

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

DOCKET NO. 96-318-C - ORDER NO. 2001-396

MAY 16, 2001

IN RE: Establishment of Fund to Address Revenue) ORDER ON REMAND
Impact of Incumbent local Exchange Carriers)
Electing to Reduce Switched Access Rates.)

I. FACTS AND PROCEDURAL BACKGROUND

This matter comes before the Public Service Commission of South Carolina (the Commission) on remand from the Supreme Court of South Carolina. A brief factual and procedural history follows.

On May 29, 1996, the South Carolina General Assembly enacted Act No. 354, which amended S.C. Code Ann. § 58-9-280. The amendments include new subsection (M) which provides in part:

The [Public Service Commission of South Carolina] shall, not later than December 31, 1996, establish an Interim LEC Fund. The Interim LEC Fund shall initially be funded by those entities receiving an access or interconnection rate reduction from LEC' s pursuant to subsection (L) in proportion to the amount of the rate reduction.

New § 58-9-280(L) provides:

Upon enactment of this section and the establishment of the Interim LEC Fund, as specified in subsection (M) of this section, the [Public Service Commission of South Carolina] shall, subject to the requirements of federal law, require any electing incumbent LEC, other than an incumbent LEC operating under an alternative regulation plan approved by the commission before the effective date of this section,¹ to immediately set its toll switched access rates at levels

¹ The only telephone company operating under an alternative regulation plan at that time was BellSouth Telecommunications, which does not participate in the Interim LEC Fund.

comparable to the toll switched access rate levels of the largest LEC operating within the State. To offset the adverse effect on the revenues of the incumbent LEC, the commission *shall allow adjustment of other rates not to exceed statewide average rates*, weighted by the number of access lines, and shall allow distributions from the Interim LEC Fund, as may be necessary to recover those revenues lost through the concurrent reduction of the intrastate switched access rates. (Emphasis added.)

The Commission initiated Docket No. 96-318-C to address and resolve issues relating to the establishment of the Interim LEC Fund, as required by S.C. Code Ann. § 58-9-280(M). The Commission ordered LECs that wished to participate in the Fund (“participating LECs”) to notify the Commission of their intent by September 15, 1996, and further required them to provide, by October 1, 1996, financial information pertaining to the access revenues that would be lost due to access rate reductions, as well as the proposed method of recovery to be utilized for those lost revenues (i.e. details of proposed rate adjustments, as provided for in § 58-9-280(L), etc.). The participating LECs complied with these requirements. The participating LECs also published notice of proposed “rate adjustments” in newspapers of general circulation in the affected areas.

A hearing was held before the Commission on December 16 and 17, 1996, to examine the legislation, the LECs’ revenue requirements, proposed methods of recovery, and all other issues relating to the Interim LEC Fund.

At the hearing, the participating LECs presented information on the access revenues that would be lost due to reducing access rates to levels comparable to the toll switched access rate levels of the largest LEC operating in the State. The participating LECs also provided the Commission with proposed rate adjustments to offset the lost access revenues.

At the beginning of the hearing, the Consumer Advocate made a motion to dismiss the LECs' requests to adjust local rates. The Commission denied the motion, proceeded with the hearing, and issued Order No. 96-882-C in this docket, establishing the Interim LEC Fund as required by law and approving rate schedules for the participating LECs. In its Order Denying Reconsideration, the Commission reaffirmed its earlier ruling. Commission Order No. 97-710.

The Consumer Advocate appealed the Commission's decision to allow rate increases to the circuit court, which issued an order affirming the Commission's orders. The Consumer Advocate then appealed to the Supreme Court of South Carolina. The Supreme Court held that the notice published by the participating LECs, which referenced proposed rate "adjustments" as opposed to rate increases, was inadequate to satisfy the requirements of S.C. Code Ann. § 58-9-530. The Supreme Court declined to grant the Consumer Advocate the remedy he sought, *i.e.*, reversal of the circuit court order and remand to the Commission with instructions to order refunds to affected consumers. Instead, the Supreme Court directed the Commission to "hold hearings for each local exchange carrier after adequate notice to the affected customers, re-evaluate the total five-year rate increases, and adjust the future scheduled annual rate increases if necessary."

Individual remand hearings were scheduled before the Commission, but the Commission ultimately approved a plan proposed by the Consumer Advocate to consolidate this matter into one proceeding for hearing purposes. A hearing on remand was held before the Commission on April 2, 2001. During the hearing, the South Carolina Telephone Coalition (SCTC) was represented by M. John Bowen, Jr., Esquire

and Margaret M. Fox, Esquire. SCTC presented the testimony of Emmanuel Staurulakis. Verizon South, Inc. (formerly GTE South, Inc.) (Verizon) was represented by Steven W. Hamm, Esquire. Verizon presented the testimony of Edward C. Beauvais. The Consumer Advocate was represented by Elliott F. Elam, Jr., Esquire. The Consumer Advocate presented the testimony of Allen G. Buckalew. AT&T Communications of the Southern States, Inc. (AT&T) was represented by Francis P. Mood, Esquire. AT&T presented no witnesses. The South Carolina Public Communications Association (SCPCA) was represented by John J. Pringle, Jr., Esquire. SCPCA presented the testimony of Walter Rice. The Commission's Staff was represented by F. David Butler, General Counsel. The Commission Staff presented the testimony of Thomas L. Ellison and Gary E. Walsh.

ACSI, BellSouth, Sprint United, South Carolina Cable Television Association, WorldCom, and MCI were parties to the proceeding below but did not appear at this remand hearing.

II. SUMMARY OF TESTIMONY

EMMANUEL STAURULAKIS

The SCTC presented the direct testimony of Emmanuel Staurulakis, President of John Staurulakis, Inc. (JSI), a telecommunications consulting firm. Mr. Staurulakis summarized the history of the Interim LEC Fund, from legislative enactment to the administrative and judicial proceedings that have occurred thus far in this matter. Mr. Staurulakis testified that the Commission had issued a notice for the SCTC member companies to publish in this proceeding, and that the companies had complied with the

publication requirement. He stated that the Commission properly followed its statutory mandate with respect to the Interim LEC Fund, examined in detail the rate adjustments proposed by each SCTC member company in relation to the revenues that would be lost through access reductions, and properly established and implemented the Interim LEC Fund and related adjustments. Mr. Staurulakis concluded that there was no need for changes to the future scheduled annual rate adjustments from those previously approved by the Commission.

EDWARD C. BEAUVAIS

Verizon presented the direct and rebuttal testimony of Edward C. Beauvais, Ph.D., Director – Economic & Regulatory Policy for Verizon Services Group. Dr. Beauvais testified that the Commission's decision adopting rate adjustments for Verizon was consistent with the legislation adopted by the General Assembly, that Verizon had complied with the publication requirement by publishing the notice provided to it by the Commission in this proceeding, and that there is no compelling basis for the Commission to change its original decision after re-evaluating this matter. Dr. Beauvais further testified that increasing rates for basic local exchange services in conjunction with implementation of the Interim LEC Fund was the most economically efficient course for the Commission to take. Dr. Beauvais concluded that the Commission should affirm its earlier decision, because the Commission properly established the Interim LEC Fund in accordance with the specific statutory criteria, after a careful examination of the evidence and various company proposals.

ALLEN G. BUCKALEW

The Consumer Advocate presented the testimony of Allen G. Buckalew, an economic consultant with J.W. Wilson & Associates, Inc. Mr. Buckalew testified that continued rate increases were not “necessary” in conjunction with the Interim LEC Fund and, specifically, that it was not necessary to continue to increase basic local exchange rates. Mr. Buckalew stated that the Commission needed to require the companies to provide the information mandated by Commission Regulation 103-834 in order to conduct a full review of each company’s earnings prior to ordering rate increases. Mr. Buckalew concluded that, before being permitted to make additional increases in basic local exchange rates, the companies should be required to show that such rate increases are necessary.

WALTER RICE

The SCPCA presented the testimony of Walter Rice, President of R&T Communications and President of the SCPCA. Mr. Rice testified that, in the earlier proceeding in this docket, the Commission ruled that “COCOT rates will be frozen at the existing rates until the 1997 COCOT proceedings, at which time all relevant COCOT regulatory issues shall be reviewed.” Mr. Rice urged the Commission to reaffirm its earlier Order in this docket and ensure that payphone line rates are unaffected by the rate rebalancing taking place in this docket.

THOMAS L. ELLISON

The Commission Staff presented the testimony of Thomas L. Ellison, an auditor with the Commission. Mr. Ellison explained in his testimony how the Interim LEC Fund is revenue neutral, as well as the steps that the Audit Department takes to verify that the Fund is revenue neutral to participating LECs. Mr. Ellison also explained in detail the process that the Audit Department uses to set the dollar amount of the Interim LEC Fund each year.

GARY E. WALSH

The Commission Staff also presented the testimony of Gary E. Walsh, Executive Director of the Commission. Mr. Walsh summarized the history of the Interim LEC Fund and testified to the vital need to continue the increases in basic local exchange rates previously ordered by the Commission. According to Mr. Walsh, the Commission has complied with all language contained in South Carolina Code Section 58-9-280 (L) and (M). Mr. Walsh testified that the Commission's action in establishing the Interim LEC Fund helps to meet the goals of the Federal Telecommunications Act of 1996 by beginning the process of removing implicit subsidies from rates (such as access, which has traditionally provided the greatest subsidy to local residential and business rates) and making that support explicit. In addition, the re-balancing of basic local exchange rates in the rural areas will provide competitive opportunities for subscribers in those areas. Mr. Walsh also testified that the rate re-balancing, by moving basic local rates closer to cost, will reduce the size of the State Universal Service Fund, which is calculated by

comparing basic local exchange rates to the cost of providing service on a per line basis.

Mr. Walsh concluded that it is vital to implement the remaining two years of the phase-in process as originally established by the Commission.

III. FINDINGS AND CONCLUSIONS

1. This issue is before the Commission on the Supreme Court's remand and directive to "hold hearings for each local exchange carrier after adequate notice to the affected customers, re-evaluate the total five-year rate increases, and adjust the future scheduled annual rate increases if necessary." The only issue before the Commission is whether the rate adjustments approved by the Commission in conjunction with implementing the South Carolina Interim LEC Fund were appropriate, or whether adjustments to the future scheduled rate increases should be made.

2. In compliance with the Supreme Court's remand order, this Commission required the companies to provide adequate notice to the affected customers, advising them of the rate increases. As testified to by Mr. Walsh, input from the Consumer Advocate was obtained to ensure that the notice was adequate to advise consumers of the rate increases. [TR 110] Each company published the Commission-prescribed notice in newspapers of general circulation in its service area and provided the Commission with proof of such publication. [TR 26; 41-42]

3. The Commission received no petitions to intervene regarding the published notices or associated rate increases. [TR 110] Furthermore, the Commission received no complaints or inquiries following publication of the notices. [TR 114] No "affected

customers” appeared at the hearing on this matter. [TR 6-8; 55]

4. At the hearing on this matter, SCTC and Verizon asked the Commission to clarify that matters contained in the first proceeding would still be considered the record in this docket and that any testimony or evidence presented in this proceeding would supplement the existing record. We agree with our own General Counsel that the Supreme Court’s remand order makes this necessary. In order to re-evaluate the total five-year rate increases, as directed by the Supreme Court, it will be necessary for us to re-examine the existing record in this case.

5. The Consumer Advocate also questioned whether it was appropriate for this Commission to examine 1996 data in the context of this proceeding, or whether the participating LECs should be required to conduct new cost studies and provide current data. This case was initially decided in 1996. A re-evaluation of our decision would necessarily involve a re-examination of the data that existed at that time. As pointed out by counsel for SCTC and Verizon, this Commission could have approved a one-time rate increase for each company in 1997, but chose to take a conservative approach in phasing in the rate adjustments over a five-year period to reduce the impact on customers. This does not mean that we should start anew at this time and require extensive cost studies that were not required or even requested in the original proceeding. There has to be some finality in administrative proceedings. We believe that we should re-evaluate this matter in light of the data that was available to us at the time this matter was first decided.

6. Also at the hearing on this matter, SCTC and Verizon moved to strike the

testimony of Allen G. Buckalew. The motion was based on their assertion that, when the Consumer Advocate appealed this matter from the circuit court to the Supreme Court, the only issue brought before the Supreme Court was that of notice. According to counsel for SCTC, the Supreme Court ruled only on the notice issue and remanded the matter back to this Commission. SCTC's counsel argued that the Consumer Advocate was a party below and should not be allowed a "second bite at the apple" to put in evidence with respect to issues in this proceeding that he did not raise below or did not perfect in his appeal to the Supreme Court. Counsel for Verizon also argued that the Supreme Court asked this Commission only to "re-evaluate" the rate increases and did not direct the Commission to accept new evidence. General Counsel for the Commission also joined in the motion to strike, asserting that the Consumer Advocate did not preserve a number of the matters he seeks to raise here, and is therefore not entitled to raise them. While we found merit in these arguments, we denied the motion and proceeded to consider the merits of the Consumer Advocate's arguments and testimony in this matter, giving them the appropriate weight. We believe this will more fully allow us to follow the directive of the Supreme Court to "re-evaluate the total five-year rate increases."

7. The Supreme Court has said that this case is a telephone rate case, and we agree. This case involves telephone rates and, thus, is a rate case in the generic sense of the term. However, this case is unlike the traditional or general rate case considered by this Commission. Here, the Commission has a statutory mandate to allow rate adjustments in conjunction with the Interim LEC Fund, within certain parameters. See S.C. Code Ann. § 58-9-280(L) ("To offset the adverse effect on the revenues of the incumbent LEC, the

Commission shall allow adjustment of other rates not to exceed statewide average rates, weighted by the number of access lines, and shall allow distributions from the Interim LEC Fund, as may be necessary to recover those revenues lost through the concurrent reduction of the intrastate switched access rates.”) Furthermore, the Interim LEC Fund is clearly required by statute to be revenue neutral. The combination of revenues received from rate adjustments and from Interim LEC Fund withdrawals cannot exceed the amount necessary to recover revenues lost as a result of reductions in intrastate switched access charges. Thus, the operation of the Interim LEC Fund does not have an impact on any company’s overall earnings – it is simply replacing lost access revenues with revenues from rate adjustments and the Interim LEC Fund. As testified to by Mr. Ellison of the Commission Staff, the Interim LEC Fund is administered in such a way to ensure this revenue neutrality. [TR 95-96] Thus, the Interim LEC Fund is revenue neutral both in theory and in practice. The statutory mandate to allow rate adjustments, along with the fact that the rate adjustments and withdrawals from the Interim LEC Fund do not impact company earnings, make this situation drastically different from a traditional rate case in which a company is seeking an increase in rates and the Commission must determine the impact of the proposed increase on the company’s earnings.

8. The Consumer Advocate has argued that the Commission should require the companies in this action to file the data required to be filed for a general rate case pursuant to Commission Regulation 103-834. Regulation 103-834 requires the filing of information that would allow the Commission to determine the effect of a proposed rate increase on a company’s earnings and rate of return. The rate adjustments permitted in

conjunction with the ILF do not impact earnings or rates of return. Nevertheless, this Commission has available to it all of the information required by Regulation 103-834. Most of the information is contained in the Annual Reports that we require each local exchange carrier to file on an annual basis. The only items not contained in the Annual Reports are rates of return and accounting and pro forma adjustments. With respect to company rates of return, the Commission Staff can and does calculate a rate of return for each company annually on a per books basis from the data provided in the Annual Report. In addition, we have required the companies to file in this docket information regarding rates of return for the relevant year, 1996. With respect to accounting and pro forma adjustments, we find that the filing of those adjustments, even in a general rate case, is optional on the part of the company seeking to increase rates.² In this case, the company's rate of return is not impacted by the proposed rate adjustments and, therefore, no accounting or pro forma adjustments need be applied to the company's earnings. Therefore, this Commission has available to it the information required by the regulation [See TR. 42; 116], and we have taken this information into consideration in our overall re-evaluation of the previously-ordered rate adjustments.

9. The Consumer Advocate appears to argue in his opening statement that this Commission should have considered increasing rates other than those for basic local exchange service. The Consumer Advocate did not present any evidence on this issue in the first proceeding and did not raise it on appeal to the Supreme Court. Furthermore,

² For example, if a company is authorized to earn a 12% rate of return on rate base, and is actually earning 5% on a per books basis, it may seek a rate increase without presenting any adjustment to its "per books" calculated rate of return.

this argument does not appear in the testimony of the Consumer Advocate's witness, Mr. Buckalew. Regardless, the language of S.C. Code Ann. § 580-9-280(L) is clear. The Commission was required to allow adjustments to participating LECs' rates (other than intrastate switched access rates), as long as they did not exceed statewide average rates. That is what the Commission did. In addition, there was convincing evidence presented that basic local exchange rates are priced below cost and are exactly the rates that should be increased in a rate rebalancing situation. [See TR. 43-46; 111-12; 125; 129-30; 145-46].

10. We find that the rate adjustments previously ordered for the companies are just and reasonable. There has been no assertion that the approved rate adjustments exceed the statewide averages for those rates. We have re-evaluated the total proposed rate adjustments, taking into consideration all evidence of record, and reaffirm those rate adjustments. We find that there is no need to adjust the future proposed rate adjustment schedules.

11. The final two rate adjustment increase increments were originally scheduled to take place in April 2000 and April 2001, respectively. These two increments were stayed, however, upon receipt of the Supreme Court Remand. We would note that the sizing of the Interim LEC Fund is a complex process, requiring the filing of detailed information by the companies as well as a great deal of work by our own Auditing Department in ensuring the integrity of the process. The ILF has already been sized for the April 1, 2001 through March 31, 2002 audit year, and it would be cumbersome for the Audit Department to resize this year's Fund based on new rates for the companies.

Therefore, we order that the companies will be permitted to make the final two incremental adjustments to rates in April 2002 and April 2003.

IT IS THEREFORE ORDERED THAT:

1. This Commission has complied with its statutory directives and the remand order of the Supreme Court of South Carolina. The rate schedules previously approved by this Commission have been re-evaluated and are found to be just and reasonable and in compliance with the law. No adjustments to the future scheduled annual rate increases are necessary.

2. The participating companies shall be permitted to take the remaining two rate increase increments in April 2002 and April 2003.

3. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Chairman

ATTEST:

Executive Director
(SEAL)