STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Midcontinent Communications/North Dakota Telephone Company Rural Exemption Investigation **Case No. PU-05-451**

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER ON FURTHER HEARING ON INTERIM DISCOUNT RATE

July 26, 2006

Appearances

Commissioners Tony Clark, Susan E. Wefald and Kevin Cramer.

Don Negaard, Pringle & Herigstad, P .C ., P .O. Box 1000, Minot, North Dakota 58702, appearing on behalf of North Dakota Telephone Company, Devils Lake, North Dakota.

Patrick W. Durick, Pearce & Durick, P .O . Box 400, Bismarck, ND 58502-0400 and J. G. Harrington, DowLohnes PLLC, 1200 New Hampshire Avenue NW, Suite 800, Washington, D.C. 20036, appearing on behalf of Midcontinent Communications.

William W. Binek, Chief Counsel, Public Service Commission, State Capitol, 600 East Boulevard, Bismarck, North Dakota 58505, appearing on behalf of the Public Service Commission.

Al Wahl, Office of Administrative Hearings, 1707 North 9th Street, Bismarck, North Dakota 58501-1882, appearing as Hearing Examiner.

Preliminary Statement

On July 15, 2005, Midcontinent Communications (Midcontinent) filed a Notice of Bona Fide Request for Services under 47 U.S.C. § 251(f)(1)(A) requesting that the Commission conduct an inquiry for the purpose of determining whether Midcontinent's request for wholesale resold services from North Dakota Telephone Company (NDTC) under 47 U.S.C. § 251(c) is not unduly economically burdensome, is technically feasible, and is consistent with section 254 of the Act. Under 47 U.S.C. § 251(f) the Commission must conduct an inquiry within 120 days after the Commission received notice of the bona fide request.

On April 26, 2006, the Commission issued its Findings of Fact, Conclusions of Law and Order in this case. The Commission ordered that NDTC begin providing to Midcontinent retail services at wholesale prices for resale in the Devils Lake exchange under an interconnection agreement no later than July 26, 2006.

On April 26, 2006, the Commission issued a Notice of Further Hearing to be held on July 10, 2006, to review two issues, as follows:

1. The interim wholesale discount rate to be applied effective with the effective date of the wholesale resale agreement and effective until the effective date of a final rate established for the service.

2. The need and design of a true-up provision should the final wholesale discount rate be different from the interim wholesale discount rate.

On May 10, 2006, NDTC filed a Petition for Reconsideration. On May 24, 2006, the Commission received Midcontinent Communications Inc.'s Opposition to the Petition for Reconsideration. On June 1, 2006, NDTC filed an e-mail clarification regarding its position regarding termination of the exemption solely to Midcontinent. On June 2, 2006, Midcontinent filed a Motion for Leave to File Supplemental Memorandum in Opposition for Petition for Reconsideration together with the Supplemental Memorandum. On June 6, 2006, NDTC filed its Reply to Midcontinent's Motion for Leave to File Supplemental Memorandum.

On June 7, 2006, the Commission issued its Order on Reconsideration and its Amended findings of Fact, Conclusions of Law and Order.

The Commission, having established the above record, the pleadings of the parties, and heard the evidence presented on July 10, 2006, and having reviewed the positions of the parties, and having reviewed the briefs and other materials filed by the parties, hereby adopts the following:

Findings of Fact

Discount Rate

1. Under North Dakota Century Code § 49-21-01.7(11) the Commission has authority to terminate a rural company's exemption under 252(f) of the Telecommunications Act of 1996 (Act). Under North Dakota Century Code §§49-21-01 and 49-21-09 the Commission has authority to establish interim and final discount rates.

2. 47 CFR § 51.611 provides that if a state commission cannot, based on information available to it, establish a wholesale rate using the methodology prescribed in § 51.609, then the state commission may elect to establish an interim wholesale rate of at least 17 percent, and no more than 25 percent. In discussion, the Federal Communications Commission (FCC) stated that a state commission that has not set

wholesale prices based on avoided cost studies that meet the FCC's criteria "*shall* use a default wholesale discount rate between 17 and 25 percent"[1] (emphasis added).

3. NDTC's witness Douglas Meredith filed a cost study to justify a 9.36 percent discount rate for wholesale/resale of NDTC's tariffed telecommunications service in Devils Lake, North Dakota. Meredith stated that the cost study was based on an MCI model, with some modification, as discussed by the FCC in its *Local Competition Order*. NDTC believes it used a method similar to that used by the FCC in determining the 17 to 25 percent default discount range.

4. Meredith stated that the NDTC cost study provides a summary of the direct, indirect, and cost onsets related to the retail services subject to being sold at a wholesale discount. The cost data was derived from NDTC's December 2005 ledger that identifies the accounts, as specified in the FCC Uniform System of Accounts, and the account balances. Other information relied upon by Meredith included various time NDTC studies to identify the tasks performed for specific accounts and items that are identified as Part 64 exclusions from the ledger. Part 64 defines the accounting for the separation between regulated and unregulated activities. The NDTC data used by Meredith in the costs was total company data. Costs were not identified separately for the Devils Lake exchange. Meredith testified that separated Devils Lake costs are not necessary to develop an interim discount rate, but, to the extent that a specific allocation for Devils Lake needs to be made, it would be done on a full-blown case study for a final discount rate. Meredith testified that the cost study he prepared for determination of the interim rate is not as complete as a full-blown cost study to determine a final discount rate, and the full-blown cost study should include more detailed account information.

5. To calculate a discount, NDTC divides the avoided costs by the total operating expenses for all retail telecommunications services, including services not subject to resale and excluding non-regulated services.

6. Midcontinent's witness Timothy J. Gates testified to several reasons why the Commission should not rely on NDTC's cost study to determine a discount rate. Gates stated that the standard practice to calculate wholesale discount rates is dividing avoided costs by retail revenues from services subject to wholesale resale. He testified that under Section 252(d)(3) a state commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier. Gates interpretation of Section 252(d)(3) is that the discount is equal to the total avoided retail costs divided by the total revenue subject to resale. Both parties agree that the numerator in the discount rate formula is avoided costs, but the parties do not agree on the denominator. NDTC believes the denominator should be total expenses while Midcontinent believes

[1] *First Report and Order*, 11 FCC Rcd 15499 (1996), FCC 96-325; *Local Competition Order,* paragraph 932.

the denominator should be revenues subject to resale. Gates also testified concerning unauthenticated cost data, inclusion of inappropriate or unreasonable costs, and mathematical errors.

7. Gates provided a calculation for the discount after making adjustments to NDTC's cost study. The result was a discount of 25.39 percent.

8. Each party gave considerable testimony criticizing the other's methodology. We find that neither the avoided cost study presented by NDTC nor the adjusted results advocated by Midcontinent are satisfactory to establish a wholesale rate. Therefore, under 47 CFR § 51.611 and paragraphs 910 and 932 of the *Local Competition Order*, we find that if the Commission elects to set a default rate, the Commission must set a default wholesale discount within the FCC range of 17 to 25 percent.

9. Within the FCC default range of 17 to 25 percent, we find that an interim discount rate of 17 percent is reasonable. The rate will apply only on an interim basis until a final discount rate is negotiated by the parties or determined by the Commission. The midpoint between the parties' recommended discount rates is 17.38. Setting a default rate at the high end of the FCC's default range may incorrectly promote resale competition at a time when the FCC focus is to encourage facility based competition. The Qwest discount rate litigated for North Dakota[2] was even below the low end of the FCC band of reasonableness, possibly indicating lower avoidable costs in North Dakota compared to other RBOCs in the nation.

10. If the parties cannot reach agreement on a final discount rate, we encourage the parties to come to consensus on the methodology for a cost study that meets FCC requirements to determine avoided retail costs and enable the Commission to establish the wholesale rate. We encourage the parties to come to consensus on whether the cost study should be based on total company versus Devils Lake exchange specific data. The cost study presented at a future hearing for determination of the final discount rate should include all underlying data.

True Up Mechanism

11. The Commission requested the parties to provide information on the need for a true-up provision should the final wholesale discount rate be different from the interim wholesale discount rate. The parties appear to agree that the correct true-up mechanism is reflected in Meredith's testimony, page 4, and as reflected in Exhibit No. P-17. This exhibit is attached to these Findings of Fact and is incorporated by reference.

12. The Commission finds this is an appropriate true-up mechanism, once a final discount rate is determined. The Commission further finds that it is appropriate to

[2] Case Nos. PU-2342-01-296 and PU-04-581.

require that the true-up funds accrue interest monthly at a rate equal to the three-month treasury bill rate as published monthly by the federal reserve board.

From the foregoing Findings of Fact, the Commission makes the following:

Conclusions of Law

1. The Commission has jurisdiction over the parties and the subject matter of this proceeding.

2. The Commission has the authority to establish an interim discount rate.

3. An avoided cost study that satisfies the criteria set forth by the FCC does not exist.

4. An interim default rate of 17 percent is appropriate in this proceeding.

From the foregoing Findings of Fact and Conclusions of Law, the Commission makes the following:

Order

The Commission orders:

1. The retail services provide to Midcontinent Communications by North Dakota Telephone Company for resale shall be discounted 17 percent until a final discount rate is established.

2. The formula agreed to by the parties for a true-up mechanism shall be applied at the time a final discount rate is established. The true-up funds must accrue interest monthly at a rate equal to the three-month treasury bill rate as published monthly by the federal reserve board and shall accrue until the final true-up payment is made.

3. A hearing to establish a final discount rate for wholesale resale services shall be held on **January 8, 2007 at 9 a.m. in the Commission Hearing Room, 12th Floor, State Capitol, Bismarck, North Dakota** absent an agreement of the parties filed with the Commission.

PUBLIC SERVICE COMMISSION

Susan E. Wefald **Commissioner**	**Tony Clark** **President**	**Kevin Cramer** **Commissioner**