

ORDER NO. 02-886

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

AR 438

In the Matter of the Rulemaking)	
Proceeding to Update and Revise the)	
Allocation of Cost Rules for)	ORDER
Telecommunications Utilities and)	
Cooperatives.)	

DISPOSITION: AMENDED RULES ADOPTED

On March 21, 2002, the Public Utility Commission of Oregon (Commission) granted Staff's request to initiate a new rulemaking proceeding to consider revisions to OAR 860-027-0052, 860-034-0394, and 860-034-0740. Previously, these rules had been part of Docket AR 437. Initiating a new docket provided AR 437 participants with an opportunity to further address cost allocation issues for telecommunications utilities and cooperatives without delaying the implementation of AR 437 updates to the Uniform System of Accounts rules.

On April 1, 2002, the Commission filed the notice of rulemaking and statement of need and fiscal impact with the Oregon Secretary of State. Notice of the rulemaking was published in the Oregon Bulletin on May 1, 2001. Interested persons were given until May 21, 2002, to file written comments.

PUC Staff (Staff), Verizon Northwest Inc. (Verizon), and United Telephone Company of the Northwest dba Sprint (Sprint) filed opening comments. As Staff submitted a revised rule proposal with its opening comments, the Administrative Law Judge allowed participants until June 28, 2002, to file reply comments. Verizon and Sprint filed timely reply comments. Oregon Telecommunications Association (OTA) had no objections to Staff's revised proposal. Qwest filed a letter on June 24, 2002, stating that it would not be filing any formal comments, as Staff's proposed rules were acceptable.¹ No request was made for a public hearing.

¹ We assume Qwest was referring to Staff's revised rules of May 21, 2002.

Discussion and Resolution

In October 2001, the Federal Communications Commission (FCC) adopted changes to the Code of Federal Regulations (CFR), Part 32 – Uniform System of Accounts and Part 64 – Subpart I, Allocation of Costs. In this docket, we are considering whether to adopt portions of the FCC's allocation of costs rule revisions for telecommunications utilities and cooperatives.

Many of Staff's recommended rule changes involve grammatical changes, new statutory citations, and date revisions. We do not separately address these changes in our discussion of the rules. Our focus is on the substantive changes proposed by Staff, along with comments made by participants in this proceeding.

**Allocation of Costs by a Large Telecommunication Utility
OAR 860-027-0052**

Staff recommends adding an exemption from cost allocation manual requirements for price-cap companies subject to ORS 759.405 that is consistent with the FCC changes adopted in October 2001. Staff does not recommend a similar exemption for companies subject to price caps under ORS 759.255, as these companies could return to rate of return regulation.

Staff further recommends a valuation threshold of \$100,000 for all nonregulated and affiliated transactions for large telecommunications utilities. The FCC threshold, which is \$500,000, was established for the utilities on a nation-wide basis. According to Staff, Oregon should have a lower threshold as it is looking at transactions solely within Oregon.

Verizon and Sprint argue that the FCC requirements should be adopted for all telecommunications utilities. They specifically object to the proposed \$100,000 threshold, stating that the Commission should use the FCC threshold of \$500,000. They argue that adoption of the lower threshold will cause regulatory accounting costs in Oregon to be more than in other states. Further, according to Verizon, transactions under \$500,000 are *de minimus*. The additional costs incurred in Oregon for maintaining separate accounting will outweigh any benefits, and will only be a burden on the ratepayer. Adoption of the FCC requirements would result in lower costs and more streamlined regulation.

Verizon also recommends adoption of FCC's prevailing price rule. Currently, the Commission rules require the utility to record transactions at the lower of net book value or fair market value for assets transferred to regulated accounts from nonregulated accounts, at cost for services and supplies sold by a regulated activity to a nonregulated activity, and the lower of cost or market for services and supplies sold to a regulated activity by a nonregulated activity. According to Verizon, use of the FCC's

prevailing price rule ultimately benefits the ratepayer because the cost of a market study is eliminated.

Finally, Verizon suggests that the Commission adopt the FCC's existing service company exemption rule. Under this FCC rule, nonregulated affiliates who meet the definition of a "service company" are exempted from conducting market studies and allowed to price services at fully distributed cost. "Service company" is defined as an affiliate that exists solely to provide services to the corporation and its subsidiaries. Verizon argues that the FCC rule provides a more efficient method of pricing service company services while still protecting ratepayers from cross-subsidies.

Commission disposition

We adopt the proposed exemption for price-cap companies. This proposed rule revision is consistent with the FCC changes adopted in October 2001. We agree with Staff that utilities subject to ORS 759.255, who could return to rate of return regulation, should not be able to utilize such an exemption.

We also adopt a \$100,000 threshold for all nonregulated and affiliated transactions for large telecommunication utilities rather than the FCC threshold of \$500,000. Using a \$500,000 threshold, which is a national standard, could exempt all Oregon transactions. A \$100,000 threshold would maintain some oversight over large transactions in Oregon, and is consistent with the \$100,000 statutory amount set forth in ORS 759.375.

There were no comments to Staff's proposed rule regarding allocation of income taxes. We adopt this revision.

Finally, while there may be merit in Verizon's proposal to revise our rules by incorporating the FCC's prevailing price and service company exemption rules, we decline to adopt such changes in this docket. Adoption of a prevailing price rule would be a significant departure from our current rules. Affected stakeholders should have an opportunity to comment on the issue prior to a Commission decision. We also note that the participants in this docket did not address Verizon's proposed rules. If there is interest in pursuing these issues, they can be addressed in a separate docket.

Allocation of Costs by Small Telecommunication Utilities OAR 860-034-0394

At the request of OTA, Staff initially considered adding thresholds for nonregulated and affiliated transactions for small telecommunications utilities and cooperatives. OTA later requested that thresholds not be established, and Staff removed them from the proposed rules. As there were no comments or objections submitted

regarding Staff's final proposed version of this rule, we adopt Staff's proposed rule revisions.

**Allocation of Costs by Type 2 Cooperatives
OAR 860-034-0740**

Staff's recommended revisions to this rule require Type 2 telecommunications cooperatives to abide by the same cost allocation rules as small telecommunications utilities. As there are no objections, we adopt Staff's proposed rule revisions.

ORDER

IT IS ORDERED that:

1. The modifications to Oregon Administrative Rules 860-027-0052, 860-034-0394, and 860-034-0740, as set forth in Appendix A, are adopted.
2. The amended rules are effective upon filing with the Secretary of State.

Made, entered, and effective _____.

Roy Hemmingway
Chairman

Lee Beyer
Commissioner

Joan H. Smith
Commissioner

A party may petition the Commission for the amendment or repeal of a rule pursuant to ORS 183.390. A person may petition the Court of Appeals to determine the validity of a rule pursuant to ORS 183.400.

860-027-0052

Allocation of Costs by a Large Telecommunications Utility

(1) As used in this rule:

(a) "Affiliate Transaction" means a transfer of assets, a sale of supplies, or a sale of services between accounts for regulated activities of a large telecommunications utility and accounts for nonregulated activities of a separate entity ~~which that~~ is either an affiliated interest or another company in which the large telecommunications utility owns a controlling interest. The term also means a transfer of assets, a sale of supplies, or a sale of services between accounts for the regulated and nonregulated activities of a single large telecommunications utility;

(b) "Asset" means any tangible or intangible property of a large telecommunications utility or other right, entitlement, business opportunity, or other thing of value to which a large telecommunications utility holds claim;

(c) "Cost" means fully distributed cost, including the large telecommunications utility's authorized rate of return and all overheads;

(d) "Fair Market Value" means the potential sales price that could be obtained by selling an asset in an arm's-length transaction to a nonaffiliated entity, as determined by commonly accepted valuation principles;

(e) "Market Rate" means the lowest price ~~which that~~ is available from nonaffiliated suppliers for comparable services or supplies;

(f) "Net Book Value" means original cost less accumulated depreciation; and

(g) "Nonregulated Service" means a service ~~which that~~ is not a telecommunications service as defined by ORS 759.005(2)(g), or a service ~~which that~~ the Commission has determined to be exempt from regulation.

(2) A large telecommunications utility that provides both regulated and nonregulated intrastate service shall:

(a) Allocate intrastate investments, expenses, and revenues between regulated activities and nonregulated activities according to principles, procedures, and accounting requirements, which the Federal Communications Commission (FCC) adopted December 23, 1986, and amended on reconsideration September 17, 1987, in CC Docket No. 86-111, except as otherwise provided in this rule;

(b) Part 64, Subpart I, Allocation of Costs, adopted by the Federal Communications Commission ~~with revisions to October 1, 1998~~ on October 11, 2001, is hereby adopted and prescribed.

(3) A large telecommunications utility's, which is subject to price caps under ORS 759.405, may account for its regulated and nonregulated intrastate activities ~~shall be accounted for~~ in accordance with ~~FCC Part 32 FCC Part 32, Section 32.27. -- Uniform Systems of Accounts, but with the following exception: For intrastate purposes For all other large telecommunications utilities~~ Part 32 rules governing affiliate transactions ~~(, Sections 32.27(a), (b), (c), and (d)) are~~ is replaced as follows for intrastate purposes:

(a) When an asset is transferred to regulated accounts from nonregulated accounts;

(A) If the asset has an original cost of more than \$100,000, the transfer shall be recorded in regulated accounts at the lower of net book value or fair market value;

(B) If the asset has an original cost of \$100,000 or less, the transfer shall be recorded in compliance with Section 32.27.

(b) When an asset is transferred from regulated accounts to nonregulated accounts;

(A) If the asset has an original cost of more than \$100,000, the transfer shall be recorded in regulated accounts at the tariff or price-listed rate if an appropriate tariff or price list is on file with the Commission. If no tariff or price list is applicable, proceeds from the transfer shall be recorded in regulated accounts at the higher of net book value or fair market value;

(B) If the asset has an original cost of \$100,000 or less, the transfer shall be recorded in compliance with Section 32.27.

(c) When an asset is transferred from a regulated account to a nonregulated account at a fair market value that is greater than net book value, the difference shall be considered a gain to the regulated activity. The large telecommunications utility shall record the gain ~~in a manner which will enable so~~ the Commission ~~to~~ can determine the proper disposition of the gain in a subsequent rate proceeding;

(d) When services or supplies are sold by a regulated activity to a nonregulated activity;

(A) If the annual value exceeds \$100,000, sales shall be recorded in regulated revenue accounts at tariffed or price-listed rates if an applicable tariff or price list is on file with the Commission. Tariffed or price-listed rates shall be established whenever possible. If services or supplies are not sold pursuant to a tariff or price list, sales shall be recorded in regulated revenue accounts at the large telecommunications utility's cost;

(B) If the annual value is \$100,000 or less, the sales shall be recorded in compliance with Section 32.27.

(e) When services or supplies are sold to a regulated activity by a nonregulated activity;

(A) If the annual value exceeds \$100,000, sales shall be recorded in regulated accounts at the nonregulated activity's cost or the market rate, whichever is lower. The nonregulated activity's cost shall be calculated using the large telecommunications utility's most recently authorized rate of return.

(B) If the annual value is \$100,000 or less, the sales shall be recorded in compliance with Section 32.27.

(f) Income taxes shall be allocated among the regulated activities of the large telecommunications utility, its nonregulated divisions, and members of an affiliated group. When income taxes are determined on a consolidated basis, the large telecommunications utility shall record income tax expense as if it were determined for the large telecommunications utility separately for all time periods.

(4) If a large telecommunications utility;

(a) is subject to ORS 759.100 through ORS 759.115 and provides both regulated and nonregulated intrastate service, the utility shall maintain a current intrastate cost allocation manual on file with the Commission. If the FCC requires the large telecommunications utility to

file an interstate cost allocation manual, the utility shall also maintain a current copy of its interstate manual with the Commission.

(b) Is subject to price caps under ORS 759.405, the large telecommunications utility is not required to file an intrastate cost allocation manual with the Commission. A large telecommunications utility that is subject to price caps must file a copy of its annual 254(k) compliance filing and make information available to the Commission as needed to review the utility's intrastate cost allocations to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

(5) An intrastate cost allocation manual, **if required under subsection (4) of this rule,** shall contain the following:

(a) A description of each of the large telecommunications utility's nonregulated intrastate activities;

(b) A list of all intrastate activities to which the large telecommunications utility now accords incidental accounting treatment, and the justification for treating each as incidental;

(c) A chart showing the large telecommunications utility's affiliates;

(d) A statement identifying affiliates that engage in or will engage in transactions with the large telecommunications utility for the purpose of providing nonregulated intrastate service and describing the nature, terms, and frequency of such transactions; and

(e) A detailed specification of the cost categories to which amounts in each account and subaccount of Part 32 will be assigned, and a detailed specification of the basis on which each cost category will be apportioned between regulated and nonregulated activities.

(6) Unless specifically allowed by the Commission, a cost allocation manual cannot be used to satisfy any other reporting requirement established by the Commission.

(7) The initial cost allocation manual filed by a large telecommunications utility pursuant to this rule must be filed with the Commission no less than 90 days before the manual's effective date. The manual shall go into effect unless rejected by the Commission before the manual's effective date.

(8) When a large telecommunications utility proposes any change to a cost allocation manual previously filed with the Commission, the utility shall file the proposed change with the Commission no less than 45 days before the effective date of the change. The changes shall go into effect unless rejected by the Commission before the effective date of the change.

(9) After the Commission has issued an order to exempt from regulation a telecommunications service provided by a large telecommunications utility ~~which~~ **that** is subject to ORS 759.100 through 759.115, the affected utility shall file with the Commission either an initial cost allocation manual or a change to its previously filed manual.

(10) A large telecommunications utility that is required to file annual independent cost allocation audits with the FCC shall at the same time file copies of the annual audits with the Commission.

[Publications: The publication(s) referred to or incorporated by reference in this rule are available from the office of the Public Utility Commission.]

Stat. Auth.: ORS Ch. 183, 756, ~~757~~ & 759

Stats. Implemented: ORS 756.105, 759.120, 759.125 & 759.130

Hist.: PUC 24-1985, f. & ef. 12-12-85 (Order No. 85-1172); PUC 15-1988, f. & cert. ef. 9-7-88 (Order No. 88-954); PUC 8-1995, f. & ef. 8-30-95 (Order No. 95-858); PUC 9-1998, f. & ef. 4-28-98 (Order No. 98-169); PUC 10-2000, f. & ef. 5-26-00 (Order No. 00-263); PUC 16-2001, f. & cert. ef. 6-21-01 (Order No. 01-488)

860-034-0394

Allocation of Costs by Small Telecommunications Utilities

(1) As used in this rule:

(a) "Affiliate transaction" means a transfer of assets, a sale of supplies, or a sale of services between accounts for regulated activities of a small telecommunications utility and accounts for nonregulated activities of a separate entity ~~which that~~ is either an affiliated interest or another company in which the utility owns a controlling interest. The term also means a transfer of assets, a sale of supplies, or a sale of services between accounts for the regulated and nonregulated activities of a single small telecommunications utility;

(b) "Asset" means any tangible or intangible property of a small telecommunications utility or other right, entitlement, business opportunity, or other thing of value to which a utility holds claim;

(c) "Cost" means fully distributed cost, including the small telecommunications utility's authorized rate of return and all overheads;

(d) "Fair market value" means the potential sales price that could be obtained by selling an asset in an arm's-length transaction to a nonaffiliated entity, as determined by commonly accepted valuation principles;

(e) "Market rate" means the lowest price ~~which that~~ is available from nonaffiliated suppliers for comparable services or supplies;

(f) "Net book value" means original cost less accumulated depreciation; and

(g) "Nonregulated service" means a service ~~which that~~ is not a telecommunications service as defined by ORS 759.005(2)(g), or a service ~~which that~~ the Commission has determined to be exempt from regulation.

(2) A small telecommunications utility that provides both regulated and nonregulated intrastate service shall:

(a) Allocate intrastate investments, expenses, and revenues between regulated activities and nonregulated activities according to principles, procedures, and accounting requirements, which the Federal Communications Commission (FCC) adopted December 23, 1986, and amended on reconsideration September 17, 1987, in CC Docket No. 86-111, except as otherwise provided in this rule;

(b) Part 64, Subpart I, Allocation of Costs, adopted by the Federal Communications Commission ~~with revisions to October 1, 1998~~ on October 11, 2001, is hereby adopted and prescribed.

(3) ~~A small telecommunications utility's regulated and nonregulated intrastate activities shall be accounted for in accordance with FCC Part 32 -- Uniform Systems of Accounts, but with the following exception:~~ For intrastate purposes, ~~Part 32~~ FCC rules governing affiliate transactions (Sections 32.27(a), (b), (c), (d), and (f)) are replaced as follows:

(a) When an asset is transferred to regulated accounts from nonregulated accounts, the transfer shall be recorded in regulated accounts at the lower of net book value or fair market value;

(b) When an asset is transferred from regulated accounts to nonregulated accounts, the transfer shall be recorded in regulated accounts at the tariff rate if an appropriate tariff is on file with the Commission. If no tariff is applicable, proceeds from the transfer shall be recorded in regulated accounts at the higher of net book value or fair market value;

(c) When an asset is transferred from a regulated account to a nonregulated account at a fair market value that is greater than net book value, the difference shall be considered a gain to the regulated activity. The small telecommunications utility shall the gain ~~in a manner which will enable so~~ the Commission ~~to can~~ determine the proper disposition of the gain in a subsequent rate proceeding;

(d) When services or supplies are sold by a regulated activity to a nonregulated activity, sales shall be recorded in regulated revenue accounts at tariffed rates if an applicable tariff is on file with the Commission. Tariffed rates shall be established whenever possible. If services or supplies are not sold pursuant to a tariff, sales shall be recorded in regulated revenue accounts at the small telecommunications utility's cost; ~~and~~

(e) When services or supplies are sold to a regulated activity by a nonregulated activity, sales shall be recorded in regulated accounts at the nonregulated activity's cost or the market rate, whichever is lower. The nonregulated activity's cost shall be calculated using the small telecommunications utility's most recently authorized rate of return; ~~and~~

(f) Income taxes shall be allocated among the regulated activities of the small telecommunications utility, its nonregulated divisions, and members of an affiliated group. When income taxes are determined on a consolidated basis, the small telecommunications utility shall record income tax expense as if it were determined for the small telecommunications utility separately for all time periods.

(4) If a small telecommunications utility is subject to ORS 759.120 through 759.130 and provides both regulated and nonregulated intrastate service, the utility shall maintain a current intrastate cost allocation manual on file with the Commission. If the FCC requires the small telecommunications utility to file an interstate cost allocation manual, the utility shall also maintain a current copy of its interstate manual with the Commission.

(5) An intrastate cost allocation manual shall contain the following:

(a) A description of each of the small telecommunications utility's nonregulated intrastate

activities;

(b) A list of all intrastate activities to which the small telecommunications utility now accords incidental accounting treatment, and the justification for treating each as incidental;

(c) A chart showing the small telecommunications utility's affiliates;

(d) A statement identifying affiliates that engage in or will engage in transactions with the small telecommunications utility for the purpose of providing nonregulated intrastate service and describing the nature, terms, and frequency of such transactions; and

(e) A detailed specification of the cost categories to which amounts in each account and subaccount of Part 32 will be assigned, and a detailed specification of the basis on which each cost category will be apportioned between regulated and nonregulated activities.

(6) A cost allocation manual cannot be used to satisfy any other reporting requirement established by the Commission.

(7) The initial cost allocation manual filed by a small telecommunications utility pursuant to this rule must be filed with the Commission no less than 90 days before the manual's effective date. The manual shall go into effect unless rejected by the Commission before the manual's effective date.

(8) When a small telecommunications utility proposes any change to a cost allocation manual previously filed with the Commission, the utility shall file the proposed change with the Commission no less than 60 days before the effective date of the change. The changes shall go into effect unless rejected by the Commission before the effective date of the change.

(9) After the Commission has issued an order to exempt from regulation a telecommunications service provided by a small telecommunications utility ~~which~~ that is subject to ORS 759.120 through 759.130, the affected utility shall file with the Commission either an initial cost allocation manual or a change to its previously filed manual.

(10) A small telecommunications utility that is required to file annual independent cost allocation audits with the FCC shall at the same time file copies of the annual audits with the Commission.

Stat. Auth.: ORS Ch. 183, 756 & 759

Stats. Implemented: ORS 756.040 & 759.045

Hist.: PUC 6-1993, f. & ef. 2-19-93 (Order No. 93-185); PUC 12-1998, f. & ef. 5-7-98 (Order No. 98-188); Renumbered from 860-034-0520 by PUC 3-1999, f. & ef. 8-10-99 (Order No. 99-468); PUC 10-2000, f. & ef. 5-26-00 (Order No. 00-263); PUC 15-2001, f. & cert. ef. 6-21-01 (Order No. 01-488)

860-034-0740

Allocation of Costs by Type 2 Cooperatives

(1) As used in this rule:

(a) "Affiliate transaction" means a transfer of assets, a sale of supplies, or a sale of services between accounts for services for which a joint rate is charged or for through services offered by

a Type 2 cooperative and accounts for nonregulated activities of a separate entity ~~which that~~ is either an affiliated interest or another company in which the Type 2 cooperative owns a controlling interest;

(b) "Asset" means any tangible or intangible property of a Type 2 cooperative or other right, entitlement, business opportunity, or other thing of value to which a Type 2 cooperative holds claim;

(c) "Cost" means fully distributed cost, including all overheads and rate of return as defined in section (1)(h) of this rule;

(d) "Fair market value" means the potential sales price that could be obtained by selling an asset in an arm's-length transaction to a nonaffiliated entity, as determined by commonly accepted valuation principles;

(e) "Market rate" means the lowest price ~~which that~~ is available from nonaffiliated suppliers for comparable services or supplies;

(f) "Net book value" means original cost less accumulated depreciation;

(g) "Nonregulated service" means a service ~~which that~~ is neither a through service nor a service for which a joint rate is charged, as defined by OAR 860-034-0015; and

(h) "Rate of return" means the rate or return established by the Commission for the calculation of a rate for a through service or for which a joint rate is charged.

(2) A Type 2 cooperative that provides both regulated and nonregulated intrastate service shall:

(a) Allocate intrastate investments, expenses, and revenues between regulated activities and nonregulated activities according to principles, procedures, and accounting requirements, which the Federal Communications Commission (FCC) adopted December 23, 1986, and amended on reconsideration September 17, 1987, in CC Docket No. 86-111, except as otherwise provided in this rule.

(b) Part 64, Subpart I, Allocation of Costs, adopted by the Federal Communications Commission ~~with revisions to October 1, 1998~~ on October 11, 2001, is hereby adopted and prescribed.

(3) For intrastate purposes, FCC rules governing affiliate transactions (Section 32.27) are replaced as follows:

(a) When an asset is transferred to regulated accounts from nonregulated accounts, the transfer shall be recorded in regulated accounts at the lower of net book value or fair market value;

(b) When an asset is transferred from regulated accounts to nonregulated accounts, the proceeds from the transfer shall be recorded in regulated accounts at the higher of net book value or fair market value;

(c) When an asset is transferred from a regulated account to a nonregulated account at a fair market value that is greater than net book value, the difference shall be considered a gain to the regulated activity. The Type 2 cooperative shall record the gain in a manner that will enable the Commission to determine the proper disposition of the gain in a

subsequent rate proceeding;

(d) When services or supplies are sold by a regulated activity to a nonregulated activity, sales shall be recorded in regulated revenue accounts at the Type 2 cooperative's cost; and

(e) When services or supplies are sold to a regulated activity by a nonregulated activity, sales shall be recorded in regulated accounts at the nonregulated activity's cost or the market rate, whichever is lower. The nonregulated activity's cost shall be calculated using the Type 2 cooperative's most recently authorized rate of return.

(f) Income taxes shall be allocated among the regulated activities of the Type 2 cooperative, its nonregulated divisions, and members of an affiliated group. When income taxes are determined on a consolidated basis, the Type 2 cooperative shall record income tax expense as if it were determined for the Type 2 cooperative separately for all time periods.

Stat. Auth.: ORS Ch. 183, 756 & 759

Stats. Implemented: ORS 756.040, 759.220 & 759.225

Hist.: PUC 3-1999, f. & ef. 8-10-99 (Order No. 99-468); PUC 10-2000, f. & ef. 5-26-00 (Order No. 00-263)