BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

April 19, 2002

IN RE:	)	
	)	
JOINT PETITION OF CROCKETT TELEPHONE COMPANY, INC., PEOPLES TELEPHONE COMPANY, WEST TENNESSEE TELEPHONE COMPANY, INC., AND THE CONSUMER ADVOCATE DIVISION OF THE OFFICE OF THE ATTORNEY GENERAL FOR THE APPROVAL AND IMPLEMENTATION OF EARNINGS REVIEW SETTLEMENT	)	**DOCKET NO. 99-00995**

FINAL ORDER APPROVING EARNINGS REVIEW SETTLEMENT AGREEMENT WITH MODIFICATIONS

This matter came before the Tennessee Regulatory Authority ("Authority" or "TRA") during an Authority Conference held on January 8, 2002, for consideration of the *Joint Petition of Crockett Telephone Company, Inc., People's Telephone Company, West Tennessee Telephone Company, Inc. and the Consumer Advocate Division of the Office of the Attorney General for Approval and Implementation of Earnings Review Settlement* ("Joint Petition").

Background

On January 12, 2000, Crockett Telephone Company, Inc., Peoples Telephone Company, and West Tennessee Telephone Company, Inc. (collectively "the TEC Companies") and the Consumer Advocate Division of the Office of the Attorney General ("Consumer Advocate") filed the Joint Petition.[1] On December 10, 1999, A&T Communications of the South Central

[1] The TEC Companies had previously filed a Settlement Agreement with the Authority on December 30, 1999 in response to a letter of December 6, 1999 from the Authority requesting said filing. The letter accompanying the Settlement Agreement stated that the TEC Companies and the Consumer Advocate would file a joint petition at a later date seeking the Authority's approval of the Settlement Agreement.

States, Inc. ("AT&T") filed a *Petition of A&T Communications of the South Central States, Inc. for the Convening of a Contested Case* ("Complaint") concerning the regulation of the rates of the TEC Companies.[2] On January 14, 2000, AT&T filed a Petition for Intervention ("Petition") in the instant docket. In its Petition, AT&T stated that it had filed its earlier Complaint in an attempt to "have an opportunity to participate fully in the determination of the overearnings of the TEC Companies, including the source thereof, the design of rates to compensate for such overearnings and the determination of any just and reasonable rates for the TEC Companies."[3] On January 31, 2000, the Consumer Advocate filed a Motion to Dismiss AT&T's Petition in this docket.

At a regularly scheduled Authority Conference held on February 1, 2000, the Authority opened a contested case in this matter, granted AT&T's Petition, thereby rendering moot the Consumer Advocate's Motion to Dismiss, and appointed General Counsel or his designee as Pre-Hearing Officer to prepare this matter for hearing.[4] On March 7, 2000, the Consumer Advocate filed its *Motion for Summary Judgment Dismissing AT&T's Complaint Against TEC's Proposed Rate Design Because AT&T's Proposed Design is not in the Public Interest or, in the Alternative, for Transfer to the Access Charge Reform Docket* ("Motion for Summary Judgment") and supporting Memorandum. On March 23, 2000, AT&T filed a reply to the Motion for Summary Judgment and served the TEC Companies and the Consumer Advocate

[2] AT&T's Complaint was originally assigned Docket No. 99-00956 when filed, but was later reassigned to Docket No. 00-00021.

[3] *Petition for Intervention of AT&T Communications of the South Central States, Inc.* (January 14, 2000), pp. 3-4. AT&T also stated that if its intervention in this docket was granted, then Docket No. 00-00021 should be consolidated with this proceeding.

[4] *See* Order Granting Intervention Petition of AT&T Communications of the South Central States, Inc., March 29, 2000.

with discovery requests. After several continuances, a Pre-Hearing Conference was held on June 9, 2000. During that Conference, the Pre-Hearing Officer ruled, without objection from any party, that Docket No. 00-00021 be consolidated with this docket. The Pre-Hearing Officer also determined that the Consumer Advocate's Motion for Summary Judgment should be held in abeyance pending further filings by the parties[5] and directed the parties to file comments relative to proposed lists of issues. In accordance with the Pre-Hearing Officer's directive, the parties each filed comments on June 14, 2000. AT&T filed a reply to the comments on June 19, 2000.

During the period following the June 9, 2000 Pre-Hearing Conference, the Pre-Hearing Officer was advised that, because BellSouth and the TEC Companies might enter into a new intraLATA toll compensation arrangement which could affect the overearnings situation, the joint petition may be amended by the TEC Companies and Consumer Advocate. A Status Conference was held on December 14, 2000 to determine whether an amended joint petition would be filed and whether there was a need for additional filings.

During the Status Conference, counsel for the TEC Companies informed the Pre-Hearing Officer that the TEC Companies would not be filing an amended joint petition but instead would proceed with the Joint Petition and Settlement Agreement as originally filed.[6] The TEC Companies also made a request that the Authority grant temporary relief in the form of an interim approval of that portion of the Settlement Agreement involving the contemplated increases in depreciation for the years 1999 and 2000. Counsel for AT&T objected to the request and on December 20, 2000, the TEC Companies filed a letter advising that they were withdrawing the issue and would not be filing such a request.

---

[5] During the Pre-Hearing Conference, the Consumer Advocate argued that because there was no dispute of material facts, the Motion for Summary Judgment could be decided as an issue of law. The TEC Companies stated that although they did not file such a motion, they agreed with the Consumer Advocate's position that the issues raised by AT&T do not belong in this proceeding. Transcript of Proceedings, (June 9, 2000) pp. 17-18.

[6] *See* Transcript of Proceedings (December 14, 2000 Status Conference), pp. 4-5, 25-26.

Thereafter, the Pre-Hearing Officer was advised that the TEC Companies and AT&T were involved in settlement negotiations as to the issues existing between them. A Pre-Hearing Conference was held on May 8, 2001 for discussion of the proposed settlement between the TEC Companies and AT&T. At the May 8, 2001 Pre-Hearing Conference, the TEC Companies and AT&T presented a Memorandum of Understanding outlining a schedule of access rate reductions designed to resolve the issues raised by AT&T in its Petition for Intervention. Through the Memorandum of Understanding, the TEC Companies and AT&T proposed to amend the Settlement Agreement by re-allocating approximately $215,000 of the overearnings from acceleration of depreciation expense to reductions in access rates for 2001, and due to the passage of time, to further amend the rate design described in the Settlement Agreement by extending the credits and charges identified therein beyond 2001 to allow for an orderly implementation of the Settlement Agreement. The Consumer Advocate objected to the proposed amendment of the Settlement Agreement to partially fund reductions in access rates by re-allocating a portion of the overearnings. After hearing from the parties concerning the potential effect of the Memorandum of Understanding on the Settlement Agreement, the Pre-Hearing Officer permitted the Consumer Advocate to file written comments or objections and the TEC Companies and AT&T to respond thereto.

Pre-Hearing Officer's Order of August 24, 2001 and Subsequent Proceedings

After reviewing the Consumer Advocate's written objections to the proposed Memorandum of Understanding and the replies filed by the TEC Companies and AT&T, the Pre-Hearing Officer issued an Order on August 24, 2001, resolving several pending matters. In the Order, the Pre-Hearing Officer denied the Consumer Advocate's Motion for Summary Judgment, rejected the Memorandum of Understanding, determined the issues to be addressed in this matter and set a procedural schedule.

In denying the Motion for Summary Judgment, the Pre-Hearing Officer found that, as an access customer of the TEC Companies, AT&T has a ratepayer's right to challenge the earnings and rate design of these rate-of-return regulated companies. Because the various rates charged by rate-of-return regulated companies are often based on policy rather than cost, it is impossible to identify, with certainty, those rates that contribute directly to an overearnings or underearnings situation. Accordingly, ratepayers have an interest in the determination of earnings and in the development of an appropriate rate design to resolve an overearnings or underearnings situation. For those reasons, the Pre-Hearing Officer concluded that AT&T should not be dismissed from this docket.

The Memorandum of Understanding filed by the TEC Companies and AT&T required the TEC Companies to file with the Authority and request approval of "all proposed tariffs required to reduce the access charge rates for Transport Interconnection Charge ("TIC"), Carrier Common Line Charge ("CCL"), and Directory Assistance ("DA") Surcharge.[7] These tariffs would result in rates for TIC, CCL, and DA Surcharge being reduced in increments of twenty-five percent (25%) every six (6) months such that by January 1, 2003, the rates would be reduced to zero. In exchange for these reductions, AT&T agreed to "cease all activities and efforts to oppose" the Settlement Agreement of the TEC Companies and the Consumer Advocate filed in this docket.[8]

In rejecting the Memorandum of Understanding, the Pre-Hearing Officer found that the access rate reductions contained in the Memorandum of Understanding did not, for the most part, address the TEC Companies' estimated overearnings situation as described in the Joint Petition and Settlement Agreement. Pursuant to the Memorandum of Understanding, only

---

[7] *See Memorandum of Understanding* (May 8, 2001).
[8] *Id.*

the first of four scheduled reductions in access rates would be partially funded from the current overearnings amount. The remaining three reductions set out in the Memorandum of Understanding would be funded from anticipated earnings. The Pre-Hearing Officer found that even though AT&T may have contributed to the estimated overearnings amount, AT&T's rights as a ratepayer do not permit it to stake out a customer's claim against potential, future overearnings that may never be realized. In addition, the Memorandum of Understanding placed the TEC Companies in a position of depending on a certain level of future overearnings to make the agreed upon access rate reductions. If these overearnings were not realized, the TEC Companies' obligation to reduce access rates could place enough pressure on revenue requirements to cause the TEC Companies to seek future rate relief from the Authority. These findings supported the Pre-Hearing Officer's decision to reject the Memorandum of Understanding.

Reviewing the Joint Petition, the Pre-Hearing Officer found that the rate design in the proposed Settlement Agreement includes items such as the accelerating certain depreciation and amortization expenses for 1999, 2000, and 2001; eliminating intra-company toll for 2000 and 2001; increasing the minutes for the Contiguous County Calling Plan for 2000 and 2001; waiving nonrecurring charges for 2000 and 2001; and instituting for residential and business customers for 2000 and 2001. Due to the passage of time, the parties recognized that this rate design could not be implemented without amendment.[9] Based on the foregoing, the Pre-Hearing Officer ordered that the docket proceed to determine the following issues: (1) whether the amount of overearnings identified in the Settlement Agreement for the TEC Companies for the

[9] *See* Transcript of Proceedings of May 8, 2001, (Pre-Hearing Conference), pp. 5-7, 11-13.

years 1999-2001 is correct; and, if so, (2) how and to what extent the rate design described in the Settlement Agreement should be amended to adjust for the overearnings identified therein.[10]

In accordance with the procedural schedule set forth in the August 24, 2001 Order, direct and rebuttal testimony was filed by Dwight S. Work on behalf of the TEC Companies, by Robert T. Buckner on behalf of the Consumer Advocate, and by Richard T. Guepe on behalf of AT&T. The Pre-Hearing Officer also instructed the parties to file comments on whether a live hearing was needed to resolve the matter.[11]

On September 6, 2001, AT&T filed a *Petition for Reconsideration* of the Pre-Hearing Officer's August 24, 2001 *Order*. AT&T's *Petition for Reconsideration* sought only to require the TEC Companies to respond to discovery requests filed by AT&T and to modify the procedural schedule to accommodate AT&T's discovery. On September 17, 2001, the TEC Companies filed a response opposing AT&T's *Petition for Reconsideration* and on September 21, 2001, the Consumer Advocate filed an objection to the petition. On October 1, 2001, the Pre-Hearing Officer entered an *Order Denying Petition for Reconsideration filed by AT&T of the South Central States, Inc., Granting Request for Discovery and Setting Pre-Hearing Conference.* The Pre-Hearing Officer found that AT&T's *Petition for Reconsideration* did not fall within the criteria of a petition for reconsideration and, therefore denied the petition but granted AT&T's request for discovery. Accordingly, the Pre-Hearing Officer decided to permit limited discovery and set a Pre-Hearing Conference for October 4, 2001 to determine the scope of discovery.

At the Pre-Hearing Conference held on October 4, 2001, the Pre-Hearing Officer heard comments from the parties concerning AT&T's requests for discovery. The Pre-Hearing Officer

---

[10] Based on a review of the parties' lists of issues, the Pre-Hearing Officer found that most of the issues articulated by the parties would be encompassed by these two issues. While the Pre-Hearing Officer recognized that the parties individually submitted other issues for consideration, the Pre-Hearing Officer concluded that these two issues, as articulated herein, would be dispositive of the case. Accordingly, adoption of these issues did not preclude the parties from bringing forth the positions in their filed issues at the appropriate time during the proceeding.

[11] *See Order,* Docket No. 99-00995, p. 17 (August 24, 2001).

denied AT&T's request to conduct discovery relative to the Consumer Advocate. The parties reached agreement as to the scope of rediscovery requests relative to the TEC Companies. The Pre-Hearing Officer also established dates for AT&T to supplement its pre-filed testimony as may be necessitated by discovery responses and for the TEC Companies and the Consumer Advocate to file supplemental rebuttal testimony if AT&T supplemented its testimony. After completing the discovery schedule, AT&T did not supplement its testimony, and no further testimony was filed by any party.

On October 25, 2001, the TEC Companies submitted a letter reflecting the parties' agreement that a live hearing was unnecessary, and requesting the opportunity to file final briefs. On November 9, 2001, the TEC Companies, the Consumer Advocate, and AT&T filed their final briefs in this matter.

Findings of Fact and Conclusions of Law

The Authority notes that all three local exchange telephone companies that comprise the TEC Companies are rate-of-return regulated public utilities. Thus, in this proceeding, the Authority reviews the rates of the TEC Companies under its general rate-setting authority, particularly Tenn. Code Ann. §§ 65-5-201[12] and 65-5-203.[13]

---

[12] Tenn. Code Ann. § 65-5-201 provides: Power to fix rates of public utilities. The Tennessee regulatory authority has the power after hearing upon notice, by order in writing, to fix just and reasonable individual rates, joint rates, tolls, fares, charges or schedules thereof, as well as commutation, mileage, and other special rates which shall be imposed, observed, and followed thereafter by any public utility as defined in § 65-4-101, whenever the authority shall determine any existing individual rate, joint rate, toll, fare, charge, or schedule thereof or commutation, mileage, or other special rates to be unjust, unreasonable, excessive, insufficient, or unjustly discriminatory or preferential, howsoever the same may have heretofore been fixed or established. In fixing such rates, joint rates, tolls, fares, charges or schedules, or commutation, mileage or other special rates, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility.

[13] Tenn. Code Ann. § 65-5-203 provides in part: Changes in utility rates, fares, schedules. (a) When any public utility shall increase any existing individual rates, joint rates, tolls, fares, charges, or schedules thereof, or change or alter any existing classification, the authority shall have power either upon written complaint, or upon its own initiative, to hear and determine whether the increase, change or alteration is just and reasonable. The burden of proof to show that the increase, change, or alteration is just and reasonable shall be upon the public utility making the same. In determining whether such increase, change or alteration is just and reasonable, the authority shall take into account the safety, adequacy and efficiency or lack thereof of the service or services furnished by the public utility.

The Tennessee Supreme Court has described the Authority's general rate-setting powers as follows:

> The polestar of public utility rate establishment and regulation is the "just and reasonable" requirement . . . There is no statutory nor decisional law that specifies any particular approach that must be followed by the [Authority]. Fundamentally, the establishment of just and reasonable rates is a value judgment to be made by the [Authority] in the exercise of its sound regulatory judgment and discretion . . . Rate making is not a judicial function and we accord the [Authority] great deference in reviewing its decisions. On fixing rates in general the Court has spoken in terms of what is just and reasonable "under the proven circumstances," of "regard to all relevant facts" and to a rate "in the zone of reasonableness" . . . Thus, the [Authority] in rate making and design cases is not solely governed by the proof although, of course, there must be an adequate evidentiary predicate. The [Authority], however, is not hamstrung by the naked record. It may consider all relevant circumstances shown by the record, all recognized technical and scientific facts pertinent to the issue under consideration and may superimpose upon the entire transaction its own expertise, technical competence and specialized knowledge. Thus focusing upon the issues, the [Authority] decides that which is just and reasonable. This is the litmus test nothing more, nothing less.[14]

Although the "just and reasonable" standard is rather broad, it is nevertheless recognized that the Authority has no retroactive rate making power. As stated by the Tennessee Court of Appeals, the Authority's power to order refunds of rates is limited by statute:

> Upon a study of the applicable statutes, especially TCA § 65-5-203, this Court concludes that the Legislature never intended to extend retroactive rate-making power (ordering refunds) beyond that expressly stated in § 65-5-203.[15]

While "[i]t is true that the [Authority] has no statutory authority to fix rates retroactively or to order refunds except in very limited circumstances,"[16] when setting rates prospectively the Authority "has the discretion to choose a historical test period, a forecast period, a combination of the two, or any other accepted method in rate making."[17] Thus, while monies for rates that

---

[14] *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 542-543 (Tenn. 1980) (citations omitted).
[15] *South Cent. Bell Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 675 S.W.2d 718, 719 (Tenn. Ct. App. 1984).
[16] *American Assoc. of Retired Persons v. Tennessee Pub. Serv. Comm'n*, 896 S.W.2d 127, 134 (Tenn. Ct. App. 1994).
[17] *Id.* at 133.

have already been collected generally cannot be returned to customers as refunds in order to adjust for a company's prior overearnings,[18] the Authority can examine and consider such historical information when setting rates on a going-forward basis.

The Authority has broad discretionary rate design powers which are to be utilized to fashion the rates of a company to achieve its authorized, fair rate of return. When fixing "just and reasonable" rates, the Authority must give due "regard to all relevant facts" and establish rates that are within "the zone of reasonableness." The Authority is not required to fix rates based on the cost of individual services.

> Specifically, there is no requirement in any rate case that the [Authority] receive and consider cost of service data, or that such data, if in the record, are to be accorded exclusivity. It is self-evident that cost of service is of great significance in the establishment of rates but is of lesser value in arriving at rate design. A fair rate of return to the regulated utility is one thing; the establishment of rates among various customer classes is quite another.[19]

Finally, if it is determined that a company's earnings are excessive, the Authority has broad discretion in determining how to best resolve the company's overearnings situation:

> The enabling statutes do not specifically delineate the [Authority's] powers when it projects that a telephone company will receive excess earnings if it continues providing the same services at its present rate. Tenn. Code Ann. §§ 65-4-104, -106 give the [Authority] broad power to regulate the services provided by the company and the rates the company charges for these services. Thus, when the [Authority] determines that a telephone company's earnings will be excessive if the company is permitted to continue to charge the same rate for the same services, the [Authority], exercising its regulatory discretion and expertise, may (1) reduce the rate prospectively, (2) order refunds in cases where the rates were put into effect under bond pursuant to Tenn. Code Ann. § 65-5-203 (Supp. 1991), or (3) require that the excess earnings be used to extend or improve the company's service.[20]

---

[18] In this case, the term "overearnings" is used to refer to the amount or level of earnings in excess of that which is required to cover regulated expenses and to provide a fair rate of return on a utility's regulated rate base.
[19] *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d at 542.
[20] *Tennessee Cable Television Assoc. v. Tennessee Pub. Serv. Comm'n*, 844 S.W.2d 151, 160 (Tenn. Ct. App. 1992).

As set forth above, the Pre-Hearing Officer adopted the following two issues in his *Order* entered on August 24, 2001, to be determined in succession:

1. Whether the amount of overearnings identified in the Settlement Agreement for the TEC Companies for the years 1999-2001 is correct; and
2. How and to what extent the rate design described in the Settlement Agreement should be amended to adjust for the overearnings identified therein.

The amount of overearnings, if any, must be specifically identified before the Authority may consider the appropriateness of any rate design proposals that purportedly adjust rates for the overearnings situation.

1. Whether the Amount of Overearnings is Correct

Positions of the Parties

The TEC Companies

The TEC Companies assert that the amount of overearnings identified in the Settlement Agreement is correct. The TEC Companies' expert, Mr. Dwight S. Work, testified that, in his opinion, "the forecasted amounts fairly present the future results and are reasonable when taken as a whole and considering past performances."[21] Additionally, Mr. Work compared the actual results for the thirty (30) month period ended June 30, 2001, with the earnings forecast for the 1999-2001 attrition period.[22] Mr. Work's calculations show that for the TEC Companies, the combined forecasted earnings were $305,022, or 6.6% greater than the actual earnings after thirty (30) months of the thirty-six (36) month attrition period.[23] Mr. Work testified that such differences between forecasted and actual results are not unusual because events and

[21] Direct Testimony of Dwight S. Work, p. 3 (September 7, 2001).
[22] *Id.*
[23] *Id.* at 3-4, Exhibit DSW-1.

circumstances frequently do not occur as expected.[24] The TEC Companies state that they are prepared to honor the original Settlement Agreement entered into in 1999 even though the actual results indicate that the amount of the overearnings was overestimated.[25] Additionally, the TEC Companies note that the Consumer Advocate supports the accuracy of the overearnings identified in the Settlement Agreement, and that AT&T has accepted the amount of overearnings as being accurate.[26] Finally, the TEC Companies state that the Authority should be satisfied from all the testimony that the amount of overearnings identified in the Settlement Agreement for the TEC Companies for the years 1999-2001 is correct.[27]

Consumer Advocate

The Consumer Advocate asserts that due to the extensive investigation into the TEC Companies' earnings and the negotiations between the TEC Companies and the Consumer Advocate leading up to the parties' settlement, the amount of overearnings identified in the Settlement Agreement is just and reasonable.[28] Additionally, the Consumer Advocate points out that the amount of overearnings is the result of extensive evaluations, reviews, and calculations that were made by experts based on what was known as well as the reasonably anticipated changes that could occur as they relate to the TEC Companies.[29] Moreover, the Consumer Advocate notes that Mr. Work's comparison of the forecasted results with actual data indicates that the projected earnings are accurate.[30] For these reasons, the Consumer Advocate believes

[24] *Id.* at 4.
[25] TEC Companies Brief, p. 8 (November 9, 2001).
[26] *Id.*
[27] *Id.* at 9.
[28] Direct Testimony of Robert T. Buckner, p. 4 (September 7, 2001).
[29] Consumer Advocate Brief, pp. 1-2 (November 9, 2001).
[30] *Id.* at 3.

that the amount of overearnings identified in the Settlement Agreement for the TEC Companies for the years 1999-2001 is correct.[31]

AT&T

AT&T does not challenge the correctness of the amount of overearnings identified in the Settlement Agreement. Initially, AT&T took the position that, due to the lack of discovery, it did not have sufficient information to dispute the accuracy of the overearnings, but that it may express a different view later.[32] Subsequently, AT&T was afforded the opportunity to supplement its testimony on this issue but after completing discovery, AT&T chose not to supplement its testimony. Moreover, AT&T does not raise the accuracy of the overearnings as an issue in its brief, nor does it otherwise object to the amount of overearnings identified in the Settlement Agreement.

Findings and Conclusions

The amount of overearnings identified in the Settlement Agreement for all three of the TEC Companies combined is $6.35 million.[33] On a per-company basis, the amounts of overearnings are $2.54 million for West Tennessee Telephone Company, $2.24 million for Peoples Telephone Company, and $1.57 million for Crockett Telephone Company.[34]

Due to the course of these proceedings, the Authority is in the unusual position of having a substantial amount of historical information available to evaluate the accuracy of the earnings forecast for the TEC Companies for the three-year attrition period ending 2001. Mr. Work's comparison of the forecasted earnings with the actual earnings for most of the attrition period

[31] *Id.* at 2.
[32] Direct Testimony of Richard T. Guepe at 4 (September 7, 2001).
[33] Joint Petition at 4.
[34] *Id.*

provides convincing evidence that the amount of overearnings identified in the Settlement Agreement, and related earnings forecast, are reasonably correct.

The Authority finds that the 6.6% difference between forecasted earnings and actual earnings computed by Mr. Work is not substantial enough to call into question the accuracy of the earnings forecast. While Mr. Work's calculations show that the overearnings may be slightly overstated, as Mr. Work himself noted, differences between forecasted earnings and actual earnings over a given period of time are not unusual. As long as such differences are immaterial, it is appropriate to rely upon the earnings forecast to set rates. Moreover, no party challenged Mr. Work's calculations or opposed Mr. Work's conclusion that the forecasted amounts fairly present the future results and are reasonable, when taken as a whole and considering past performances. In fact, the Consumer Advocate stated that Mr. Work's comparison of the forecast with actual results indicates that the amount of overearnings is correct.

In addition, the earnings review process used by the parties supports the accuracy and reliability of the overearnings identified in the Settlement Agreement. As noted by the Consumer Advocate, the amount of overearnings is a culmination of extensive evaluations, reviews, calculations, and negotiations made by regulatory experts to compute the TEC Companies' earnings based upon known and reasonably anticipated changes that could occur.

There is no real contest as to the correctness of the amount of overearnings identified in the Settlement Agreement. The TEC Companies and the Consumer Advocate are in agreement that the amount of overearnings is correct. AT&T does not dispute the amount of overearnings agreed upon by the TEC Companies and the Consumer Advocate in the Settlement Agreement.

Based on the foregoing, the Authority finds that the amount of overearnings identified in the Settlement Agreement for the TEC Companies for the 1999-2001 attrition period is correct. The Authority further finds that the earnings forecasts presented in the Settlement Agreement are

indicative of the future earnings of the TEC Companies. The Settlement Agreement reflects that the earnings forecasts for the 1999-2001 attrition period resulted in overearnings of $2.54 million for West Tennessee Telephone Company, $2.24 million for Peoples Telephone Company, and $1.57 million for Crockett Telephone Company. When these results are aggregated, the amount of overearnings for all three of the TEC Companies combined is $6.35 million for the 1999-2001 attrition period.

2. How and to What Extent the Rate Design Should be Amended

Having found the amount of overearnings identified in the Settlement Agreement to be correct, the Authority must address the issue of how and to what extent the rate design described in the Settlement Agreement should be amended to adjust for the overearnings identified therein.

Positions of the Parties

The TEC Companies

The TEC Companies contend that the Settlement Agreement should be approved because it is fair, just, reasonable, and in the best interests of the TEC Companies' local service customers.[35] The TEC Companies point out that the Consumer Advocate, which is charged by law with representing the consumers of Tennessee, gives its full support to the Settlement Agreement, and that the agreement is similar to the settlement agreement that the Authority approved for the TEC Companies for the 1996-1998 attrition period.[36]

The TEC Companies state that the rate design proposed in the Settlement Agreement must be modified due to the passage of time since the agreement was reached.[37] The TEC Companies note that the Consumer Advocate has proposed modifications to the rate design proposed in the Settlement Agreement that will allow for its implementation on a going forward

[35] TEC Companies Brief, p. 5.
[36] *Id.* at 5-6.

basis.[38] The TEC Companies do not object to the Consumer Advocate's modifications to the rate design proposal.[39] Furthermore, the TEC Companies support the implementation of the rate design proposed in the Settlement Agreement as modified by the Consumer Advocate.[40]

With respect to AT&T's position, the TEC Companies aver that AT&T bases its claim for reduced access charges on its theory that access rates exceed costs.[41] Nevertheless, the record reflects that the TEC Companies are average schedule companies; therefore, there are no costs specifically associated with access charge elements.[42] Thus, according to the TEC Companies, there is no evidence to support AT&T's claim.[43] Finally, the TEC Companies assert that the issues raised by AT&T in this proceeding challenge established rate-setting policies that have been applied across the board to all rate-of-return companies.[44] For this reason, the TEC Companies state that the issues raised by AT&T should be addressed in a generic docket, such as Access Charge Reform, rather than being considered piecemeal in individual company earnings review proceedings.[45]

Consumer Advocate

Due to the passage of time since the Settlement Agreement was reached, the Consumer Advocate recommends that the rate design proposed in the Settlement Agreement be modified as follows: (1) utilize appropriate accounting processes to resolve the acceleration of certain depreciation and amortization expenses for 1999, 2000, and 2001; (2) implement the increase in minutes for the Contiguous County Calling Plan, the elimination of intra-company toll, and the

---

[37] *Id.* at 9.
[38] *Id.* at 10.
[39] Rebuttal Testimony of Dwight S. Work, p. 1 (September 14, 2001).
[40] TEC Companies Brief, p. 11.
[41] *Id.* at 6.
[42] Rebuttal Testimony of Dwight S. Work, p. 2.
[43] TEC Companies Brief, p. 6.
[44] *Id.* at 7.
[45] *Id.*

waiver of nonrecurring charges prospectively in 2002 and 2003; (3) apply the total monthly credits for residential and business access lines scheduled for 2000 to customers' bills no later than thirty (30) days after the Authority enters its order in this docket; and (4) apply the monthly credits for residential and business access lines scheduled for 2001 prospectively to 2002.[46]

The Consumer Advocate contends that AT&T's recommendation to decrease intrastate switched access charges should not be approved as a part of this proceeding. First, the Consumer Advocate asserts that its recommended rate design does the most to benefit the TEC Companies' ratepayers.[47] There is no assurance that any of the benefits of reducing intrastate access charges will be passed on to consumers.[48]

The Consumer Advocate asserts further that the broad issues involving the appropriate level of access charges and their support of local telephone service, and how access charges impact competition in the toll market can be more appropriately addressed in the Access Charge Reform or Universal Service dockets.[49] The issues that should be addressed in this docket concern the appropriate rates for the TEC Companies' customers rather than the broad issues raised by AT&T.[50] Finally, the Consumer Advocate claims that AT&T is simply not a consumer with respect to the TEC Companies' overearnings situation.[51]

AT&T

AT&T maintains that the rate design proposed by the TEC Companies and Consumer Advocate in the Settlement Agreement should not be approved because it is unlawful and

---

[46] Direct Testimony of Robert T. Buckner, pp. 5-6.
[47] Consumer Advocate Brief, p. 6.
[48] *Id.* at 6.
[49] *Id.* at 7-8.
[50] *Id.*
[51] *Id.*

contrary to the public interest. AT&T avers that the temporary waiver of nonrecurring charges and the temporary monthly credits for residential and business access lines proposed in the Settlement Agreement are intended to give refunds for rates extracted from customers in the past.[52] According to AT&T, the Settlement Agreement attempts to fix rates retroactively rather than to correct rates on a going forward basis.[53]

In support of its claim that the Settlement Agreement is contrary to the public interest, AT&T states that the provisional nature of the rate design proposed in the Settlement Agreement traps the TEC Companies' customers in an unending cycle of attempting to remedy overearnings with retroactive rate adjustments.[54] According to AT&T, the rate design proposed in the Settlement Agreement is flawed because it does not adjust rates permanently on a going forward basis.[55] AT&T also asserts that the agreement proposes to reduce rates for services that are already priced below their costs rather than reducing rates for services that contributed to the overearnings amount.[56] Further, AT&T claims that the rate design proposed in the Settlement Agreement produces unreasonably low rates that will discourage the development of competition and are therefore contrary to the public interest.[57] AT&T points out that, after implementing the temporary monthly credits proposed in the Settlement Agreement, residential basic local service effectively would go from $10.54 to $5.79 per month for Crockett Telephone Company; from $6.66 to $1.91 per month for Peoples Telephone Company; and from $5.66 to $1.11 per month for West Tennessee Telephone Company.[58] AT&T contends that significant reductions in basic

[52] AT&T Brief, p. 4 (November 9, 2001).
[53] *Id.*
[54] *Id.*
[55] *Id.* at 6.
[56] *Id.*
[57] *Id.*
[58] *Id.*

local service rates could exacerbate the need for a Universal Service fund and inflate the size of the fund.[59]

AT&T claims that a reduction in intrastate switched access charges is just and reasonable. AT&T notes that the current intrastate access rates are $.149 per minute for Crockett Telephone Company, $.155 per minute for Peoples Telephone Company, and $.141 per minute for West Tennessee Telephone Company.[60] While no cost data was presented, AT&T claims that the TEC Companies do not incur any costs in the provisioning of several components of access services for which the companies currently charge.[61] Thus, AT&T argues that intrastate access charges are significantly above costs and consequently, intrastate access revenues have been a major contributor to the TEC Companies' overearnings.[62] Moreover, AT&T asserts that reducing intrastate access charges is just and reasonable: (1) because the high access charges currently in place provide an unfair advantage to VarTec, an affiliate of the TEC Companies that provides toll services; and (2) because competition will not drive the price of intrastate access services to cost because such services are not competitive.[63]

AT&T rejects the argument that it is seeking access charge reform throughout the state in this proceeding. AT&T states that, as one of the TEC Companies' largest customers, it has a stake in the remedy associated with the $6.35 million in overearnings.[64]

Findings and Conclusions

The rate design proposed in the Settlement Agreement to resolve the TEC Companies' overearnings is summarized in the chart below:[65]

---

[59] *Id.* at 7-8.
[60] Direct Testimony of Richard T. Guepe, p. 7.
[61] *Id.* at 12.
[62] AT&T Brief, p. 9.
[63] *Id.* at 9-10.
[64] *Id.* at 8.
[65] Source of Information: Joint Petition, pp. 3-4.

Description	(In Millions)
1. Increase in depreciation and amortization expense	$ 2.47
2. Implementation of dialing parity	$ 1.45
3. Monthly credits of $4.75 per residential access line	$ 1.40
4. Monthly credits of $5.00 per business access line	$ 0.36
5. Waiver of nonrecurring charges	$ 0.35
6. Increase Contiguous County Calling Plan minutes	$ 0.28
7. Elimination of intra-company toll	$ 0.04
Total amount of overearnings per rate design	$ 6.35

The waiver of nonrecurring charges and the monthly credits for residential and business access lines represent only $2.11 million (33%) of the total amount of overearnings identified in the Settlement Agreement. AT&T does not directly challenge the appropriateness of utilizing $4.24 million of the overearnings to fund the other rate design proposals in the Settlement Agreement. AT&T opposes that part of the rate design proposed in the Settlement Agreement that relates to the waiver of nonrecurring charges and the monthly credits for residential and business access lines. AT&T avers that the temporary nature of these waivers and monthly credits renders the Settlement Agreement unlawful on retroactive rate making grounds.

The Authority finds that AT&T's claim of retroactive rate making is without merit. AT&T argues that the rate design proposed by the Consumer Advocate and the TEC Companies is unlawful because the overearnings were calculated based on a time period that has already substantially passed and that this, coupled with the provisional nature of the proposed rate adjustments, constitutes retroactive rate making. The record does not support AT&T's assertion that the overearnings were quantified solely from an historical time period. In fact, both Mr. Work and Mr. Buckner, the two regulatory experts responsible for computing the overearnings amount, testified that the overearnings were based on known and reasonably anticipated changes that could occur as they relate to the TEC Companies.

AT&T did not challenge Mr. Work's expert opinion that the forecasted amounts fairly present the future results of the TEC Companies. While the forecast was completed and submitted to the Authority in 2000, the testimony as to the accuracy of the forecast was filed in October 2001, and no party presented any evidence that the forecast is not reflective of future earnings. To the extent it asserts that the mere passage of time causes the forecast to be based on historical results, AT&T is simply incorrect. It is appropriate for the Authority to rely on historical data when setting rates if it finds such information useful.[66] The Authority may choose an historical test period, a forecast period, a combination of the two, or any other accepted method in rate making to determine the rates of a public utility.

Retroactive rate making occurs when prior overearnings estimates are quantified and returned to customers through refunds. The mere fact that a temporary credit exists does not constitute retroactive rate making. There must be a direct correlation between the temporary credit and the refund of prior excess earnings. No such correlation has been shown to exist in this case. Based on the record in this proceeding, the Authority finds that the rate design proposed by the Consumer Advocate and the TEC Companies does not constitute retroactive rate making.

AT&T generally asserts that residential and business local service rates should not be reduced further because they are currently provisioned at or below cost. AT&T also generally asserts that intrastate access service is priced well above cost. According to AT&T, access charges have contributed to the TEC Companies' overearnings situation, whereas residential and business local services have not contributed much, if at all, to the excess earnings experienced by the TEC Companies. Nevertheless, all three of the TEC Companies are average schedule companies that do not track costs on a per-service basis. Accordingly, there has been no cost

[66] Historical information is often useful in forecasting future results.

data entered into the record in support of AT&T's general assertions concerning costs. Moreover, because this proceeding involves the setting of rates for three rate-of-return regulated local exchange companies, there is no requirement that the Authority receive or consider cost of service data or that such data, if in the record, is to be accorded exclusivity.

The regulatory objective of rate design is to formulate just and reasonable rates for customers that will also permit the company to generate sufficient revenues to cover regulated expenses and provide a fair rate of return on the company's regulated rate base investment. During the rate design phase of an earnings review proceeding, the Authority has broad discretion to adjust rates in the manner that will best achieve this objective, including reducing rates prospectively and requiring excess earnings to be used to extend or improve a company's service. Because costs are not tracked on a per-service basis for average schedule companies, such as the TEC Companies, it would be difficult, if not impossible, to ascertain from a cost standpoint exactly which of the various rates for regulated services produced the excess earnings. Therefore, the Authority finds that although costs may be considered as a factor in setting rates, AT&T's argument that the Authority is required to review costs in evaluating a rate design proposal is without merit. Likewise, the Authority finds no merit in AT&T's assertion that implementation of the proposed rate design would lead to local service rates that are unreasonably low whereas access rates will remain unreasonably high.

AT&T contends that the unreasonably low local service rates brought about by the implementation of the Settlement Agreement will discourage the development of competition in the local service market. No per-service cost data has been provided in the record to support AT&T's contention in this regard. Further, AT&T's general statements with respect to costs have been effectively challenged by the other parties in this proceeding. The only data that AT&T provides to support its position relates to residential local service, and the Authority finds

AT&T's interpretation of that data to be incomplete.[67] In addition, the slow manner in which competition has developed since passage of the State Telecommunications Act of 1995 and the Federal Telecommunications Act of 1996 alleviates the Authority's immediate concerns about competition in the rural residential local service markets served by the TEC Companies.

AT&T asserts that reducing basic local service rates will exacerbate the need for a Universal Service fund. With respect to this argument, AT&T presented no cost data to support its conclusion that implementation of the Settlement Agreement would increase the need for a Universal Service fund or increase its size. AT&T's proposal to reduce access charges could have the same affect on the Universal Service fund as a reduction in local service rates if the revenue benchmark is set to include both local and access charges.[68]

The Authority finds that AT&T's objection to the level of access charges and the impact of such charges on competition should not be considered in this proceeding. On the one hand, AT&T claims that it is not introducing access charge reform issues into this proceeding, and that its appearance in this docket is that of an ordinary customer that has contributed to the TEC Companies' overearnings. On the other hand, AT&T suggests that competition in the intrastate toll market will be harmed unless access charges are reduced; that the lack of competition in the intrastate access market has inflated access rates; and that the current contribution that access charges provide to the local exchange companies is unfair. Both the Consumer Advocate and the TEC Companies state repeatedly that many of the broad issues that AT&T raises should not be

---

[67] AT&T quoted the residential access line rates that would result if the Settlement Agreement is approved. However, the access line is only a single component of local service that customers typically purchase. For example, customers pay additional amounts for local service through subscriber line charges, E911 and federal universal service fees and customer calling feature charges.

[68] The Revenue Benchmark in the non-rural Universal Service Docket includes both local and access charges. (Docket No. 97-00888)

addressed in this proceeding. They claim that AT&T's problems with access charges are universal to all local exchange companies, and they caution the Authority against setting state-wide policies dealing with access charge reform on a piecemeal basis through individual company earnings review proceedings.

AT&T's objections relative to competition in the intrastate access and toll markets as well as the level of contribution that access charges provide to local exchange companies are clearly access charge reform issues. These are broad issues that are universal to all rate-of-return regulated local exchange companies, and it would be imprudent for the Authority to address such broad-ranging issues through individual company earnings review proceedings. Nevertheless, AT&T raises one objection in this regard that is specific to the TEC Companies and should therefore be addressed in this proceeding. AT&T states that the current level of intrastate access charges that it must pay to the TEC Companies is hindering its ability to compete with VarTec, an affiliate of the TEC Companies that provides toll services. The Consumer Advocate correctly points out that the TEC Companies charge the same intrastate access rates to all toll carriers, and that AT&T is engaged in straight competition in the toll market. AT&T did not introduce any evidence in this proceeding that would support a finding that the TEC Companies are utilizing their system of access charges to "squeeze out" the carriers that are competing with VarTec in the toll market. Without such evidence, the Authority cannot find that VarTec is gaining any type of unfair competitive advantage over AT&T through the TEC Companies' uniform application of access charges to all toll carriers.

AT&T's assertion that the proposed rate design is flawed due to its provisional nature has some merit. According to AT&T, the TEC Companies' customers will continue to be charged excessive rates in the future because the credits to end-user rates last for no more than two (2) years before reverting back to previous levels. The record reflects that the earnings forecast

submitted as part of the Settlement Agreement is indicative of the TEC Companies' future earnings. Accordingly, any adjustments made to end-user rates should be made permanently on a going forward basis. The rate design adopted in this matter will be strengthened and improved by permanent rate adjustments, irrespective of which rates are finally adjusted.[69]

The Authority concludes that the rate design proposed by the Consumer Advocate and supported by the TEC Companies should be approved with the condition that all end-user rates should be set permanently on a going forward basis. In weighing the access service customers' claims, as represented by AT&T, against the claims of the TEC Companies' end-user customers, as represented by the Consumer Advocate and the TEC Companies, the Authority concludes that the rate design proposed by the Consumer Advocate and the TEC Companies does the most to benefit all customers. The General Assembly's recent deregulation of toll rates provides toll carriers such as AT&T with a ready mechanism to recover all costs associated with intrastate access. Because the TEC Companies charge the same rates for access service to all toll carriers, and because there is no evidence that access charges are central to any anti-competitive scheme perpetrated by the TEC Companies in favor of their toll affiliate, no individual toll carrier will be unfairly treated if access charges are not reduced.

Moreover, if access charges were reduced, the deregulation of toll rates significantly increases the likelihood that the resulting access charge savings would not be flowed through to toll customers. Even if such savings were to be flowed through to toll customers, the rate design proposed in the Settlement Agreement would benefit a broader range of customers rather than the smaller class of heavy toll users who stand to benefit the most by the flow through of access savings. The Authority therefore concludes that the rate design proposed in the Settlement

[69] The expiration of the temporary credits that were implemented in the last earnings investigation (Docket No. 96-00774) contributed to the TEC Companies' present overearnings level.

Agreement, as modified by the Consumer Advocate, should be adopted as the best alternative for resolving the TEC Companies' overearnings situation.

Based on the foregoing findings and conclusions, the Directors of the Authority voted unanimously to approve the rate design proposed in the Settlement Agreement as modified by the Consumer Advocate, subject to the following conditions:

(1) an adjustment that all rates for end-user services be made permanent on a going forward basis,[70] and

(2) an exception that the total monthly credits for residential and business access lines scheduled for 2000 not be applied to customers' bills as a lump-sum credit.

The Directors also voted unanimously to direct Crockett Telephone Company, Peoples Telephone Company, and West Tennessee Telephone Company to file, within thirty (30) days from the date of the Authority's order in this matter, all tariffs necessary to adjust end-user rates as follows:

(1) reduce residential access line rates by $4.75 per month;

(2) reduce business access line rates by $5.00 per month;

(3) reduce nonrecurring charges to zero;

(4) eliminate intra-company toll charges; and

(5) increase the Contiguous County Calling Plan minutes to 180 minutes.

Finally, the Authority directed Crockett Telephone Company, Peoples Telephone Company, and West Tennessee Telephone Company to use appropriate accounting conventions to recognize the accelerated depreciation and amortization expense amounts specified in the Settlement Agreement.

---

[70] End-user services consist of residential and business local services, nonrecurring charges associated with installation service, intra-company toll service, and the Contiguous County Calling Plan service.

As ordered by the Authority, the adjustments to end-user rates are made permanent on a going forward basis, such that the rates will not automatically revert to pre-earnings-review levels at any point in the future. This action does not prevent the TEC Companies from requesting the Authority to increase these end-user rates in the future, should the need arise. Approval of any such filings to increase rates in the future should, of course, be based on the merits of the rate requests as they exist at that time.

IT IS THEREFORE ORDERED THAT:

1. The Settlement Agreement between the TEC Companies and the Consumer Advocate is approved with the following modifications to the rate design:

a. the adjustment of all rates for end-user services shall be permanent on a going forward basis; and

b. the total monthly credits for residential and business access lines scheduled for calendar year 2000 shall not be applied to customers' bills as a lump-sum credit.

2. Crockett Telephone Company, Peoples Telephone Company, and West Tennessee Telephone Company shall file within thirty (30) days from the date of this Order, all tariffs necessary to adjust end-user rates as follows:

a. reduce residential access line rates by $4.75 per month;

b. reduce business access line rates by $5.00 per month;

c. reduce nonrecurring charges to zero;

d. eliminate intra-company toll charges; and

e. increase the Contiguous County Calling Plan minutes to 180 minutes.

3. Crockett Telephone Company, Peoples Telephone Company, and West Tennessee Telephone Company shall use appropriate accounting conventions to recognize the accelerated depreciation and amortization expense amounts specified in the Settlement Agreement.

4. Any party aggrieved by this Order may file a Petition for Reconsideration pursuant to Tenn. Code Ann. § 4-5-317 with the Tennessee Regulatory Authority within fifteen (15) days of the entry of this Order; and

5. Any party aggrieved by the decision of the Tennessee Regulatory Authority may file a Petition for Review with the Tennessee Court of Appeals, Middle Division, within sixty (60) days of the date of entry of this Order.

Sara Kyle, Chairman

H. Lynn Greer, Jr., Director

Melvin J. Malone, Director

ATTEST:

K. David Waddell, Executive Secretary