

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6914

Investigation into the Existing Rates of)
Shoreham Telephone Company, Inc.)
)
)

Order entered: 12/30/2003

**ORDER OPENING INVESTIGATION
AND NOTICE OF HEARING**

I. INTRODUCTION

The Public Service Board ("Board") has, pursuant to 30 V.S.A. § 218, continuing responsibility to ensure the rates charged by incumbent telecommunications companies in Vermont are just and reasonable. Based on a preliminary review of recent financial reports filed by Shoreham Telephone Company, Inc. ("Shoreham" or the "Company"), there is sufficient reason to examine whether Shoreham's existing rates are just and reasonable. Pursuant to 30 V.S.A. § 227(b), the Board opens this investigation into the justness and reasonableness of the existing rates charged by Shoreham Telephone Company, Inc.

II. BACKGROUND

On September 2, 2003, Shoreham, along with the other Independent Telephone Companies of Vermont¹, filed with the Board and the Vermont Department of Public Service ("DPS") supplemental financial reports to their 2002 Annual Report. Thereafter, a series of discussions concerning these reports were held between Board staff and some of the independent

1. The nine independent telephone companies are: Franklin Telephone Company; Ludlow Telephone Company; Northfield Telephone Company, Perkinsville Telephone Company; Shoreham Telephone Company, Inc.; STE/NE Acquisition Corp., d/b/a Northland Telephone Company of Vermont, d/b/a FairPoint New England; Topsham Telephone Company, Inc., Vermont Telephone Company, Inc., d/b/a Vtel; and Waitsfield-Fayston Telephone Company, Inc., d/b/a Waitsfield Telecom, d/b/a Champlain Valley Telecom.

telephone companies. On November 20, 2003, Board staff met with Shoreham, Shoreham's accountants and the DPS. Following this meeting, and as requested, Shoreham's accountants filed two revised supplemental reports.

For a "cost-based" local exchange company, traffic and cost studies are used to separate costs and to establish both interstate and intrastate revenue requirements. Currently, Shoreham is not a "cost company," but is an "average schedule" company. This allows Shoreham to use an FCC-approved formula for establishing its interstate revenue requirement. It also allows Shoreham to avoid separation studies, which are expensive and time consuming, particularly for small companies. However, without those studies, it becomes more difficult to properly set the company's intrastate revenue requirement. The question is how to separate Shoreham's total costs into an intrastate component, a step necessary to determining its jurisdictional revenue requirement. Three methods are possible: using general industry separations data; using Shoreham-specific separations data; and adopting "total company" ratemaking.

One of the revised supplemental reports filed by Shoreham assumes that Shoreham's intrastate costs should be determined by industry average separation factors. The other revised supplemental report uses Shoreham-specific data derived from Docket 6401.² That docket did not, however, overtly address an appropriate cost of equity or capital structure, each of which has a direct bearing on the determination of whether current rates are just and reasonable. Both filings show that Shoreham's rates are insufficient to meet its intrastate revenue requirement. However, these analyses do not reflect the possibility of adjustment of some of the assumptions underlying the filings. In particular, we note that Shoreham assumed a capital structure consisting of a high percentage of equity to debt and a cost of equity that appears to be excessive in relation to comparable investments. In contrast to Shoreham's capital structure, typical utility capital structures are closer to a 50/50 split between debt and equity. We conclude that there is a significant possibility that Shoreham's intrastate revenues are higher than a just and reasonable level, and we accordingly open an investigation.

2. In February, 2001, the Board approved a stipulation in Docket 6401 between Shoreham and the DPS. The stipulation resulted in a decrease in rates. However, the stipulation was a bottom line settlement and was silent on a number of important issues.

Under a "total company" ratemaking methodology, Shoreham would be considered a single entity with a single unseparated revenue requirement. Federal revenue would be treated as one of many sources of revenue, and state rates would be set to establish the remaining or residual revenue requirement.³ The total company method has been adopted in some states to avoid the need to develop intrastate separations factors for average schedule companies that do not conduct separation studies. It also has the advantage of ensuring that an average schedule company does not have an opportunity to recover more than 100 percent of its revenue requirement.⁴ The Public Service Board has never explicitly adopted the total company ratemaking methodology for average schedule companies, and the stipulation in Docket 6401 did not discuss the issue. However, based on the filings to date, it appears that if the Board were to adopt a total company rule for Shoreham, its rates would be substantially reduced. We anticipate that this investigation will also evaluate the desirability of adopting total company ratemaking for Shoreham, as an average-schedule company in Vermont.

On the basis of these updated, Company-revised reports and an independent analysis, we find sufficient reason to investigate the reasonableness of Shoreham's current rates.

In addition to identifying just and reasonable rates, we ask the Company, the DPS and other interested parties to explicitly address, among other items, the following:

- (1) known and measurable changes in operations;
- (2) appropriate capital structure;
- (3) appropriate cost of equity; and,
- (4) benefits (and costs) of establishing Shoreham's rates using a total company (or residual) methodology.

3. For this reason, the method is sometimes called "residual ratemaking."

4. See *Crockett Telephone Company, et al v. FCC* 963 F. 2d 1564 U.S. App. D.C. 397 (1992).

I. ORDER

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

1. Pursuant to 30 V.S.A. Section 227(b), an investigation is hereby commenced into the existing rates of the Shoreham Telephone Company, Inc.
2. Pursuant to 30 V.S.A. Section 8, Thomas Lyle, Utilities Analyst, is appointed to serve as the Hearing Officer in this proceeding.
3. Pursuant to 30 V.S.A. Section 11(a)(2), a prehearing conference will be held in this matter on Friday, January 16, 2004, commencing at 11:00 A.M., at the Public Service Board Hearing Room, Third Floor, Chittenden Bank Building, 112 State Street, Montpelier, Vermont.

Dated at Montpelier, Vermont, this 30th day of December, 2003.

<u>s/Michael H. Dworkin</u>)	PUBLIC SERVICE BOARD OF VERMONT
)	
<u>s/David C. Coen</u>)	
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<u>s/John D. Burke</u>)	

OFFICE OF THE CLERK

FILED: December 30, 2003

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 in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)