

Agenda Date: November 10, 2016  
Item Numbers: A4 through A19

**Dockets:**

**UT 160927, UT 160939, UT 160942, UT 160945**  
**UT 160947, UT 160953, UT 160956 UT 160957**  
**UT 160962, UT 160963, UT 160964, UT 160965**  
**UT 160966, UT 160971, UT 160982, UT 160987**

Company Names: *As listed on the Agenda for each Docket Number above*

Staff: Roger Hahn, Regulatory Analyst  
Tim Zawislak, Regulatory Analyst  
Jing Roth, Assistant Director - Telecommunications

**Recommendation**

Issue an order granting the distribution of funds no later than December 23, 2016, from the state universal communications service program (State USF) in the amounts shown to companies listed in the Attachment. The total amount includes the monies previously received from the 2012 state Traditional Universal Service Fund (TUSF) pool and the annualized cumulative reduction in support received from the federal Connect America Fund Intercarrier Compensation (CAF-ICC) mechanism.

**I. Background**

In 2013, the Legislature established the State USF Program to be administered by the Washington Utilities and Transportation Commission (commission). The State USF program is primarily intended to provide direct financial support to Washington's small incumbent Class B telephone companies<sup>1</sup> serving high-cost rural areas of Washington. Financial support from the program is a five year transitional measure designed to offset certain revenue reductions imposed on small companies as a result of discontinuing TUSF and the Federal Communications Commission (FCC) order FCC 11-161, commonly known as the FCC's USF/ICC Transformation Order.<sup>2</sup> This is the third year of the five year State USF Program. The commission may distribute up to \$5 million annually (less commission administrative costs) to qualifying companies during each year of this transitional period.

The State USF Program addresses two concerns. The first is the temporary replacement support for the State TUSF pool eliminated effective July 1, 2014. The second is replacing the annualized cumulative reduction in support the company previously received from the federal

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<sup>1</sup> Class B companies that are affiliates of CenturyLink are not eligible for state universal communications program funds.

<sup>2</sup> *Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and Reasonable Rates for Local Exchange Carriers; High-Cost Universal Service Support; Developing a Unified Intercarrier Compensation Regime; Federal-State Joint Board on Universal Service; Lifeline and Link-Up; Universal Service Reform—Mobility Fund*; WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663, 17694, 17751, paras. 84-85, 238 (2011) (*USF/ICC Transformation Order*).

CAF-ICC mechanism up through and including the year for which program support is distributed.<sup>3</sup>

A company is eligible to receive distributions from the State USF Program if the company demonstrates that its financial circumstances are such that its customers are at risk of rate instability, or service interruptions, or cessations absent a distribution to the company that will allow it to maintain local telephone rates that are reasonably close to the benchmark the commission has established.

In determining eligibility the commission will consider the following factors:

- a. The provider's earned rate of return (ROR) on a total Washington company books and unseparated regulated operations basis;
- b. The provider's return on equity (ROE);
- c. The status of the provider's existing debt obligations;
- d. Other relevant factors including, but not limited to, the extent to which the provider is planning or implementing operational efficiencies;
- e. Business plan modifications to transition or expand from primary provision of legacy voice telephone service to broadband service or otherwise reduce its reliance on support from the program.<sup>4</sup>

## **II. Discussion**

Each company identified in the Attachment filed their petition including financial information, on or before August 1 and meets the prerequisites for requesting program support and petition requirements in accordance with State USF Program rules.

Staff reviewed the financial data the companies submitted and the information was reconciled to the balance sheet and income statement from the Rural Utilities Service (RUS) Form 479 which is filed annually with the FCC on Form 481.<sup>5</sup> Staff when appropriate considered out-of-period adjustments to more accurately establish a financial analysis that excludes material abnormalities in the rate of return calculation. Staff also reviewed each companies' current circumstance with respect to the status of servicing existing debt obligations.

Staff reviewed each company's total Washington earned ROR based on its regulated operation and the consolidated ROE of both regulated and nonregulated operations.

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<sup>3</sup> WAC 480-123-120(2)

<sup>4</sup> WAC 480-123-120(1)

<sup>5</sup> Not all companies have RUS debt which requires filing a Form 479 with FCC Form 481. In those instances, financial results provided in the template were compared to the Annual Report filed with the commission.

### Rate of Return Analysis:

For the purpose of granting distribution of funds from the State USF program, a Washington ROR of 10 percent was used and previously accepted by the commission in years one and two of the program as a threshold test to assess the relative earning levels of the petitioning companies in order to evaluate and make eligibility recommendations.<sup>6</sup> Staff performed the following analysis by comparing the yield rates between 1990 and 2015<sup>7</sup> for the following debt instruments to establish that an ROR of 10.00 percent is reasonable.

- The annual yield of 10-year U.S. Treasury securities decreased from 8.55 percent to 2.14 percent.
- Moody's yield on all industry corporate bonds rated AAA decreased from 9.32 percent to 3.89 percent.
- Moody's yield on all industry corporate bonds rated BAA changed from 10.36 percent to 5.00 percent.<sup>8</sup>

Each company listed in the attachment has an ROR in 2015 that is below the 10 percent threshold.

### Return on Equity Analysis:

As an additional measure to assess the petitioning companies' financial condition, staff calculated each company's ROE using the audited or certified public accountant reviewed financial statements or books. The ROE analysis of the consolidated company enables the commission to consider the overall health of the company (i.e., regulated and nonregulated operations) before allowing the company to participate in the State USF Program. The returns on equity for 15 of the 16 petitioning companies identified in the Attachment have an ROE ranging from (10.4) percent to 9.3 percent. One petitioning company had an ROE greater than 10 percent; however its ROR was 6.0 percent. In addition, this company recently completed a project upgrading its network and incurred significant debt.

Upon review and analysis as previously described, staff has determined that all 16 companies identified in the Attachment by docket number meet the requirements of State USF program in

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<sup>6</sup> The FCC's 11.25 percent authorized rate of return was last set in 1990 when it was reduced from 12.00 percent. *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990)

<sup>7</sup> On March 30, 2016, the FCC released the Rate-of-Return Reform Order which implemented a transitional approach to reducing the 11.25 percent rate of return. Effective July 1, 2016 the authorized rate of return was reduced to 11.00 percent and will be reduced 25 basis points each July 1 until reaching 9.75 percent on July 1, 2021. *Connect America Fund et al.*, WC Docket Nos 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, Report and Order, Order and Order on Reconsiderations, and Further Notice of Proposed Rulemaking, FCC 16-33 (rel. Mar. 30. 2016).

<sup>8</sup>Source: Federal Reserve Board: H 15 Release – Selected Interest Rates – Historical Data; <http://www.federalreserve.gov/releases/h15/data.htm>

WAC 480-123. Staff finds that each company's total Washington regulated operations ROR is not greater than 9.1 percent, and each company's consolidated ROE for combined operations, both regulated and non-regulated, is not excessive. Accordingly, staff concludes and recommends that each company should be eligible for State USF Program support in the amounts listed in the Attachment (which totals to \$3,612,980 for this fiscal year).

### **III. Conclusion**

The commission should grant the request for funds from the State USF Program in the amounts specified in the Attachment. Staff recommends that the total amount for each company listed be distributed no later than December 23, 2016.

Attachment

[Open Meeting Memo for the November 10, 2016 Open Meeting](#)