

Decision **PROPOSED DECISION OF ALJ PULSIFER** (Mailed 1/12/2010)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application to Modify D.91-09-042.

Application 09-01-002
(Filed January 6, 2009)**DECISION REGARDING APPLICATION
TO MODIFY ELIGIBILITY RULES FOR
THE CALIFORNIA HIGH-COST FUND-A PROGRAM****1. Introduction**

We herein clarify Decision (D.) 91-09-042 (Decision) with respect to the manner in which the so-called “150% formula” is to be applied in light of the issues raised by Application (A.) 09-01-002. The application is jointly sponsored by a group of Small Local Exchange Carriers (Small LECs or Applicants).¹ The Decision established the current rules for eligibility for funding from the California High-Cost Fund-A (CHCF-A), including the “150% formula” as a basis to determine eligibility. The CHCF-A provides a funding mechanism to close the gap between the costs of serving customers residing in high-cost rural exchanges

¹ The Small Local Exchange Carriers sponsoring the Application are Calaveras Telephone Company (Calaveras), Cal-Ore Telephone Co. (Cal-Ore), Ducor Telephone Company (Ducor), Foresthill Telephone Co., Happy Valley Telephone Co., Hornitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Co. (Pinnacles), The Ponderosa Telephone Co. (Ponderosa), Sierra Telephone Company, Inc., The Siskiyou Telephone Company, Volcano Telephone Company, and Winterhaven Telephone Company.

and the revenue collected from those customers under Commission-approved rates.

The 150% guideline set forth in D.91-09-042 states that Small LECs that file general rate cases must first increase their monthly residential rates up to 150% of the California urban basic rate in order to receive CHCF-A funding. The Commission has interpreted the “urban basic rate” to be that of Pacific Bell Telephone Company dba AT&T California, Inc. (AT&T). The Application requests that the Commission modify D.91-09-042 to no longer require the Small LECs to charge 150% of AT&T’s basic rate to be eligible to receive CHCF-A funding. The Small LECs assert that increasing rates in this manner will cause rate shock or lead customers to disconnect phone service entirely. They also argue that the 150% rule has been misinterpreted and that the 150% level should be only a price benchmark ceiling on basic rates, not a floor, and ask the Commission to confirm this interpretation.

We affirm that meeting the 150% threshold set forth in D.91-09-042 should be interpreted as a requirement to receive CHCF-A funding. We shall also continue to apply the basic rate of AT&T as the “urban basic rate” for purposes of calculating the amount of the 150% formula at this time subject to the interim restriction as explained below. We recognize that the new AT&T pricing flexibility raises questions about the continued use of the AT&T rate for purposes of measuring eligibility to receive CHCF-A funding under the 150% threshold test. We do not believe, however, that the instant application for modification of D.91-09-042 is the most suitable forum in which to resolve these issues.

In response to the new pricing flexibility realized by AT&T, we conclude that issues relating to the appropriate criteria to develop future Small LEC rate designs for purposes of qualifying for high-cost support through the CHCF-A

Program should be addressed in a new rulemaking proceeding where all relevant issues regarding high-cost support for Small LECs can be examined. Accordingly, while we deny the application to modify D.91-09-042, we intend to promptly address the issues raised by the application by opening a new rulemaking to address needed reforms to the CHCF-A program, particularly in view of recent changes in the regulatory framework applicable to the large incumbent telecommunications carriers. As explained below, we set a deadline of 90 days from the effective date of this decision to have a new rulemaking on CHCF-A reform placed on the Commission's agenda. As an additional interim measure to protect against the risk of rate shock, the basic residential rate that a Small LEC must charge to qualify for CHCF-A funding shall be fixed at the current level of \$20.25 per month pending further action to reform the CHCF-A.

2. Background

The Small Local Exchange Carriers (Small LECs or Applicants) jointly filed Application (A.) 09-01-002 on January 6, 2009, seeking a clarification or modification of Decision (D.) 91-09-042. No parties oppose Applicants' request. Responses to the Application were filed jointly by the Division of Ratepayer Advocates (DRA) and The Utility Reform Network (TURN) on January 28, 2009, and separately by Pacific Bell Telephone Company dba AT&T California, Inc. (AT&T) on January 26, 2009.

The California High-Cost Fund-A (CHCF-A) was established by D.88-07-022, as modified by D.91-05-016 and D.91-09-042. The CHCF-A was intended to provide a source of supplemental revenues to mid-sized and Small LECs whose basic exchange access line service rates would otherwise be increased to levels that would threaten universal service. In D.96-10-066, a separate high-cost fund was established for the largest Incumbent Local

Exchange Carriers, and the name of fund providing high-cost support to mid-sized and Small LECs was changed to the CHCF-A. As a condition of receiving funding for high-cost support, the Small LECs were limited as to the maximum amount that their retail customers could be charged for basic service. Limiting the maximum level of Small LEC basic rates in this manner, basic service remained affordable, and the availability of universal service for all Californians was protected.

In D.91-09-042, the Commission set forth the rules whereby Small LECs could receive funding to support the provision of basic service in high-cost regions. Among these requirements was language prescribing that Small LECs' average local exchange rates should not exceed the target level of 150% of comparable California urban rates.² The revenue from this basic rate is taken into account in determining the amount to be drawn from the CHCF-A. To the extent that revenue from the basic rate upon reaching the 150% threshold is not sufficient to meet the Small LEC revenue requirement, the Small LEC may receive CHCF-A support which would provide no more than the utilities authorized rate of return. An increase in the required draw from the CHCF-A could lead to an increase in the surcharge amount assessed on other California landline and wireless customers. The 150% ceiling on basic rates was established by the Commission following the enactment of Public Utilities Code Section 739.3(a) to ensure that the rates of rural telephone customers would be set at a reasonable level, compared to the rates of urban customers. The relevant language prescribing the so-called "150% rule," and setting forth the

² D.91-09-042, Appendix [41 CPUC2d, 326, 330.]

corresponding eligibility requirements to receive CHCF-A is set forth in Appendix D of D.91-09-042, as follows:

The company's average local exchange rates contained in any rate design proposed by such Advice Letter filing shall not exceed the target level of 150% of comparable California urban rates, a standard to be measured generally by a target R-1 flat rate of \$8.35 monthly. Presently authorized rates shall not, however, be reduced to this target level by operation of this mechanism. Any proposals for an exception to this rule shall be addressed separately to the Commission. The 150% level of comparable California urban rates shall constitute a benchmark against which specific company rate designs are measured rather than a rigid requirement that each rate design element be set at 150% of the underlying urban rate.

Those companies with a revised local exchange revenue requirement (the sum of the present level of local exchange revenues and the net positive and negative settlements effects for such company herein specified) which cannot be met from the local exchange rate designs incorporating the 150% threshold shall be eligible to receive the balance of their revised local exchange revenue from the [CHCF]. . .

3. Position of Applicants

Applicants seek a Commission order to clarify or modify the manner in which the so-called 150% rule is applied in view of changes in the AT&T basic rate that have taken effect pursuant to the Uniform Regulatory Framework (URF). Prior to the introduction of URF rate flexibility, the basic rates of AT&T had remained uniform for an extended period. As long as the AT&T basic rates remained uniform, the calculation of a Small LEC's maximum basic rate, based on the 150% rule, was straightforward. However, on September 18, 2008, the Commission issued D.08-09-042, which implemented rate flexibility provisions

whereby the URF LECs may increase prices for stand-alone basic service subject to specified caps for up to two years, and thereafter have full pricing flexibility. Pursuant to D.08-09-042, AT&T filed Advice Letter No. 34152, to raise its basic residential flat unbundled rate in most of its exchanges to \$13.50 per month.

With the introduction of basic rate flexibility as granted in D.08-09-042, AT&T is now able to change its basic rates, effective immediately, with a Tier 1 Advice Letter, and geographically deaverage rates. As the AT&T basic rate changes, the Small LECs' rates set in general rate case (GRC) proceedings will no longer maintain the 150% relationship to the AT&T basic rate without a separate adjustment.

In late 2007, a number of Small LECs filed Advice Letters with the Commission that constituted GRC filings. In those filings, the Small LECs each proposed no increase in its basic residential rates, as the rates for each of those LECs were already at approximately 150% of the AT&T comparable urban rate in effect at that time. The Commission's Communication Division, however, drafted resolutions utilizing rate designs that increased basic rates for each of the aforementioned Small LEC Advice Letters, based upon the 150% rule. In response to the AT&T Advice Letter filed on December 1, 2008, for a basic rate increase to \$13.50 per month, the draft resolutions for the Small LECs' GRC filings incorporated basic rates at 150% of the AT&T rate, or \$20.25 per month. In comments on the draft GRC Resolutions, the Small LECs objected to this treatment, arguing that applying the 150% rule in such a strict fashion would constitute rate shock, prompting a significant number of their customers to drop off their networks. They argued that such a development would cause revenue loss to the Small LECs and increase their CHCF-A draws. The Small LECs joining in the instant application thus seek to have the Commission clarify or

revise the CHCF-A rules set forth in D.91-09-042 to eliminate “the wooden, inflexible interpretation of the 150% rule that is reflected in the GRC Draft Resolutions.”

Subsequent to the filing of the instant application, the Commission adopted resolutions in response to the above-referenced Small LEC Advice Letters. The adopted resolutions, interpreted the 150% rule as proposed by the Communications Division thereby authorizing basic rate increases for the Small LECs up to 150% of the AT&T basic rate.

Applicants state that although they do not agree with this interpretation of the 150% rule, if such an interpretation is the prevailing view within the Commission, then the CHCF-A rules must be changed to reflect contemporary market conditions and shifts in regulatory paradigms that allow AT&T to exercise pricing flexibility as to its basic residential rates. Applicants express concern that a rigid application of the 150% rule would cause the Small LEC basic rates to be increased mechanically, with no ability to exercise discretion or flexibility. The 150% rule creates a multiplier effect whereby any increase in the AT&T basic rate causes a corresponding increase in the Small LEC rate by 150% of the AT&T increase.

4. Position of Other Parties

Responses in support of the application were filed jointly by the DRA and TURN, and separately by AT&T.

DRA supports the request of the Small LECs, arguing that the deregulation of AT&T's basic rate makes the 150% rule obsolete. DRA argues that the Commission should expeditiously open a proceeding to comprehensively review the CHCF-A program in order to update it in the post-URF environment. The CHCF-A Fund is open to 17 Small LECs; however, 10 of the Small LECs do not

collect CHCF-A Fund revenues, suggesting that some companies can provide affordable service without this subsidy. If some Small LECs no longer need the subsidy, DRA believes that the Commission should examine whether the Small LECs that continue to receive funds are using the money for appropriate purposes. DRA recommends that the Commission conduct reasonableness reviews of the companies who receive CHCF-A Fund revenues to ensure that the revenues are used for the purpose they were meant to address: providing affordable service in high-cost areas. These reviews would evaluate how these funds were used, and if they were used appropriately, and whether they were actually needed.

Currently, Small LECs increase rates by filing a Tier 3 Advice Letter which requires the Commission to approve rate increases by adopting a Resolution. Though the Advice Letter process is expedient, there is no opportunity to review the reasonableness and prudence of these companies' spending. Without a reasonableness review, DRA believes there is no way of knowing whether the CHCF-A Fund money is actually used to subsidize the high-cost of providing service to customers or if it is used for other unrelated purposes or excessive corporate expenditures.

DRA recommends that the Commission open a CHCF-A Fund rulemaking, similar to the current CHCF-B and Public Purpose Program proceedings.

While AT&T does support breaking the direct link between its basic rate and those of the Small LECs, it maintains that objective criteria for adjusting the Small LECs' rates are needed. AT&T believes that leaving the future rates of the Small LECs to be adjusted through the Commission's "informed judgment" (as the Small LECs propose) is too amorphous. AT&T suggests that in response to

the application, the Commission should immediately discontinue the link to AT&T's rate, solicit comments on the appropriate criteria to adjust the Small LECs' rates, and adopt appropriate criteria for future adjustments to their rates.

5. Discussion

We conclude that the application should be denied insofar as it seeks to eliminate the 150% formula as discussed below. We affirm that a rate design incorporating the 150% threshold is a requirement, as prescribed in Decision 91-09-042 for eligibility to receive California High-Cost Fund-A (CHCF-A) funding at the time rates are set in an eligible carrier's general rate case (GRC) or other rate proceeding. Basic rates are therefore not automatically increased without regard to the actual revenue requirements of the Small LEC nor are they increased as a result of subsequent Pacific Bell Telephone Company dba AT&T California, Inc. (AT&T) rate increases. If a Small LEC revenue requirement can be met from local exchange rates incorporating a basic rate of less than 150% they shall not be eligible to receive CHCF-A funding.

While we do not grant the application to modify D.91-09-042, we nonetheless recognize that the applicability of the continued use of the AT&T basic rate in applying the 150% formula should be examined in an appropriate forum.

The traditional linkage of Small LEC rates to a level equal to 150% of the AT&T basic rate should be examined in a comprehensive review of the CHCF-A fund in a new rulemaking, in view of the increased rate flexibility that now applies under the provisions of Uniform Regulatory Framework (URF). Also, because AT&T will be authorized to geographically deaverage its basic rates as of January 1, 2011, there may no longer be a single AT&T basic rate to which the Small LEC rates can be pegged. We also recognize that appropriate criteria need

to be identified for purposes of establishing eligibility for Small LECs to draw from the CHCF-A.

Although we applied the 150% guideline, based on AT&T rates, in adopting rate changes for Small LECs in the recent series of Commission resolutions referenced in the Applicants' pleading, we also left open the flexibility to adopt a different result in the future based on the changed circumstances relating to the URF. While authorizing these increases in the Small LECs' basic rates by applying the 150% rule, the Commission also included the following language in its resolutions, such as that found in Resolution T-17133:

Given that AT&T has increased pricing flexibility under URF, we will be reviewing in the immediate future whether to continue linking the company's Basic Residential rate to 150% of AT&T's Basic Residential rates as a condition for the company to receive CHCF-A support. We recognize that the changed circumstances may support reconsideration of this practice and we will also consider whether any changes we make should be reflected on a prospective basis for the company's rates.³

Based on the language adopted in Resolution T-17133, as cited above, we retained the flexibility to apply the 150% adjustment on a prospective basis without being bound by prior restrictions contained in the aforementioned Commission resolutions. Issues relating to the appropriate criteria to apply for future Small LEC rate adjustments for purposes of qualifying for high-cost support through the CHCF-A Program should be addressed in a new

³ *Id* at 17.

rulemaking proceeding where all relevant issues regarding high-cost support for Small LECs can be examined.

In comments on the Proposed Decision, the Small LECs express concern that the new rulemaking on A-Fund reform may not produce a Commission decision before the next round of Small LEC filings for CHCF-A support. Until a Commission decision on reform of the CHCF-A, the Small LECs and their customers would remain vulnerable to potential effects of rate shock resulting from potential increases in the AT&T basic rate. In January 2009, AT&T raised its basic residential rate to \$16.45 per month effective January 2, 2010. In accordance with the 150% formula, Small LECs seeking to receive CHCF-A funding would have to increase their rates by 21.8% beyond the rates set for the five Small LECs that had rate cases decided in January 2009. If AT&T raises its basic rate again beginning in 2011, further rate increases would result for the Small LEC customers.

As a protection against the potential for rate shock, the Small LECs propose that on an interim basis until the proposed CHCF-A rulemaking can be completed, the basic residential flat rate that a Small LEC must charge to qualify for CHCF-A funding be fixed at no more than the current \$20.25 per month. The Small LECs argue that such an interim measure would have little impact on the CHCF-A surcharge and would spare Small LEC customers further rate shock until the Commission's review of the CHCF-A is complete.

We appreciate the concerns regarding the potential timing of a Commission decision in a new rulemaking on CHCF-A reform, and the potential intervening impacts on Small LEC rate changes under the current application of the 150% formula. We intend to move forward with the issuance of a new rulemaking on CHCF-A reform promptly, and shall set a deadline of no more

than 90 days from the effective date of this decision for placing an Order Instituting Rulemaking on the Commission agenda. Although we recognize the need for timely attention in moving forward with the new OIR, it is possible that a final Commission decision may not be completed in the CHCF-A rulemaking before the next AT&T basic rate change in 2011.

In view of the timing considerations involved, therefore, we find it reasonable to adopt interim measures to provide some protection to Small LEC customers until the Commission resolves the pertinent CHCF-A rulemaking reform issues. Accordingly, we shall adopt as an interim requirement that the basic residential flat rate that a Small LEC must charge to qualify for CHCF-A funding shall be fixed at the current level of \$20.25 per month. This interim requirement shall continue in effect until the Commission adopts a decision in the new CHCF-A rulemaking resolving pertinent reform issues, or otherwise modifies the restriction. Thus, under this interim requirement, if a Small LEC increases its basic rate above the \$20.25 per month level, the Small LEC may not draw additional money from the CHCF-A for the rate differential above the \$20.25 level. This interim measures will provide reasonable protection against the risk of rate shock to the Small LECs and their customers pending Commission resolution of the pertinent reform issues in the new CHCF-A rulemaking.

6. Comments on the Proposed Decision

The proposed decision of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on February 1, 2010 and reply comments were

filed on February 8, 2010. We have taken the comments into account in finalizing this order.

7. Assignment of the Proceeding

John A. Bohn is the assigned Commissioner and Thomas R. Pulsifer is the assigned ALJ in this proceeding.

Findings of Fact

1. The CHCF-A was established to provide a source of supplemental revenues to mid-size and Small LECs whose basic exchange access line service rates would otherwise be increased to levels that would threaten universal service.
2. In order to draw from the CHCF-A, D.91-09-042 set forth a guideline that a qualifying Small LEC's basic rates were not to exceed 150% of comparable California urban rates. This 150% guideline has historically been applied by referencing the intrastate basic service rate of AT&T as a measure of comparable California urban rates.
3. At the time rates are set in an eligible carrier's GRC or other rate proceeding a rate design incorporating the 150% threshold is a requirement, as prescribed in D.91-09-042 for eligibility to receive CHCF-A funding.
4. Basic rates are not automatically increased without regard to the actual revenue requirements of the Small LEC nor are they increased as a result of subsequent AT&T rate increases.
5. If a Small LECs revenue requirement can be met from local exchange rates incorporating a basic rate of less than 150% they shall not be eligible to receive CHCF-A funding.
6. The Small LECs filed the instant application to modify or clarify D.91-09-042 in view of pending draft resolutions which interpreted the

150% guideline as requiring an increase in Small LEC rates up to 150% of the AT&T basic rate level.

7. In adopting rate changes for certain Small LECs, as identified in the instant application, the Commission adopted the recommendation of the Communications Division to increase Small LEC basic rates up to 150% of the AT&T basic rate level.

8. The original rationale for applying the 150% guideline was developed in an era when AT&T basic rates were mostly fixed and subject to strict price caps.

9. The Commission issued D.08-09-042, which implemented rate flexibility provisions whereby the URF LECs may increase prices for stand-alone basic service subject to specified caps for up to two years, and thereafter have full pricing flexibility.

10. As the AT&T basic rate changes, the Small LECs' rates set in their rate case proceedings may not maintain the 150% relationship to the AT&T basic rate on an ongoing basis.

11. Unless their revenue requirements as set forth in a GRC proceeding justify such increases there is no corresponding basis for the Small LEC rates to rise because AT&T raises its basic rates.

12. In view of the basic rate flexibility that AT&T now has under the provisions of the URF, as implemented in D.08-09-042, the original rationale for setting Small LEC rates equivalent to 150% of the AT&T may no longer be appropriate.

13. Because AT&T is authorized to geographically deaverage its basic rates as of January 1, 2011, there may no longer be a single AT&T basic rate to which the Small LEC rates can be pegged.

14. No party contests the Small LEC application, and DRA and AT&T affirmatively support the application.

15. As an interim measure until the Commission issues a decision on pertinent CHCF-A reform, Small LEC customers will be protected against potential rate shock by fixing the amount a Small LEC must charge to qualify for CHCF-A funding at the current level of \$20.25 per month.

Conclusions of Law

1. The application of the Small LECs should be denied as set forth below.

2. The 150% threshold as set forth in D.91-09-042 should be applied as a requirement for a Small LEC to be eligible to receive CHCF-A support. The use of the AT&T basic rate as a proxy for California urban basic rates in applying the 150% guideline should be continued at this time subject to the following interim restriction: The basic residential flat rate that a Small LEC must charge to qualify for CHCF-A funding should be fixed at the current level of \$20.25 per month. This interim requirement should continue until the Commission adopts a decision in the CHCF-A rulemaking resolving pertinent reform issues, or otherwise modifies the restriction.

3. Although the new AT&T pricing flexibility raises questions about the continued use of the AT&T rate for purposes of measuring eligibility to receive CHCF-A funding under the 150% threshold test, the instant application for modification of D.91-09-042 is not the most suitable forum in which to resolve these issues.

4. The Commission should consider the implications of the new AT&T pricing flexibility, and other issues regarding the appropriate criteria by which to adjust Small LEC basic rates in order to qualify for high-cost support under the CHCF-A Program in a separate rulemaking proceeding.

O R D E R**IT IS ORDERED** that:

1. The application of the Small Local Exchange Carriers for modification of Decision 91-09-042 is hereby denied in accordance with the order below.
2. Decision 91-09-042 is hereby clarified to affirm that the 150% differential between Small Local Exchange Carrier rates and California urban rates is a threshold that must be met if a Small Local Exchange Carrier wishes to receive California High-Cost Fund-A funding.
3. The use of the Pacific Bell Telephone Company dba AT&T California, Inc. basic rate as the required proxy for urban rates in applying the 150% guideline set forth in Decision 91-09-042 is hereby continued subject to the following restriction: The basic residential flat rate that a Small Local Exchange Carrier must charge to qualify for California High-Cost Fund-A funding shall be fixed at the current level of \$20.25 per month. This interim requirement shall continue in effect until the Commission adopts a decision in the California High-Cost Fund-A rulemaking resolving pertinent reform issues, or otherwise modifies the restriction.
4. The Communications Division shall draft an Order Investigating Rulemaking for our consideration to be placed on the Commission's agenda within 90 days of the effective date of this decision to address all relevant issues regarding high-cost support for Small Local Exchange Carriers.
5. Application 09-01-002 is closed.

Dated _____ in San Francisco, California.