

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6530

Investigation into State Certification of)
Compliance by Nine Rural Telephone)
Companies with Subsection 254(e) of the)
Telecommunications Act of 1996)

Order entered: 9/26/2001

FINAL ORDER

Summary

In today's Order, the Public Service Board ("Board") concludes that on or before October 1, 2001, the Board will certify each of the nine Independent local exchange carriers that are parties in this docket ("Independents")¹ to receive federal universal service support in 2002. We have also decided not to impose, as a condition of that certification, a requirement that the carriers establish explicit customer credits reflecting federal support. We do, however, require the Independents to provide semi-annual notices to customers describing details of federal support and its effects on customer rates. We also announce that we intend to consider establishing such credits in future rate reviews of the Independents. Finally, we require each of the Independents to file, on or before September 1 of each year, a Federal Support Summary designed to assist the Board in determining whether to make a certification to the Federal Communications Commission on or before the first day of October for support to be received in the following year.

¹ The nine Independents are Franklin Telephone Company, Ludlow Telephone Company, Northfield Telephone Company, Perkinsville Telephone Company, STE/NE Acquisition Corp. d/b/a Northland Telephone Company of Vermont ("Northland"), Shoreham Telephone Company, Inc., Topsham Telephone Company, Inc. ("Topsham"), Vermont Telephone Company, Inc., and Waitsfield-Fayston Telephone Company, Inc. d/b/a Waitsfield Telecom, d/b/a Champlain Valley Telecom.

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I. BACKGROUND

A. Federal Background

On May 23, 2001, the Federal Communications Commission ("FCC") issued an order concerning federal support to "rural" telephone companies ("Rural Task Force Order").² In the Order, the FCC adopted most of the recommendations of the "Rural Task Force," thereby making several modifications to its rules. The modifications are intended to apply for a period of five years, and they make some significant changes to the manner in which federal high-cost universal service support is provided to rural carriers.³ The new rules are designed in part to provide certainty and stability to rural carriers over the next five years so that they can provide supported services to their consumers at affordable rates.⁴ The changes are expected to result in an increase in rural carrier support of approximately \$1.26 billion over the five-year period,⁵ principally by adjusting existing features of the "high cost loop" support program. Another existing support program for "local switching" costs will continue largely without change.

In the same order, the FCC also adopted a new requirement that state regulatory commissions must certify to the FCC, on an annual basis, that:

all federal high-cost support provided to such carriers within that State will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.⁶

The first such certification is due October 1, 2001. If no certification is filed, the affected carriers will not be eligible to receive any federal high-cost support.⁷ If certification is filed later than

² *In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, CC Docket No. 00-256, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45 and Report and Order in CC Docket No. 00-256, May 23, 2001 (FCC 01-157).*

³ Rural Task Force Order at ¶¶ 1, 12 (e.g., adoption of "rural growth factor" that allows total amount of fund to increase).

⁴ *Id.* at ¶ 11.

⁵ *Id.* at ¶ 26.

⁶ 47 C.F.R. § 54.314(a); Rural Task Force Order at ¶ 187.

⁷ 47 C.F.R. § 54.314(a); Rural Task Force Order at ¶ 191.

October 1, carriers will receive reduced support.⁸ If any support is withheld, that decision will affect "high cost loop support,"⁹ "local switching support,"¹⁰ and so-called "Safety Valve" support that is provided upon sale or transfer of exchanges.¹¹

B. This Docket

In response to the FCC's Order, we initiated this docket on August 2, 2001, to determine under what conditions the Board should issue the required certifications to ensure the continued receipt of the high-cost support dollars by Vermont's rural carriers. We designated Peter Bluhm as Hearing Officer and directed him to explore whether an explicit bill credit should be instituted for all or some portion of the high-cost dollars received by Vermont's rural carriers, and if so, what other billing changes might be necessitated by such an approach.¹²

This docket has necessarily been conducted on an extremely abbreviated schedule because of the need to meet the FCC's deadline for certification of October 1, 2001. The Hearing Officer conducted a Prehearing Conference on August 13, 2001, and issued a Procedural Order on August 20, 2001. He directed the nine independent telephone companies that are respondents in this docket ("Independents") and the Department of Public Service ("Department" or "DPS") to file briefs on September 3 and reply briefs on September 6, 2001. He directed the parties to consider three options:

1. Full Credit Option. Under this option, all federal intrastate cost support (high cost loop support plus local switching support) received by the incumbent local exchange company would be assigned to an explicit credit shown on customer bills. The credit amount would change from time to time as federal support changes. Under this option, companies would also restate their existing retail rates upward to reflect the removal of federal support. If the amount of federal support did not change, however, while gross customer charges would increase, net customer charges would be the same.

⁸ For example, if certification is delayed until December, the carriers would receive support only in the second, third and fourth quarters of 2002. 47 C.F.R. § 54.314(d)(2).

⁹ 47 C.F.R. § 54.314(a). High cost loop support is provided under 47 C.F.R. § 36.301.

¹⁰ 47 C.F.R. § 54.314(a). Local switching support is provided under 47 C.F.R. § 54.301.

¹¹ 47 C.F.R. § 54.314(a). Support upon sale or transfer of exchanges was referred to by the Rural Task Force as "Safety Valve" support. This support is provided for additional investment made in exchanges that previously were acquired from other carriers. 47 C.F.R. § 54.305.

¹² Order of 8/2/01 at 2.

2. Incremental Credit Option. This option is similar to the full credit option, but it applies only to incremental federal support. Under this option, federal intrastate cost support (high cost loop support and local switching support) in existence on June 30, 2001, would constitute a "base amount" that is presumed to be a revenue offset, and thereby reducing existing rates. However, any future increases in support, after June 30, 2001, and above the base amount, would be reflected in an explicit credit showing on customer bills. Thus in most or all cases there would be no need to restate existing rates. If federal support drops below the base level, other arrangements might be needed, such as permitting the company to initiate a rate case.

3. General Revenue Option. Under this option, the Board would certify compliance with 47 U.S.C. § 254(e) based upon material filed with the Board by the Independents. The Independents were given broad latitude to define this option as they thought appropriate under the FCC rule. No explicit customer credits would be established, and any future increases in federal support would be treated as general revenue by each of the nine companies.¹³

The parties filed briefs on each of the Options. The Independents also filed affidavits on seven major factual points, with a variety of sub-points.¹⁴ Because of the limited time available, no live hearings have been held, and this decision has been prepared on the basis of filed papers.¹⁵

The Hearing Officer prepared a Proposal for Decision and circulated it to all parties in accordance with 3 V.S.A. § 811, and a copy of that proposed decision is in the record.

Comments on the proposed decision were filed by the parties and have been considered.

C. Positions of the Parties

1. Nine Independent Telephone Companies

The Independents argue that the Board should separate the certification decision from consideration of a customer-credit requirement, in part because of the complexity and number of the issues and in part because of the short time remaining until the certification deadline. Separating the issues, they argue, will allow due consideration to be given to the customer credit issue, without jeopardizing the Independents' federal support.

¹³ Order of 8/20/01 at 1-2.

¹⁴ *Id.* at 2-4.

¹⁵ The only factual matters here are submitted by the Independents. The Department of Public Service was offered an opportunity to challenge these factual assertions, but has not done so. Order of 8/20/01 at 1.

Substantively, the Independents oppose providing bill credits in both the FCO and ICO form. They assert instead that high-cost support should "continue to be used for infrastructure investments to provision, maintain and upgrade the facilities and services for which such support is intended in 47 U.S.C. § 254(e)." They offer numerous arguments against establishing credits. These involve statutory construction, the intent of the FCC, difficulties that the Independents anticipate in making other decisions, conflicts with other dockets and with jurisdictional separations, needless customer confusion, and "single-issue ratemaking."

The Independents urge the Board to make the required FCC certification "based on information that the Independents have already provided or will provide to the Board," and that the increase, if any, in universal service support received by the Independents should remain part of their general revenues, "to be used to support services and facilities for which such support is intended." The Independents thus recommend that the first annual certification should proceed in accordance with the "General Revenue Option" described above. This certification should be based, they contend, on detailed information that the Independents have already provided, or promise to provide, to the Board.¹⁶ The Independents contend that this information is sufficient

¹⁶ The promised or provided information consists of:

- A. The annual report that each Independent has already filed with the Board and the Department.
- B. The information filed in response to the First Procedural Order.
- C. An attestation by each Independent that such Independent will use its high cost universal service support only for the purposes intended in 47 U.S.C. § 254(e).
- D. The following information, which all nine Independents assert they have filed in this docket:
 1. Amount of High Cost Support for 2000;
 2. Amount of Local Switching Support (LSS) for 2000;
 - 3a. Outside Plant capital expenditures projected for 2000;
 - 3b. Central Office Equipment capital expenditures projected for 2000;
 - 4a. Cable and Wire facilities expenses for 2000 (as reflected in the determination of High Cost Support in 2002);
 - 4b. Central Office Switching expenses for 2000 (as reflected in the determination of High Cost Support in 2002);
 - 4c. Corporate expenses for 2000 (as reflected in the determination of High Cost Support in 2002);
 5. The loop cost determined by NECA based upon the Company's July 2001, filing; and
 6. The number of Category 1.3 Loops reflected in the Company's July 2001, filing with NECA.

to allow the Board to complete the state certification required by the FCC in the Rural Task Force Order.

In the event the Board does desire to investigate customer credits further, the Independents recommend that the investigation be separated from and follow the first annual certification due at the FCC by October 1 of this year. They suggest such credits would apply, at the earliest, in Calendar Year 2003, based upon a certification filed on or before October 1, 2002.

Finally, the Independents suggest that, instead of requiring a credit, the Board might require the carriers to issue annual or semi-annual notices with customer bills. Those notices would explain that federal universal service supports are used to subsidize the cost of providing basic service in rural and high-cost areas, and also explain how the support affects Vermont rates and services.

2. Department of Public Service

The DPS contends that the Board has the legal authority under state and federal law to implement each of the three options described above. For that reason, the Department suggests that the Board should select the best option primarily as a matter of policy. The DPS recommends that the Board adopt either the Incremental Credit Option or the General Revenue Option, but subject to certain conditions.

The DPS does not recommend that the Board adopt the Full Credit Option. This option, the Department argues, would increase administrative burdens on the carriers without creating a corresponding benefit to end-users. The DPS also believes the Full Credit Option is likely to create consumer confusion because of the necessary formal rate changes, particularly for those carriers that have other rate changes at approximately the same time. While the DPS recognizes the attraction of a direct flow-through of high-cost support to individual consumers, it contends that substantially the same benefits can be realized under other options that have fewer disadvantages.

The DPS supports the Incremental Credit Option, but only if two conditions are met. First, the DPS asks for a semi-annual notice from carriers to consumers identifying all implicit support in their rates. The Department notes that this is consistent with this Board's existing

policy, expressed in Docket No. 5903, that consumers should have the right to know the full price of the goods and services that they are purchasing.

The DPS recommends a second condition as well. It proposes annual informational filings from the Independents to ensure that federal high-cost support funds are utilized for their intended purposes. The filing should be made, urges the DPS, some time before the first of each October, and should include a proposed semi-annual notice to customers, as well as anticipated funding for the upcoming year, the anticipated amount of the incremental bill credit, and a listing of the specific accounts to which the funding will be attributed, the amounts attributable for each account, and the planned individual investments and their anticipated costs under each account that will be funded by the base amount of high-cost support. Additionally, the DPS urges that each report detail how the support was actually spent in the preceding year, by account, amount and project. This filing requirement, urges the DPS, would allow us to determine that the funds are actually being used for support of intended services prior to making a certification on behalf of each carrier.¹⁷

The DPS also supports the General Revenue Option described above. If we select that option, the DPS proposes requiring the similar notices and filings as described above.

D. Precedent

Under a similar FCC certification requirement applicable to "nonrural" carriers,¹⁸ this Board has twice filed similar certifications for its only "nonrural" carrier, Verizon Vermont. Those certifications were made on the premise that Verizon would use what is functionally equivalent to the Incremental Credit Option described above. The "new" portion of federal universal service support is the basis for an explicit monthly bill credit for Verizon's residential and commercial customers. Verizon files tariffs to effectuate that plan, reporting the amount of the credit, which is adjusted annually.

¹⁷ The FCC has set forth the list of supported services for rural, insular and high cost areas. It consists of voice grade access to the public switched network, local usage, dual tone frequency signaling or its functional equivalent, access to emergency services, access to operator services, access to interexchange services, access to directory assistance, and toll limitation for qualifying low-income consumers. 47 C.F.R. § 54.101(a). In their reply brief, the Independents contest that federal support must be used only for these purposes.

¹⁸ 47 C.F.R. § 54.313.

II. FINDINGS, DISCUSSION AND DECISION

Pursuant to 30 V.S.A. § 8, and based on the record and evidence before us, the Board makes the following findings of fact and conclusions of law.

A. Summary of Decision

We intend to certify the Independent carriers on or before October 1, 2001, based upon the General Revenue Option. We reject the Full Credit Option principally because of the profound constraints imposed by the single-issue ratemaking doctrine, as explained below.¹⁹ This doctrine might prevent us from capturing for ratepayers the benefit of any federal support increases that occurred on July 1, 2001, and that may occur in the future.

We also conclude that nearly equal benefit can be derived from periodic customer notifications.²⁰ Notices provide almost all of the benefits of credits, but without the drawbacks of a possibly startling change in billing practice. We also commit to undertaking a long-term process of educating customers about the pre-subsidy cost of their telephone services. However, we conclude that periodic notices to customers are an adequate first step in that process.

The notices should include details about both the high cost loop support and local switching support programs. The notice should assume one of two allocations of support. First, the carriers may assume that federal support is distributed equally over all access lines. Second, the carriers may assume that federal support is distributed over each line, but with a weighting reflecting that line's monthly fixed charges.²¹ If the carrier disaggregates support for CLECs, it may also disaggregate for purposes of the notice. The notice should estimate the amount that local fixed charges would increase without federal support.

We recognize that the timing and content of the notices is a close question. The DPS proposes biannual notices. However, telephone customers pay universal service charges every

¹⁹ Consequently, we need not, and do not, address in today's Order the other issues that the Hearing Officer included in the Proposed Decision and that relate solely to the Full Credit Option or the Incremental Credit Option. Those omitted issues include deciding whether federal statute prohibits customer credits and whether such credits would be contrary to the intent of the FCC.

²⁰ In one form or another, both the DPS and the Independents have supported such periodic notices.

²¹ Under the latter option, the presumed benefit to business lines would ordinarily be greater than to residential lines.

month in a variety of guises. There is merit to reporting to customers the benefit of universal service programs on approximately the same frequency as they are informed of the costs of those programs. Still, monthly notices may be burdensome or they may need to be too brief to be informative. We adopt the recommendation of the DPS and recommend that notices be issued biannually. We suggest that the report be distributed in the first and third quarters, but with the specific month selected by the carrier.

We also intend to explicitly consider establishing credits in future rate reviews of the Independents. This docket has been brought to a proposed decision in a very short time, and the factfinding process has been greatly abbreviated. In the future, we will take up the credit issue on a case-by-case basis, and we will be much better informed of the likely effects on each of the company's customers. Moreover, by that time we will have had greater opportunity to evaluate the effects of the customer notice.

We also require each of the Independents to file, on or before November 1 of this year and before September 1 of each following year, a Federal Support Summary. This summary will assist us in determining whether to make a certification on or before the first day of October for federal support to be received in the following year. The summary should include the detailed information listed below in our Order. The parties should work informally over the next few weeks with the Clerk of the Board and the Hearing Officer to prepare a standard filing format that will meet these requirements.

B. Single-Issue Ratemaking

The Independents contend that the Board should not create customer credits resulting from an expected increase in a single revenue source, without taking into account all other increases or decreases in revenues or expenses that the Independents are likely to experience. Because the Independents are all rate-regulated companies, they contend that we can, through the statutory annual reporting process, review all of their revenue and expense changes and adjust rates as needed. Specifically, the Independents argue that if customer credits offset basic rates in response to expected increases in federal high cost universal service support, then the result would constitute improper, single-issue ratemaking. They argue that a measurable increase in a single revenue source does not warrant a change in basic exchange rate design, without also

taking into account the other known and measurable fluctuations in expenses and revenues during a test year. The Independents also assert that "selective updating" is particularly repugnant in the present context where anticipated federal support increases are "intended to provide rural carriers with incentives to invest in their infrastructure."²²

The Vermont Supreme Court has held that the Board may not establish utility rates by "selectively updating" one cost factor alone and without assessing other cost and revenue factors. For example, in *In re Central Vermont Public Service Corp.*,²³ the Court disapproved of a "current power year" ("CPY") tariff that was designed to allow the utility to fully recover its purchased power and energy costs on an annual basis. The Court understood that the CPY tariff had been intended to reduce the scope and frequency of major rate cases. Nevertheless, the Court disapproved of the CPY tariff as "selective updating" or single-issue ratemaking because it allowed the utility to update:

one cost factor alone without giving attention to whether that cost factor was itself something needing evaluation or adjustment because of transitory or abnormal factors, or without assessing other, related cost or revenue changes concurrent with it, is a forbidden procedure.²⁴

In analyzing this issue, we consider first the process of initially establishing customer credits and then consider the issues raised by subsequent credit adjustments. In both cases we consider the likely effects of the Full Credit Option.

When credits are first established, those credits might increase or decrease the carriers' current revenues. For example, Rural Task Force Order changes went into effect on July 1, 2001. If we now set the carrier's rates and credit amounts in a way that effectively transfers from the company to customers the July 1, 2001, support increase, this would reduce the carrier's current revenues. Under the single-issue ratemaking doctrine, however, current revenue can be changed

²² Independents' brief at 17 (citation omitted). Nor do the Independents believe that treating the increases in high cost support as general revenues should trigger a rate review. The Independents claim that they experience a variety of revenue and cost fluctuations over the course of a calendar year, and will file their annual reports with the Board, in accordance with Board Rule 3.101, at which time, or indeed at any time, the Board can determine whether a general examination of the rates is necessary to take account of such changes.

²³ 144 Vt. 46, 49 (1984); *see also In re Tariff Filing of New England Telephone & Telegraph Co.*, 145 Vt. 309 (1984)

²⁴ *Id.* at 59 (internal quotation omitted)

only after offering all parties an opportunity to present evidence on the carrier's other current costs and revenues.

To solve this problem, we might establish credits in a revenue-neutral manner. That is, the increase in base rates would be exactly balanced by a new customer credit. In that case, we would not be adjusting the carrier's revenue requirement, and we would not be obligated to offer the carrier an opportunity to explain other costs and revenues. While a revenue-neutral credit avoids single-issue ratemaking, however, it might also prevent us from channeling to customers the support increases that some Independents received, under the Rural Task Force Order, on July 1, 2001. Thus, customers might be deprived of the benefit of much of the support increases resulting from the Rural Task Force Order.

A methodology that includes subsequent periodic credit adjustment would also suffer from the same deficiency. The parties considered a customer credit that would be recalculated annually in response to support changes from USAC. Such a recalculation, however, would change each customer's net rates without allowing the carrier routinely to place in evidence other factors affecting its cost of service.²⁵

The same problems arise with the Incremental Credit Option. Although the initial credit would be smaller, it still must be revenue-neutral. Likewise, future adjustments would not consider other cost and revenue factors affecting the carrier.

In summary, although a Full Credit Option could be established consistent with Vermont law, the credit must be established in a revenue-neutral manner. This could be accomplished if the credit were established through a one-time change in rate design, with the understanding that no future adjustments would be made without initiating rate proceedings. Under those facts, however, the credit mechanism would have significantly reduced benefits.²⁶

²⁵ Of course, the carrier could initiate a new rate case if it needed to offset rates, but that has not been considered an adequate response to single-issue ratemaking. *In re Tariff Filing of New England Telephone & Telegraph Co.*, 145 Vt. 309, 312 (1984) (subsequent rate case litigated on same issue does not cure single-issue ratemaking deficiency).

²⁶ The comments of the parties were directed towards a broader proposal under which the credits might have removed from carrier net revenues the July 1, 2001, increases as well as future increases.

C. Customer Confusion

The Independents contend that explicit customer credits would generate significant customer confusion and that customers would see unpredictable basic service rates. They find the Full Credit Option to be particularly objectionable, although they object to the Incremental Credit Option as well, in both cases because the credit amount would change from time to time as federal support changes. This, they claim, will create uncertainty, unpredictability and confusion for customers in their basic service charges.

The Independents raise a valid objection. Customers will, no doubt, be concerned about changes in their bills, and Independents will, as they anticipate, be required to field the majority of inquiries from customers. We agree that frequent rate changes can be confounding to customers, and that a system of bill credits could require a great deal of customer relations work by carriers. Nevertheless, we do not believe that customer confusion is a reason to refrain from ordering credits. Primarily, this is because there will be compensating benefits.

First, since universal service support is a subsidy, a bill credit can inform customers of the pre-subsidy cost of their service. Currently, a customer's bill provides no hint of the unsubsidized cost of providing their telephone service. Many customers would indeed be surprised to know the degree to which their current rates are reduced by federal loop and switching support. Exposing this to customers may generate some reaction to which the carriers, and the Board, must respond. We do not, however, believe that customers are incapable of understanding how such a credit, once established, can vary from year to year with federal support. Nor do we accept that disseminating this information would be harmful.

Second, many local exchange customers already have universal service charges evident on their bills. Customers of large local exchange carriers now must pay a Subscriber Line Charge each month, as well as a new universal service surcharge that is a percentage of that charge. A similar plan is now pending at the FCC for small carriers, including many or all of the Independents. If a universal service credit should also appear on the customer's bill, customers

may well have a chance to learn that universal service can provide a benefit even larger than the burden it imposes.²⁷

D. Disaggregation Plans

Currently, rural carriers do not "disaggregate" support below the study area level. That is, rural LECs allocate support in equal amounts to all their customers. In the Rural Task Force Order the FCC found that providing support uniformly through a study area may create uneconomic incentives for competitive entry, and may also result in support not being used for the purpose for which it was intended.²⁸ Accordingly, the FCC allowed rural carriers, at their election, to disaggregate per-line federal high-cost support into geographic areas below the study area level.²⁹ When a CLEC succeeds in winning over one of the Independents' customers, the CLEC receives support attributable to the customer. If the Independent has disaggregated, then the amount of support received by the CLEC will vary, depending upon the location of the customer and the cost of serving customers in that area. The rural carriers must make their election by March 18, 2002. The Independents make two arguments concerning disaggregation.

First, the Independents claim that the "disaggregation" provisions of the Rural Task Force Order argue against customer credits. The Independents contend that while they are contemplating this decision, they should "be allowed to formulate any plans for disaggregation without the constraint of undertaking incremental customer credits."³⁰

We reject this argument. First, the Independents have not shown that implementing customer credits would impair any rights the Independents have under the Rural Task Force Order or that it would interfere in any meaningful way with any data collection activities needed for them to make an intelligent disaggregation decision. They simply ask to be left alone for the

²⁷ The Independents also express concern that customer confusion might be magnified if federal support is reduced in the future. Vermont Telephone Company, Inc. reports that its 2002 high-cost loop support will be lower than its support level under the previous formula. The situation, in the Independents' view, "underscores the potential for customer confusion in treating these fluctuations in federal support as rate events on customer bills. Independents' brief at 7. In light of our conclusion above that any customer credit cannot be adjusted in the future without giving the carrier an opportunity for a full examination of costs and revenues, the Independents' concern is moot.

²⁸ Rural Task Force Order at ¶148.

²⁹ *Id.* at ¶¶136-164.

³⁰ Independents' comments on Proposed Decision at 7.

next half-year while they ponder whether to consent to disaggregation. We find this totally unpersuasive. To the contrary, if the Board were to establish a system of credits, the Independents would be better served to know of that result before next March; they would then make a more informed election regarding disaggregation.

In their comments to the Proposed Decision, the Independents also argued that if one of their number should elect to disaggregate support, then:

a program of immediate customer credits, to be applied uniformly to all lines in an Independents' study area, might very well compound the problem, identified by the FCC in the Rural Task Force Order, created when "the per-line support available throughout the study area is the same even though the costs throughout the study area may vary widely," which "could result in support not being used for the purpose for which it was intended, in contravention of section 254(e)."³¹

We see no basis to conclude that customer credits would "compound the problem" identified by the FCC. The FCC explained this problem to be that without disaggregation, CLECs would receive too much federal support for serving low-cost customers and too little support for high-cost customers. The result, according to the FCC, could be "artificial barriers to competitive entry in the highest-cost areas and artificial entry incentives in relatively low-cost portions of a rural carrier's study area are created."³² There is a significant risk of such harm if the Independents elect not to disaggregate. For that reason the FCC concluded that:

as a general matter, support should be disaggregated and targeted below the study area level so that support will be distributed in a manner that ensures that the per-line level of support is more closely associated with the cost of providing service.³³

We agree with the Independents that the FCC's goal may not be met, but it seems to us the most likely mechanism for that failure would be a decision by the Independents to decline disaggregation, as they have the power to do under the Rural Task Force Order. Conversely, we do not see how establishing credits for retail customers could in any way defeat this FCC goal. Establishing retail credits for ILECs would not alter the amount of federal support available to a

³¹ Independents' Comments on Proposed Decision at 7.

³² Rural Task Force Order, ¶ 145.

³³ *Id.*

CLEC, and thus it would not alter the CLEC's probable gain or loss from serving a new customer. Without creating such a risk, retail credits cannot affect CLEC incentives.

If an Independent does elect to disaggregate support for CLECs, it might also wish to disaggregate its retail credits, although that would not be essential. If an Independent does disaggregate for CLECs, the Independent could file revised tariffs at the Board that similarly disaggregate retail credits.

E. Separations

The Independents question whether bill credits, if established, should exclude "local switching support." Their argument is based upon the mechanism by which this support is now reflected in rates.

Local switching support is paid to local exchange carriers primarily to reduce the intrastate costs of switching for small companies, and it has that effect. Rather than directly apply the support as intrastate revenue, however, a more indirect method was chosen. Largely for historical reasons not relevant here, the FCC continues to measure the need for support by a factor called the "weighted interstate DEM." That measure produces two effects. First, it is used to calculate federal local switching support.³⁴ Second, it produces a matching expense transfer.³⁵ Thus, when USAC pays a dollar of switching support, a dollar of intrastate cost is transferred to the interstate jurisdiction. The net effects are that federal support covers that newly-created interstate cost and intrastate cost is reduced.

³⁴ 47 C.F.R. § 54.301(a)(2). This section provides as follows for federal support:

(2) Local switching support factor. (i) The local switching support factor shall be defined as the difference between the 1996 weighted interstate DEM factor, calculated pursuant to Sec. 36.125(f) of this chapter, and the 1996 unweighted interstate DEM factor.

³⁵ 47 C.F.R. § 36.125(f). This section provides as follows for the separation of local switching equipment:

(f) Beginning January 1, 1998, for study areas with fewer than 50,000 access lines, Category 3 investment is apportioned to the interstate jurisdiction by the application of an interstate allocation factor that is the lesser of either .85 or the sum of the interstate DEM factor specific in paragraph (a)(5) of this section, and the difference between the 1996 weighted interstate DEM factor and the 1996 interstate DEM factor. The Category 3 investment that is not assigned to the interstate jurisdiction pursuant to this paragraph is assigned to the state jurisdiction.

Given this structure, the Independents argue that, since the weighted interstate DEM factor continues to be used to assign local switching costs to the interstate jurisdiction, revenue derived from application of DEM weighting must continue to be treated as interstate. Explicit customer credits, they say, would alter this practice by including local switching support revenues in the calculation of customer credits for basic local rates. By treating local switching support as an intra- rather than an interstate revenue, they argue that a customer credit could shift a significant portion of the Independents' interstate revenue requirement into the intrastate jurisdiction, without also shifting the allocated costs, thereby causing a mismatch between revenues and allocated costs. They conclude that local switching support should be excluded from this proceeding.

The Independents do not accurately describe the effect of a customer credit. A credit would not alter the amount of federal local switching support. Nor would a credit alter the amount of the expense transfer from intrastate to interstate. Neither of these amounts is controlled by the Public Service Board. If a credit would not alter the support amount, and it would not alter the separation of costs, then it cannot create a mismatch.

Customer credits can be created by the Public Service Board whether federal support offsets an intrastate cost or offsets an interstate cost created through an expense transfer. In either case we can raise intrastate rates in an amount equal to the support and then create an offsetting credit. There is no net effect on the carrier's interstate revenues and costs.

In summary, creating a customer credit for local switching support would not create a mismatch between interstate costs and revenues. To the contrary, credits would not affect interstate revenue or interstate cost.

F. Average Schedule Companies

The Independents contend that support estimates provided by the two Independents who are "average schedule" companies (Franklin Telephone Company and Shoreham Telephone Company) were difficult to project. Average-schedule company rates are determined through an annual filing by the National Exchange Carrier Association ("NECA") at the FCC. The NECA filing consists of cost studies and includes revenue requirement data for average-schedule

companies. Typically, NECA makes the filing in December that will take effect the following July.³⁶

The two Vermont average-schedule Independents have faced an added difficulty. NECA has advised the average-schedule companies that the FCC has rejected NECA's methodology for estimating adjustments in federal universal service disbursements for average-schedule companies. The issue remains unresolved as of the date that the parties filed briefs. The Independents argue that the unresolved status of the NECA average-schedule revenue-requirement formula makes more difficult an accurate calculation of customer credits for the Full Credit Option and the Incremental Credit Option.

We recognize the timing difficulty for average schedule companies. Given our decision not to establish credits, however, we anticipate that most of the potential problem has been mooted. If the average schedule Independents have timing problems with the notices required under this Order, they may petition for reconsideration on that point.

A second issue involves average-schedule companies, one not briefed by the parties. States may set the rates of average-schedule companies using a "residual ratemaking" methodology. That is, rather than following the usual rules for separating costs and revenues that apply to "cost" companies, the Board may set the intrastate rates of average-schedule companies based upon the difference between the company's total revenue requirement and its interstate "average schedule" revenue.³⁷ Because of this, *all* federal support received by average-schedule companies offsets local rates, including federal universal service support intended to defray interstate costs. Within this category is "Long Term Support," a support program that provides universal service type support for high companies with high interstate costs.³⁸

If we had decided to establish customer credits here, they would have included all federal high cost support that reduces intrastate rates, including Long Term Support. For similar reasons,

³⁶ Independents' brief at 9.

³⁷ *Crockett Tel. Co. v. Federal Communications Commission*, 963 F.2d 1564, 1574 (D.C. Cir. 1992) (state use of "residual" or total company ratemaking as an alternative to traditional separations under Part 36 rules allowable under the Communications Act).

³⁸ For so-called "cost companies" (those Independents that are not average schedule companies), Long Term Support is irrelevant here because the support reduces only interstate rates.

the notices given by average schedule companies to customers should include Long Term Support as a component of federal support.

G. Pending Rate Investigations

Two of the Independents face current or pending obligations that could conflict with adoption of a support credit. First, Northland Telephone Company has filed a stipulated agreement proposing resolution of the pending rate investigation in Docket No. 6474. The stipulation includes a proposed rate structure, but does not include an explicit support credit. If the proposed settlement is approved, Northland's rates will already have taken account of support changes arising from the Rural Task Force Order. The Independents suggest this is an impediment to imposing credits on Northland.

We do not agree with the Independents' analysis. The Board can consider the question of Northland's revenue requirement, at issue in Docket 6474, independently of whether its rate design is altered here. As noted above, any action taken here would be revenue-neutral.

Second, Topsham Telephone Company recently received authority in Docket 6501 to borrow funds for the purpose of upgrading Topsham's Central Office and outside plant facilities throughout the Topsham service area. The Independents assert that repayment of the loans relies, in part, upon expected increases in federal universal service support that will result from the facilities investment paid from loan proceeds. However, since this Order does not require Topsham to offer credits, we have not taken any action here that affects Topsham's revenues. Therefore, the issue is moot.

III. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The findings and recommendations of the Hearing Officer are adopted, as modified herein.
2. The Board intends to file a certification before October 1, 2001, for each of the Independents, applicable to 2002. The certification will state that all federal high-cost support

provided to such carriers within that State will be used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended.

3. Each of the Independents shall file, on or before November 1, 2001, a proposed notice to consumers meeting the requirements described in Section II above. Those notices shall be sent to customers in the first and third quarters of each year, beginning in 2002, during a month within that quarter selected by the carrier.

4. Each of the Independents shall file on or before November 1, 2001, and annually thereafter on or before September 1, a Federal Support Summary designed to assist the Board in determining whether to make a certification on or before the first day of October for support to be received in the following year. The Summary should include the following information:

Annual Federal Support Usage Report:

1. Number of residential, business, and total access lines:
 - a. as calculated by NECA for support in the current year; and
 - b. as filed by the carrier on the preceding July 1.
2. Average loop cost per line:
 - a. as calculated by NECA for support in the current year; and
 - b. as filed by the carrier on the preceding July 1.
3. Federal high cost loop support:
 - a. in the current year;³⁹ and
 - b. expected in the upcoming year.
4. Average local switching cost per line:
 - a. as calculated by NECA for support in the current year; and
 - b. as filed by the carrier on the preceding July 1.
5. Federal local switching support:

³⁹ In comments to the Proposed Decision, the DPS asked that the report not include calendar year information, but instead use "support actually received in the current [calendar] year, as well as any support actually received in the prior [calendar] year which was previously reported as 'expected in the current calendar year.'"

The Department's recommendations are useful if there will be substantial uncertainty on September 1 of each year about the amount of support likely to be received in the remainder of the current calendar year. We are under the impression that ordinarily there is little uncertainty on this point, since we understand that USAC publishes reliable support estimates in advance. The record is silent on this point, and we need not resolve it here. The beginning and end dates of each "year" can be defined later with the parties through informal discussions that are informed by their knowledge of the usual publication dates and reliability of USAC support estimates. In the unexpected event of an inability to agree, the parties may return to us to resolve any differences.

- a. in the current year; and
- b. expected in the upcoming year.
- 6. Acquired exchange ("Safety Valve") support:
 - a. in the current year; and
 - b. expected in the upcoming year.
- 7. Long Term Support (average schedule companies only):
 - a. in the current year; and
 - b. expected in the upcoming year.
- 8. Capital expenditures for Cable and Wire, and a summary of the purposes of those expenditures, by project if relevant:
 - a. received or expected in the current calendar year; and
 - b. expected in the upcoming calendar year.
- 9. Capital expenditures for Central Office Equipment, and a summary of the purposes of those expenditures, by project if relevant:
 - a. received or expected in the current calendar year; and
 - b. expected in the upcoming calendar year.
- 10. The expense and plant accounts to which federal support will be allocated in the coming year, by type of support and by plant and expense account.
- 11. A draft of a customer notice that will be distributed in the first and third quarters of the following year describing the effects of federal support.

5. This docket shall be closed, effective December 31, 2001.

Dated at Montpelier, Vermont, this 26th day of September, 2001.

s/Michael H. Dworkin)
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s/David C. Coen)
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)
s/John D. Burke)

PUBLIC SERVICE
 BOARD
 OF VERMONT

OFFICE OF THE CLERK

FILED: September 26, 2001

ATTEST: s/Susan M. Hudson

Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or mail) of any technical errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.