

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on January 22, 2003

COMMISSIONERS PRESENT:

Maureen O. Helmer, Chairman¹
Thomas J. Dunleavy
James D. Bennett
Leonard A. Weiss
Neal N. Galvin

CASE 02-C-0938 - Proceeding on Motion of the Commission to
Investigate the Appropriate Rate for the Use of
Frontier Telephone of Rochester, Inc.'s
Conduits.

ORDER DIRECTING THE FILING OF A TARIFF AND
ESTABLISHING A MAXIMUM RATE PERMITTED BY LAW

(Issued and Effective March 25, 2003)

BY THE COMMISSION:

INTRODUCTION

On March 11, 2002, Fiber Technologies Networks, L.L.C.
(Fibertech) filed a request for relief under our Expedited
Dispute Resolution (EDR) process. Fibertech states that
Frontier Telephone of Rochester, Inc. (Frontier) refuses to
grant Fibertech access to Frontier's poles and conduit until a
billing dispute involving the conduit rental rate is settled.
Fibertech contends that the conduit rental rate does not meet

¹ Chairman Helmer served as Chairman until January 31, 2003.

the "just and reasonable" standard established by §119-a of the Public Service Law (PSL).²

On August 15, 2002, we instituted a proceeding to investigate the appropriate rate for the use of Frontier's conduits. Frontier was directed to demonstrate why a \$0.75 per duct foot per year rate, as calculated by staff, should not be adopted and made part of the company's tariff. Interested parties were given an opportunity to address this issue and to respond to Frontier's filing.

BACKGROUND

Fibertech and Frontier entered into an agreement in May 2000 establishing a conduit rental rate of \$0.96 per foot per innerduct per month, or \$11.52 per year. The agreement indicates that where a regulation or rule or tariff conflicts with the agreement, the regulation prevails. Fibertech claims the rate it is being charged by Frontier is unjust and unreasonable and asks us to determine the maximum conduit rate Frontier is permitted to charge under §119-a. Moreover, alleging discrimination, Fibertech contends it subsequently learned that other cable companies were paying Frontier \$0.08 per foot per innerduct per month, or \$0.96 per year.

Frontier claims that Fibertech entered into the contract knowing what rate was being applied to other cable companies, and states that the only test it needs to meet is whether the agreement with Fibertech discriminates against a non-party carrier in accordance with the Telecommunications Act of 1996.

Department staff attempted to resolve the dispute in a series of conference calls between the parties; no agreement was

² Because the dispute was primarily a billing dispute, expedited relief was not warranted.

reached. Because Frontier has no tariffed conduit rate, staff applied the Federal Communications Commission (FCC) formula, adopted by the Commission in Opinion No. 97-10 and again in the Verizon Unbundled Network Elements (UNE) proceeding, to Frontier's financial data to calculate the conduit rate.³ Staff shared the result with Frontier, and asked it to comment on the calculation. After Frontier failed to provide any substantive comment, we required Frontier to show cause why the rate of approximately \$0.75 per duct foot per year should not be adopted.

In response to our August 15, 2002 Order, Frontier claims that a tariff conduit rate is not needed, noting that other parties have succeeded in negotiating a conduit occupancy contract including a monthly recurring price. Frontier argues that a negotiated result, similar to the results of an interconnection agreement, is preferable to a Commission-mandated result under the Telecommunications Act. According to Frontier, Fibertech willingly entered into the contract knowing the conduit rental rate in the Rochester area and subsequently placed orders for many thousands of feet of conduit between May 2000 and January 2002. Frontier notes that, when payment was due, Fibertech refused to pay and asserted that it was entitled to a lower rate.⁴

If a new tariffed rate is initiated, however, Frontier argues that rate should not be applied to existing contracts. Frontier claims that both parties factored the contract rate into their business plans and that doing so would give Fibertech

³ Case 98-C-1357 - Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements, Order on Unbundled Network Element Rates, p. 146 (issued January 28, 2002).

⁴ Fibertech paid at \$.96 per foot per year.

an unjustified windfall. Frontier notes that, under the Act, an agreement should be upheld unless it discriminates against a non-party or it would be contrary to the public interest. Regarding Fibertech's claim that it learned cable television companies were paying much less than Fibertech, Frontier notes that these cable television contracts were over 20 years old, were cancelled effective September 1, 2002, and contained price escalation language. Frontier argues that Fibertech's claim is irrelevant and simply an attempt to back out of a contract after obtaining the benefits of that contract from Frontier. Frontier also notes that TC Systems, now part of AT&T Communications, negotiated and agreed to the \$0.96 per foot per month rate.

Regarding the use of the FCC formula, Frontier asserts that it would be unjust, unreasonable, discriminatory, and confiscatory for us to use an embedded cost methodology for conduit occupancy rates. Frontier claims that conduit costs should be examined on the basis of incremental and not embedded costs, as are unbundled network elements. According to Frontier, the use of embedded costs should be rejected as result-oriented, arbitrary, and unfair. Frontier maintains that, if we were to proceed with the use of the embedded cost methodology, existing contracts should be exempt for the remainder of their terms.

Frontier further claims that our calculation contains serious errors that understate Frontier's embedded costs. Specifically, Frontier argues that the pro-rated portion of the Accumulated Deferred Income Tax balance does not reflect the relatively long depreciation life of conduit compared to other elements of telecommunication plant. Instead, the actual Accumulated Deferred Income Tax associated with conduit

investment should be used.⁵ In addition, Frontier claims that in developing the overhead rate we used an incorrect administrative expense that recovers only the company's corporate operations expense. If the company had to follow embedded costing rules, Frontier believes it should be allowed to recover an allocated portion of all embedded operating expenses not recovered elsewhere in the computation of the annual cost factors. Frontier submitted its own study that purports to show a monthly rate of \$0.20 per duct foot, or \$2.40 per year, based on the embedded methodology.

Fibertech asserts that Frontier's rates should be set in accordance with the methodology already adopted by the Commission in Case 98-C-1357. The approved methodology, according to Fibertech, produces rates that are comparable to other regions of the country and encourages the deployment of competitive facilities in New York.

Fibertech alleges that the parties' agreement does not require payment in excess of the maximum fee allowed by PSL §§119-a.⁶ Fibertech also states that its contract rate of \$11.52 per year constitutes an undue or unreasonable prejudice or disadvantage to Fibertech.

Fibertech argues that we should not view the parties' negotiation as between two equal parties. According to Fibertech, we recognized that providers of right-of-way space may have the ability to inflict undue discrimination. Fibertech also cites FCC decisions that nullified these so-called

⁴ Frontier stated that it would update us on this matter but has failed to do so.

⁶ The Agreement states that "[t]o the extent any provision herein shall contradict or be inconsistent with any government rule or regulation or tariff relating to the subject matter thereof, the terms of the latter shall prevail."

negotiations as being in excess of legal limits. It further comments that under the Telecommunications Act of 1996 (Act) a utility must provide a telecommunication carrier with nondiscriminatory access to conduit owned or controlled by it.

Fibertech argues that Frontier misapplies §252 of the Act, and claims that this section does not apply to contracts for the occupation of conduit space unless the licensee (in this case, Fibertech) "affirmatively states such intent." Fibertech asserts that it did not do so in its relation with Frontier.

Further, Fibertech alleges Frontier suffered no harm as the result of an expectation of receiving the \$11.52 rate. Fibertech explains that it was required to pay the full cost for the installation of conduit before the work was done and this is not part of the recurring conduit cost calculation. Fibertech claims that Frontier benefits when it puts in a new conduit since it installs additional capacity that is fully paid for by a third party.⁷ Therefore, according to Fibertech, Frontier was not only fully reimbursed for all "upfront" costs, but was paid for new inner duct that Frontier may use for its own purposes or rent to others.

DISCUSSION

Tariff Rate

The focus of this proceeding is the rate level that Frontier should charge under the PSL for the use of its conduits. In setting tariff rates for Verizon in Case 98-C-1357, a case in which Frontier participated, we concluded that conduit rentals are not UNEs under the Act and are not

⁷ Frontier installs three inner ducts, all paid for by Fibertech, only one of which is used by Fibertech. The remaining two are retained for Frontier's use.

required by Federal law to be priced in accordance with total element long-run incremental cost (TELRIC).

PSL §119-a states "that a just and reasonable rate shall assure the utility of the recovery of...no[t] more than the actual operating expenses and return on capital of the utility attributed to that portion of the pole, duct, trench or conduit used." Based on the record evidence in Case 98-C-1357, we found that conduits were analogous to pole attachments and should be set according to historical (embedded) costs, and adopted the Federal methodology for setting conduit tariff rates.

Our Order instituting the instant proceeding places the burden on Frontier to show why the rate, as we calculated it, should not be adopted. Frontier has not demonstrated why it is different from Verizon and has provided no justification for us to deviate from the prescribed methodology. Applying that methodology to Frontier results in a tariff rate of \$0.75 per foot per year.

Regarding the two issues that Frontier raises concerning the application of the FCC formula, the rate is consistent with the methodology prescribed by the FCC and adopted in Case 98-C-1357 for pricing ducts and conduits.

Frontier argues that the prorated allocation of Accumulated Deferred Income Tax based on net conduit investment is not appropriate because the calculation should be based instead on the actual Accumulated Deferred Income Tax associated with conduit investment. This issue was specifically considered when the FCC established the conduit rate formula. Certain LECs objected to use of the formula because the actual amount of Accumulated Deferred Income Tax for conduit is available directly from the LEC's books. Others argued that book amounts

for Accumulated Deferred Income Tax should not be used because the information is not publicly available.

The FCC stated that its "goal has always been to adopt a formula which allows parties to calculate the maximum rate using public data when available, in a fair and expeditious manner."⁸ It concluded that if the LEC conduit owner is required to keep Accumulated Deferred Income Tax data precisely as required by the formula, the owner could use it in the rate calculation, as long as it was reported to and available through the public ARMIS database. The FCC went on to say that until ARMIS reports for LECs include this required data after 2001, the proration method should continue to be used to calculate the conduit portion of Accumulated Deferred Income Tax for use in the formula to calculate the net linear cost of conduit.⁹ Since no disaggregated data is available for Frontier, our analysis relied on the most recent, publicly-available information that met the FCC's reporting requirements, the prorated 1998 ARMIS data.¹⁰

Frontier complains that the computation of the administrative element of the annual cost factor for conduit fails to include the cost of all overhead expenses. It argues that the calculation only considers corporate operations

⁷ Amendment of Rules and Policies Governing Pole Attachments and Implementation of §703(e) of the Telecommunications Act of 1996, CS Docket Nos. 97-98 and 97-151, Consolidated Partial Order on Reconsideration, p. 50 (released May 25, 2001) ("FCC Reconsideration Order").

⁹ Id., p. 52.

¹⁰ Starting in 1999 Frontier was no longer required to file ARMIS 43-02 reports, which included the Accumulated Deferred Income Tax information. Frontier declined to provide the 1998 data, stating that it was no longer required to file such data. The data was acquired from the FCC.

expenses and ignores plant non-specific and customer operations expenses. The calculation of the administrative element was made in accordance with the FCC formula, which includes total executive and planning and general and administrative expenses as reported in ARMIS.

In the FCC proceeding the United States Telecom Association (USTA) argued that the FCC should include all accounts that the USTA claimed indirectly supported the administration of poles. In rejecting that argument, the FCC said that the accounts listed by USTA did not fall into the category of plant-wide administrative expenses that are attributable in any way to poles. Further, it said:

We do not believe Congress intended us to discover and aggregate all de minimis expenses which might have some intangible nexus to pole attachments. On the contrary, we believe Congress gave us a clear mandate not to engage in full scale ratemaking exercises every time we had a pole attachment complaint before us. We have chosen not to disaggregate the major accounts selected for inclusion in our calculations in order to eliminate expenses not directly attributable to administrative costs with a nexus to pole attachments, such as corporate strategic planning. On reconsideration, we declined to draw in more expenses to the administrative element because we already apply a comprehensive set of expenses in conformance with the statutory directive to allocate a percentage of operating expenses attributable to pole attachments (FCC Reconsideration Order, supra., p. 57) (citations omitted).

Frontier's proposal to include all overhead expenses in the computation of the administrative cost element for conduits is not in compliance with the FCC formula adopted in Case 98-C-1357. Moreover, a substantive review of Frontier's

claims reveals that the category of accounts excluded, plant non-specific and customer operations expenses, do not record expenses that are in any way attributable to conduits.

Using current data, Frontier calculated the conduit rate to be \$.78 per year based on the embedded cost methodology and FCC formula (Appendix A). We reviewed Frontier's calculations, and do not find material differences between the two calculations. Therefore, Frontier will be directed to file a tariff for conduits at \$0.78 per linear foot for a full duct.

Maximum Rate Under PSL §119-a

We also asked Frontier to determine what it believes to be the maximum conduit rate allowable under PSL §119-a. That section indicates that the rate charged shall not be more than "actual operating expenses and return on capital." It does not specify a particular method of calculating the expenses or the return. Although we specified a reasonable methodology for setting tariff rates, we never determined what a maximum rate could be or the method for determining that rate.

In this proceeding, Fibertech argues that its contract specifically defers to regulations, laws, and tariffs and, accordingly, the PSL §119-a maximum rate would limit the rate Frontier could charge. Frontier provided Fibertech and us with a calculation based on forward looking costs using current contractor and material costs. Fibertech did not respond. Frontier calculated a rate of \$3.37 per innerduct foot per year. We reviewed this calculation, inspected the workpapers, and find that the methodology and calculations appear to be reasonable. Therefore, for the limited purpose of this case, we find that the maximum allowable annual rate under PSL §119-a is \$3.37 as calculated by Frontier (Appendix B).

Frontier's main argument is that Fibertech entered into a contract for conduit occupancy knowing full well what

others were being charged and willingly signed the agreement. It claims that the rates agreed to by individual carriers should be honored. On one hand, carriers voluntarily entered into and signed these contracts. On the other hand, conduits (or, for that matter, other plant involving use of rights-of-way) remain a vestige of monopolies. Fibertech rightly notes that carriers entering into these agreements have little choice about the terms and conditions that are imposed on them by the utility owners. Moreover, Fibertech references language in the agreement that conforms the contract with a government rule, regulation or tariff. Fibertech argues that application of §119-a would supersede the agreement if we determine that the rate Frontier is charging Fibertech per the contract is in excess of the maximum rate allowed under the law.¹¹

In this Order we determine that the rate Frontier can charge in compliance with PSL § 119-a could not be more than \$3.37 per innerduct foot per year. We are not making any determination concerning the legal interpretation of the agreement with respect to the appropriate charge.

CONCLUSION

Frontier has not shown why the rate calculated pursuant to the FCC methodology adopted in Case 98-C-1357 should not be tariffed. Therefore, Frontier will be directed to file an appropriate tariff reflecting a conduit occupancy rate of \$0.78 per foot per year. We also determine that the rate allowable under PSL §119-a for conduits supplied by Frontier could not be more than \$3.37 per innerduct foot per year.

¹¹ The FCC formula used for setting the tariff rate produced a rate that has been deemed reasonable by the Commission, but that rate is not necessarily the maximum rate allowed under PSL §119-a.

The Commission orders:

1. Frontier Telephone of Rochester, Inc. is directed to file an appropriate tariff reflecting a conduit occupancy rate of \$0.78 per foot per year, consistent with this Order, to become effective within 60 days.

2. This proceeding is continued.

By the Commission,

(SIGNED)

JANET HAND DEIXLER
Secretary

Frontier Telephone of Rochester Conduit Cost Study

Based On Embedded Investment Per Duct Foot
Information as of 12/31/01

<u>Line</u>	<u>Item</u>	<u>Source</u>	<u>Amount</u>
1	Gross Conduit Investment	2001 PSC Annual Report	\$56,184,457
2	Accumulated Depreciation - Conduit	2001 PSC Annual Report	\$24,389,876
3	Accumulated Deferred Income Taxes - Conduit	2001 PSC Annual Report	<u>(\$90,334)</u>
4	Net Conduit Investment	=L1+L2+L3	\$31,884,915
5	System Duct Length (Feet)	Accounting Records / CPR	14,588,608
6	Net Conduit Investment Per Duct Foot	=L4L/5	\$2.19
7	Carrying Charge Factor	Per PSC Computation - 2001	35.89%
8	Rate Per Full Duct Foot Per Year	=L6*L7	\$0.78
9	Rate Per Full Duct Foot Per Month	=L8/12	\$0.07

**FTR - Forward Looking Conduit Cost Study
Based on TELRIC Costing Methodology**

	Source:	Asphalt	Grass & Gravel	Weighted Average
<u>FTR - Forward Looking Conduit Cost Study:</u>				
1 Contractor cost to install 3 innerducts inside 4 inch PVC Conduit (per foot)	Construction	\$ 1.250	\$ 1.250	
2 Cost of 1 innerduct (per foot)	Materials Mgt	\$ 0.275	\$ 0.275	
3 Innerduct Multiplier (3 innerducts inside one 4" PVC conduit)		3	3	
4 Installed Cost of 3 1 1/4" Innerducts Within 1 4" PVC conduit (per foot)	L1+(L2*L3)	\$ 2.075	\$ 2.075	
5 Contractor cost to trench & install 4 inch PVC Conduit (per foot encased in concrete)	Construction	\$ 39.000	\$ 8.500	
6 Cost of 4 inch PVC conduit (per foot)	Materials Mgt	\$ 0.900	\$ 0.900	
7 Installed Cost of 4 inch PVC conduit encased in concrete (per foot)		\$ 39.900	\$ 9.400	
8 Total Cost Per Foot - Type C Conduit equipped with 3 Innerduct (Per foot)	L4+L7	\$ 41.975	\$ 11.475	
9 Percentage of Conduit Placement		85%	15%	
10 Weighted Average Cost Per Foot - Innerduct and Conduit	L8*L9	\$ 35.679	\$ 1.721	\$ 37.400
11 Annual Cost Factor	Worksheet			0.2703
12 Annual Cost Per Foot - 3 Innerducts within Conduit	L10*L11			\$ 10.11
13 Monthly Cost Per Foot - 3 Innerducts within Conduit	L12/12mos			\$ 0.84
14 Monthly Cost Per Foot - Per Each Innerduct within Conduit	L13/3			\$ 0.28

Annual Cost Factors: FTR Conduit:

	<u>A/C 2441</u>
Depreciation Rate (41.67yrs)	2.40%
Levelized Cost of Money	9.79%
Maintenance	1.33%
Property Taxes	1.60%
Overhead Factor	11.91%
	27.03%