

**STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION**

DT 11-248

NORTHERN NEW ENGLAND TELEPHONE OPERATIONS, LLC

Petition to Implement Municipal Property Tax Surcharge

Order on the Merits

ORDER NO. 25,384

June 27, 2012

I. PROCEDURAL AND FACTUAL BACKGROUND

On November 15, 2011, Northern New England Telephone Operations, LLC (FairPoint or Company)¹ filed a tariff change seeking to implement a surcharge to cover all or a portion of new property taxes it now must pay on its utility poles and conduits. Prior to 2010 FairPoint, and other telecommunications providers, were exempt from certain municipal property taxes on their utility poles and conduits. That exemption was withdrawn by the New Hampshire Legislature effective July 1, 2010 and, as a result, numerous municipalities began assessing property taxes on FairPoint's poles and conduits. *See* RSA 72:8-a. In addition, some municipalities began assessing taxes on FairPoint's use of municipal rights-of-way.

On November 15, 2011, FairPoint filed proposed revisions to its tariff to institute a surcharge of \$0.99 per month on customers' bills, on up to 25 lines per billing account, to recover all or a substantial portion of the amount of municipal property taxes billed to it for telephone poles, conduits, and use of municipal rights-of-way. According to the explanatory

¹ Though the petition included references only to Northern New England Telephone Operations (NNETO), at the December 14, 2011 hearing on temporary rates in this case NNETO agreed that for purposes of this matter, NNETO and FairPoint Communications-NNE (FairPoint) are one-in-the-same. Accordingly, for purposes of consistency with prior orders involving this entity, the Commission shall use the trade name FairPoint in this order.

memorandum accompanying FairPoint's submission, the surcharge was proposed to be applied on a per access line basis in the same manner as the E911 surcharge. In its filing, FairPoint requested, pursuant to RSA 378:6, IV, that the new tariff pages be effective on December 1, 2011.

By Order No. 25,293 (November 28, 2011), the Commission concluded that the proposed tariff revisions represented a general increase in rates under RSA 378:6, I(a), rather than a tariff for services under RSA 378:6, IV and suspended the taking of effect of the revisions pending an investigation. The Commission scheduled a hearing for December 14, 2011 for the purpose of determining whether a charge – either the proposed surcharge or some other charge – should be implemented on a temporary basis during the Commission's investigation pursuant to RSA 378:27.

Prior to the temporary rate hearing, the Commission received petitions to intervene from George Sansoucy, P.E., segTEL, Inc. (segTEL), Freedom Ring Communications, LLC d/b/a BayRing Communications (BayRing), and the New Hampshire Municipal Association (NHMA). On December 13, 2011, FairPoint filed a response to the Commission's order suspending the tariff and an updated version of the explanatory memorandum. On December 14, 2011, FairPoint objected to the interventions of Mr. Sansoucy and NHMA. Also on December 14, the Office of Consumer Advocate (OCA) notified the Commission of its intent to participate in this docket on behalf of residential ratepayers consistent with RSA 363:28. In addition, on December 14, 2011, FairPoint filed a motion for confidential treatment relating to some of the information in the explanatory memoranda. The hearing set for December 14, 2011 was held as scheduled with the Commission addressing the requests for intervention, FairPoint's motion for

confidential treatment, the parties' initial positions in the docket, and the parties' positions on temporary rates.

On December 16, 2011, FairPoint filed an updated version of its explanatory memorandum comporting with discussions held at the hearing regarding confidentiality, an updated "Table of Poles and Conduit Property Tax Appraised Value and Estimated 2011 Tax" (Exhibit 4), as well as tax bills from the municipalities that had invoiced FairPoint since its previous submission. On December 28, 2011, the Commission issued Order No. 25,308 and granted the interventions of all parties except that of Mr. Sansoucy. In addition, the Commission granted FairPoint's motion for confidential treatment only to the extent FairPoint sought to protect the number of its access lines. Further, in that order, the Commission reiterated its conclusion that this matter was properly addressed under RSA 378:6, I(a). The Commission also concluded that although this filing related to a general increase in rates, it could be handled by less than a full rate case. Lastly, the Commission permitted FairPoint to implement its proposed surcharge of \$0.99, as a temporary rate, but concluded that the charge could not be imposed until at least April 1, 2012 under the terms of the settlement agreement in Docket No. DT 07-011.

Following discovery by the parties, a hearing on the merits was held on May 16, 2012 with Kevin O'Quinn, FairPoint's director of financial reporting for Northern New England and to the Federal Communications Commission (FCC), as the only witness. No pre-filed testimony was submitted by any party.

II. POSITIONS OF THE PARTIES

A. FairPoint

According to Mr. O'Quinn's direct testimony, as of May 1, 2012, FairPoint had received tax bills from 167 municipalities for fiscal year 2011. Transcript of May 16, 2012 Hearing (Tr.) at 12. Including refunds, FairPoint had paid approximately \$5.5 million in new property taxes for that fiscal year. Tr. at 15; see also Exhibit 4. Mr. O'Quinn testified that he believed this amount was not a good representation of what FairPoint would be charged going forward, because it is "very possible" that FairPoint would be taxed by more municipalities. Tr. at 15-16. According to Mr. O'Quinn, regulatory rules from the FCC "dictate that [FairPoint is] to assign approximately 34 percent of the costs to FCC-regulated or interstate operations, with the residual 66 percent allocated to intrastate or PUC-regulated operations." Tr. at 19. Based upon the allocation methods from the FCC, of the \$5.5 million FairPoint has paid, approximately \$3.4 million of the cost would be allocated to regulated intrastate services in New Hampshire. Tr. at 19-20. Mr. O'Quinn further testified that under the currently allowed surcharge of \$0.99 per month FairPoint expected to collect approximately \$2.9 million over 12 months. Tr. at 20. Finally, in his direct testimony, Mr. O'Quinn stated that based upon FairPoint's last reported earnings statement to the Commission, FairPoint's annual New Hampshire earnings were approximately a negative \$72.4 million. Tr. at 20.

Upon cross examination from the NHMA, Mr. O'Quinn confirmed that FairPoint owns other property in New Hampshire for which it is assessed property tax, but that it does not impose a surcharge on customers' bills to recover that tax. Tr. at 21-22. Mr. O'Quinn also stated his belief that FairPoint does not impose a property tax surcharge in any other state in

which it operates. Tr. at 23. With respect to FairPoint's pursuit of abatements, Mr. O'Quinn confirmed that FairPoint has filed for abatements on "virtually every invoice." Tr. at 26. Mr. O'Quinn, however, did not have information on what the total tax liability would be should FairPoint be successful in each of its abatement actions. Tr. at 26.

Upon cross examination from the OCA, Mr. O'Quinn confirmed that the surcharge would cover costs other than the property taxes; in particular, the costs of a consultant retained by FairPoint to challenge its tax assessments. Tr. at 27-28. In response to later questioning, however, Mr. O'Quinn stated that he did not have information on the amount of that cost to be covered through the surcharge. Tr. at 53.

In response to further questions from the OCA, Mr. O'Quinn proposed that once FairPoint had "the full benefit of an abatement process" it would return to the Commission to quantify the total costs incurred and the allocation to New Hampshire. Tr. at 29-30. At the point of that reconciliation, Mr. O'Quinn stated that FairPoint would be in a better position to determine a proper rate going forward. Tr. at 30.

Upon questioning from Staff, Mr. O'Quinn stated that he was not sufficiently familiar with Senate Bill 48 (SB 48) to determine whether future reconciliations of these costs would be possible. Tr. at 32. In addition, Mr. O'Quinn stated that he did not believe the property tax cost recovery should be incorporated into FairPoint's base rates until the billing and abatement periods had been completed, and in the meantime it should continue as a surcharge. Tr. at 32. According to Mr. O'Quinn, the abatement period could last for many months. Tr. at 33-34. Mr. O'Quinn also re-affirmed his conclusion that FairPoint has not been fairly assessed in most instances. Tr. at 35.

Mr. O'Quinn noted that Exhibit 6 showed that fourteen municipalities had already issued abatements to FairPoint. Tr. at 37-38. Mr. O'Quinn, however, did not offer any estimate on how the success in these municipalities might affect FairPoint's overall assessment. Tr. at 38. Mr. O'Quinn, though, did confirm that FairPoint is challenging the assessments on FairPoint's poles and conduits, as well as its use of municipal rights-of-way. Tr. at 39.

With respect to the amount of recovery, Mr. O'Quinn testified that although the estimates for the total tax liability had gone up, and the estimates for the amount to be recovered had gone down, FairPoint did not intend to alter the amount of the charge. Tr. at 41. Mr. O'Quinn also stated that FairPoint had not yet determined how to handle any shortfall in its recovery, nor had it determined whether it intended to recover the total amount of the tax expense allocated to other services. Tr. at 41-42.

With respect to its rates, Mr. O'Quinn testified to his understanding that upon the passage of SB 48, FairPoint would have flexibility in setting its retail rates. Tr. at 43. He further testified that the flexibility would permit FairPoint to include this tax expense in its retail rates in any manner it sees fit. Tr. at 44.

Upon questioning from the Commissioners, Mr. O'Quinn stated that at present FairPoint was seeking only that the surcharge become a permanent rather than a temporary charge. Tr. at 51. He also confirmed other information relating to the amounts FairPoint has been billed and the nature of the consultant costs FairPoint sought to recover through the surcharge. Tr. at 53-55, 57-58.

Relative to the potential impact of SB 48, and upon direct questioning from the Commissioners to FairPoint's counsel, FairPoint stated its understanding that under SB 48 it

would be permitted to increase its rates for basic service without Commission approval by up to ten percent per year and by up to five percent per year for Lifeline customers. Tr. at 63.

FairPoint also stated that it understood the Commission to have already determined that the surcharge in issue here was part of basic rates and would, therefore, be included in the amounts from which those percentages are calculated. Tr. at 63-64. FairPoint further confirmed that as to anything other than the basic rates, FairPoint would be able to decide how to set its rates to meet the competitive market without Commission review or approval. Tr. at 65.

In its closing, FairPoint stated its understanding that although SB 48 complicated the issues, at the moment the Commission retained authority over FairPoint's rates and under that authority it should continue FairPoint's existing surcharge. Tr. at 84. FairPoint also contended that the consultant costs relating to abatements were appropriate for recovery since they would not exist but for the new property tax. Tr. at 84.

B. NHMA

In its closing, NHMA confirmed that its interest in the proceeding was to ensure that the property tax expense was recovered in the appropriate manner. Tr. at 73. In particular, NHMA stated that it had no objection to FairPoint recovering the cost of these taxes, but it believed that a municipal property tax surcharge was not the appropriate manner. Tr. at 73. NHMA stated that this is an operating expense of FairPoint and that it should be treated in the same way as any other operating expense, including FairPoint's other property tax expenses, and that it should be recovered through rates. Tr. at 73-74. NHMA also stated that it did not find relevant FairPoint's argument that it needed to develop historical information about the total expense before setting an amount of recovery. Tr. at 74. NHMA pointed out that similar situations happen frequently

in other circumstances and are not afforded unique treatment as a surcharge. Tr. at 74. NHMA also stated that it was not persuaded by FairPoint's argument that the tax impact is easier to track if it is applied as a surcharge. Tr. at 74-75. Therefore, it contended that FairPoint had not presented any compelling reason to treat this expense differently from any other and the tax expense should be included in FairPoint's rates. Tr. at 75.

C. OCA

In its closing, the OCA first contended that the consultant costs incurred for addressing abatements could not properly be recovered through this surcharge since FairPoint had not previously requested to do so and the Commission had not provided notice that such an issue would be part of the proceeding. Tr. at 75. The OCA also expressed concern that no amount was given for the consultant costs and that Commission approval of an undetermined amount could lead to an unreasonable level of recovery. Tr. at 75-76. The OCA expressed further concern that FairPoint's tax costs had not been audited and that without an audit it was difficult to know whether the costs for which recovery was sought were ones for which recovery is appropriate. Tr. at 76-77.

D. Staff

In its closing, Staff began by stating that it believed FairPoint's estimates for its total tax were too high because nearly all larger municipalities had already billed FairPoint and because the \$5.5 million cost identified by FairPoint took into account only fourteen abatements out of the 167 bills received. Tr. at 79. Staff also argued that the averaging method that FairPoint had been using to estimate the total possible tax was somewhat misleading. Tr. at 79-80.

As to the method of recovery, Staff agreed with the NHMA that the cost should be recovered through FairPoint's rates rather than as a surcharge. Tr. at 80. Staff noted, however, that FairPoint had not produced any proposal for including the amounts in its rates. Tr. at 81. In light of the pending passage of SB 48, Staff proposed that the Commission withhold issuing an order until there is final action on SB 48. Tr. at 81. Further, under Staff's proposal, once SB 48 was passed the Commission would then order FairPoint to submit a rate proposal covering basic service and Lifeline service customers and require FairPoint to justify the amounts proposed to be charged to those customers. Tr. at 82. If SB 48 does not pass, then, under Staff's proposal, the Commission would order FairPoint to make a rate filing incorporating the tax expense into its existing retail rates. Tr. at 82. Staff also stated that under its proposal the surcharge would remain as a temporary rate surcharge until SB 48 and the resulting rate issues are addressed. Tr. at 82-83.

III. COMMISSION ANALYSIS

Earlier in this docket, the Commission determined that the property tax now imposed upon FairPoint's poles and conduits and its use of municipal rights-of-way is a new expense of the Company that is not otherwise accounted for in its rates. *Northern New England Telephone Operations*, Order No. 25,308 (Dec. 28, 2011) at 17. Accordingly, it is appropriate for FairPoint to seek recovery of that expense. The amount of the expense recovered and the manner of recovery, however, must be reasonable and appropriate.

With respect to the manner of recovery, property taxes are an operating expense of the utility which are accounted for in the traditional ratemaking process. *See, e.g., Southern New Hampshire Water Co. v. Town of Hudson*, 139 N.H. 139, 144 (1994). Consistent with that

treatment, Mr. O'Quinn confirmed that FairPoint includes in its rates the cost of property taxes on items other than poles and conduits. He further confirmed that in no other instance are FairPoint's property taxes addressed through the imposition of a surcharge. Given these realities, and because FairPoint has offered no compelling reason for continuing a surcharge to cover these new property taxes, we conclude that any on-going recovery of this expense is properly done through FairPoint's rates rather than as a surcharge.

FairPoint contended that it is appropriate to continue the surcharge until the actual amount of the expense is known following the abatement process. That the final amount is not known, however, is no basis for continuing this unique treatment of an operating expense. Tax rates and valuations fluctuate and it is up to a utility to manage these variable costs, including by seeking rate relief where appropriate. It is not a basis, in itself, for creating a new charge to pass through the costs. Accordingly, to the extent FairPoint seeks to recover this tax expense, it must do so through its rates.

As to the amount of the expense, FairPoint has presented only estimates of the actual expense. Further, it has contended that the estimates it has provided may prove wrong because the underlying valuations are flawed and because it is possible that more municipalities may yet bill it for these taxes. FairPoint is also seeking abatements on nearly all of these assessments. These facts make any analysis of the expense difficult.

Since the time of the hearing on this matter, SB 48 has been signed into law and will take effect on August 10, 2012. At that time, the Commission will no longer possess certain authority over retail rate setting by FairPoint. For retail services other than basic service and Lifeline service the Commission will not have authority over those rates and FairPoint will have the

flexibility to set rates and recover expenses as it deems appropriate. Due to the passage of SB 48 and the lack of precise information as described above, we determine the temporary rate should be discontinued on August 9, 2012, and FairPoint should recover the expense pursuant to the terms of SB 48.

Under the legislation, increases to rates for basic service are subject to an annual cap of ten percent in each of the eight years after the effective date of the law. There is a similar cap of five percent per year on increases to Lifeline service rates. Additional adjustments to basic and Lifeline rates are allowed without regard to the cap, subject to Commission review and approval, to address changes in federal, state, or local government taxes, mandates, rules, regulations, or statutes. With these limitations in mind, the following options are presented to FairPoint.

FairPoint may either address this cost by adjusting the rates for basic service and Lifeline service, up to no more than the cap provided by statute, without Commission review and approval or it may address the cost as an additional expense for which adjustments to basic and Lifeline rates are permitted without regard to the cap, subject to Commission review and approval. If it elects to treat the expense within the statutory cap, FairPoint shall thereafter file the rate reports required by law so that the Commission may confirm that any newly proposed rates do not violate the cap.

If, however, FairPoint elects to address the expense as an additional adjustment without regard to the cap, it shall file a rate proposal covering basic service and Lifeline service. That rate proposal shall, at a minimum, contain the present rates for those services, the new proposed rates, and a justification for any increase including all costs and allocations upon which the

increase is based. The Commission will review that filing to determine that any proposed increase does not unfairly or improperly burden customers with basic or Lifeline service.

Based upon the foregoing, it is hereby

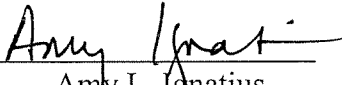
ORDERED, that recovery of FairPoint's property tax expense must be through its rates, rather than as a surcharge; and it is

FURTHER ORDERED, that on or by August 9, 2012, FairPoint shall cease billing the temporary rate surcharge; and it is

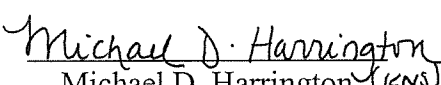
FURTHER ORDERED, that if FairPoint elects to address a portion of the tax expense through a rate change to basic and Lifeline service customers under the cap, it shall file the rate reports required by law; and it is

FURTHER ORDERED, that if FairPoint elects to address a portion of the tax expense through a rate change to basic and Lifeline service customers without regard to the cap, it shall make a rate proposal as outlined above.

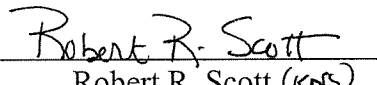
By order of the Public Utilities Commission of New Hampshire this twenty-seventh day of June, 2012.



Amy L. Ignatius
Chairman

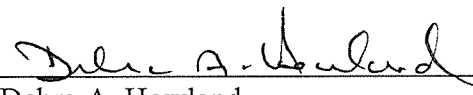


Michael D. Harrington (KNS)
Commissioner



Robert R. Scott (KNS)
Commissioner

Attested by:



Debra A. Howland
Executive Director

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