

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

June 28, 2002

IN RE:

**TELLICO TELEPHONE COMPANY'S TARIFF
TO PROVIDE RATE REDUCTIONS TO OFFSET
A PORTION OF THE 2002 TAX CREDIT**

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**DOCKET NO.
02-00141**

ORDER APPROVING TARIFF

This matter came before the Tennessee Regulatory Authority (the "Authority") at the regularly scheduled Authority Conference held on May 21, 2002, for consideration of *Tellico Telephone Company's* ("Tellico" or the "Company") *Tariff to Provide Rate Reductions to Offset a Portion of the 2002 Tax Credit* ("*Tariff*"). Tellico filed the *Tariff* with the Authority on February 8, 2002 with a proposed effective date of April 1, 2002. Tellico filed revisions to the *Tariff* on April 4, 2002 which reduced business service rates to offset a portion of the 2002 Tax Credit. Both the *Tariff* and the revisions (hereinafter referred to collectively as the *Tariff*) have an effective date of April 30, 2002.

BACKGROUND

The *Tariff* seeks to implement Tennessee Public Chapter No. 195 (the "Act") that was approved on May 10, 2001 and provides property tax relief to both local exchange carriers ("LECs") and telephone cooperatives.¹ The Act provides a property tax rebate system that effectively reduces the assessment ratio on the property owned by the LECs

¹ See generally 2001 Tenn. Pub. Acts ch. 195, codified at Tenn. Code Ann. §§ 67-6-221 and 67-6-222.

and telephone cooperatives by making annual ad valorem tax equity payments to eligible LECs and telephone cooperatives.²

The Act levies an additional four percent (4%) sales tax on interstate telecommunications services sold to businesses.³ The Act directs a portion of the revenue collected from this sales tax into the Telecommunications Ad Valorem Tax Reduction Fund (the "Fund").⁴ The Comptroller of the Treasury (the "Comptroller") is charged with administration of the Fund.⁵

LECs and telephone cooperatives providing taxable telecommunications services receive payments from the Fund in an amount equal to 27.27% of the aggregate ad valorem taxes paid on real property and 45.45% of the aggregate ad valorem taxes paid on personal property.⁶ To claim a payment, the LEC or telephone cooperative must notify the Comptroller in writing of the amount and basis for claiming the payment on or before May 15, 2003 and on or before May 15th of each year thereafter.⁷

The Act also provides for a pass-through of the net tax savings experienced by the LECs and telephone cooperatives to their business and interconnection customers by way of price adjustments to offered telecommunications services.⁸ The initial price adjustment shall be effective as of January 1, 2002, based on the applying carrier's estimate of the payment it is eligible to receive from the Fund as projected by the Department of Revenue.⁹ Subsequent price adjustments shall be made effective October 1, 2003 and on

² *Id.*

³ Tenn. Code Ann. § 67-6-221(a) (establishing a total rate of seven and one-half percent (7.5%)).

⁴ Tenn. Code Ann. § 67-6-221(b).

⁵ Tenn. Code Ann. § 67-6-222(a)(1).

⁶ Tenn. Code Ann. § 67-6-222(b)(1)(A) and (B).

⁷ Tenn. Code Ann. § 67-6-222(b)(2).

⁸ Tenn. Code Ann. § 67-6-222(c).

⁹ *Id.*

October 1st of each year thereafter, based on the actual ad valorem tax equity payments received by each carrier for the immediately preceding June 30th payment date, and taking into account the cumulative amount of previously implemented price adjustments.¹⁰

Tellico uses an assessed-property basis methodology in estimating the payment it is eligible to receive from the Fund. Tellico gathered from each LEC and telephone cooperative the amounts of assessed property for 2001. Based on each carrier's proportionate share of total assessed property, the initial amount of ad valorem tax equity payments can be projected for each eligible carrier by multiplying the carrier's assessed property ratio by the projected Fund balance. Using this methodology, Tellico submitted calculations estimating its initial ad valorem tax equity payment to be \$42,216. In the *Tariff* (as revised), the Company reduced the total tax savings by \$12,188 for Part 36/69 cost and compliance costs of \$70. The Company proposes to pass through net tax savings of \$29,466 to business customers by reducing PBX trunk, key system and DID trunk service rates by \$3.00 per line/trunk per month and by reducing system plus service rates by \$7.00 per line per month over the twelve (12) months of 2002.¹¹

While the assessed-property basis is a reasonable method to determine the Company's share of the Fund, the Comptroller is still developing the procedures it will use to administer the Fund and has not yet adopted a final methodology to apportion the Fund among the LEC's and telephone cooperatives. In previously finding this methodology reasonable, the Authority is not attempting to influence the final development of the

¹⁰ *Id.*

¹¹ For all of the TDS companies, the aggregate amount of estimated net tax savings is \$300,937, and the aggregate amount of proposed rate reductions to business services is \$300,947.

methodology by the Comptroller.¹² Thus, the amount of the rate reductions proposed by the Company may require adjustment if the Comptroller adopts a methodology that apportions the Fund on some basis other than assessed property values. Additionally, the amount of the rate reductions proposed in the *Tariff* may require adjustment if the Comptroller revises its estimated expense for administration of the Fund or if the Department of Revenue revises its estimate of the initial size of the Fund.

The Act requires that the mandated reductions in business and interconnection rates become effective January 1, 2002.¹³ The Authority cannot ascertain or predict when the Comptroller will adopt final Fund administration procedures. This notwithstanding, any rate reductions made now can be subsequently adjusted to conform with Act requirements as administered by the Comptroller. The Act requires ongoing rate adjustments in order to true-up rates to reflect each eligible carrier's net tax savings resulting from the carrier's receipt of annual ad valorem tax equity payments from the Fund.¹⁴

FINDINGS

At the Authority Conference held on March 12, 2002, the Directors first considered the original *Tariff* to pass through net property tax savings to business customers as well as the *Complaint and Petition to Intervene* filed by the Consumer Advocate and Protection Division of the Office of the Attorney General and Reporter ("CAPD") on March 5, 2002.

At that Conference, the Directors voted unanimously to find:

1. That the *Tariff* accurately applied a reasonable methodology based on assessed property values to compute their estimated property tax savings;
2. That the Comptroller of the Treasury is in the process of establishing administrative procedures for operation of the Fund created by the Act;

¹² Transcript of Directors' Conference, pp. 16-17 (Dec. 18, 2001).

¹³ 2001 Tenn. Pub. Acts ch. 195, Section 4.

¹⁴ *Id.*

3. That the Authority's acceptance of the Company's calculations of estimated tax savings based on assessed property values for the purpose of flowing through estimated net tax savings to business customers does not constitute an endorsement or recommendation of any particular methodology to apportion the Fund among eligible carriers;
4. That the rate adjustments proposed by the Company are appropriately applied only to the services purchased by business customers in accordance with the Act;
5. That the rate adjustments proposed by the Company do not properly reflect the net amount of estimated property tax savings. The Company proposed to flow through the net tax savings to business customers over an 18-month period. The Authority determined that such flow through should occur over a 12-month period, or annualized level of rate adjustments;
6. That the Company has two options with respect to the flow through period for adjusting business rates pursuant to the Act:
 - a. Option 1: The Company may flow through its estimated net tax savings to business customers over a 12-month period. Companies choosing this option should give business customers credit for the period of time that has expired between January 1, 2002 (the effective date required by the Act) and the institution of the rate adjustments to customers' bills;
 - b. Option 2: The Company may flow through its estimated net tax savings to business customers prospectively over the remaining months of 2002. Companies choosing this option should be allowed to readjust rates effective January 1, 2003, to reflect the company's annualized level of rate adjustments for its estimated net tax savings for the following calendar year; and
7. That in accordance with the Act, each rate-of-return regulated company that jurisdictionally separates its costs for rate purposes may deduct Part 36/69 costs that are attributable to the interstate jurisdiction from the amount of net tax savings flowed through to business customers as long as such costs are computed in a reasonable manner that is correctly applied. Companies that fail to provide adequate supporting documentation for the calculation of their Part 36/69 costs shall have such deduction from their estimated tax savings determined by the traditionally accepted 75%-intrastate, 25%-interstate separations factor for non-traffic sensitive cost.

The Directors further voted unanimously to:

1. Suspend the effective date of the *Tariff* until April 30, 2002;
2. Hold the CAPD's *Complaints and Petitions to Intervene* in abeyance pending further deliberations;
3. Direct the CAPD and the Company to file briefs within seven (7) days from the date of the Authority Conference addressing the following two issues:
 - a. Whether or not the estimated net tax savings created by the Act must be flowed through to business customers only in the form of price adjustments to the tariffed rates of telecommunications services as opposed to credits;
 - b. Whether or not it is appropriate for qualifying companies, particularly rate-of-return regulated companies, to deduct costs for complying with the Act's requirements in such companies' calculation of estimated net tax savings; and
4. Place the *Tariff* on the next Authority Conference agenda for further review following the submission of briefs in order to expeditiously proceed with an appropriate course of action to implement the rate adjustments required by the Act.

As directed by the Authority, the Consumer Advocate and the Company submitted their briefs on March 19, 2002.¹⁴

At the Authority Conference held on March 26, 2002, the Directors voted unanimously to find:

1. That the price adjustments to pass through the estimated net tax savings to business customers shall be in the form of rate reductions to specific tariffed services;
2. That the annual price adjustments required by the Act may be accomplished through simple tariff filings rather than full rate hearings; and

¹⁴ Sixteen (16) local exchange companies collectively submitted one brief. Those companies are: Ardmore Telephone Company, Crockett Telephone Company, Peoples Telephone Company, West Tennessee Telephone Company, CenturyTel of Adamsville, Inc., CenturyTel of Claiborne, Inc., CenturyTel of Ooltewah-Collegedale, Inc., Loretto Telephone Company, Millington Telephone Company, Concord Telephone Exchange, Inc., Humphreys County Telephone Company, Tellico Telephone Company, Tennessee Telephone Company, Citizens Telecommunications Company of Tennessee, Citizens Telecommunications Company of the Volunteer State, and United Telephone Company, Inc.

3. That rate-of-return regulated companies will be allowed to deduct reasonable and necessary costs of complying with the Act in computing the estimated net tax savings to be passed onto business customers provided that sufficient documentation is filed to justify such costs.

The Authority then directed the Company to revise its *Tariff* to be consistent with the Authority's rulings regarding the procedures for flowing through to its business customers the estimated net tax savings created by the Act. To carry out this directive, the Authority instructed the Executive Secretary to immediately send a letter to all sixteen companies outlining the Authority's rulings in this matter relative to each company and directing each company to revise and refile its tariff with all required supporting documentation within ten days from the date of the March 26th Conference. Finally, the Directors voted to continue to hold in abeyance the Consumer Advocate's *Complaint and Petition to Intervene* pending the filing and review of the Company's revised *Tariff*.

On March 26, 2002, the Executive Secretary forwarded a letter to the Company describing the Authority's rulings in this matter and directing the Company to file its revised tariff by April 5, 2002. As directed, the Company timely filed its revised *Tariff*.

At the April 30, 2002 Authority Conference, the Directors voted unanimously to find that the Company's deductions in arriving at estimated net tax savings for reductions in federal Universal Service high-cost support payments, while valid and appropriate, are premature at this time because companies receiving high-cost support will not experience reductions in such payments resulting from the cost savings created by the Act until 2004. The Directors instructed the Company to revise its *Tariff* to eliminate the untimely deduction for the future loss of high-cost support payments in the initial calculation of estimated net tax savings to be flowed through to business customers and re-file the revision within ten (10) days.

At the Authority Conference held on May 21, the Consumer Advocate stated that the revisions to the *Tariff* made by the Company satisfied the concerns raised in its *Complaint and Petition to Intervene*; therefore, the Consumer Advocate voluntarily withdrew its *Complaint and Petition to Intervene*. The Directors then voted unanimously to find:

1. That all issues pertinent to the flow through of estimated net tax savings to business customers, including the issues raised in the Consumer Advocate's *Complaint and Petition to Intervene*, have been considered and decided relative to Tellico; and
2. That Tellico's *Tariff* is consistent with the Act and that Authority's rulings in this matter.

CONCLUSIONS

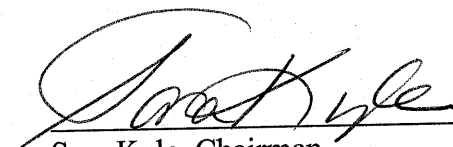
Authority approval of the revised *Tariff* essentially designates the business rate reductions as those mandated by the Act, and the *Tariff* should be approved so that the estimated net tax savings created by the Act can be passed through to the business customers of Tellico in a timely manner. Therefore, the Authority concludes that:

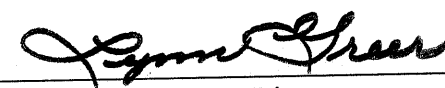
1. The *Tariff* proposes reductions to the rates of business and interconnection services as required by the Act.
2. The rate reductions proposed in the *Tariff* become effective on January 1, 2002.
3. The total amount of rate reductions proposed by Tellico is sufficient to pass through its estimated net tax savings created by the Act.
4. According to all presently available information, the *Tariff* is consistent with the Act's requirements.

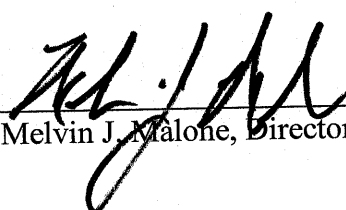
Based on the foregoing findings and conclusions, at the April 30, 2002 Authority Conference, the Directors voted unanimously to approve the *Tariff* as revised.

IT IS THEREFORE ORDERED THAT:

Tellico Telephone Company's Tariff to Provide Rate Reductions to Offset a Portion of the 2002 Tax Credit is approved as revised.


Sara Kyle, Chairman


H. Lynn Greer, Jr., Director


Melvin J. Malone, Director

ATTEST:


K. David Waddell, Executive Secretary