-1202. In contrast, Midvale's reading of embedded costs as a generic reference to normal ratemaking costs produces none of these results, and it would allow AUSF support in precisely those areas where it is needed the most.

B. Midvale's embedded costs should include pro forma changes for the cost of serving Millsite and Silver Bell.

Like most other regulatory commissions, the ACC uses an historical test year as the initial basis for setting utility rates. The historical test year suffers, however, from one fundamental defect. Regulatory bodies are charged with the duty of setting rates that will be just and reasonable on a going forward basis, but the simple historical test year does not always accurately reflect future expense and revenue relationships. Consequently, "[f]or many years, commissions have adjusted test-year data for 'known changes'" that take place after the conclusion of the test year. Charles F. Phillips, Jr., *The Regulation of Public Utilities* 196 (3d ed. 1993).

These changes can be reflected in pro forma revenue and expense adjustments, or even the use of a fully projected test year. *Id.*

In Arizona, as in most states, the Commission has “broad discretion” to determine whether expenditures and investments not yet devoted to the public service may nevertheless be included in ratemaking determinations. *See Arizona Corporation Commission v. Arizona Public Service Company*, 113 Ariz. 368, 371, 555 P.2d 326, 329 (1976). The most recent Arizona case on point is *Litchfield Park Service v. Corp Com’n*, 178 Ariz. 431, 874 P.2d 988 (Ariz. App. Div. I, 1994). In *Litchfield*, the utility sought inclusion in rate base of a well constructed to meet future needs and placed in service after the conclusion of the test year. The Commission rejected the utility’s request on two grounds:

To include Well No. 23A in rate base without a corresponding inclusion of new customers and revenues results in a violation of the matching concept implicit in the use of a historical test year. Second, even if the well were in service during the test year, we are not convinced it is necessary to serve the Company’s customers.

Litchfield, 874 P.2d at 994 (quoting Commission order). In sustaining the Commission, the court pointedly noted that “the Commission properly could have considered the cost of Well 23A,” *Litchfield*, 874 P.2d at 995, but would not be required to do so where it provided a reasonable basis and explanation for its decision.

The *Litchfield* case is instructive because it clearly demonstrates that the rationales of the “known and measurable” and “used and useful” doctrines do not apply in this case. These guidelines are designed to prevent pro forma adjustments that distort the relationship between revenues and expenses and to insure that ratepayers do not pay for investments that are not employed in providing utility

service. Neither of these rationales apply to the present case or to any case involving unserved areas. In contrast with the *Litchfield* applicant, Midvale has matched its projected expenses in the new exchanges with projected revenues from the new customers, so there is no mismatchin problem. Nor can it be argued that the pro forma expenses and rate base adjustments may prove unnecessary or not used and useful. If these expenditures are not made Midvale will never receive any revenue or return on its investment because the customer will not receive service in the first place. In an unserved area case the evil the used and useful doctrine was designed to prevent cannot occur.

Under these circumstances, it is irrational to employ the “known and measurable” and “used and useful” doctrines to bar pro forma projections in a case involving unserved areas. In fact, the Staff concedes pro formas are appropriate for unserved areas that are served by a new company because there is no alternative to the use of projections. Tr. At 119-121. What the Staff fails to acknowledge is that there is likewise no alternative to the use of projections in the case of an existing company that intends to expand into unserved areas. In either case, there are no relevant historical costs on which a revenue requirement and customer rates can be based. Thus, pro forma projections of revenues and costs must be utilized to determine a revenue requirement for unserved areas regardless of the status of the serving company as either a new or pre-existing utility.

Once it is recognized that pro forma adjustments can be included in the embedded costs referred to in R14-2-1202, the logical path forward becomes obvious. The Commission should grant Midvale’s revenue increase request in two stages. The first stage should be an immediate increase of \$66,789 for Midvale’s existing

service territory. The second stage should authorize Midvale to draw \$71,651 per year from the AUSF beginning with the commencement of service to Millsite and Silver Bell. This will insure that customers do not pay for property that is not used and useful by withholding recovery of the incremental revenue requirement for the unserved areas until service is actually implemented. The Arizona AUSF draw can be subsequently adjusted when, and if, federal USF support becomes available. If further safeguards are deemed necessary, a post implementation audit or review can be ordered to insure that the company has in fact incurred the costs it projected and is not overearning.⁶

CONCLUSION AND RECOMMENDATIONS

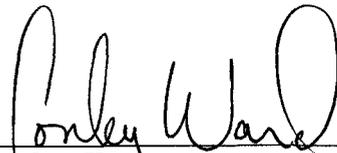
For the above and foregoing reasons, Midvale requests that the Hearing Officer issue a recommended order containing the following findings and determinations:

1. Midvale should be granted a certificate of public convenience and necessity to serve the Millsite and Silver Bell exchanges.
2. Midvale's just and reasonable cost of equity is 13%.
3. Midvale is entitled to include \$40,000 per year in its revenue requirement for the recovery of rate case expenses.
4. Midvale is authorized to immediately increase its rate in the amount of \$66,789.
5. Upon commencement of service to the Millsite and Silver Bell exchanges, Midvale is authorized to draw \$71,651 per year from the Arizona Universal Service Fund.
6. Midvale shall file a request for federal universal service fund support for Millsite and Silver Bell at the earliest practicable

⁶This is in fact the procedure that was followed when Midvale implemented service to the Cascabel exchange. See *In the Matter of the Application of Midvale Telephone Exchange, Incorporated, for a Certificate of Public Convenience and Necessity*, ACC Docket No. U-2532-89-134, Decision No. 58048 (Nov. 2, 1992) (Copy attached as Appendix D).

opportunity, and upon receipt of such support its Arizona Universal Service Fund draw shall be reduced by an appropriate amount.

RESPECTFULLY SUBMITTED this 29th day of June, 2001.



Conley Ward
GIVENS PURSLEY LLP
Attorneys for Applicant

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 29th day of June, 2001, I caused to be served a true and correct copy of the foregoing by the method indicated below, and addressed to the following:

Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

U.S. Mail Fax Hand Delivery Federal Express

Maureen Scott
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

U.S. Mail Fax Hand Delivery Federal Express

Todd C. Wiley
Gallagher & Kennedy, P.A.
2575 East Camelback Rd
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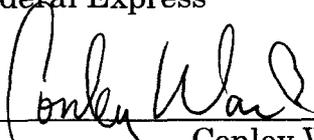
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APPENDIX A

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

Border to Border
Communications, Inc.

AAD 94-61

Petition for Waiver
of Sections 36.611 and 36.612
of the Commission's Rules

MEMORANDUM OPINION AND ORDER

Adopted: May 4, 1995;

Released: May 10, 1995

By the Chief, Common Carrier Bureau:

I. INTRODUCTION

1. On May 5, 1994, Border to Border Communications, Inc. ("BBC," or "Petitioner"), filed a petition ("Petition") requesting that the Commission grant it a waiver of Sections 36.611 and 36.612 of the Commission's rules to allow BBC to receive Universal Service Fund ("USF") support beginning April 2, 1994.¹ BBC also requests that the Commission direct the National Exchange Carrier Association, Inc. ("NECA") to disburse such USF support consistent with the methodology proposed in the Petition. On June 6, 1994, the Common Carrier Bureau ("Bureau") released a public notice soliciting comments on the petition for waiver.² Four parties filed comments and three parties filed reply comments.³ In addition, BBC provided supplemental financial and cost data concerning the Petition on June 7, 1994.⁴ In this order, we grant the Petition, in part, as explained more fully below.

¹ See 47 C.F.R. §§ 36.611 and 36.612.

² Public Notice, 9 FCC Rcd 2537 (Com. Car. Bur. 1994).

³ Comments were filed by MCI Telecommunications Corporation ("MCI"), NECA, the National Telephone Cooperative Association ("NTCA"), and the United States Telephone Association ("USTA"). Reply comments were filed by American Telephone and Telegraph ("AT&T"), BBC and NTCA.

⁴ Letter from Thomas Moorman, BBC, to William Eaton, Acting Secretary, FCC, dated June 7, 1994 ("Border Letter").

⁵ See Petition at 2-4.

⁶ USF assistance is provided in the form of an expense adjustment that shifts a portion of total expenses from the state to the interstate jurisdiction. See generally, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, 96 FCC 2d 781 (1984).

See generally 47 C.F.R. §§ 36.601-36.631.

⁷ See 47 C.F.R. § 36.611. See also NECA Petition for Waiver of Sections 36.611(a) and 36.613(a) of the Commission's Rules, MO&O, 9 FCC Rcd 2531 (Com. Car. Bur. 1994). LECs may choose to make three data submissions, as quarterly updates, in addition to the required July 31 annual submission. LECs re-

II. BACKGROUND

2. *BBC service area.* On August 1, 1991, BBC was granted a certificate of convenience and necessity from the Public Utility Commission of Texas ("Texas PUC") and became a newly authorized local exchange carrier ("LEC") within the State of Texas. On April 2, 1994, BBC began providing local exchange service to portions of Zapata County previously without telephone service. The BBC service area encompasses 850 square miles. It is located within Zapata County and borders the Republic of Mexico. Because this service area is largely unsettled and has few public roads, BBC constructed a local exchange network that relies on radio facilities in addition to traditional land line facilities.⁵

3. *USF program.* The Commission established the USF program to promote the nationwide availability of telephone service at reasonable rates. Toward this end, USF support permits high-cost LECs to reduce local rates by recovering additional expenses from the interstate services they provide.⁶ Eligibility for USF support is based on historical data, and thus, a newly established LEC typically would not be eligible for support under Sections 36.611 and 36.612 until its third year of operation. Those rules impose certain data requirements and filing dates that, for new LECs, effectively impose a waiting period of up to two years for the receipt of assistance. Pursuant to the methodology prescribed by the Commission's rules, NECA calculates the level of USF support for a particular study area based on the historical loop-cost data that each LEC must provide to NECA.⁷ The required data include certain expenses, investment costs and working loop counts for a 12-month period. LECs must report these data by July 31 of each year for the full 12 months of the preceding calendar year.⁸

4. NECA uses these data to develop and file access charge tariffs that, if approved by the Commission, become effective on January 1 of the following calendar year.⁹ In addition to calculating the amount of USF assistance provided to individual study areas, NECA also calculates the total USF assistance available to all study areas combined. During an interim period from January 1, 1994 to January 1, 1996, the total USF is subject to an indexed cap. That cap allows the total USF to increase each calendar year at the annual rate of increase in the industry's total number of working loops.¹⁰

porting data for the last nine months of the previous calendar year and the first three months of the existing calendar year must submit data no later than September 30 of the current calendar year. LECs reporting data for the last six months of the previous calendar year and the first six months of the current calendar year must submit that data no later than December 30 of the current calendar year. Finally, LECs reporting data for the last three months of the second preceding calendar year and the first nine months of the previous calendar year must submit that data no later than March 30 of the current calendar year. See 47 C.F.R. § 36.612.

⁹ See 47 C.F.R. § 36.611.

¹⁰ 47 C.F.R. § 36.60. See Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 9 FCC Rcd 303 (1993) ("Interim Cap Order"). The Commission adopted the indexed cap to moderate growth in the USF during a two-year interim period in which a rulemaking proceeding on permanent USF changes is pending. See *Id.* at 303; and Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 8 FCC Rcd 7114 (1993) ("USF Notice").

III. PETITION AND COMMENTS

5. *Petition.* BBC seeks a waiver of Sections 36.611 and 36.612 of the Commission's rules to permit it to receive USF support starting when it first began providing service. BBC proposes that it be permitted to use a combination of current and projected data rather than the required 12 months of historical data. Specifically, BBC requests that it be permitted to use a rolling annualized average of such combined data that would be reconciled quarterly with actual costs. BBC states that, over time, an increasingly larger share of its projected cost data would be replaced with actual cost data so that in time the USF calculations would be based entirely on historical data.¹¹

6. BBC asserts that the rules requiring USF assistance to be based on 12 months' historical data are not intended to preclude new LECs from having immediate access to assistance if they need it to set rates at affordable levels. BBC states that a grant of the requested waiver is consistent with the intent of the USF, *i.e.*, to assist LECs serving high cost areas in maintaining affordable local service rates. BBC claims this goal will be frustrated if the requested waiver is not granted because the Commission's rules would have the unintended result of preventing a new LEC from being able to offer affordable local service during its first year of operation. BBC argues that, absent the waiver, its monthly local service rate for residential customers would be prohibitively expensive. Specifically, in order to allow recovery of all of BBC's costs, this monthly rate would need to be at least \$239 per subscriber line, which is \$220 greater than the \$19 rate approved, on an interim basis, by the Texas PUC. BBC concludes that such an excessive local residential rate would be contrary to the public interest. The lack of affordable service, BBC states, would leave the residents within its service area isolated from the community of Zapata and the city of Laredo, as well as from their schools, hospitals, and government centers.¹²

7. BBC estimates that its share of USF assistance would be approximately \$149,414 for the nine-month period from April 2, 1994 to the end of 1994.¹³ BBC states that, because the USF is currently capped, its receipt of such assistance would not affect existing payment obligations of parties paying into the USF.¹⁴

8. *Comments.* NECA, NTCA and USTA support the Petition. NECA claims it would be unfair to require new LECs to wait two years to start receiving USF payments because this delay could deter them from providing service in territories that currently are unserved. NECA further claims that it is unclear whether the Commission intended that the USF assistance provided to new LECs is to be included in the USF cap. NECA submits that, in the Commission order adopting this cap, the language does not specifically address how the cap is affected when new carriers begin serving previously unserved territories. NECA concludes that the Commission should consider whether the cap will be adjusted upward to accommodate BBC's entry into service. If this adjustment is not made, NECA states, the granting of BBC's petition would result in a reduction in the USF payments to existing USF partici-

pants, even though their cost characteristics had not changed. NECA states that the methodology BBC proposes for calculating its USF draw is administratively feasible and would not disrupt NECA's administration of the fund as a whole.¹⁵

9. NTCA states that, because BBC has no more than 75 working loops, it cannot have a noticeable impact on the growth of the USF cap. NTCA also states that BBC's choice of a combined radio and copper cable design, at a substantial cost savings compared with the traditional copper cable design, indicates that BBC has seriously examined the cost issue and is not expending funds unnecessarily. NTCA submits that BBC's service area is part of a region that, according to 1990 Census Bureau data, exhibits a low median household income level and a telephone penetration level of only 78 percent. NTCA claims these statistics show that the households in BBC's service area need service.¹⁶

10. MCI conditionally opposes the Petition. MCI states that it does not oppose BBC's proposed waiver to the extent it would allow BBC to receive USF support at an earlier date. MCI states that it is alarmed, however, at the extraordinary high loop cost that BBC anticipates in order to serve 75 customers. MCI submits that, if BBC's average annual loop cost proves to be \$3,828 as BBC projects, BBC will have established a new national record for loop cost under the USF program. MCI further submits that, when BBC filed its local exchange rate application with the Texas PUC, BBC estimated its average annual loop cost to be \$6,096, an amount 59 percent greater than the \$3,828 estimate reported in the instant waiver petition. MCI argues that the great disparity between these two cost estimates, together with the extraordinarily high level of both estimates, raise serious questions of reasonableness, particularly with respect to the basis on which BBC is calculating its loop costs. For these reasons, MCI requests that the Commission thoroughly examine BBC's loop costs before granting the waiver request.¹⁷ In response, BBC claims that the disparity between its cost estimates is due to the use of updated cost information in the Petition, which was submitted in May 1994. That information was unavailable, BBC states, when the earlier estimate was provided to the Texas PUC in October 1993.¹⁸

11. AT&T does not oppose the Petition. AT&T does oppose, however, NECA's suggestion that the Commission consider raising the USF indexed cap to accommodate BBC's eligibility for assistance and thereby prevent a reduction in assistance to existing USF recipients. AT&T submits that, since the adoption of the *Interim Cap Order*, the Commission has not made such an adjustment to the cap when granting study area waiver requests even though the Commission recognized that many of those waivers would result in a redistribution of the USF among eligible recipients. AT&T argues that, with respect to this redistributive effect on the USF, there is no difference between a new LEC such as BBC and the new or expanded study areas that serve an established customer base. AT&T further argues that such an adjustment to the cap is contrary to the

¹¹ Petition at 10-11.

¹² *Id.* at 3 and 7-9. The estimated monthly rate of \$239 is based on BBC's assumption that all of the 75 potential subscribers within the BBC serving area agree to subscribe to residential service. *Id.* at 9.

¹³ Petition at 8 and Attachment A.

¹⁴ *Id.* at 7 and 10.

¹⁵ NECA Comments at 4-6.

¹⁶ NTCA Comments at 2-4.

¹⁷ MCI comments at 2-5.

¹⁸ BBC reply comments at 4-5.

Commission's express objectives in adopting the *Interim Cap Order*. That objective, AT&T observes, is to produce a stable and moderate USF growth during the two-year interim period while preserving adequate support for the recipients most in need of assistance.¹⁹

IV. DISCUSSION

12. Waiver of a Commission rule is appropriate only if special circumstances warrant a deviation from the general rule and such deviation will serve the public interest.²⁰ Further, the waiver generally must be consistent with the principles underlying the rule for which a waiver is requested.²¹ As noted above, a primary principle underlying Sections 36.611 and 36.612 is that the goal of the USF program is to promote the nationwide availability of telephone service at reasonable rates by assisting LECs operating in high-cost areas.

13. BBC claims that, given its special circumstances as a high-cost LEC entering a territory previously without service, the rules would frustrate that Commission goal and disserve the public interest. This is so, BBC argues, because the rules would compel it to charge such high rates during its first two years of operation that potential customers effectively would be denied service. In contradiction to this claim, however, BBC already has been providing residential service for more than a year at an affordable monthly rate of \$1⁰ per loop. BBC has not shown that this rate has discouraged customers from seeking service. We therefore find, to this point in time at least, that the rules have neither frustrated the Commission's goal nor disserved the public interest. Consequently, we conclude that BBC should not be allowed to receive USF support for the period predating the effective date of this order.

14. Whether this situation will persist, however, is unclear. One possibility is that the Texas PUC could allow BBC to raise rates substantially above the current levels, an action that might result in customers effectively being denied service, as BBC predicts. Another possibility is that BBC, being confronted by average loop costs well in excess of the allowed rates, will choose to terminate service before the end of the year. In either case, the rules would have the unintended effect of discouraging service in a high cost area. This consideration implies that, under BBC's special circumstances, the rules may frustrate the Commission goal of promoting affordable service and thus may disserve the public interest. The likelihood of such an outcome cannot be readily dismissed, particularly when we consider the high average loop costs demonstrated by BBC.²² For this reason, we find BBC has shown good cause for a granting of the waiver for the remainder of this year. We therefore grant the requested waiver, in part, to allow BBC to be eligible to start receiving USF support on the effective date of this order.

15. Another aspect of the waiver request warrants discussion. NECA claims that the language in the *Interim Cap Order* does not address how the USF is affected when new high-cost carriers, such as BBC, begin serving previously unserved territories. Specifically, NECA claims it is unclear whether the Commission intended the magnitude of each year's USF to be increased to accommodate the support provided to these new LECs. NECA suggests that the Commission consider requiring such an increase so as to prevent the entry of new high-cost LECs from reducing the capped support payments to existing USF participants.

16. We disagree with NECA's claim that the Commission's intent is unclear. In the *Interim Cap Order*, the Commission decided to index the rate of growth in the USF to the nationwide rate of growth in total loops because, with such an index, an expansion in the subscriber base leads to an increase in the authorized USF and thus permits additional support to the LECs that expand service to new customers.²³ This consideration implies that the indexing of the USF growth already accommodates the situation in which service is provided to previously unserved customers. Regardless of whether the new customers are served by an existing LEC or by a new LEC such as BBC, the USF will be automatically increased by an amount corresponding to the growth in total loops. Hence, BBC's new operations will increase the size of the USF by contributing to the total number of working loops.

17. Moreover, there is a second reason why the Commission chose the rate of growth in total working loops as the measure by which the USF is to grow during the interim period. The stability of this measure assures that the USF will grow only moderately and predictably during the period in which the Commission is reviewing the USF program.²⁴ NECA's proposal is inconsistent with this Commission goal because, if the USF were increased to accommodate all support provided to new LECs entering unserved territories—as NECA suggests—the USF growth would be potentially unpredictable.

V. ORDERING CLAUSE

18. Accordingly, IT IS ORDERED, pursuant to Sections 4(i) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), and Sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91 and 0.291, that the Petition of Border to Border Communications, Inc. for waiver of Sections 36.611 and 36.612 of the Commission's rules, 47 C.F.R. §§ 36.611 and 36.612, IS GRANTED IN PART, to the extent described above.

¹⁹ AT&T reply comments at 2-3.

²⁰ See 47 C.F.R. § 1.3; *WALT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969), cert. denied, 409 U.S. 1027 (1972); *Northeast Cellular Telephone Company v. FCC*, 847 F.2d 1164, 1166 (D.C. Cir. 1990).

²¹ *City of Angels Broadcasting, Inc. v. FCC*, 745 F.2d 650, 662-63 (D.C. Cir. 1984).

²² BBC provided a summary of the system plan, including a description of the radio, microwave and other equipment employed. That summary contains sufficient detail to provide a

clear picture of BBC's operations. BBC also provided maps of the service area, loan documents showing financial arrangements, and engineering reports estimating construction costs and operating expenses. These cost estimates were based on updated engineering reports and actual financial arrangements. In contrast, the cost estimates that BBC had provided a year earlier to the Texas PUC had been based on pro-forma financial statements and early cost projections.

²³ *Interim Cap Order*, 9 FCC Rcd at 305.M

²⁴ *Id.*

FEDERAL COMMUNICATIONS COMMISSION

Kathleen M.H. Wallman
Chief, Common Carrier Bureau

APPENDIX B

Federal Communications Commission

DA 98-127

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
)
Fremont Telcom Company) AAD 97-56
)
Petition For Waiver of Sections 36.611 and)
36.612 of the Commission's Rules)

ORDER

Adopted: January 23, 1998

Released: January 23, 1998

By the Chief, Accounting and Audits Division:

I. INTRODUCTION

1. On April 28, 1997, Fremont Telcom Co. ("Fremont") filed a petition ("Petition") requesting a waiver of Sections 36.611 and 36.612 of the Commission's rules to enable it to receive high cost loop support retroactively from January 1, 1997.¹ On April 29, 1997, the Accounting and Audits Division ("Division") released a public notice soliciting comment on the petition for waiver.² Four parties filed comments.³ Fremont filed reply comments. In this Order, we deny Fremont's Petition.

II. BACKGROUND

2. In 1984, the Commission established high cost support mechanisms to promote the nationwide availability of telephone service at reasonable rates.⁴ Specifically, high cost loop support allows incumbent local exchange carriers with high local loop costs to allocate an additional portion of those costs to the interstate jurisdiction, enabling the state jurisdictions to

¹ Fremont Telcom Co., Petition for Waiver, AAD 97-56 (April 28, 1997)

² Fremont Telcom Co. Petition for Waiver of Sections 36.611 and 36.612 of the Commission's Rules, Public Notice, DA 97-904 (Com. Car. Bur. April 28, 1997).

³ Comments were filed by the National Telephone Cooperative Association ("NTCA"), the Idaho Telephone Association ("ITA"), the Idaho Public Utilities Commission ("Idaho Commission"), and ITCs, Inc. ("ITCs").

⁴ See generally, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, 96 FCC 2d 781 (1984).

Federal Communications Commission

DA 98-127

establish lower local exchange rates in study areas receiving such assistance.⁵ Under these rules, a company's high cost loop support is based on the relationship of its historical loop cost to the national average historical loop cost.⁶

3. In the Universal Service Order released on May 8, 1997, the Commission established new federal universal service support mechanisms consistent with the Communications Act of 1934, as amended (the "Act").⁷ Under the new federal universal support mechanisms, support for high cost areas will be based upon forward-looking economic cost mechanisms. Thus, a carrier's support will be based on the forward-looking economic cost of providing the supported services to a service area. Non-rural incumbent local exchange carriers ("incumbent LECs") will receive support based on forward-looking economic costs beginning January 1, 1999; rural incumbent LECs will begin to receive support based on forward-looking economic costs no earlier than January 1, 2001.⁸ Until an incumbent LEC's high cost loop support is based on forward-looking economic cost, its support will continue to be based on historical cost data.

4. In accordance with Sections 36.611 and 36.612 of the Commission's rules, on July 31 of each year, incumbent LECs submit to the National Exchange Carrier Association ("NECA") loop cost data for the prior year.⁹ NECA compiles and analyzes these data to determine the average cost per loop for each incumbent LEC as well as the nationwide average cost per loop. Each incumbent LEC's high cost loop support amount for the following year is based upon the relationship between the incumbent LEC's average cost per loop and the nationwide average cost per loop. Because the cost data is not submitted by carriers until seven months after the end of a calendar year and because NECA requires time to compile and analyze data, support is not provided generally to carriers until two years after costs are incurred.¹⁰ This period can be less than two years if quarterly updates are filed.¹¹

⁵ *Id.*

⁶ See 47 C.F.R. § 36.611.

⁷ See generally Federal-State Joint Board on Universal Service, *Report and Order*, CC Docket No. 96-45, FCC 97-157, 12 FCC Red 8776 (re), May 8, 1997) (*Universal Service Order*).

⁸ *Id.* at 8942-43, para. 308.

⁹ See 47 C.F.R. §§ 36.611 and 36.612.

¹⁰ For example, on June 30, 1996, incumbent LECs submitted 1995 cost data that was used to determine their 1997 high cost support. Thus, there is a two-year lag between when costs are incurred (1995) and receipt of high cost support (1997).

¹¹ See 47 C.F.R. § 36.612.

Federal Communications Commission

DA 98-127

III. PETITION AND COMMENTS

5. *Petition.* On August 29, 1996, the Division granted Fremont a study area waiver associated with Fremont's purchase of three rural Idaho exchanges from US West Communications, Inc. ("US West").¹² The study area waiver was granted based on Fremont's assertion that its planned upgrades would improve customer service and that the estimated increase in high cost loop support draw would not have a substantial adverse impact on the total universal service fund.¹³ Fremont states that, as a new incumbent LEC, it lacks the historical cost data upon which to base high cost loop support distributions and, therefore, requests a waiver of Sections 36.611 and 36.612 to permit it to receive immediate high cost loop support. In the absence of the requested relief, Fremont will not receive any high cost loop support revenues for up to two years as a result of the application of the high cost loop support distribution rules. As actual costs become known, Fremont proposes to provide documentation to NECA and to true up the payments it receives on a quarterly basis.¹⁴

6. Fremont argues that application of the Commission's rules in this instance would be contrary to the public interest because improvements to service quality and availability in its high cost rural service area cannot be achieved without immediate revenue recovery from the high cost loop support mechanism.¹⁵ Fremont states that it must replace or upgrade its switching equipment and that the plant it acquired from US West is antiquated and of insufficient capacity to provide service to existing customers requesting additional service or to any new customers.¹⁶

7. *Comments.* NTCA, the Idaho Commission, ITA, and ITC support Fremont's Petition. NTCA states that because Fremont plans to make needed improvements to service quality and availability via new digital switching equipment and replacement of antiquated outside plant in its existing service area, its requested waiver for immediate high cost loop support would further the Commission's goal of providing universal service.¹⁷ The Idaho Commission states that it is in the public interest to grant Fremont's request so that it might provide upgraded telecommunications services to its rural customers.¹⁸ ITA also supports the waiver as being in

¹² See Albion Telephone Co., Cambridge Telephone Co., Inc., Fremont Telcom Co., Midvale Telephone Exchange, Inc., Rockland Telephone Co., Inc., and US West Communications, Inc., Petition for Waivers of Sections 61.41(c)(2) and 69.3(e)(1) and the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, *Memorandum Opinion and Order*, 11 FCC Red 10138 (1996) (*Order*).

¹³ *Id.* at 10140.

¹⁴ *Petition* at 2.

¹⁵ *Id.* at 4.

¹⁶ *Id.* at 5.

¹⁷ NTCA comments at 2.

¹⁸ Idaho Commission comments at 1-3.

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the public interest, adding that the subject territory encompasses rugged terrain and suffers under extreme weather conditions that cause Idaho carriers to experience high costs in providing supported services.¹⁹ Finally, ITC states that, should the Commission deny the requested waiver, the only parties injured would be the customers, a result that would be contrary to the goals of universal service.²⁰

8. In reply, Fremont contends that because it is serving an isolated, high cost area that is not currently included in existing high cost loop support mechanisms, it should, in accordance with the procedures set forth in the Commission's *Universal Service Order*, receive support based on an estimate of annual amounts of its embedded costs, as it requested.²¹

IV. DISCUSSION

9. Fremont began operations on November 15, 1996, providing local exchange service in three rural Idaho exchanges previously served by US West. Fremont, as a new company, has no historical cost data. Because the Commission's rules require calculation of high cost loop support disbursements to be based on historical cost data, Fremont would be precluded from receiving high cost loop support for up to two years.

10. Under Section 1.3 of our rules, we are required to grant waivers "if good cause therefor is shown."²² As interpreted by the courts, this requires that a petitioner demonstrate that "special circumstances warrant a deviation from the general rule and such a deviation will serve the public interest."²³

11. It has been long standing policy not to waive sections 36.611 and 36.612 of the Commission's rules.²⁴ In fact, we have granted waivers of these sections only when a requesting

¹⁹ ITA comments at 2-3.

²⁰ ITC comments at 3.

²¹ Fremont reply comments at 2.

²² 47 C.F.R. § 1.3.

²³ *Northeast Cellular Tel. Co. v. FCC*, 897 F.2d 1154, 1166 (D.C. Cir. 1990); *WALT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969); 47 C.F.R. § 1.3.

²⁴ See *GVNW Inc./Management for Declaratory Ruling*, or Alternatively, a Waiver of Section 36.612(a) of the Commission's Rules USF Data Collection, *Order*, 11 FCC Rcd 13915 (1996) and *TelAlaska Inc., and TelHawaii Inc., Petition for Waiver of Sections 36.611, 36.612, and 61.41(c)(2) and the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order*, 12 FCC Rcd 10309 (1997).

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carrier proposes to serve or is serving previously unserved areas.²⁵ Fremont does not assert any special circumstances affecting it that were not faced by any of the numerous rural telephone companies that have received study area waiver requests to obtain exchanges. As a result, Fremont fails to demonstrate the special circumstances that would support the grant of a waiver of sections 36.611 and 36.612.

12. We note that the Commission's high cost loop support distribution rules related to the sale and acquisition of exchanges have been in place for many years. In negotiating the purchase price of an exchange, therefore, it is incumbent upon the purchaser and the seller to take into consideration the necessary investments and future cash flows related to the sale. In fact, in its initial study area waiver petition, Fremont provided a description of its upgrades and extensions of service, but failed to provide detailed costs of the planned upgrades or proposed timetables for the upgrades.²⁶ Furthermore, Fremont made no claim that its planned upgrades would be burdened by the application of sections 36.611 and 36.612. Thus, Fremont could have, but failed, to request a waiver for immediate high cost loop support at its first opportunity to do so. Because high cost loop support receipts represent an important source of funds for the operation of an exchange with high loop costs, the acquiring company would undoubtedly negotiate a lower price for the exchange if the high cost loop support payments were delayed than it would be willing to pay if there were no delay. Because the selling company and the buying company negotiate the transfer of an exchange with full knowledge of the Commission's rules that apply to the transaction, we see no reason to waive the rules to compensate the buying company further. In the case at hand, allowing Fremont to receive immediate high cost loop support would result in support for US West and for Fremont for the same exchanges.²⁷ Consequently, we conclude that Fremont's request for immediate high cost loop support must be denied.

13. We also reject Fremont's assertion that the Commission's new universal service rules set forth procedures that would allow Fremont to receive high cost loop support immediately. In the paragraph of the *Universal Service Order* that Fremont uses to support this contention, the Commission stated that any carrier serving an insular area that is not currently included in the existing universal service mechanism, shall receive support based on an estimate

²⁵ See *Border to Border Communications, Inc., Petition for Waiver of Sections 36.611 and 36.612 of the Commission's Rules, Memorandum Opinion and Order*, 10 FCC Rcd 5055 (1995) and *South Park Telephone Company, Petition for Waiver of Sections 36.611 and 36.612 of the Commission's Rules, Order*, AAD 97-41, DA 97-2730 (rel. December 31, 1997).

²⁶ See *Fremont Telecom Co., Expedited Joint Petition for Waiver*, AAD 96-49 at Attachment B3, p. 2 (April 11, 1996). Fremont proposed to install a digital host switch and digital remote switches to support new services such as CLASS services and access to the Internet; replace and upgrade outside plant facilities; install fiber between host and remote switches; and extend telephone service to unserved exchange subdivisions.

²⁷ During the two-year lag, acquired exchanges continue to be associated with the selling LEC's study area and the USF payments continue to go to the selling LEC.

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of annual embedded amount of their embedded costs.²⁴ Fremont may be located in landlocked Idaho, but Idaho is clearly not considered an "insular area."²⁵ We thus find the cited Universal Service Order paragraph completely inapplicable to Fremont.

V. ORDERING CLAUSE

14. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), 5(c), 201, 202, 218-220, and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 155(c), 201, 202, 218-220, 205, and 254, and Sections 1.3, 0.91, and 0.291 of the Commission's rules, 47 C.F.R. §§ 1.3, 0.91, and 0.291 that the Petition of Fremont Telcom Co., for Waiver of Sections 36.611 and 36.612 of the Commission's rules, 47 C.F.R. §§ 36.611 and 36.612, IS DENIED.

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Kenneth P. Moran

Kenneth P. Moran
Chief, Accounting and Audits Division

²⁴ See Universal Service Order at para. 318.

²⁵ See Universal Service Order at paras. 410-423 noting insular areas such as the Pacific Island territories and commonwealths (Guam, American Samoa, and Commonwealth of the Northern Mariana Islands), U.S. Virgin Islands, and Puerto Rico. See also, e.g., 16 U.S.C. § 1802(30) (providing for conservation and management of the United States' fishery resources and defining "Pacific Insular Area" as American Samoa, Guam, the Northern Mariana Islands, Baker Island, Howland Island, Jarvis Island, Johnston Atoll, Kingman Reef, Midway Island, Wake Island, or Palmyra Atoll, and including all islands and reefs appurtenant to such islands, reefs, or atolls); 16 U.S.C. § 2503(k) (defining, for the purposes of the urban park and recreation recovery program, "insular areas" as Guam, the Virgin Islands, American Samoa, and the Northern Mariana Islands); 42 U.S.C. § 5204 (providing for disaster relief for insular areas and defining them as American Samoa, the Federated States of Micronesia, Guam, the Marshall Islands, the Northern Mariana Islands, the Trust Territory of the Pacific Islands, and the Virgin Islands as insular areas); 48 U.S.C. § 1469a (congressional declaration of policy regarding insular areas for certain grant-in-aid programs and defining them as the U.S. Virgin Islands, Guam, American Samoa, the Trust Territory of the Pacific Islands, and the Government of the Northern Mariana Islands); 48 U.S.C. § 1492 (congressional declaration of energy policy with respect to insular areas and defining them as Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, the Federated States of Micronesia, the Marshall Islands, and Palau). See also 47 C.F.R. § 2.105 (stating that the Caribbean insular areas comprise the Commonwealth of Puerto Rico, the unincorporated territory of the United States Virgin Islands, and Navassa Island, Quita Sueno Bank, Roncador Bank, Serrana Bank and Serranilla Bank; listing the Pacific insular areas in International Telecommunication Union Regions 2 and 3 as Johnston Island, Midway Island, the Commonwealth of the Northern Mariana Islands; the unincorporated territory of American Samoa; the unincorporated territory of Guam; and Baker Island, Howland Island, Jarvis Island, Kingman Reef, Palmyra Island, and Wake Island).

APPENDIX C

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matters of)

Petitions for Waiver and Reconsideration)
Concerning Sections 36.611, 36.612, 61.41(c)(2), 69.605(c),)
69.3(e)(11) and the Definition of "Study Area" Contained)
in Part 36 Appendix-Glossary of the Commission's Rules)
Filed by)

Copper Valley Telephone, Inc.; Midvale Telephone Exchange;)
Table Top Telephone Company; and US West)
Communications, Inc.)

AAD 95-93

and)

BEK Communications I, Inc.; CTC Communications, Inc.;)
Dakota Central Telecom I, Inc.; and West River)
Communications, Inc.)

AAD 95-72

and)

Champlain Valley Telecom, Inc. and Northland)
Telephone Company of Vermont)

AAD 95-50

and)

Table Top Telephone Company)

AAD 97-21

and)

Midvale Telephone Exchange)

AAD 97-23

and)

BEK Communications I, Inc.; CTC Communications, Inc.;)
Dakota Central Telecom I, Inc.; Dickey Rural Communications,)
Inc.; Dickey Rural Telephone Cooperative; Gilby Telephone)
Company; Griggs County Telephone Company;)

AAD 97-117

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Inter-Community Telephone Company II, Inc.; Moore & Liberry)
 Telephone Company; Northwest Communications)
 Cooperative; Red River Telecom, Inc.; RTC II, Inc.;)
 Turtle Mountain Communications, Inc.; US West)
 Communications, Inc.; United Telephone Mutual Aid)
 Cooperative; West River Communications, Inc.; and York)
 Telephone Company)

and)

Tularosa Basin Telephone Company)

AAD 98-44

and)

Sanborn Telephone Cooperative; Sancom, Inc.;)
 Stockholm-Strandburg Telephone Company; Sully Buttes)
 Telephone Cooperative, Inc.; Valley Cable & Satellite)
 Communications, Inc.; Valley Telecommunications)
 Cooperative Association, Inc.; and Venture)
 Communications, Inc.)

and)

Albion Telephone Company; BPS Telephone Company, Inc.;)
 Cambridge Telephone Co., Inc.; Fremont Telecom; Leaco Rural)
 Telephone Cooperative, Inc.; Midvale Telephone Exchange,)
 Inc.; Rockland Telephone Company, Inc.; South Central)
 Communications, Inc.; Table Top Telephone Co., Inc.; Tularosa)
 Basin Telephone Company, Inc.; United Utilities, Inc.; and)
 West River Telephone Cooperative, Inc.)

AAD 98-53

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**MEMORANDUM OPINION AND ORDER
ON RECONSIDERATION**

Adopted: September 9, 1999

Released: September 9, 1999

By the Common Carrier Bureau:

I. INTRODUCTION

1. In this Order, we address petitions for waiver and petitions for reconsideration of previous study area waiver orders filed separately by the above-captioned petitioners (collectively, "petitioners").¹ Petitioners raise two common issues: (a) whether the Commission should remove the individual caps that were placed on petitioners' high cost loop support; and (b) whether petitioners should be allowed to create study areas separate from their affiliates' existing study areas for newly acquired exchanges. Champlain and Northland also request that the effective date of their study area waiver requests be made retroactive. In this Order, we grant in part petitioners' requests to lift the individual caps placed on their high cost loop support and deny petitioners' requests to establish study areas separate from their affiliates' existing study areas. In addition, we grant the requests of Champlain and

¹ Copper Valley Telephone, Inc., Midvale Telephone Exchange, Table Top Telephone Company, and US West Communications, Inc., Petition for Reconsideration, AAD 93-93 (March 23, 1995) and Copper Valley Telephone, Inc., Amended Petition for Clarification and/or Reconsideration, AAD 93-93 (May 21, 1999) ("*Copper Valley*"); BEK Communications I, Inc., CTC Communications, Inc., Dakota Central Telecom I, Inc., and West River Communications, Inc., Petition for Reconsideration, AAD 95-72 (May 19, 1995) ("*BEK*"); Champlain Valley Telecom, Inc., and Northland Telephone Company of Vermont, Petitions for Reconsideration, AAD 95-30 (July 15, 1996) ("*Champlain*," and "*Northland*"); Table Top Telephone Company, Petition for Waiver, AAD 97-21 (December 23, 1996) ("*Table Top*"); and Midvale Telephone Exchange, Petition for Waiver, AAD 97-23 (January 16, 1997) ("*Midvale*"); BEK Communications I, Inc.; CTC Communications, Inc.; Dakota Central Telecom I, Inc.; Dickey Rural Communications, Inc.; Dickey Rural Telephone Cooperative; Gilby Telephone Company; Griggs County Telephone Company; Inter-Community Telephone Company II, Inc.; Moore & Liberty Telephone Company; Northwest Communications Cooperative; Red River Telecom, Inc.; RTC II, Inc.; Turtle Mountain Communications, Inc.; US West Communications, Inc.; United Telephone Mutual Aid Cooperative; West River Communications, Inc.; and York Telephone Company, Expedited Request for Elimination or Modification of Waiver Conditions, AAD 97-117 (December 22, 1997) ("*CTC*"); Tularosa Basin Telephone Company, Expedited, AAD 98-44 (February 27, 1998) ("*Tularosa*"); Sanborn Telephone Cooperative; Sancom, Inc.; Stockholm-Strandburg Telephone Company; Sully Burnes Telephone Cooperative, Inc.; Valley Cable & Satellite Communications, Inc.; Valley Telecommunications Cooperative Association, Inc.; and Venture Communications, Inc., Conditional Request to Raise Universal Service Caps, AAD 98-48 (March 27, 1998) ("*Sanborn*"); Albion Telephone Company; BPS Telephone Company, Inc.; Cambridge Telephone Co., Inc.; Fremont Telecom; Leaco Rural Telephone Cooperative, Inc.; Midvale Telephone Exchange, Inc.; Rockland Telephone Company, Inc.; South Central Communications, Inc.; Table Top Telephone Co., Inc.; Tularosa Basin Telephone Company, Inc.; United Utilities, Inc.; and West River Telephone Cooperative, Inc., Petition for Expedited Elimination or Modification of Waiver Conditions, AAD 98-53 (April 3, 1998) ("*Albion*").

Northland to change the effective date of their study area waivers.

II. NEED FOR CAPS ON HIGH COST LOOP SUPPORT IN INDIVIDUAL STUDY AREA WAIVER ORDERS

A. Introduction

2. In these petitions, several carriers have asked the Common Carrier Bureau (Bureau) to remove the individual caps placed on their high cost loop support. As discussed below, we grant in part petitioners' requests.

B. Background

3. All of petitioners' requests involve issues related to study area waiver requests. A study area is a geographic segment of an incumbent local exchange carrier's (LEC's) telephone operations. Generally, a study area corresponds to an incumbent LEC's entire service territory within a state. Thus, incumbent LECs operating in more than one state typically have one study area for each state, and incumbent LECs operating in a single state typically have a single study area. Study area boundaries are important because incumbent LECs perform jurisdictional separations, determine high cost loop support amounts, and generally tariff their rates at the study area level. Effective November 15, 1984,² the Commission froze all study area boundaries. The purpose of the freeze was to enable the Commission to ensure that policy decisions made in significant reliance on the number and size of existing study areas were not significantly undercut by study area boundary changes. For instance, existing federal high cost support mechanisms are based on the level of study-area-wide averaged cost, in effect requiring low cost regions within a study area to support high cost regions within that study area. The study area freeze was to help ensure that incumbent LECs did not undermine this decision by setting up high-cost exchanges within their existing service territories as separate study areas in order to increase interstate cost allocations, and therefore their high cost support.³ An incumbent LEC must apply to the Commission for a waiver of the frozen study area rule if it wishes to sell or purchase an exchange and if that transaction would change the study area boundaries of either the seller or

² 47 C.F.R. Part 36 app. (defining "study area"). See MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, *Recommended Decision and Order*, 49 Fed. Reg. 48325 (1984) ("1984 Joint Board Recommended Decision"); *Decision and Order*, 50 Fed. Reg. 939 (1985) ("1985 Order Adopting Recommendation"), see also Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Notice of Proposed Rulemaking*, 5 FCC Rcd 5974 (1990) ("Study Area Notice").

³ *Id.*

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the buyer.⁴

4. Consistent with the reasons for the 1984 study area freeze, the Commission has been concerned from the beginning about the potential adverse impact of waivers on the high cost loop support mechanism. This was an important concern in acquisitions because, when a low-cost carrier sold a high-cost exchange, the acquiring carrier could substantially increase its high cost loop support by including the new exchange in its study area, without a corresponding reduction in the low-cost carrier's support.⁵ This concern was heightened in the early 1990's when large, low-cost, incumbent LECs began to sell substantial numbers of high-cost exchanges to smaller incumbent LECs.⁶ The Bureau subsequently began to condition individual grants of study area waiver requests with caps on the high cost loop support drawn by those requesting incumbent LECs.⁷ Specifically, study area waivers were granted subject to the condition that, absent explicit approval from the Bureau, the annual high cost loop support provided to the acquiring carrier's study area could not exceed the amounts specified in their waiver petitions. This practice was established to prevent carriers from: (1) underestimating the effects the waiver may have on the high cost loop support mechanism in order to increase the chances that the waiver would be granted; and (2) then revising the cost figures upward, once the waiver was granted, thereby increasing the high cost loop support substantially.

C. Petitions

5. *Petitions for Reconsideration.* Copper Valley seeks reconsideration of the Accounting and Audits Division's (Division's) decision to deny its request to remove a cap on its high cost loop support.⁸ Champlain and Northland (filing separately) also urge reconsideration of the Division's decision to place a cap on the amount of high cost loop

⁴ 47 C.F.R. § 1.3, Part 36 app.

⁵ The selling carrier's support might not be reduced, for instance, because it may not have been receiving high-cost support before the sale. Because high-cost support was based on costs averaged throughout a study area, a carrier easily could be low-cost for a particular study area where it was operating several low-cost exchanges and a few high-cost exchanges.

⁶ Since 1992, GTE has sold 95 exchanges serving 75,895 access lines and US West has sold 462 exchanges serving 346,130 access lines.

⁷ See in the Matter of Nevada Bell and Oregon-Idaho Utilities, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, *Memorandum Opinion and Order*, 9 FCC Rcd 5236 (1994).

⁸ *Copper Valley* at 5.

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support that may be received.⁷

6. *Petitions for Waiver.* CTC,¹⁰ Sanborn,¹¹ and Albion,¹² Midvale, Table Top, and Tularosa¹³ filed petitions for waiver requesting removal of the cap placed on their high cost loop support.¹⁴

7. CTC, Albion, and Tularosa argue that the caps on their high cost loop support were superseded by the rules announced in the Commission's *Universal Service Order*.¹⁵ In the alternative, should the Commission elect to keep the caps in place, petitioners contend that the individual caps should be modified to reflect the submission of more accurate and relevant data regarding their costs of providing service.¹⁶

8. Midvale and Table Top claim that the caps placed on their high cost support are particularly unreasonable because their caps were based on the "initial post transfer amount" rather than following the completion of upgrades. Copper Valley requests that the Commission clarify that the cap placed on their high cost support applies only to increases in support directly associated with the acquisition of exchanges and not to the overall support for

⁷ *Champlain* at 6; *Northland* at 5.

¹⁰ The carriers requesting modification of the waiver conditions in the CTC petition are BEK Communications Cooperative and BEK Communications I, Inc.; Consolidated Telephone Cooperative and CTC Communications, Inc.; Dakota Central Telecommunications Cooperative and Dakota Central Telecom I, Inc.; Inter-Community Telephone Company and Inter-Community Telephone Company II, Inc.; and Reservation Telephone Cooperative.

¹¹ The carriers requesting modification of the waiver conditions in the Sanborn petition are Sanborn Telephone Cooperative; Sancom, Inc.; Stockholm-Strandburg Telephone Company; Sully Buttes Telephone Cooperative, Inc.; Valley Cable & Satellite Communications, Inc.; Valley Telecommunications Cooperative Association, Inc.; and Venture Communications, Inc.

¹² The carriers requesting modification of waiver conditions in the Albion petition are Albion Telephone Company; BPS Telephone Company, Inc.; Cambridge Telephone Co., Inc.; Fremont Telecom; Leaco Rural Telephone Cooperative, Inc.; Midvale Telephone Exchange, Inc.; Rockland Telephone Company, Inc.; South Central Communications, Inc.; Table Top Telephone Co., Inc.; Tularosa Basin Telephone Company, Inc.; United Utilities, Inc.; and West River Telephone Cooperative, Inc.

¹³ Midvale, Table Top, and Tularosa filed separate petitions in conjunction with their inclusion in the Albion petition.

¹⁴ *Table Top* at 2; *Midvale* at 2; *CTC* at 2; *Tularosa* at 5; *Sanborn* at 1; *Albion* at 1.

¹⁵ *CTC* at 3-4; *Tularosa* at 5; *Albion* at 6.

¹⁶ *CTC* at 5; *Tularosa* at 11-12; *Albion* at 4-5; *Sanborn* at 5.

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the study area.¹⁷ Champlain, Northland, CTC, and Sanborn argue that the limits on high cost loop support are arbitrary or unfairly discriminatory.¹⁸

D. Discussion

9. As stated above, the Commission has long been concerned about the potential adverse impact study area waivers could have on the high cost loop support mechanism. To monitor this impact, carriers that received study area waivers to account for the acquisition of new exchanges were required to submit an estimation of the amount of money they would be eligible to receive from the high cost loop support mechanism following the completion of necessary and planned upgrades in the new study area. Those estimates were then used to establish a cap, limiting the carrier's draw from the high cost loop support mechanism. Absent such caps, we found that, even in a period of a few years, payments from the high cost loop support mechanism for some incumbent LECs rose by unexpected amounts.¹⁹ The Commission's concern about adverse impacts on the high cost loop support mechanism has been of particular importance since it adopted the Joint Board's recommendation for an overall indexed cap on the high cost loop support mechanism.²⁰ Because of the operation of the indexed cap, any study area reconfiguration that increases the high cost loop support of

¹⁷ *Copper Valley* at 12.

¹⁸ *Champlain* at 15-16; *Northland* at 4-5; *CTC* at 11; *Sanborn* at 10.

¹⁹ See *Delta Telephone Co., Inc., Petition for Waiver of the Definition of "Study Area" in Part 36 Appendix-Glossary of the Commission Rules, Memorandum Opinion and Order*, 5 FCC Rcd 7100 (1990) (high cost loop support payments grew from \$82,500 in 1991 to \$445,700 in 1993); *US West and Gila River Telecomm., Inc., Petition for Waiver of the Definition of "Study Area" in Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order*, 7 FCC Rcd 2161 (1992) (Gila River estimated 1992 high cost support would be \$169,155, yet actual 1992 payment was \$390,993, and the 1995 payment was approximately \$750,000).

²⁰ The Joint Board recommended, and the Commission adopted, interim rules that limit the rate of growth of the high cost loop support mechanism to the rate of growth in the total number of working loops nationwide. See generally Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Recommended Decision*, 9 FCC Rcd 334 (Joint Bd. 1993) ("*1993 Joint Board Recommended Decision*") *id.*, *Report and Order*, 9 FCC Rcd 305 (1993) ("*Interim Cap Order*"). The Commission extended these interim rules through July 1, 1996. Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Report and Order*, 11 FCC Rcd 1077 (1995), summarized in 60 Fed. Reg. 65011 (1995). Recently, the Joint Board recommended, and the Commission adopted, an extension of the interim cap rules on the USF until the final universal service rules become effective. Federal-State Joint Board on Universal Service, *Recommended Decision*, CC Docket No. 96-45, released June 19, 1996 ("*1996 Joint Board Recommended Decision*"); *id.*, *Report and Order*, FCC 96-281, released June 26, 1996 ("*Extension of Interim Cap Rules*").

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one recipient often reduces that of other recipients.²¹ Although the concerns that prompted the Commission to impose these caps persist, we conclude that limiting the duration of these caps is appropriate. We therefore remove the caps on petitioners' high cost support on a going-forward basis.

10. We conclude that limiting the petitioners to the high cost loop support estimated in their original petitions, in perpetuity, is not necessary to accomplish the policies outlined above. We also believe that caps of unlimited duration may hinder petitioners' incentive and ability to extend service to previously unserved areas, as well as to upgrade service to their existing customers. We therefore find that the annual caps placed on petitioners' high cost loop support should be removed. Thus, as of January 1, 2000, petitioners' high cost loop support will be based upon the average cost of all their lines. We note that the caps imposed on petitioners' high cost loop support have been in effect in excess of three years.²² We have concluded that, in that time, the individual caps placed on the carriers' high cost loop support have served their purpose by preventing the carriers from underestimating the effect the transfer of exchanges would have on the high cost loop support

²¹ In evaluating whether a study area change would have an adverse impact on the distribution or level of the universal service fund ("USF"), the Commission has applied a "one-percent" guideline to study area waivers filed after January 5, 1995. Under this guideline, no study area waiver is granted if it would result in an annual aggregate shift in USF assistance in an amount equal to or greater than one percent of the total USF, unless the parties can demonstrate extraordinary public interest benefits. To prevent carriers from evading this limitation by disaggregating a single large scale of exchanges into a series of smaller transactions that in the aggregate have the same effect on the USF, the Commission has further required that the "one-percent" guideline be applied to all exchange transfers where either carrier has been a party as a purchaser or seller and where a study area waiver request was submitted and granted within the previous twelve months. See *US West Communications, Inc. and Eagle Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 10 FCC Rcd 1771 (1995) ("US West-Eagle Order")*; *US West Communications, Inc. and Eagle Telecommunications, Inc., Joint Petition for Waiver of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules and Petition for Waiver of Section 61.41(c) of the Commission's Rules, Memorandum Opinion and Order on Reconsideration, 12 FCC Rcd 4645 (1997)*.

²² See *Copper Valley Telephone, Inc., et al. Petition for Waiver of the Definition of "Study Area" in Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 10 FCC Rcd 3373 (1996)*; *Champlain Valley Telecom, Inc., et al. Petition for Waiver of the Definition of "Study Area" in Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 11 FCC Rcd 7111 (1996)*; *BEK Communications I, Inc., Albion Telephone Company, et al. Petition for Waiver of the Definition of "Study Area" in Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 11 FCC Rcd 10855 (1996)*; and *Sanborn Telephone Cooperative, et al. Petition for Waiver of the Definition of "Study Area" in Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 11 FCC Rcd 11513 (1996)* (orders implementing caps on petitioners' high cost loop support). In *JBN Telephone*, the Accounting and Audits Division imposed a cap on JBN's high cost support but only for a three year period following the transfer. *J.B.N. Telephone Company, Inc. and United Telephone Company of Eastern Kansas; Concerning Section 61.41(c)(2) and the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, AAD 95-174, 11 FCC Rcd 8619, at para. 12 (1996)*.

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mechanism immediately following the transfer. In addition, we believe that lifting the caps on petitioners' high cost support may increase their incentive and ability to extend service to previously unserved areas²⁷ and upgrade their networks.²⁸

11. Although we have concluded that we should eliminate the caps placed on the petitioners' high cost loop support, we conclude we should not do so retroactively. We disagree with CTC, Tularosa, Sanborn, and Albion's contention that the new universal service rules effectively eliminate the caps placed on their high cost loop support. In the *Universal Service Order*, which was adopted on May 8, 1997, the Commission determined that a carrier that had entered into a binding commitment to buy exchanges prior to May 7, 1997 would receive support for the newly acquired lines based upon an analysis of the average cost of all its lines, both those acquired and those served prior to the acquisition.²⁹ It is important to note that this rule merely codified the general rule that carriers receive support based on the average cost of all their lines. Moreover, by its terms, this rule applies only to transactions that were pending when the *Universal Service Order* was adopted. It does not apply to transactions that were completed prior to May 7, 1997.³⁰ In particular, it did not eliminate the caps that were conditions on the approval of petitioners' study area waivers.

12. We also disagree with Copper Valley's contention that the Bureau intended only to limit the high cost support that is directly associated with the acquired exchanges and not to the entire study area. Copper Valley cites two Bureau orders to support its

²⁷ The Commission's commitment to ensuring service in unserved areas is reflected in the recent release of a Notice Of Proposed Rulemaking which seeks comment on ways to promote the deployment of facilities to unserved and underserved areas and to provide the support necessary to increase subscriberhip in these areas. See generally, *Federal-State Joint Board on Universal Service: Promoting Development and Subscriberhip in Unserved Areas, Including Tribal and Insular Areas, Further Notice of Proposed Rulemaking*, CC Docket No. 96-45, FCC 99-204 (rel. Sept. 3, 1999).

²⁸ See Letter from Kenneth C. Johnson, on behalf of Tularosa Basin Telephone Company, to Magalie Roman Salas, FCC, dated Apr. 7, 1999 (Tularosa Apr. 7 *ex parte*) at 1-2.

²⁹ *Federal-State Joint Board on Universal Service, First Report and Order*, CC Docket No. 96-45, 12 FCC Rod 8776, 8943, para. 308 (1997), *affirmed in part, remanded in part and reversed in part*, Texas Office of Util. Counsel, No. 97-60421 (5th Cir. Jul. 30, 1999) (*Universal Service Order*); 47 C.F.R. § 54.305. Where a carrier enters into a binding commitment to buy exchanges after May 7, 1997, the carrier will receive universal service support for the acquired exchanges at the same per-line support for which those exchanges were eligible prior to the transfer of the exchanges. 47 C.F.R. § 305.

³⁰ Even for a transaction covered by the rule, the Commission is not precluded from imposing a cap as a condition on the approval of a study area waiver.

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contention.²⁷ In both decisions, the Bureau granted study area waivers "subject to the condition that any high cost support increase associated with the sale"²⁸ not exceed the amounts estimated by the respective petitioners. In those cases, the Bureau's use of the phrase "associated with the sale" is alternative language used to describe the condition limiting high cost support increases to "post-transfer" or "post-upgrade" amounts estimated by petitioners for study area waivers. Copper Valley, therefore, misinterprets the Bureau's use of the phrase as applying only to its acquired exchanges. In support of this interpretation, Copper Valley notes that since it has demonstrated that it would not qualify for high cost support if its acquired exchanges were established as a separate study area, its consolidation need not limit overall high cost support for the new study area. We disagree. Because Copper Valley must consolidate the acquired exchanges with its affiliate's study area, it is reasonable that the imposed limits be based on the high cost support estimates for operations within that study area. This condition, that high cost support shall not exceed the initial post-transfer amounts specified in their petition,²⁹ therefore, is consistent with the conditions the Bureau has placed on other grants of study area waivers.³⁰

13. Similarly, we reject Champlain, Northland, CTC, and Sanborn's further claim that the caps on their high cost loop support are unfair and discriminatory because telephone companies that do not participate in acquisitions are able to upgrade their networks and outside plant, receiving increased high cost loop support, if necessary.³¹ We are not persuaded by that argument. The caps on petitioners' high cost support were based on petitioners' own estimates of their need for high cost support. Moreover, we believe that Champlain, Northland, CTC, and Sanborn are distinguishable from other carriers that have not participated in acquisitions of exchanges. Because high cost loop support depends on study area average loop cost, upgrading the exchanges after they have been transferred will result in a higher level of high cost support than would occur if the upgrading had been performed instead by the sellers. As a result, those transactions tend to have a negative effect on the support available to other recipients pursuant to the overall indexed cap on the high cost mechanism.

²⁷ See GTE Midwest, Inc. and Winnebago Cooperative Telephone Association, *Memorandum Opinion and Order*, 9 FCC Rcd 7789 (1994) and GTE Southwest, Inc. and Pioneer Telephone Cooperative, Inc., *Memorandum Opinion and Order*, 9 FCC Rcd 7785 (1994).

²⁸ *Id.*

²⁹ *Copper Valley* at 7-8.

³⁰ See Farmers Mutual Telephone Company; Project Mutual Telephone Cooperative Association Inc. and US West Communications, Inc., Petition for Waiver of Section 61.41(c) and the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, *Memorandum Opinion and Order*, 11 FCC Rcd 9380, 9385, para. 15 (1996).

³¹ *Champlain* at 15-16; *Northland* at 4-5; *CTC* at 11; *Sanborn* at 10.

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14. Although petitioners were invited to request an increase in their caps, we conclude that petitioners have not demonstrated that complete retroactive removal of their caps is warranted. At the time the caps were imposed, it was contemplated that petitioners would be upgrading their exchanges. Petitioners' assertions that these upgrades have been more costly than they anticipated emphasize the need for the caps imposed on their support. We conclude that the "unforeseen conditions" alleged by petitioners could have been discovered through due diligence and investigation before the exchanges were acquired.

15. Similarly, we reject Midvale and Table Top's contention that their caps warrant modification because the caps were based on the "initial post transfer amount" rather than following the completion of upgrades. In its original study area waiver petition, Table Top estimated that its high cost support for its study area would be \$219,300 as a result of its acquisition and *upgrade* of five new exchanges.³² Similarly, Midvale estimated in its original petition that its annual high cost support would decrease as a result of its acquisition and *upgrade* of a singular exchange.³³ The limits on high cost support imposed by the caps, therefore, are consistent with Midvale and Table Top's representations in their original petitions that their projections of high cost support included the completion of upgrades. We conclude, therefore, that the decision to limit Midvale and Table Top's high cost support based on post-transfer amounts is equivalent to similar limitations in other orders based on post-upgrade amounts.

16. For the reasons stated above, we grant petitioners' requests to remove the individual caps imposed on their high cost loop support. As of January 1, 2000, petitioners' high cost loop support will be based upon the average cost of all their lines.

III. SEPARATE STUDY AREAS

A. Introduction

17. In this proceeding, petitioners have asked the Bureau to allow them to create new study areas for newly acquired exchanges separate from their existing study areas in a state. As previously explained, a study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to a carrier's entire service area within a state. Study area boundaries are important because incumbent LECs perform jurisdictional separations, determine high cost loop support amounts, and generally tariff their rates at the study area level. In addition, as stated earlier, the Commission adopted the rule freezing

³² See Copper Valley Telephone, Inc., Midvale Telephone Exchange, and Table Top Telephone Company, Joint Petition for Waiver of the Definition of "Study Area" contained in Part 36, Appendix-Glossary of the Commission's Rules, *Memorandum opinion and Order*, 10 FCC Rcd 3373, 3374 (1995).

³³ *Id.*

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study area boundaries, effective November 15, 1984.²⁴

B. Petitions

18. *Petitions for Reconsideration.*²⁵ Copper Valley seeks reconsideration of the Division's decision to deny its request to establish separate study areas for Arizona exchanges acquired from US West. Similarly, BEK, CTC, Dakota, and West River seek reconsideration of the Division's decision to deny their request to establish separate study areas for North Dakota exchanges acquired from US West. Instead, the Division required the companies to consolidate the exchanges with their respective parents' existing North Dakota study areas. Petitioners claim that the decisions to deny requests for separate study areas for newly acquired exchanges were founded on criteria that have no basis in fact or law,²⁶ and contradict Commission precedent and established study area waiver standards.²⁷

C. Discussion

19. Both the study area definition and the high cost loop support rules were initiated by the *1984 Joint Board Recommended Decision*, and their creation and the concerns they reflect are intertwined.²⁸ Because it is administratively infeasible to calculate the precise cost of providing service to each customer in a service area, and because rate averaging and the absence of competition generally have allowed it, the cost of providing service is calculated by study area, and the total cost of providing service in that area is averaged over the number of customers in that area.²⁹ This average cost provides the basis for calculating high cost loop support in that area. Because high cost loop support is calculated based on study area data, freezing study area boundaries was implemented as a means of controlling

²⁴ See para. 3, *supra*.

²⁵ On January 14, 1999, Waitfield-Fayson Telephone Company, Inc. (Waitfield) filed a petition requesting to withdraw a portion of the Petition for Reconsideration of Champlain Valley Telecom, Inc. (Champlain) filed on July 15, 1996. Because Champlain has since merged into Waitfield, Waitfield seeks a withdrawal of Champlain's request for separate study areas for the two carriers. Because this issue is rendered moot by the merger, we grant Waitfield's request for withdrawal.

²⁶ *Copper Valley* at 17; *BEK* at 4.

²⁷ *Copper Valley* at 12-13, 18-19 and *BEK* at 2-3.

²⁸ The rule section regarding the DEM (dial equipment minutes) allocator that allows very small companies to triple their assignment to the interstate jurisdiction is also an intrinsic part of this program. See generally *1984 Joint Recommended Decision*; see also 47 C.F.R. § 36.125.

²⁹ These calculations are performed by carriers that submit this data to NECA, which, in turn, submits it to the Commission as part of its duties pursuant to part 36 of our rules. See generally 47 C.F.R. § 36.601 *et seq.*

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unreasonable growth of the high cost loop support mechanism.

20. Specifically, the rule freezing study area boundaries was adopted to prevent carriers from inflating interstate cost allocations by establishing separate high cost exchange study areas in states within their service territories.⁴⁰ Allowing new, separate study areas, therefore, is counter to the reasons for freezing study area boundaries. For Copper Valley and BEK, the creation of new study areas would enable them to avoid reductions in their annual high cost loop support draws that would occur if the low-cost exchanges were consolidated with their high cost study areas, thereby frustrating the intent of the study area freeze rule and undermining the Commission's determination that high cost loop support should be based on carrier's entire service territory or study area within a state. Such a course could encourage disaggregation of study areas, thereby shifting high cost loop support among carriers and adding unnecessary complexity to the regulatory process.

21. Because the Commission decided to set high cost support levels at the study area level, and thereby require the averaging of costs within the service territory/study area in a state, we find that the consolidation of study areas located within the same state, not the disaggregation of such areas, is the type of study area reconfiguration consistent with the public interest.⁴¹

22. In addition, as stated above, the Commission's concern about adverse impacts on the high cost loop support mechanism has been of particular importance since it adopted the Joint Board's recommendation for an indexed cap on the high cost loop support mechanism. Because of the operation of the indexed cap, any study area reconfiguration that increases the high cost loop support of one recipient often reduces that of other recipients. This benefit to one carrier at the disadvantage of another may also seriously impact the integrity of the network. Finally, the Commission recognized that, even in the short term, the granting of a study area waiver may adversely affect the distribution of high cost loop support, if not its size.

⁴⁰ See 1984 Joint Board Recommended Decision, 49 Fed. Reg. at 48325; 1985 Order Adopting Recommendation, 50 Fed. Reg. at 939.

⁴¹ See US West Communications, Inc. and Range Telephone Cooperative, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Order on Reconsideration, 10 FCC Red at 13270 (1995) ("US West-Range Recon Order"); ALLTEL Service Corporation, Petition for Waiver of the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 9 FCC Red 4450, 4451 (1994); ALLTEL Service Corporation, Petition for Waiver of the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 8 FCC Red 6411 at para. 6 (1993); Study Area Notice, 5 FCC Red at 5975-5976; 1984 Joint Board Recommendation, 49 Fed. Reg. at 48340; 1985 Order Adopting Recommendation, 50 Fed. Reg. at 939.

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23. We disagree with the petitioners' claims that Commission precedent requires us to permit the creation of separate study areas.⁴² The cases cited by petitioners do not persuade us under these circumstances because of what has happened since those waivers were granted. Specifically, the decisions cited occurred before the Bureau became aware of the magnitude of the potential cumulative effect of other similar waiver grants affecting hundreds of exchanges. The increased number of sales of exchanges that occurred at that time increased our concern that such transactions, in the aggregate, would have a substantial impact on the high cost loop support mechanism. Thus, we must carefully consider how a grant of a separate study area is consistent with the intent and purposes that underlie Commission rules and whether a grant would be in the public interest. We therefore reject Copper Valley's assertion that we are obligated to permit the creation of separate study areas because of the decisions they cited.

24. For the reasons stated above, we affirm the Division's denials of petitioners' requests to establish study areas separate from their affiliates' existing study areas.

IV. OTHER ISSUES

25. *Study Area Effective Date.* Champlain and Northland request that the carriers' study area changes be made effective on January 1, 1996, instead of June 14, 1996, the release date of the *Memorandum Opinion and Order* granting the study area waivers.⁴³ In support of their requests, Champlain and Northland state that without retroactive approval, they will be forced to conduct additional burdensome cost studies and would suffer a drastic reduction in interstate revenue requirements.⁴⁴ We find that these two carriers have

⁴² See *Copper Valley* at 14-19 (citing Division decisions allowing incumbent LECs to establish a second study area as support for allowing separate study areas in the current proceeding). See *US West Communications, Inc., Central Utah Telephone, Bear Lake Communications, Joint Petition for Waiver of Sections 61.41(c) and 69.3(e)(11) and the Definition of "Study Area" Contained in the Part 36 of Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order*, 9 FCC Red 194 (1993); *US West Communications Inc., Blackfoot Telephone Cooperative, Clark Fork Telecommunications, Inc., Triangle Telephone Cooperative Association, Inc., and Central Montana Communications, Inc., Joint Petition for Waiver of Sections 61.41(c) and 69.3(e)(11) and the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order*, 9 FCC Red 202 (1993); and *Nevada Bell and Oregon-Idaho Utilities, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in the Part 36 of Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order*, 9 FCC Red 5236 (1994). See also *BEK* at 2-4 (contending that it should be permitted to establish separate study area because disaggregation would not have an adverse effect on the high cost loop support program, particularly in light of the considerations emphasized by the Bureau in previous study area waiver decisions).

⁴³ *Champlain* at 2; *Northland* at 6.

⁴⁴ *Id.*

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sufficiently supported their claim that an earlier effective date would be in the public interest and we therefore grant their requests. We note, however, that Champlain and Northland's requests for a change in the effective date of their study area waivers is granted only for the purposes contained in their petitions, that is to avoid a loss of interstate revenues associated with DEM weighting.⁴⁵

V. ORDERING CLAUSES

26. Accordingly, IT IS ORDERED, pursuant to Sections 4(i), 5(c), 201, 202, 219-220, and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 155(c), 201, 202, 218-220, 254 and Sections 1.3, 0.91, and 0.291 of the Commission's Rules, 47 C.F.R. §§ 1.3, 0.91, and 0.291, that the Petitions of Champlain Valley Telecom, Inc.; Copper Valley Telephone Inc.; Table Top Telephone Company, Midvale Telephone Exchange, Northland Telephone Company of Vermont, BEK Communications I, Inc.; et al, Tularosa Basin Telephone Company, Sanborn Telephone Cooperative, et al, and Albion Telephone Company requesting modifications to their existing cap on high cost loop support ARE GRANTED IN PART. As of January 1, 2000, these caps shall be removed and petitioners' high cost loop support shall be based on the average cost of all of their lines.

27. IT IS FURTHER ORDERED, pursuant to Sections 4(i), 5(c), 201, 202, 218-220, and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 155(c), 201, 202, 218-220, 254, and Sections 1.3, 0.91, and 0.201 of the Commission's rules, 47 C.F.R. §§ 1.3, 0.91, and 0.291, that the Petitions for Reconsideration requesting separate study areas filed by Copper Valley Telephone Inc.; BEK Communications I Inc.; CTC Communications, Inc.; Dakota Telecom I Inc.; and West River Communications, Inc., ARE DENIED.

28. IT IS FURTHER ORDERED, pursuant to Sections 4(i), 5(c), 201, 202, 219-220, and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 155(c), 201, 202, 218-220, 254 and Sections 1.3, 0.91, and 0.291 of the Commission's rules, 47 C.F.R. §§ 1.3, 0.91, and 0.291, that the Petitions of Champlain Valley Telecom, Inc. and Northland Telephone Company of Vermont requesting a change in the effective date of the grant of their study area waivers ARE GRANTED subject to the condition contained in paragraph 25.

29. IT IS FURTHER ORDERED, pursuant to Sections 4(i), 5(c), 201, 202, 219-220, and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 155(c), 201, 202, 218-220, 254 and Sections 1.3, 0.91, and 0.291 of the Commission's rules, 47 C.F.R. §§ 1.3, 0.91, and 0.291, that the Petition of Waitsfield-Fayston Telephone Company,

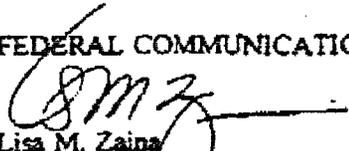
⁴⁵ Grant of this request shall not, for example, affect Champlain and Northland's high cost loop support payments for 1996.

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Inc. requesting a partial withdrawal of a portion of the Petition for Reconsideration of Champlain Valley Telecom, Inc. is GRANTED.

FEDERAL COMMUNICATIONS COMMISSION


Lisa M. Zaina
Acting Deputy Chief
Common Carrier Bureau

APPENDIX D

BEFORE THE ARIZONA CORPORATION COMMISSION

DOCKETED

RECEIVED

OCT 29 1992

NOV 02 1992

RENZ D. JENNINGS
CHAIRMAN
MARCIA WEEKS
COMMISSIONER
DALE H. MORGAN
COMMISSIONER

DOCKETED BY *JPL*

Givens, Pursley, Webb & Huntley

IN THE MATTER OF THE APPLICATION OF)
MIDVALE TELEPHONE EXCHANGE,)
INCORPORATED, FOR A CERTIFICATE OF)
PUBLIC CONVENIENCE AND NECESSITY.)

DOCKET NO. U-2532-89-134

DECISION NO. 58048

OPINION AND ORDER

DATE OF HEARING: August 27, 1992

PLACE OF HEARING: Tucson, Arizona

PRESIDING OFFICER: Bradley S. Carroll

APPEARANCES: GIVENS, PURSLEY, WEBB & HUNTLEY, by Mr. Conley Ward, on behalf of Applicant;

Mr. W. Douglas Hickey, Chief Counsel, on behalf of Intervenor U S West Communications, Inc.

Ms. Deborah Scott Engelby and Ms. Elizabeth A. Kushibab, Staff Attorneys, Legal Division, on behalf of the Arizona Corporation Commission Staff.

BY THE COMMISSION:

On June 6, 1989, Midvale Telephone Exchange, Incorporated ("Midvale" or "Company") filed with the Arizona Corporation Commission ("Commission") an application for a Certificate of Convenience and Necessity ("CC&N") and approval of Rural Electrification Administration ("REA") financing to fund the construction of the local exchange system. On October 12, 1989, the petition for leave to intervene filed by U S West Communications, Inc. ("U S West"), formerly known as Mountain States Telephone and Telegraph Company, was granted. On June 15, 1992, the Commission's Utilities Division ("Staff") filed its Staff Report recommending that the application be

1 approved. On July 8, 1992, Midvale notified its proposed customers of
2 the hearing in this matter.

3 On August 27, 1992, a hearing was held before a duly authorized
4 Hearing Officer at the Commission's offices in Tucson, Arizona. The
5 Company, Staff and U S West appeared at the hearing. Additionally,
6 several potential Midvale customers attended the hearing and gave
7 comment. At the conclusion of the hearing, the Hearing Officer took
8 the matter under advisement pending submission of a Recommended
9 Opinion and Order to the Commission.

10 * * * * *

11 Having considered the entire record herein and being fully
12 advised in the premises, the Commission finds, concludes, and orders
13 that:

14 FINDINGS OF FACT

15 1. Midvale is an Idaho corporation currently providing
16 telecommunications utility service to the public within the states of
17 Idaho and Oregon.

18 2. U S West is a Colorado corporation engaged in providing
19 telecommunications services to the public in various parts of Arizona
20 pursuant to authority granted by the Commission.

21 3. On June 1, 1989, Midvale filed with the Commission an
22 application for a CC&N and for approval of REA financing to provide
23 local exchange and toll access service to an unserved area east of
24 Tucson and north of Benson, Arizona generally known as the Cascabel
25 area.

26 4. On April 29, 1991 and June 9, 1992, Midvale filed an
27 amendment to its application.
28

1 5. Maps of the proposed service area, as amended, and a metes
2 and bounds description of the Cascabel telephone exchange are attached
3 hereto as Exhibits A and B and incorporated herein.

4 6. As Exhibit A indicates, Midvale reduced the Cascabel service
5 area it intended to serve since the filing of the original
6 application. Midvale also withdrew its proposed Rain Valley service
7 area which is located southwest of Benson, Arizona. These areas were
8 eliminated because they represent areas where existing U S West
9 customers and/or network facilities were located.

10 7. Included in its application, Midvale filed proposed tariffs
11 which set forth its proposed rates, charges and terms and conditions
12 for service.

13 8. Notice of the application was provided in accordance with
14 law.

15 9. The reduced Cascabel service area would overlap existing U
16 S West service areas in the San Manuel Exchange and the Benson
17 Exchange. According to U S West, it has no existing customers or
18 service facilities in the remaining areas that overlap. In a letter
19 to Staff dated August 14, 1992, U S West indicated that it was willing
20 to relinquish these areas to Midvale.

21 10. U S West tariff maps for the Benson and San Manuel Exchanges
22 are attached hereto as Exhibit C and are incorporated herein.

23 11. Midvale estimates that there are approximately 130 potential
24 customers in the Cascabel area along the San Pedro River.

25 12. A central office building will be constructed in the
26 Cascabel service area which will house a new stored program control
27 digital switching system equipped to accommodate growth in the area
28 for several years.

1 13. Shielded buried cable will be used in the local loop for
2 customer access to the system. Interexchange calls will be routed
3 over a new digital interoffice cable facility connected to U S West
4 facilities at Benson.

5 14. Midvale estimates that construction of the system will take
6 approximately six months to complete. The Company further estimates
7 that potential customers would be able to receive telephone service
8 approximately nine months after Commission approval of its
9 application.

10 15. Midvale intends to construct facilities with a value of
11 approximately \$526,308. Approximately seven percent, or \$40,000, will
12 be funded by Midvale and the balance, or \$486,308, will be funded by
13 an REA loan.

14 16. The loan is expected to be issued at an interest rate of
15 five percent per annum for a period of 20 to 30 years. The REA
16 application is contingent upon the Commission's approval of this
17 financing.

18 17. On June 12, 1992, Staff filed its Staff Report recommending
19 approval of the Company's application and proposed tariffs as amended.

20 18. Staff has also recommended approval of Midvale's proposed
21 financing.

22 19. In its report, Staff noted that the REA requires a minimum
23 of 1.5 times interest in determining the Net Times Interest Earned
24 Ratio ("TIER") and a 1.25 Net Debt Service Coverage ("DSC").

25 20. Midvale estimates a net TIER of 2.10 and a net DSC of 2.97
26 which is adequate coverage for the REA requirement.

27 21. Additionally, Staff has recommended that: a) Midvale be
28 ordered to refile its amended tariffs incorporating the approved rates

1 and charges and maps which describe its certificated area within 30
2 days from the effective date of this Decision reflecting an effective
3 date 30 days from the effective date of the filing; and b) U S West
4 delete Midvale's service area from U S West's tariff maps for the
5 Benson and San Manuel area.

6 22. Staff had also recommended that Midvale be ordered to file
7 for a review of its rates and charges no later than June 1, 1994.

8 23. Since Midvale has subsequently indicated that it anticipates
9 that potential customers would be able to receive service
10 approximately nine months after Commission approval of its
11 application, Midvale should file for a review of its rates and charges
12 after it has been in operation for at least one year. Midvale should,
13 therefore, file for review of its rates and charges on or before
14 January 1, 1995.

15 24. On August 14, 1992, Staff filed a supplement to its Staff
16 Report recommending that a limit of \$10,000 be placed on the amount
17 that Midvale can request from the Arizona Universal Service Fund
18 ("Fund") established in Decision No. 56639 (September 22, 1989) after
19 all other revenue sources available are accessed by the Company.

20 25. In formulating this recommendation, Staff reviewed the
21 revenues of Contel of the West, dba GTE-West, the only recipient of
22 monies from the Fund, factoring into the analysis the differences
23 between the two companies.

24 26. Staff's recommendation of a \$10,000 limit is the approximate
25 mid-point between Midvale's projected net income and Staff's most
26 conservative revenue estimate for the Company. Staff noted, however,
27 that the actual amount, if any, of any disbursement of money from the
28 Fund would be determined by the Commission in a rate proceeding.

1 effective date of this Decision reflecting an effective date of 30
2 days from the effective date of the filing.

3 IT IS FURTHER ORDERED that Midvale shall file for a review of its
4 rates and charges no later than January 1, 1995.

5 IT IS FURTHER ORDERED that Midvale is hereby authorized to enter
6 borrow up to \$486,308 from the REA at five percent interest for a
7 period of 20 to 30 years.

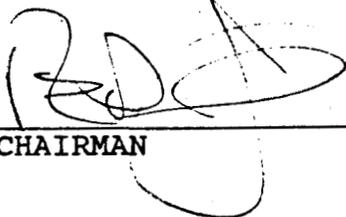
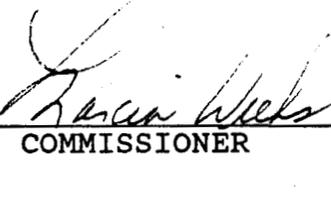
8 IT IS FURTHER ORDERED that Midvale is hereby authorized to
9 execute and deliver all documents and agreements reasonably necessary
10 to effectuate the authorizations granted hereinabove.

11 IT IS FURTHER ORDERED that the approval of the requested
12 financing as set forth hereinabove does not constitute or imply
13 approval or disapproval by the Commission of any particular
14 expenditure of the proceeds derived thereby for purposes of
15 establishing just and reasonable rates.

1 IT IS FURTHER ORDERED that U S West shall file within 30 days of
2 the effective date of this Decision revised tariff maps for the Benson
3 and San Manuel area reflecting the deletion of Midvale's service area.

4 IT IS FURTHER ORDERED that this Decision shall become effective
5 immediately.

6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

7
8   
CHAIRMAN COMMISSIONER COMMISSIONER
9

10 IN WITNESS WHEREOF, I, JAMES MATTHEWS, Executive
11 Secretary of the Arizona Corporation Commission, have
12 hereunto set my hand and caused the official seal of the
13 Commission to be affixed at the Capitol, in the City of
14 Phoenix, this 29 day of October, 1992.

15 
JAMES MATTHEWS
EXECUTIVE SECRETARY

17 DISSENT _____
18 BSC