BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service Commission, on its own motion, to make adjustments to the universal service fund mechanism established in NUSF-26.	Application No. NUSF-50 ORDER December 19, 2006

APPEARANCES:

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BY THE COMMISSION:

Background:

1. The Nebraska Public Service Commission (Commission) opened this proceeding on its own motion pursuant to *Neb. Rev. Stat.* § 86-324(2)(b)(2004 Supp.) to consider certain adjustments to the universal service high cost program mechanism established in NUSF-26 ("NUSF").

2. On December 6, 2005, and on January 18, 2006, the Commission sought comment on some modifications to the NUSF.

3. On July 18, 2006, the Commission released a staff proposal for public comment in NUSF-50. Comments were due on August 17, 2006. Comments were filed by United Telephone Company of the West d/b/a Embarq (Embarq), the Nebraska Rural Independent Companies (RIC), the Nebraska Rural Telephone Coalition (RTCN), Citizens/Frontier (Frontier), N.E. Colorado Cellular d/b/a Viaero Wireless (Viaero), Qwest Corporation (Qwest), Nebraska Telecommunications & Technology (NT&T) and Cingular Wireless PCS, LLC and Sprint Spectrum L.P. d/b/a Sprint PCS and Nextel West Corporation d/b/a Nextel (Cingular/Sprint/Nextel).

4. On August 29, 2006, the Commission released several proposals requesting interested parties to file testimony or comments in response. Testimony was filed by Embarq, RIC, RTCN, Frontier, Qwest, NT&T and the Commission staff. Comments were filed by Allo and Sprint/Nextel.

5. The Commission held a hearing on the proposals on November 8 and 9, 2006 in the Commission Hearing Room, Lincoln, Nebraska. Appearances at the hearing were as described above.

6. Post-hearing briefs were filed on November 29, 2006 by Embarq, RIC, RTCN, Qwest, Frontier, NT&T and the staff. Post-hearing comments were filed by Allo.

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

Updates and Adjustments:

7. There are several updates and adjustments the Commission believes the staff could have made to the Distribution Model without Commission approval, pursuant to the

authority given to the staff by our order in NUSF-26.[1] However, since the staff has asked Commission for approval to make these changes, the Commission discusses and makes the following findings on the proposed changes.

8. As the staff previously explained, some of the adjustments outlined in the Commission's August 29, 2006 Order were planned to be made regardless of this proceeding. The Data Updates which were displayed in Column C of Attachment "A" (Attachment "A") to the Commission's August 29, 2006 Order were to be made as required by our Order in NUSF-26.[2] No party filed testimony opposing these updates. As a result, high-cost support would be reduced by approximately $3.7 million for the 2007 payment year as displayed in Attachment "A".

9. In addition, the staff commented that it would be appropriate for the Commission to make adjustments for the over-earning (OE) credit removal and the zone adder removal. With respect to the OE credit removal, which was also displayed in Attachment "A", the Commission finds that this adjustment should be made. With respect to the zone adder, the Commission staff previously provided that beginning in 2005, revenue reductions due to the elimination of zone charges will be included in the NUSF-EARN Form. For affected companies filing on a one-year average, there is no longer a need for zone adder earnings adjustment in the Distribution Model. However, for affected companies filing on a three-year average, a 1/3 phase-out reduction to the zone adder earnings adjustment is needed for each year, beginning with 2005. As previously indicated, this correction was made to the TM worksheet of the Distribution Model. The Commission finds these adjustments to be appropriate for the staff to make these updates, collectively, to the Distribution Model as reflected in the attachment to this Order.

10. The Commission also sought comment on setting the urban benchmark at $17.95, an increase from the previously established benchmark of $17.50. This was labeled as Step Two of the Commission's proposal. The Commission staff performed a calculation, which indicates that the average urban rate charged in Nebraska is $17.95. That calculation was released for comment as Attachment "B" (Attachment "B") to the Commission's August 29, 2006 Order. The Commission finds the staff appropriately defined the urban benchmark in Attachment "B." The Commission

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[1] *In the Matter of the Nebraska Public Service Commission, on its own motion, seeking to establish a long-term universal service funding mechanism*, Application No. NUSF-26, Findings and Conclusions, November 3, 2004 (NUSF-26).

[2] *Id.*

further finds that the staff could have made this adjustment to the distribution model to reflect the current urban average rate without explicit Commission approval. However, given the fact that Commission approval was sought, the Commission finds the adjustment should be made in the distribution model and the urban rate benchmark should be $17.95. Further, the Commission finds that the urban benchmark in the distribution model should be updated by the staff on a periodic basis without explicit review by the Commission if the average urban rate changes.

NUSF-7 Depreciation:

11. The Commission proposed in Step One to depreciate the NUSF-7 support allocated to companies receiving such support. The impact of depreciating the NUSF-7, the staff estimated, was a $500,000 per year reduction in support requirements to the fund. While the overall impact to the fund is $500,000, due to per-line backstop and OER transitional mechanisms the actual impact to the affected companies in the 2007 payment year is an estimated decrease of $32,423 as shown in column G of Attachment “A.” A worksheet describing how each company would be affected in the 2007 funding year was made available to the affected companies, upon request. No party opposed depreciation of the NUSF-7 support at the hearing.

12. We find it appropriate to make this change as proposed. Given the changes in the NUSF, it is no longer reasonable to keep disbursing NUSF-7 monies without recognizing depreciation. Accordingly, the Commission finds this proposal should be adopted. The staff is directed to make this change in the NUSF-26 Distribution Model.

Imputation of Federal Universal Service Support:

13. In Step Three of the proposed modifications, the Commission proposed to impute certain amounts of federal universal service fund payments into the NUSF earnings calculation. The Commission proposed to examine whether some or all of federal universal service fund payments are in fact recovering costs assigned to the state jurisdiction. The calculation of federal universal service support is no longer driven solely by the federal cost accounting rules. These accounting rules allocate costs between interstate and state jurisdictions and form the basis for the NUSF-EARN Form used in the calculation of NUSF support. Further, the NUSF by statute is designed as a supplement to federal universal service support mechanisms. *See Neb. Rev. Stat.* § 86-317. Given the potential mismatch of federal universal service support and the allocated costs, as well as the statutory requirement, the Commission

believes federal universal service support must be taken into account when determining a company's need for NUSF support. Accordingly, the Commission proposed, if a company received federal universal service funding, to determine if interstate revenues exceed interstate costs, using the Commission's approved earnings benchmark. In the event a company's interstate revenues exceed interstate costs, the Commission proposed to impute into the determination of NUSF support the lesser of the federal universal service support or the amount by which interstate revenues exceed interstate costs. This amount is then added to the NUSF EARN Form as additional revenue for the purpose of recovering costs assigned to the state jurisdiction. This would only affect companies that have elected to file NUSF-EARN Forms on a jurisdictional or support service basis. This proposed modification was displayed in column I in Attachment "A" to the Commission's August 29, 2006 Order.

14. A number of parties opposed the proposal, alleging, inter alia: the Commission cannot impute FUSF on state earnings without also including interstate expenses; the proposal would force companies to file the NUSF-EARN Form on a total company basis; and the NUSF high cost program is designed to recover loop costs and therefore it would be inappropriate to impute FUSF designed to recover switching costs.[3] Qwest disagrees with the methodology proposed for imputing FUSF, but generally agrees with the concept.[4] The Commission disagrees with the arguments made in opposition of the Commission's proposal. *Neb. Rev. Stat.* § 86-317 provides that the state support mechanism should supplement the federal universal service fund. To the extent that the parties argue the Commission cannot look at federal universal service payments or that it is inappropriate to do so, the Commission emphasizes that the language in § 86-317 provides that the Legislature intends for the Commission to take federal support into consideration when determining NUSF support.

15. The Commission rejects the argument by some parties that the FUSF imputation will be a burden on the federal fund, in violation of 254(f). The Commission's imputation of FUSF

[3] *See Direct Testimony of Sue Vanicek on Behalf of the Rural Independent Companies*, (September 29, 2006) at 5; *Reply Testimony of Sue Vanicek on Behalf of the Rural Independent Companies* (October 23, 2006) at 2; *Direct Testimony of Mark D. Harper on Behalf of United Telephone Company of the West d/b/a Embarq* (September 29, 2006) at 7; *Reply Testimony of Mark D. Harper on Behalf of United Telephone of the West d/b/a Embarq* (October 23, 2006) at 8; *Direct Testimony of David Ruhland on behalf of Citizens Telecommunications Company of Nebraska d/b/a Frontier Communications of Nebraska* (September 28, 2006) at 5; and *Direct Pre-Filed Testimony of Kevin J. Kelly* (September 29, 2006) at 8.

[4] *See Reply Testimony of Peter B. Copeland* (October 23, 2006) at 4-7.

earnings in no way changes the level of FUSF support, nor requires any changes in the FUSF mechanisms. The only change occurring is relative to the determination of NUSF support, which is subject to the jurisdiction of the Commission.

16. The Commission further rejects the arguments that the FUSF imputation proposal constitutes an unlawful taking, and that the proposal improperly assesses interstate revenues.[5] Contrary to the arguments made, the Commission does not view the proposal as regulating interstate services. Rather, as discussed above, this proposal only affects the determination of appropriate state support. Accordingly, the argument that the Commission is attempting to regulate or assess interstate services is rejected.

17. In addition, the primary goal of the Commission's universal service policy is to direct support to areas with the most critical universal service fund needs. The FUSF imputation, adopted here, enhances the earnings review process and further ensures that the available NUSF support is targeted to the companies most in need of the support to provide telecommunications service in high-cost areas of the state.

18. In reaching the foregoing conclusion regarding FUSF imputation, the Commission is cognizant of the pending FCC dockets in which the FUSF mechanism are being re-examined. In particular, the Commission is mindful of the current consideration of the "Missoula Plan" for inter-carrier compensation reform and that resolution of that matter may have a material impact on the NUSF. Thus, the Commission will continue to monitor these federal activities and make such changes to the NUSF as may be appropriate.

<u>Earnings Benchmark</u>:

19. In Step Four of the Commission's proposal, the Commission sought comments on a proposal to reduce the earnings benchmark from 12.00 percent to 11.25 percent. The Commission proposed 11.25 percent using the federal rate of return benchmark as guidance. Most of the parties opposed this proposed modification. A number of parties argued that the Commission should not adopt this proposal because of the significant

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[5] *See Post Hearing Brief of United Telephone Company of the West d/b/a Embarq* (November 29, 2006) at 7.

difference in how the federal rate of return and earnings benchmark are utilized.[6] Qwest supported this adjustment.

20. Upon consideration of the testimony provided in this proceeding, the Commission declines at this time to change the earnings benchmark from 12.00 percent to 11.25 percent as proposed.

Rural Benchmark:

21. In Step Six of the proposed change, the Commission questioned whether it should establish a rural benchmark of $19.95 and subsequently make an explicit reduction in high-cost support payments to reflect said rural benchmark. A number of parties opposed the rural benchmark proposal arguing that the rate was not reasonably comparable, affordable and that the rural benchmark would risk RUS funding for carriers implementing zone charges or rates based on mileage.

22. Based on the record, the Commission finds that a rural benchmark of $19.95 should be established, and a rural benchmark imputation mechanism adopted to make explicit high-cost support payment reductions to reflect the rural benchmark established here. The imputation shall be made according to the Commission's proposal as modified herein.

23. The Commission's findings regarding this issue do not constitute a mandate to raise local rates. The Commission believes the companies possess the option of increasing local rates, e.g. xDSL, local service, or vertical features, to recover explicit NUSF support reductions due to the rural benchmark imputation proposal, if so desired.

24. The Commission adopts the rural benchmark imputation method as contained in the proposal with a modification that limits the imputation amount, on a company basis, to a maximum of $1.00 per month, per residential access line.

25. The resulting adjustments to the companies are shown in the attachment to this Order.

[6] See*, e.g., Direct Testimony of Dr. Brian K. Staihr on Behalf of United Telephone of the West d/b/a Embarq* (September 28, 2006) at 15.

Over Earnings Redistribution:

26. In Step Five of the Commission’s proposal, the Commission sought to phase down over earnings redistribution (OER) 25 percent per year for the next three years such that OER is eliminated subsequent to payment year six following the Commission’s NUSF-26 Order. Qwest opposed this proposal. A number of the rural companies supported this proposal. The goal of the OER step-down was to ease the transition for companies experiencing a reduction of support.

27. Upon consideration of the testimony, the Commission finds that the OER proposal should be adopted, but that implementation should be delayed until January 2008. The Commission finds it appropriate to give the companies facing a reduction of support additional time to make these significant adjustments. The Commission also finds it appropriate to explore other options, including the changes which might be made by the Federal Communications Commission (FCC) to reform the intercarrier compensation regime. Accordingly, the Commission finds that this step down proposal should be implemented beginning January of 2008. Adjustments consistent in manner to those shown in Attachment “A” of the Commission’s August 29, 2006 Order will be made in January 2008 unless otherwise modified by the Commission before that time. The Commission recognizes that the OER step-down proposal envisioned implementation in 2007 and would last three years, coinciding with the end of the transition period. Delaying implementation until January of 2008 breaks this connection. Accordingly the Commission will reserve judgment as to the second and third step of the OER step-down proposal at this time.

Base Allocation Reduction:

28. The Commission proposed to reduce the size of the NUSF by approximately $6.8 million. The Commission finds that it should not make the base allocation reduction as proposed. In a separate proceeding, the Commission raised the surcharge to 6.95 percent on an emergency basis, which will negate the need to make the proposed base allocation reduction at this time.

Porting of Support to Competitive Local Exchange Carriers:

29. In its August 29, 2006 Order, the Commission proposed to index NUSF support for competitive local exchange carriers (CLECs) to the underlying incumbent local exchange carrier (ILEC) NUSF support. If the ILEC support was reduced in the

ILEC territory, the amount ported to the CLEC would also be reduced based on the index selected. NT&T opposed this proposal. Instead, NT&T offered its own proposal for porting NUSF support. In its brief, the staff recommended that the Commission reject NT&T's proposal and instead asked the Commission to consider eliminating all support in zones 1 and 2.

30. The Commission finds the staff's proposal to eliminate ported support to CLECs in zones 1 and 2 should be given further consideration. As no party had an opportunity to comment on this proposal, the Commission seeks comment on the staff proposal to eliminate ported support in zones 1 and 2. The Commission does not envision holding a hearing on this proposal. Rather, comments on this proposal should be filed on or before **January 23, 2007**. The Commission will give further consideration to this issue after comments are filed.

Reasonably Comparable Rates:

31. There was significant discussion in this proceeding about "reasonably comparable" rates. In its August 29, 2006 Order, the Commission acknowledged that state statute required rates be reasonably comparable throughout the state. *See Neb. Rev. Stat.* § 86-323(3). The Commission finds it appropriate to address those arguments in the scope of this Order given the arguments of the staff and the interested parties.

32. The Commission finds that a range of rates from $17.50 to $19.95 is reasonably comparable within the meaning § 86-323(3). Companies are free to charge rates ranging from $17.50 to $19.95 without foregoing NUSF support eligibility. Increases in basic local exchange rates that companies may choose to implement are subject to the procedures set forth in the Nebraska Telecommunications Regulation Act, including, but not limited to *Neb. Rev. Stat.* Sections 86-141 and 86-145 (2004 Cum. Supp.).The Commission considers a rural benchmark rate of $19.95, an 11 percent increase from $17.95, which is the current average urban rate, is reasonably comparable to the urban rate.

33. In reaching this conclusion, the Commission finds the FCC analysis and the Tenth Circuit opinion cited by RIC[7] does not control its consideration of whether the rate is reasonably comparable. Using the FCC's analysis and the 10th Circuit opinion, RIC argues the Commission's proposed rural benchmark

[7] *See Direct Testimony of Sue Vanicek on Behalf of the Rural Independent Companies*, (September 29, 2006) at 5.

rate will result in non-comparable local rates.[8] The Commission rejects the use of a two standard deviation argument to determine comparable rates in Nebraska. Standard deviation is a measure of dispersion, or variation in data. Tightly clustered data, by definition, result in a small variance and a low standard deviation. Thus, in Nebraska, where local rates as a matter of public policy have been kept relatively uniform, i.e. tightly clustered, a low standard deviation and a small two standard deviation interval around the mean is, by definition, the result. Therefore, the Commission finds the FCC analysis and the 10th Circuit opinion cited by RIC[9] does not control its consideration of whether the rate is reasonably comparable. Rather, the Commission agrees that the FCC approach would be illogical since existing local rates in Nebraska are relatively uniform.

34. In setting this range, the Commission is also cognizant that as the urban benchmark calculation performed by the staff in Attachment “B” to the Commission’s August 29, 2006 Order demonstrates, some carriers are currently charging a residential local rate of $18.15 in urban markets. In addition, some companies have charged zone rates or mileage rates, which exceeded the $19.95 rate in out-of-town areas, which to the Commission’s knowledge, did not have any affect on subscribership.

Sufficiency and Predictability:

35. A number of parties raised objections to the proposals stating that they would harm the sufficiency and predictability of the NUSF mechanism. The Commission finds that it should balance the policy goals of the NUSF Act with the sufficiency and predictability requirements of *Neb. Rev. Stat.* § 86-323(5) in considering the proposals adopted herein, namely the FUSF imputation, the urban and rural benchmark rate adjustments and the OER adjustment. The Commission finds that many of these adjustments are necessary to further the goals of the NUSF Act. Giving additional time for the OER adjustment, as the Commission does here, enhances the predictability of the mechanism adopted in NUSF-26. The Commission believes updates to the NUSF, such as to rate benchmarks, which have not been reviewed since the passage of the NUSF Act, are appropriate from time to time and do not require a public hearing or an Order by the Commission to make these necessary updates. As the companies are free to decide whether to adjust local rates appropriately within what

[8] *See id.*
[9] *See id.*

the Commission has found to be an appropriate range, the Commission does not believe that adopting these proposals make the mechanism less sufficient, specific or predictable. Finally, the FUSF imputation proposal adopted herein is an update to the methodology used by the staff when considering company earnings. The Commission does not believe this earnings adjustment makes the mechanism less sufficient or predictable. Rather, such an adjustment is appropriate given the Commission's legislative directive to structure the NUSF so that it supplements the federal universal service mechanism.

O R D E R

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that the above findings and conclusions be and they are hereby adopted.

IT IS FURTHER ORDERED that the Commission staff is directed to make adjustments in accordance with this Order.

IT IS FURTHER ORDERED that comments may be filed on or before January 23, 2007 on the staff's proposal to eliminate ported support for competitive local exchange carriers in zones 1 and 2.

MADE AND ENTERED at Lincoln, Nebraska this 19th day of December, 2006.

NEBRASKA PUBLIC SERVICE COMMISSION

COMMISSIONERS CONCURRING:

Chairman

ATTEST:

Executive Director