

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska) Application No. NUSF-64
Public Service Commission, on)
its own Motion, seeking to)
Investigate the use of Expense) ORDER
Caps in the earnings calculation)
for Nebraska Universal Service)
Fund Support.) Entered: June 3, 2008

APPEARANCES:

**For the Rural Independent
Companies**

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For Embarras

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And

Mr. Tre Hendricks
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For the Commission

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**For the Rural Telephone
Coalition of Nebraska**

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And

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BY THE COMMISSION:

The Nebraska Public Service Commission (Commission) opened the above-captioned docket on December 19, 2006 to investigate the use of expense caps in the earnings calculation for Nebraska universal service fund (NUSF) support. Notice of this proceeding was published in The Daily Record, Omaha, Nebraska on December

20, 2006. Several rounds of comments were filed and admitted to the record collectively as Exhibit 3.

On April 8, 2008, the Commission solicited further comment on some adjustments to the proposed earnings cap model. The Commission released two alternative proposals for comment. In one proposal, Supported Households and total Plant in Service were used as independent variables. Alternatively, the Commission sought comment on a proposal using net investment as an independent variable. Comments were filed on April 22, 2008 by interested parties.

A hearing was held on March 4, 2008 in Lincoln. Appearances were entered as shown above. Testimony was offered at the hearing by Commission staff, Qwest Corporation, Embargo, and a group of Rural Independent Companies (RIC).

Dr. David Rosenbaum was called to the witness stand to answer any questions related to the operation of the proposed earnings cap model. Dr. Rosenbaum testified that he believes it is in the public interest for the Commission to adopt an expense cap model.¹

Mr. Wayne Culp testified on behalf of Qwest. Mr. Culp testified that Qwest was encouraged by the Commission staff's adjustments to the model.² He stated that Qwest was concerned about its treatment in the model since it is a much larger company.³ He would like to make sure that the model adopted by the Commission takes its size and expanse of operations into account.⁴ One remaining concern was the treatment of wholesale service. He testified that wholesale lines should be included.⁵

Ms. Sue Vanicek testified on behalf of RIC. She testified that RIC believes further policy rationale should be offered to support the adoption of an expense cap model. RIC believes expense caps are not necessary, given current oversight mechanisms.⁶ However, in the event that the Commission adopts expense caps, she stated, RIC concurs with the recommendation of the NTIPS Director, that using supported households and total plant in service would make the model more predictable and that

¹ See Transcript of Proceedings at 22. ("TR.")

² TR. at 25.

³ TR. at 25-26.

⁴ See *id.*

⁵ TR. at 27-28.

⁶ TR. at 44-47.

the results of the model should be adjusted to account for inflation.⁷ RIC disagrees with the suggestion to make an adjustment for productivity. The development of productivity factors is difficult and costly.⁸

Ms. Ann Prockish testified on behalf of Embargo. Embargo believes expense caps are unnecessary.⁹ Expenses for NUSF support are limited by virtue of the Commission's use of forward-looking economic costs in the distribution model.¹⁰ In addition, she stated, eligible carriers will not have an incentive to invest in their networks with expense caps in place.¹¹ This, Ms. Prockish testified, is contrary to the goals of the Commission.¹² Ms. Prockish also testified that it was not necessary to link the expense cap methodology to the NUSF distribution methodology. The two were created and designed for two completely different purposes.¹³

Mr. Jeff Pursley, Director of the NTIPS Department testified in support of the staff's expense cap model. He testified that the staff continues to believe that expense caps are an important piece of the Department's analysis to make sure that funds collected by the NUSF are used appropriately and that the NUSF distributes those amounts that are necessary.¹⁴

Mr. Pursley testified that the Department supports the concept of moving to supported households and believes an inflation factor, and a productivity factor if necessary, should be used to allow the model to transition over time.¹⁵

Mr. Pursley confirmed that one of the policy reasons behind adoption of expense caps is public accountability.¹⁶ Mr. Pursley believed expense caps were an appropriate tool for the NUSF-EARN Form process.¹⁷ While the NUSF-Earn Form is designed as a check on the use of NUSF, it is based upon the information that the companies provide to the Commission.¹⁸ The NUSF-Earn Forms are

⁷ See *id.*

⁸ TR. at 47-49.

⁹ TR. at 59.

¹⁰ *Id.*

¹¹ TR. at 60.

¹² *Id.*

¹³ *Id.*

¹⁴ TR. at 74.

¹⁵ TR. at 75.

¹⁶ TR. at 76.

¹⁷ TR. at 77.

¹⁸ *Id.*

audited but, the auditor does not give any opinion about whether those accounts are appropriate.¹⁹ The proposed expense cap model will look at the appropriate uses of NUSF. The annual certification method has been a self-certification process until recently.²⁰ Mr. Pursley testified that the expense cap model is a tool the Commission should use to make sure that monies are being used appropriately.²¹

Mr. Pursley further testified that he did not believe expense caps would have a detrimental effect on the ability of companies to invest and recover their investments.²² He believed the relationship between inducing investment and expense caps would be neutral.²³

As for the inflation factor, Mr. Pursley testified that the Commission should review the type of factor that should be adopted. However, for the present time, he suggested adoption of the expense cap model without that factor.²⁴

Upon further questioning, Mr. Pursley testified that if a company exceeds the upper boundary of the expense cap model, the staff would first seek information regarding expenses to determine the cause. Next, if appropriate, the staff would either recommend approval without an adjustment to the calculation of NUSF support or request a Commission review of a proposed adjustment of a company's NUSF-Earn Form.²⁵

O P I N I O N A N D F I N D I N G S

We begin by addressing some of the adverse positions surrounding the need for expense caps. Some interested parties questioned the need for an expense cap model requesting the Commission first decide the propriety of using expense caps.²⁶ These commenters believed the current mechanisms were adequate to determine whether NUSF monies are being spent appropriately.

¹⁹ TR. at 78.

²⁰ TR. at 79.

²¹ *Id.*

²² TR. at 81.

²³ TR. at 82.

²⁴ See TR. at 87.

²⁵ See TR. at 95-97.

²⁶ See generally, the Comments and Reply Comments of the Rural Independent Companies (filed November 14, 2007, November 30, 2007, January 18, 2007 and April 22, 2008), the Reply Comments of the Rural Telecommunications Coalition of Nebraska (November 30, 2007).

The staff testified that an expense cap model would be an important tool for analyzing how NUSF support is used.²⁷ The Hearing Officer in prior orders indicated that expense caps were important for public accountability. The Commission has given these comments significant consideration and concludes that despite arguments to the contrary, an expense cap model is a needed tool for proper oversight of NUSF support.

In this Order we find we have the authority and justification to adopt an expense cap model. This Order further adopts an expense cap model based on the variation suggested by the NTIPS Department to include households as an independent variable. The Commission adopts a mechanism for reviewing expenses that exceed the upper boundary of the expense cap model. Finally, the Commission seeks comment on the development of an inflation factor to be used to update the expense cap model in future years.

Neb. Rev. Stat. § 86-324(2)(b) states the Commission "[s]hall have the authority and power to issue orders carrying out its responsibilities and to review the compliance of any eligible telecommunications company receiving support for continued compliance with any such orders or regulations adopted pursuant to the act[.]" Subpart (1) of § 86-324 specifies that a telecommunications company that receives support "shall use the support only for the provision, maintenance and upgrading of facilities and services for which the support is intended." Indeed, as the commenters have pointed out in this proceeding, the Commission has used other tools such as audit procedures, certification and benchmarks in the distribution model to encourage the proper use and appropriate amount of NUSF support. The earnings cap model developed by the Commission staff serves as an objective tool to oversee the use of NUSF support. Like those other tools, the consequence of falling outside an established boundary means that NUSF support amounts may be altered. As the staff testified, the purpose of an expense cap model is to ensure that NUSF support is being used appropriately. Consequently, the Commission believes it is well within its statutory authority to adopt an expense cap model to oversee the use of NUSF support.

Mr. Pursley testified that the expense cap model is a needed tool for reviewing NUSF-EARN Forms and determining the appropriateness of how NUSF support is used. In the agreed-upon-procedures, the independent auditors certify that they have

²⁷ TR. at 79.

traced the amounts on the NUSF-Earn Form back to the financial statements of the company. The auditor does not, however, give an opinion about whether those accounts are appropriate.²⁸ The use of a forward-looking cost model does not completely alleviate our concerns because companies are not investing at the level assumed in the forward-looking cost model.²⁹

Some commenters correctly point out the Commission has recently required detailed information in NUSF-25/NUSF-66 to review the use of high-cost federal and state universal service funds. The Commission reviews this information companies to determine whether funds are being used for the provision, maintenance and upgrading of facilities and services for which the support is intended consistent with federal and state law.

Notwithstanding the recent changes in NUSF-25/NUSF-66, the expense cap model will ensure that information provided in the NUSF-Earn Forms is measured with an objective standard. It is a needed tool in the NUSF-EARN Form process. In addition, the staff proposal blends the objective review of the model with an opportunity to look at a company's expenditures should the circumstances warrant a detailed review.

The Commission continues to believe that adoption of an expense cap model is appropriate for public accountability to ratepayers. In addition, we do not believe adoption of an expense cap model is contrary to the goals established by the Commission in NUSF-26. The Commission has previously found that the focus of the NUSF support should be on the consumers,³⁰ that support should be used for its intended purpose,³¹ and that the Commission should protect the public interest and welfare.³² The expense cap model would give the Commission a tool to make sure that consumers are realizing the goals of the NUSF Act, namely affordable and comparable telephone service.³³

We find the proposal using Supported Households and total Plant in Service as independent variables should be adopted effective with the 2008 NUSF-Earn Form which would be filed in

²⁸ TR at 78.

²⁹ TR. at 77.

³⁰ See Docket No. NUSF-26, *In the Matter of the Nebraska Public Service Commission, on its own Motion, Seeking to Establish a Long-term Universal Service Funding mechanism*, Progression Order No. 2 (August 27, 2002) at 12, i).

³¹ See *id.* at b).

³² See *id.* at g).

³³ See *id.* at d).

2009. Of the two alternatives released by the Commission, the methodology using Supported Households and total Plant in Service as independent variables received more support. RIC commented that using Supported Households and Plant in Service as independent variables would make the method more predictable by making it less susceptible to significant changes from year to year.³⁴ This proposal, we believe, is also consistent with the NUSF-26 distribution model which distributes support based on households. Supported households are the highest cost households. Consequently, it seems appropriate to use the same areas that the Commission provides support in to measure expense caps in the model we adopt in this Order. Using Net Investments on the other hand would arguably make the methodology less predictable according to RIC.³⁵ We agree. Adopting a model based on net investment could fluctuate greatly depending on investment cycles of companies and make the expense cap standard less predictable. Accordingly, we adopt the expense cap model released on April 8, 2008³⁶ which uses Supported Households and Plant in Service.

The Commission will run the expense cap model using the expenses and total plant in service reported in the 2008 NUSF-Earn Form which will be filed in 2009 and using Supported Households consistent with the NUSF-26 distribution model released as of February, 2008, and forward. In the event of merger, transfer or acquisition of property that affects Supported Households and total Plant in Service for a company, the model will be re-run based upon the accurate supported household information/total plant in service for the period where the expenses occurred.

Each expense cap, or upper boundary, is determined based on the expense cap model's forecasted total cost, the forecast standard deviation, and a parameter from a standard normal distribution. The upper boundary is based upon two standard deviations.

We further adopt a mechanism for review of a company which may have expenses above the upper boundary of the expense cap model. Such companies will be given notification by the NTIPS Department and shall have an opportunity to provide a written

³⁴ See Comments of the Rural Independent Companies (April 22, 2008) at 7.

³⁵ *Id.*

³⁶ See NUSF-64, Order Seeking Comment (April 8, 2008). The proposed expense cap model was released to persons signing the Nondisclosure Agreement pursuant to the provisions of the Protective Order in this proceeding.

explanation detailing why the company's expenses exceed the upper boundary of the model and why the expenses are reasonable. The NTIPS Department will review the explanation and will give the Commission a recommendation. Any company subject to this review will have an opportunity for a hearing if it disagrees with the staff recommendation. The Commission will determine if a hearing is necessary or whether to adopt the staff recommendation. If the Commission finds after a hearing that the NUSF-Earn Form of a company should be adjusted, it will provide its reasoning in a Commission order which will be subject to judicial review.

Further Request for Comment:

Finally, the Commission seeks further comment on the development of an inflation factor. The Commission staff proposed that an inflation factor be added to the expense cap model as a way to update the model rather than using actual expenditures of the companies each time an update is appropriate. The Commission seeks comment on the adjustment interval and how a factor can be efficiently developed. Specifically,

- 1) Should the Commission make adjustments for inflation? If so, should the Commission use the Chained Consumer Price Index (C-CPI) as suggested by RIC?
- 2) Should the Commission develop an annual productivity factor?
- 3) Should Supported Households be recalculated when the Commission updates this figure in the NUSF-26 model? Should it be re-run after the next United States census information is made available?

Comment on these issues should be filed no later than August 4, 2008. Commenters should file five (5) paper copies and one (1) electronic copy which can be electronically mailed to Brandy.Zierott@psc.ne.gov. Commenting parties should also serve the other interested parties in this proceeding.

O R D E R

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that the opinions and findings herein be, and they are hereby, adopted.

IT IS FURTHER ORDERED that the expense cap model released on April 8, 2008 using Supported Households and total Plant in Service as independent variables is hereby adopted.

IT IS FURTHER ORDERED that interested persons may file comments on or before August 4, 2008 on the adoption of an inflation factor as described herein.

MADE AND ENTERED at Lincoln, Nebraska this 3rd day of June, 2008.

Commissioners Concurring:

NEBRASKA PUBLIC SERVICE COMMISSION

Chair

ATTEST:

Executive Director