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

In the Matter of	)	
	)	
GTE Southwest Incorporated and	)	
Santa Rosa Telephone Cooperative, Inc.	)	
	)	
Joint Petition for Waiver of Section 61.41(c)(2)	)	AAD 94-111
and the Definition of "Study Area"	)	
Contained in the Part 36 Appendix-Glossary	)	
of the Commission's Rules	)	

MEMORANDUM OPINION AND ORDER

Adopted: August 4, 1995 **Released: August 7, 1995**

By the Chief, Accounting and Audits Division:

I. INTRODUCTION

1. On August 5, 1994, GTE Southwest Incorporated ("GTE") and Santa Rosa Telephone Cooperative, Inc. ("Santa Rosa") (collectively, "Petitioners") filed a joint petition for waiver ("Joint Petition") of two commission rules. GTE and Santa Rosa both seek a waiver 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. The requested waivers would allow GTE and Santa Rosa to alter the boundaries of their Texas study areas when transferring one telephone exchange from GTE to Santa Rosa. In addition, Santa Rosa seeks a waiver of the price cap rule contained in Section 61.41(c)(2) of the Commission's rules. That 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 waiver would permit Santa Rosa to remain under rate-of-return regulation after acquiring the one exchange which currently is under price cap regulation.

2. On October 18, 1994, the Common Carrier Bureau ("Bureau") released a public notice soliciting comments on the Joint Petition.[1] The Bureau received comments supporting the Joint Petition from three parties: the National Exchange Carrier Association, Inc. ("NECA"), the National Telephone Cooperative Association ("NTCA"), and the United States Telephone Association ("USTA"). At the request of Bureau staff, Petitioners provided additional financial

[1] Public Notice, 9 FCC Rcd 5257 (Com. Car. Bur. 1994).

and cost data concerning the Joint Petition.[2] In this Order, we find that the public interest would be served by allowing GTE and Santa Rosa to alter their study area boundaries and allowing Santa Rosa to continue operating under rate-of-return regulation after acquiring the exchange. We therefore grant the Joint Petition, as conditioned and explained more fully below.

II. STUDY AREA WAIVERS

3. ***Background.*** 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 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 high-cost payments.[5] The study area freeze also prevents LECs from transferring exchanges among existing study areas for the purpose of increasing interstate revenue requirements and compensation. A LEC must apply to the Commission for a waiver of the frozen study area rule if the LEC wishes to sell an exchange to another carrier and if that

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[2] Letter from Edwin Shimizu, GTE Service Corporation, to Kent Nilsson, Chief, Cost Analysis Branch, FCC, dated Sept. 6, 1994 ("GTE Sept. 6 Supplement"); letter from Robert W. Gee, Chairman, Texas PUC, to Kent Nilsson, Chief, Cost Analysis Branch, FCC, dated Mar. 24, 1995 ("Texas PUC Letter"); letter from Margaret Nyland, Kraskin & Lesse, to Kent Nilsson, Chief, Cost Analysis Branch, FCC, dated May 1, 1995 ("Santa Rosa May 1 Letter"); letter from Sylvia Lesse, Kraskin & Lesse, to Office of the Secretary, FCC, dated June 2, 1995 ("Santa Rosa June 2 Supplement"); letter from Edwin Shimizu, GTE Service Corporation, to William Caton, Acting Secretary, FCC, dated June 15, 1995 ("GTE June 15 Letter"); letter from Sylvia Lesse, Kraskin & Lesse, to Office of the Secretary, FCC, dated June 15, 1995 ("Santa Rosa June 15 Letter"); letter from Sylvia Lesse, Kraskin & Lesse, to William Caton, Acting Secretary, FCC, dated June 27, 1955 ("Santa Rosa June 27 Supplement"); letter from Whitney Hatch, GTE Services Corporation, to Kent Nilsson, Chief, Cost Analysis Branch, FCC, dated July 26, 1995 ("GTE July 26 Supplement").

[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., Part 36, Appendix-Glossary, definition of "Study Area" (1993). *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984) (*1984 Joint Board Recommended Decision*), adopted by the Commission, 50 Fed. Reg. 939 (Jan. 8, 1985) (*1985 Order Adopting Recommendation*). *See also* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Notice of Proposed Rulemaking, 5 FCC Rcd 5974 (1990) (*Study Area Notice*).

[5] *See 1985 Order Adopting Recommendation*, 50 Fed. Reg. 939, 940. *Also see 1984 Joint Board Recommended Decision*, 49 Fed. Reg. 48325, 48337.

transaction would have the effect of changing the study area boundaries of either carrier.[6]

4. Waiver of commission rules is appropriate only if special circumstances warrant deviation from the general rule[7] and such a deviation will serve the public interest.[8] In evaluating petitions seeking a waiver of the rule freezing study area boundaries, the Commission employs a three-prong standard:[9] first, that the change in study area boundaries does not adversely affect the Universal Service Fund ("USF") support program;[10] second, that the state commission(s) having regulatory authority over the exchange(s) to be transferred does not object to the change; and third, that the public interest supports such a change. In evaluating whether the change would adversely affect the USF, the Commission applies a "one percent" guideline to study area waiver requests filed after January 5, 1995.[11] This guideline does not apply in the instant case because Petitioners filed before that date.

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[6] 47 C.F.R. Part 36, Appendix-Glossary. *See also* 47 C.F.R. § 1.3.

[7] *Northeast Cellular Telephone Company v. FCC*, 897 F.2d 1164, 1166 (D.C. Cir. 1990).

[8] *WAIT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969).

[9] *See* US West Communications, Inc., and Eagle Telecommunications, Inc., Joint 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 (1995) (*US West-Eagle Study Area Order*) at ¶ 5.

[10] *See 1984 Joint Board Recommended Decision*, 49 Fed. Reg. at 48337, ¶ 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, 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 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.

[11] The Commission stated that no waiver of the rule freezing study area boundaries should 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. The USF effect for the year must be computed on an annualized basis. 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 "one percent" guideline be applied to all study area waivers granted to either carrier, as a purchaser or seller, pending completion of the current review of the USF program. 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). *See US West-Eagle Study Area Order* at ¶¶ 14-17.

5. ***Petition.*** GTE seeks a waiver of the rule freezing study area boundaries to enable it to remove one exchange, which serves approximately 630 access lines, from its Texas study area, which serves approximately 1,229,000 access lines. Santa Rosa seeks a similar waiver to enable it to add this one exchange to its existing Texas study area, which currently consists of nine exchanges serving approximately 1,450 access lines.[12]

6. Petitioners assert that these requests are consistent with the original purpose of the USF and that the resulting impact on the USF would be marginal. Petitioners estimate that, if the study area waivers were granted, the transfer of the exchange would cause a net decrease of $2,232 in Petitioners' combined USF draw. This net decrease, they state, is the combined result of an expected increase of $5,586 (or 0.17 percent) in GTE's USF draw and an expected decrease of $7,818 (or 1.35 percent) in Santa Rosa's USF draw.[13] Petitioners further assert that the proposed change would serve the public interest because Santa Rosa would improve customer service in the newly acquired exchange by constructing a new digital central office that would provide the latest signalling technology and custom calling features. Santa Rosa also would upgrade the local network with new copper distribution plant.[14] Santa Rosa estimates that these upgrades would require an investment outlay of $600,000.[15]

7. ***Discussion.*** Petitioners' proposals demonstrate that current and potential customers in the affected exchange will likely be better served by Santa Rosa than GTE. Petitioners state that Santa Rosa would construct a modern local network, including a new digital office and new copper distribution plant, that would enable it to provide single-line service to customers now served by party lines and provide enhanced digital services to all customers.[16] We thus believe the transfer of this exchange, which has not been objected to by the Texas Public Utilities Commission ("Texas PUC"),[17] likely will serve the public interest. In addition, we have

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[12] Joint Petition at 2.

[13] Santa Rosa June 2 Supplement; GTE Sept. 6 Supplement. The transaction would result in an *increase* in USF draws for GTE and a *decrease* in USF draws for Santa Rosa, because the transferred exchange exhibits loop costs that are below average in comparison to the existing GTE study area and, even after upgrades, would be below average in comparison to the existing Santa Rosa study area. Hence, the exchange transfer together with the upgrades would raise average loop costs for the GTE study area and lower average loop costs for the Santa Rosa study area. *See id.*

[14] Joint Petition at 2-3.

[15] Santa Rosa June 15 Letter.

[16] *Id.*

[17] The Texas PUC states that it neither endorses nor objects to a grant of the study area waivers requested by GTE and Santa Rosa. The Texas PUC also states that Section 63 of Article VIII of the Texas Public Utility Regulatory Act does not require LECs to obtain its prior approval when transferring exchanges among themselves; LECs must report, however, such sales within a reasonable period of time after the sale, and remedies are provided

determined that the net decrease of $2,232 in the combined USF draw for GTE and Santa Rosa would not have a significant adverse effect on the USF. We therefore find that the three existing criteria for granting a study area waiver have been met in this instance and that the waiver requests should be granted.

8. Although we find no reason to question Santa Rosa's 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. 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 exchange being acquired by Santa Rosa.[18] Moreover, we are concerned that this sale and a number of similar proposed transactions might, in the aggregate, have a substantial effect on the size of the USF and on those high-cost LECs that draw from the USF.

9. This concern has been mitigated, in the short term at least, by the Commission's adoption of the Joint Board's recommendation for an indexed cap on the USF.[19] Yet, even in the short term, unidentified errors contained in Santa Rosa's impact estimates 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 reduces that of other USF recipients. Hence, if Santa Rosa's estimate proves to be too low, the support provided to other USF recipients could be lowered by an amount that does have a material impact. We therefore find that the waivers should be subject to the condition that, absent our explicit approval, the annual USF support provided to the Santa Rosa study area shall not exceed the amount for which that study area is currently qualified. This condition will ensure that the study area waivers will not result in adverse effects on the USF program which substantially exceed Santa Rosa's

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to ensure that the sales do not adversely affect the public interest. *See* Texas PUC Letter.

[18] *See, e.g.*, Delta Telephone Company, 5 FCC Rcd 7100 (1990), whose USF payment grew from $82,500 in 1991 to approximately $445,700 in 1993; and US West and Gila River Telecommunications, Inc., 7 FCC Rcd 2161 (1992), whose projection of $169,155 for Gila River's 1992 USF payment was more than doubled by the actual 1992 payment of $390,993, which has been nearly doubled again by the 1995 scheduled payment of approximately $750,000.

[19] The Joint Board recommended, and the Commission adopted, interim rules that will limit the rate of growth of the USF to the rate of growth in the total number of working loops nationwide. That rate of growth has generally ranged from two percent to five percent per year. This moderate growth rate will allow the USF to continue to provide adequate support to carriers serving high-cost areas, while preventing excessive increases in the USF. *See generally* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 9 FCC Rcd 334 (1993)("*1993 Joint Board Recommended Decision*"), adopted by the Commission, 9 FCC Rcd 303 ("*Interim Cap Order*"). In its *Interim Cap Order*, the Commission also expressed its intention to review the USF rules to determine whether permanent changes are necessary. *Interim Cap Order* at 303.

forecasts.[20]

10. We note that we recently granted GTE's requests for two study area waivers applicable to the same GTE study area that is at issue here. Those waivers permitted GTE to reconfigure its Texas study area to reflect the sale of nine small exchanges. Both waivers are subject to the condition that the USF assistance for that study area shall not exceed certain limitations, absent our explicit approval.[21] On July 26, 1995, GTE provided updated information concerning changes in the USF-related costs of its Texas study area.[22] Based on our review of that information, we are removing the study area's limitations on USF assistance because we find them unnecessary. In view of the relatively small share of total access lines being transferred out of that study area by the sale of the exchange at issue here, and by the sale of the nine other small exchanges, it is highly unlikely that the size or distribution of USF assistance could be adversely affected by these transactions.

III. PRICE CAPS WAIVER

11. ***Background.*** Section 61.41(c)(2) of the Commission's rules provides that, when a non-price cap company acquires a price cap company, 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

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[20] These study area waivers also are subject to the condition that, if the selling LEC is a price cap carrier selling a high-cost portion of its operations, it shall make a downward exogenous adjustment to its Price Cap Index to reflect the change in its study area boundaries. *See* Price Cap Performance Review for Local Exchange Carriers, First Report and Order, CC Docket No. 94-1, FCC 95-132, released April 7, 1995 (*"LEC Price Cap Review Order"*), at ¶¶ 328 and 330. Under that requirement, GTE must reduce the Price Cap Index for its Texas study area if the change in study area boundaries reduces the cost basis for that index. The Price Cap Index, which is the cost index on which price-capped rates are based, is calculated pursuant to a formula specified in the Commission's rules for price cap LECs. *See* 47 C.F.R. § 61.45.

[21] *See* Memorandum Opinion and Order, GTE Southwest Incorporated *et al.*, DA 95-1481, AAD 94-110 (released June 30, 1995); Memorandum Opinion and Order, GTE Southwest Incorporated *et al.*, DA 95-1501, AAD 94-109 (released July 10, 1995).

[22] *See* GTE July 26 Supplement.

[23] 47 C.F.R. § 61.41(c). *See* Second Report and Order, 5 FCC Rcd 6786, 6821 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (*LEC Price Cap Order*), *modified on recon.* 6 FCC Rcd 2637 (1991) (*LEC Price Cap Reconsideration Order*), *petitions for further recon. dismissed,* 6 FCC Rcd 7482 (1991), *aff'd, National Rural Telecom Assoc. v. FCC*, 988 F.2d 174 (D.C. Cir. 1993), *further modification on recon.*, 6 FCC Rcd 4524 (1991)(*ONA Part 69 Order*), *second further recon.*, 7 FCC Rcd 5235 (1992).

acquisition of an entire LEC but also to the acquisition of part of a study area.[24] Hence, under this rule, Santa Rosa's acquisition of GTE's one rural exchange obligates Santa Rosa to exit the NECA pools and become subject to price cap regulation instead of rate-of-return regulation.

12. The Commission explained that the all-or-nothing rule is intended to address two concerns it has regarding mergers and acquisitions involving price cap LECs. The first concern is that, in the absence of the rule, a company 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 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 LEC 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 caps, 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 caps regulation, because rates would not fall in the manner intended under price cap regulation.[25]

13. 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, similar to certain study area waivers,[27] waivers of the all-or-nothing rule would be granted subject to the condition that the selling price cap LEC shall make a downward exogenous adjustment to its Price Cap Index to reflect the change in its study area. That adjustment is needed to remove the effects of the transferred exchanges from price-capped 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]

14. ***Petition.*** Santa Rosa seeks waiver of Section 61.41(c)(2) so it may operate as a rate-of-return LEC, rather than a price cap LEC, after acquiring the one exchange which currently is under price cap regulation. Petitioners argue that the rule's application in this instance is

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[24] 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. *See LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637, 2706.

[25] *LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637, 2706.

[26] *Id.*

[27] *See supra* at note 20.

[28] *See LEC Price Cap Review Order* at ¶ 330.

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

15. ***Discussion.*** We agree with Petitioners that the Commission's first concern underlying the all-or-nothing rule is not applicable in this case. Santa Rosa has no incentive to shift costs between price cap and rate-of-return affiliates, because it is not seeking to maintain separate affiliates under different systems of regulation. As to the Commission's second concern, we find it implausible that GTE could game the system by moving the one exchange back and forth between price caps and rate-of-return regulation, because GTE is selling this exchange and a reacquisition would require a second study area waiver. Moreover, GTE cannot transfer the exchange without removing the rate-increasing effects of this exchange from the price-capped rates that have been based, in part, upon the inclusion of this exchange in its Texas study area.[30]

16. We therefore find there is good cause to grant Santa Rosa a waiver of the all-or-nothing rule to permit it to remain under rate-of-return regulation after acquiring the one exchange which currently is under price cap regulation. As noted above, this waiver is subject to the condition that GTE shall make a downward exogenous adjustment to its Price Cap Index to reflect the removal of the exchange from its Texas study area. For the present, we will continue to regulate Santa Rosa as a rate-of-return carrier. Because we are waiving Section 61.41(c)(2), Santa Rosa need not withdraw from the NECA pools. We note that, as with any other rate-of-return carrier, Santa Rosa may elect price cap regulation in the future if it decides to withdraw from the NECA pools.

IV. ORDERING CLAUSES

17. Accordingly, IT IS ORDERED, pursuant to Sections 4(i) and 5(c) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i) and 155(c) and Sections 0.91 and 0.291 of the Commission's Rules, 47 C.F.R. §§ 0.91, 0.291, that the Joint Petition of GTE Southwest Incorporated and Santa Rosa Telephone Cooperative, Inc., for waiver of Part 36, Appendix-Glossary, of the Commission's Rules, 47 C.F.R. Part 36 Appendix-Glossary, and 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 conditions set forth above.

18. IT IS FURTHER ORDERED that NECA shall not distribute USF assistance exceeding the limit imposed in paragraph 9, *supra*, and that the limitations referenced in paragraph 10, *supra*, are removed.

19. IT IS FURTHER ORDERED that this Order is effective immediately upon release.

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[29] Joint Petition at 8.

[30] *See supra* at ¶ 13.

FEDERAL COMMUNICATIONS COMMISSION

Kenneth P. Moran
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Common Carrier Bureau