Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Petition for Waivers Filed by Albion Telephone Co. Cambridge Telephone Co., Inc. Fremont Telcom Co. Midvale Telephone Exchange, Inc. Rockland Telephone Co., Inc., and U S WEST Communications, Inc. Concerning Section 61.41(c)(2) and 69.3 (e)(11), and the Definition of "Study Area" Contained in the Part 36 Appendix-Glossary of the Commission's Rules	))))))))))))))	AAD 96-49

MEMORANDUM OPINION AND ORDER

Adopted: August 29, 1996 **Released: August 29, 1996**

By the Chief, Accounting and Audits Division:

I. INTRODUCTION

1. On April 11, 1996, Albion Telephone Co. ("Albion"), Cambridge Telephone Co. Inc. ("Cambridge"), Fremont Telcom Co. ("Fremont"), Midvale Telephone Exchange, Inc. ("Midvale"), Rockland Telephone Co., Inc. ("Rockland"), and U S WEST Communications, Inc. ("U S WEST") filed a joint petition for waiver of various Commission rules. The petitioners seek waivers of the definition of "Study Area" contained in the Part 36 Appendix-Glossary of the Commission's rules. That definition constitutes a rule freezing all study area boundaries, effective November 15, 1984. The requested waivers would allow Albion, Cambridge, Midvale, Rockland, and U S WEST to alter the boundaries of their existing study areas as a result of U S WEST's sale of nine exchanges. Fremont is a newly formed Idaho corporation and seeks permission to establish a new study area.

2. In addition, the buyers seek waivers of the price cap rule contained in Section 61.41(c)(2) of the Commission's rules. This rule requires non-price cap companies, and the telephone companies with which they are affiliated, to become subject to price cap regulation after acquiring a price cap company or any part thereof. The requested waivers would permit the buyers to remain under rate-of-return regulation after acquiring the exchanges which currently

are under price cap regulation.[1]

3. On April 19, 1996, the Common Carrier Bureau ("Bureau") released a Public Notice soliciting comments on the joint petition.[2] In this Order, we find that the public interest would be served by allowing petitioners to alter their study area boundaries and allowing the buyers to continue operating under rate-of-return regulation after acquiring the exchanges. We therefore grant the petition, as explained more fully below.

II. STUDY AREA WAIVERS

A. Background

4. A study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to a carrier's entire service territory within a state. Thus, carriers operating in more than one state typically have one study area for each state, and carriers operating in a single state typically have a single study area. Study area boundaries are important primarily because carriers perform jurisdictional separations at the study area level.[3] For jurisdictional separations purposes, the Commission froze all study area boundaries effective November 15, 1984.[4] The Commission took that action primarily to ensure that local exchange carriers ("LECs") do not set up high-cost exchanges within their existing service territories as separate study areas to maximize interstate cost allocations.[5] A LEC must apply to the Commission for a waiver of the frozen study area rule if the LEC wishes to sell or purchase an

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1 The buyers also seek waivers of Section 69.3(e) of the Commission's rules, if necessary, to become Issuing Carriers in the National Exchange Carrier Association ("NECA") tariffs. As shown in para.18, *infra*, a waiver is not required.

2 *Public Notice*, Albion Telephone Co., Inc., Cambridge Telephone Co., Fremont Telcom Co., Midvale Telephone Exchange, Inc., Rockland Telephone Co., and U S WEST Communications, Inc. filed a Petition for Waiver Sections 61.41(c) (2), 69.3(e)(11) and the Definition of "Study Area" Contained in Appendix-Glossary of Part 36 of the Commission's Rules, AAD 96-49, DA 96-610, released (April 11, 1996) (Common Carrier Bureau 1996). Comments were filed by the National Telephone Cooperative Association on May 20, 1996.

3 The phrase "jurisdictional separations," or "separations," refers to the process of dividing costs and revenues between a carrier's state and interstate operations. *See generally* 47 C.F.R. §§ 36.1-36.741.

4 47 C.F.R. § 36 app. (defining "study area"). *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, *Recommended Decision and Order*, 49 Fed. Reg. 48325 (December 12, 1984) (*"1984 Joint Board Recommended Decision"*); *id., Decision and Order*, 50 Fed. Reg. 939 (January 8, 1985) (*"1985 Order Adopting Recommendation"*); *see also* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Notice of Proposed Rulemaking*, 5 FCC Rcd 5974 (October 10, 1990) (*"Study Area Notice"*).

5 *See 1984 Joint Board Recommendation Decision, supra* note 4 ¶ 66; *1985 Order Adopting Recommendation, supra* note 4, ¶¶ 1, 5.

exchange.[6]

5. Waiver of Commission rules is appropriate only if special circumstances warrant deviation from the general rule and such a deviation will serve the public interest.[7] In evaluating petitions seeking a waiver of the rule freezing study area boundaries, the Commission employs a three-prong standard: first, the change in study area boundaries does not adversely affect the Universal Service Fund ("USF") support program;[8] second, the state commission(s) having regulatory authority over the exchange(s) to be transferred does not object to the change; and third, the public interest supports such a change.[9]

6. The Commission's concern about adverse USF impacts was mitigated, in the short term at least, by its adoption of the Joint Board's recommendation for an indexed cap on the USF.[10] The Commission nonetheless recognized that, even in the short term, the granting of a study area

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[6] 47 C.F.R. §§ 1.3, 36 app.

[7] *Northeast Cellular Tel. Co. v. FCC*, 897 F.2d 1164, 1166 (D.C. Cir. 1990); *see also WAIT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969); 47 C.F.R. § 1.3.

[8] *See 1984 Joint Board Recommended Decision, supra* note 4, ¶ 66. The Commission created the USF to preserve and promote universal service. *See* Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, *Decision and Order*, 96 FCC 2d 781 (1984). The USF allows LECs with high local loop plant costs to allocate a portion of those costs to the interstate jurisdiction, thus enabling the states to establish lower local exchange rates in study areas receiving such assistance. To determine which LEC study areas are eligible for USF support, the USF rules prescribe an eligibility threshold set at 115 percent of the national average unseparated loop cost per working loop. When the loop cost in a particular study area exceeds that threshold, the study area is eligible for support equal to a certain percentage of the loop cost in excess of that threshold. The study area becomes eligible for higher levels of support as its loop cost rises above additional thresholds set farther above the national average unseparated loop cost. Because USF assistance is targeted primarily at small study areas, the level of support provided at each threshold generally is greater if the study area has 200,000 or fewer working loops. *See* 47 C.F.R. § 36.631.

[9] *See* U S WEST Communications, Inc., and Eagle Telecommunications, Inc., Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules, *Memorandum Opinion and Order*, 10 FCC Rcd 1771, ¶ 5 (1995) (*"U S WEST-Eagle Study Area Order"*).

[10] The Joint Board recommended, and the Commission adopted, interim rules that limit the rate of growth of the USF to the rate of growth in the total number of working loops nationwide. *See generally* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Recommended Decision*, 9 FCC Rcd 334 (1993) (*"1993 Joint Board Recommended Decision"*); *id.*, *Report and Order*, 9 FCC Rcd 303 (*"Interim Cap Order"*). The Commission extended these interim rules through July 1, 1996. Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, *Report and Order*, 11 FCC Rcd 1077 (1995), summarized in 60 Fed. Reg. 65011 (1995). Recently, the Joint Board recommended, and the Commission adopted, an extension of the interim cap rules on the USF until the final universal service rules become effective. Federal-State Joint Board on Universal Service, *Recommended Decision*, CC Docket No. 96-45, released June 19, 1996 (*"1996 Joint Board Recommended Decision"*); *id.*, *Report and Order*, FCC 96-281, released June 26, 1996 (*"Extension of Interim Cap Rules"*).

waiver may adversely affect the fund's distribution, if not its size. Under the indexed USF cap rules, any study area reconfiguration that increases the USF draw of one USF recipient often reduces that of other USF recipients. Consequently, in evaluating whether a study area change would have an adverse impact on the distribution or level of the USF, the Commission applies a "one-percent" guideline to study area waiver requests filed after January 5, 1995.[11] Under this guideline, no study area waiver is granted if it would result in an annual aggregate shift in USF assistance in an amount equal to or greater than one percent of the total USF, unless the parties can demonstrate extraordinary public interest benefit. To prevent carriers from evading this limitation by disaggregating a single large sale of exchanges into a series of smaller transactions that in the aggregate have the same effect on the USF, the Commission further requires that the guideline be applied to all study area waivers granted to either carrier, as a purchaser or selier, pending completion of the current review of the universal service program.[12]

B. Pleadings

7. Albion currently serves 995 access lines; Cambridge serves 936 access lines; Midvale serves 367 access lines; Rockland serves 325 access lines; and U S WEST serves 393,000 access lines in Idaho. U S WEST proposes to sell nine exchanges: three exchanges serving 3,391 access lines to Albion; one exchange serving 932 access lines to Cambridge; three exchanges serving 5,439 access lines to Fremont; one exchange serving 457 access lines to Midvale; and one exchange serving 822 access lines to Rockland. U S WEST seeks waiver of the rule freezing study area boundaries to enable U S WEST to remove these nine exchanges from its Idaho study area.[13] The requested waivers also would allow the buyers to consolidate the acquired exchanges with their existing Idaho study areas. Fremont seeks a waiver to establish a new study area.

8. Petitioners state that the proposed changes would serve the public interest because the buyers would install new facilities, such as fiber optic cables, and offer additional customer services, such as CLASS,[14] and access to the internet. Petitioners estimate that, if the study area waivers were granted and all planned upgrades were completed, the transfer of the nine exchanges would increase the combined annual USF draw of the buyers by $1,787,360.[15]

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[11] *See U S WEST-Eagle Study Area Order*, *supra* note 9, ¶¶ 14-17.

[12] *Id.* In this context, the Commission defines the term "carrier" to include all affiliated carriers (i.e., those carriers that are in common control, as the term "control" is defined in Section 32.9000 of the Commission's rules, 47 C.F.R. § 32.9000). *Id.* ¶ 14 note 34.

[13] Joint petition at 2.

[14] Custom Local Area Signaling Services, or CLASS, includes automatic callback, automatic recall, call waiting, call forwarded and other similar services.

[15] *Id.* at 12.

C. Discussion

9. *Request for waivers.* We have reviewed the data the petitioners filed with NECA[16] and the estimates filed in this proceeding and have determined that the combined increase in USF draws will not have a substantial adverse impact on the USF total or on individual carrier draws. In addition, the Idaho Public Utilities Commission states that it does not object to these requested waivers.[17] Based upon the petitioners' statement that customer service would improve in the newly acquired exchanges, we believe that the requested study area waivers will likely serve the public interest. We therefore find that the three-prong standard for granting a study area waiver has been met in this instance and that the study area waiver requests should be granted.

10. *Need for imposed limits on USF draws.* Although we find no reason to question the buyers' estimates of the USF impact, we nonetheless are concerned that those estimates may later prove inaccurate when the planned upgrades are completed. We have found that, even in a period of a few years, the USF payments for some LECs have risen by unexpected amounts.[18] These LECs generally had undertaken substantial upgrades or expansions of the local network in difficult-to-serve, sparsely populated exchanges that are similar to the exchanges being acquired by the buyers.

11. We therefore find that the waivers should be subject to the condition that, absent explicit approval from the Bureau, the annual USF support provided to the buyers' study areas shall not exceed the post-upgrade amounts estimated in the joint petition.[19] This limit ensures that the study area waivers will not, due to error or unforeseen circumstances, result in adverse USF impacts which substantially exceed the buyers' forecasts. We note that the Telecommunications Act of 1996, which became effective on February 8, 1996,[20] requires the reform of many mechanisms the Commission uses to support its universal service goals, including

[16] *See* NECA USF 1995 Submission of 1994 Study Results filed September 29, 1995.

[17] Idaho Public Utilities Commission, Case No. ALB-T-94, Case No. CAM-T-94-1, MID-T-94-1, FRE-T-94-1, SIL-T-94-1, and ROK-T-94-1, dated March 5, 1996.

[18] *See, e.g.*, Delta Tel. Co., Inc., Waiver of the Definition of "Study-Area," *Memorandum Opinion and Order*, 5 FCC Rcd 7100 (1990). The USF payment grew from $82,500 in 1991 to approximately $445,700 in 1993. *See*, e.g., U S WEST Comm. and Gila River Telecomm., Inc., Petition for Waiver of the Definition of "Study Area," *Memorandum Opinion and Order*, 7 FCC Rcd 2161, ¶ 7 (1992) (stating that Gila River estimates 1992 high-cost support to be $169,155). Gila River's 1992 USF estimate was more than doubled by the actual 1992 payment of $390,993, which has been nearly doubled again by the 1995 payment of approximately $750,000.

[19] Buyers estimate that their post-sale, post upgrade USF draws will be $713,951 for Albion; $310,748 for Cambridge; $1,268,662 for Fremont; $350,367 for Midvale; and $454,213 for Rockland.

[20] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

the USF, by May 8, 1997.[21] It is likely that any new universal service rules will alter the method used to determine the distribution of USF support to high-cost areas, thereby changing the projected level of support to the buyers' study areas. This, in turn, may require us to revisit these issues, and the related waiver conditions that we have established herein.

III. PRICE CAPS WAIVER

A. Background

12. Section 61.41(c)(2) of the Commission's rules provides that, when a cost company acquires a price cap company,[22] the acquiring company, and any LEC with which it is affiliated, shall become subject to price cap regulation within a year of the transaction.[23] The Commission stated that this "all-or-nothing" rule applies not only to the acquisition of an entire LEC but also to the acquisition of part of a study area.[24] U S WEST is a price cap company, and hence, under this rule, the buyers' acquisition of U S WEST's nine exchanges obligates them to become subject to price cap regulation instead of rate-of-return regulation.

13. The Commission explained that the all-or-nothing rule is intended to address two concerns it has regarding mergers and acquisitions involving price cap companies. The first concern is that, in the absence of the rule, a LEC might attempt to shift costs from its price cap affiliate to its non-price cap affiliate, allowing the non-price cap affiliate to earn more, due to its

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21 *Id.* 47 U.S.C. 254(a)(2). To develop new USF rules, the Commission has initiated a proceeding to address this issue. *See* Federal-State Joint Board on Universal Service, *Notice of Proposed Rulemaking and Order Establishing Joint Board*, 61 Fed. Reg. 10499 (March 14, 1996). *Id.* ¶ 39.

22 Price cap companies are those LECs that receive compensation for the use of their facilities in originating and terminating interstate telecommunication services on the basis of the Commission's price cap rules. 47 C.F.R. §§ 61.41-61.49. Cost companies are those LECs that receive compensation for the use of their facilities in originating and terminating interstate telecommunications services on the basis of their actual costs.

23 47 C.F.R. § 61.41(c). *See* Policy and Rules Concerning Rates for Dominant Carriers, *Second Report and Order*, 5 FCC Rcd 6786, 6821 (1990), *Erratum*, 5 FCC Rcd 7664 (Com. Car. Bur. 1990) (*"LEC Price Cap Order"*), *modified on recon.*, *Order on Reconsideration*, 6 FCC Rcd 2637 (1991) (*"LEC Price Cap Reconsideration Order"*), *aff'd sub nom. National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993), *petitions for further recon. dismissed*, 6 FCC Rcd 7482 (1991), *further modification on recon.*, Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, Policy and Rules Concerning Rates for Dominant Carriers, *Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rulemaking*, 6 FCC Rcd 4524 (1991) (*"ONA Part 69 Order"*), *further recon.*, *Memorandum Opinion and Order on Second Further Reconsideration*, 7 FCC Rcd 5235 (1992).

24 *See LEC Price Cap Reconsideration Order, supra* note 23, ¶ 149 note 207. The Commission explained that, if these two types of acquisitions were not treated the same under the all-or-nothing rule, a LEC could avoid the rule by selling all but one of its exchanges. *Id.*

increased revenue requirement, without affecting the earnings of the price cap affiliate, *i.e.*, without triggering the sharing mechanism. The second concern is that, absent the rule, a LEC may attempt to "game the system" by switching back and forth between rate-of-return regulation and price cap regulation. The Commission cited, as an example, the incentive a price cap company may have to increase earnings by opting out of price cap regulation, building up a large rate base under rate-of-return regulation so as to raise rates and, then, after returning to price cap, cutting costs back to an efficient level. It would disserve the public interest, the Commission stated, to allow a LEC to alternately "fatten up" under rate-of-return regulation and "slim down" under price cap regulation, because rates would not fall in the manner intended under price cap regulation.[25]

14. The Commission nonetheless recognized that a narrow waiver of the all-or-nothing rule might be justified if efficiencies created by the purchase and sale of a few exchanges were to outweigh the threat that the system may be subject to gaming.[26] Such a waiver would not be granted unconditionally, however. Rather, waivers of the all-or-nothing rule would be granted subject to the condition that the selling price cap company shall make a downward exogenous adjustment to its price cap indices to reflect the change in its study area.[27] That adjustment is needed to remove the effects of the transferred exchanges from rates that have been based, in whole or in part, upon the inclusion of those exchanges in the study areas subject to price cap regulation.[28]

B. Pleadings

15. *Petition.* The buyers seek waivers of Section 61.41(c)(2) so they may operate as rate-of-return LECs, rather than price cap LECs, after acquiring the nine exchanges which currently are under price cap regulation. Petitioners argue that the rule's application in this instance is contrary to the public interest and does not serve the purposes for which the rule was adopted. Petitioners further argue that the Commission's two concerns, the threat of cost shifting between

[25] *Id.* ¶ 148

[26] *Id.* ¶ 149 note 207.

[27] *See* Price Cap Performance Review for Local Exchange Carriers, *First Report and Order*, 10 FCC Rcd 8962, ¶¶ 328, 330 (1995) ("*LEC Price Cap Review Order*"). Under that requirement, U S WEST must reduce the price cap indices for its Idaho study area if the changes in study area boundaries reduce the cost bases for those indices. The price cap indices, which are the cost indices on which price-capped rates are based, are calculated pursuant to a formula specified in the Commission's rules for price cap LECs. *See* 47 C.F.R. § 61.45.

[28] *See LEC Price Cap Review Order*, *supra* note 27, ¶ 330.

affiliates and gaming of the system, are not at issue in this case.[29]

C. Discussion

16. We agree with petitioners that the Commission's first concern underlying the all-or-nothing rule is not applicable in this case. None of the buyers has an incentive to shift costs between price cap and cost affiliates, because none of these companies are seeking to maintain separate affiliates under different systems of regulation. As to the Commission's second concern, we find it implausible that U S WEST could game the system by moving the nine exchanges back and forth between price cap and other forms of regulation, because U S WEST is selling these exchanges and a reacquisition would require a second study area waiver. Moreover, it cannot transfer the exchanges without removing the rate-increasing effects of the exchanges from the price-capped rates that have been based, in part, upon the inclusion of these exchanges in its Idaho study area.

17. We therefore find there is good cause to grant the buyers waivers of the all-or-nothing rule to permit them to remain under rate-of-return regulation after acquiring the nine exchanges which currently are under price cap regulation. As noted above, these waivers are subject to the condition that U S WEST shall make a downward exogenous adjustment to its price cap indices to reflect the removal of these generally high-cost exchanges from its Idaho study area. For the present, we will continue to regulate buyers as rate-of-return carriers. Because we are waiving Section 61.41(c)(2), they need not withdraw from the NECA pools. We note that, as with any other rate-of-return carriers, the buyers may elect price cap regulation in the future if they decide to withdraw from the NECA pools.

IV. OTHER ISSUES

18. To the extent necessary, the buyers seek waivers of Section 69.3(e(11) of the Commission's rules. That rule requires that any changes in NECA common line tariff participation and long term support resulting from a merger or acquisition of telephone properties are to be made effective on the next annual access tariff filing effective date following the merger or acquisition. Buyers are concerned that under a strict interpretation of this rule they, rather than NECA, would be required to file a tariff on the next annual access tariff filing date. Assuming its acquisition occurs this year, each buyer represents that it plans to utilize NECA as its interstate tariff administrator; consequently, the buyers' carrier common line costs will be included in NECA's 1997 filing. We conclude that, none of the buyers are required to make a separate annual access filing for their carrier common line costs, and therefore, a waiver of Section 69.3(e)(11) is not required.

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[29] Joint petition at 6. We note that, although U S WEST signed the joint petition, U S WEST does not seek a waiver of the all-or-nothing rule.

V. ORDERING CLAUSES

19. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), 5(c), 201-202 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 155(c), 201-202, and Sections 0.91, 0.291, and 1.3 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3, that the joint petition of Albion Telephone Co., Inc., Cambridge Telephone Co., Fremont Telcom Co., Midvale Telephone Exchange, Rockland Telephone Co., Inc., and U S WEST, for waiver of Part 36, Appendix-Glossary, of the Commission's rules, 47 C.F.R. Part 36 Appendix-Glossary IS GRANTED subject to the condition stated in paragraph 11 and footnote 19 of this Order.

20. IT IS FURTHER ORDERED, pursuant to Sections 1, 4(i), 5(c), 201-202 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 155(c), 201-202, and Sections 0.91, 0.291, and 1.3 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3, that the joint petition of Albion Telephone Co., Inc., Cambridge Telephone Co., Fremont Telcom Co., Midvale Telephone Exchange, Rockland Telephone Co., Inc., and U S WEST for waiver of Section 61.41(c)(2) of the Commission's rules, 47 C.F.R. § 61.41(c)(2), IS GRANTED subject to the condition stated in paragraph 17 of this Order.

21. IT IS FURTHER ORDERED, pursuant to Sections 1, 4(i), 5(c), 201-202 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 155(c), 201-202, and Sections 0.91, 0.291, and of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that the National Exchange Carrier Association shall not distribute USF assistance exceeding the limit imposed in paragraph 11 and footnote 19 of this Order.

22. IT IS FURTHER ORDERED, pursuant to Sections 1, 4(i), 5(c), 201-202 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 155(c), 201-202, and Sections 0.91 and 0.291 of the Commission's rules, 47.C.F.R. §§ 0.91, 0.291, that this Order IS EFFECTIVE IMMEDIATELY UPON RELEASE.

FEDERAL COMMUNICATIONS COMMISSION

Kenneth P. Moran

Kenneth P. Moran
Chief, Accounting and Audits Division
Common Carrier Bureau