

Agenda Date: November 9, 2017
Item Number: A17

Docket: UT-170861

Company Name: Skyline Telecom, Inc.

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

Recommendation

Issue an order granting the delayed distribution of funds from the state universal communications services program (State USF) in the amount of \$92,091 to Skyline Telecom, Inc. (Skyline or company) with the following conditions:

1. The company provides staff with an officer approved¹ 2018 capital budget plan of approximately \$450,000 for the project² to install a 30 mile aerial fiber build in the Silverton exchange which will be used to support broadband. The budget plan must be submitted to staff for review at least 30 days prior to the beginning of construction.
2. The construction must begin in 2018. Once the company provides notification and verifiable documentation to staff that construction has started, program funds will be distributed within 30 days of the notification date.
3. The commission requires that Skyline submits a progress report to staff no later than January 31, 2019. The report must include cost detail of the capital expenditures and a narrative how the program funds received further the goal of State USF.

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 Class B telephone companies³ 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 the state Traditional Universal Service Fund (TUSF) and the Federal Communications Commission (FCC) order FCC 11-161, commonly known as the FCC's USF/ICC Transformation Order.⁴ This is the fourth year of the five year State USF

¹ An Officer signed affidavit attesting to the detail and estimated amount of the 2018 capital budget plan.

² A detail description of the capital project is described in a company submission filed under Docket UT-151526

³ Class B companies that are affiliates of CenturyLink are not eligible for state universal communications program funds.

⁴ *Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and Reasonable Rates*

program. The commission may distribute up to \$5 million annually (less commission administrative costs)⁵ 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, 2014.⁶ The second, is replacing the annualized cumulative reduction in support the company previously received from the federal Connect America Fund Intercarrier Compensation (CAF-ICC) mechanism up through and including the year for which program support is distributed.⁷

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.⁸ (*Emphasis added for this company.*)

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).

⁵Senate Bill 5670 approved in March 2016 allows for the carry-over of unexpended funds to subsequent fiscal years when less than \$5 million in a fiscal year is distributed. During the first three years of the program, \$10.3 million of the \$15 million (less administrative costs) maximum has been distributed.

⁶ Skyline was not eligible for TUSF funding

⁷ WAC 480-123-120(2)

⁸ WAC 480-123-120(1)

II. Discussion

Skyline filed its 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 Skyline's submitted financial data for the years of 2015 and 2016. This information was reconciled with the balance sheet and income statement from the Rural Utilities Service (RUS) Form 479 which is filed annually with the FCC on Form 481.⁹ Staff also considered the company's current circumstance with respect to the status of servicing existing debt obligations.

Rate of Return Analysis:

For the purpose of granting distribution of funds from the State USF program, a Washington regulated ROR of 10 percent was used and previously accepted by the commission in the prior three years of the program. This was used as a threshold test to assess the relative earning levels of the petitioning companies in order to evaluate and make eligibility recommendations. There have been no significant changes in 2016 related to the yield rates in debt instruments reviewed previously and the ROR of 10.00 percent is reasonable.

Skyline meets the 10.00 percent threshold as its 2016 total Washington ROR decreased to 9.3 percent from 9.8 percent in 2015. This is a result of lower switched access revenue which is partially offset by reduction in expenses primarily in corporate operations.¹⁰

Return on Equity and Debt Analysis:

Staff calculated the company's ROE using audited financial statements. Staff's analysis of ROE normally uses the consolidated company results 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. In this case, staff believes that the company's individual ROE is a better measure because it has not remitted dividends to its Parent and maintains long-term debt on its books. Staff is concerned that Skyline's financial circumstances may expose its customers to potential risk of rate instability, or service interruptions, or cessation of service. Skyline's ROE is less than one percent primarily due to the cost of provisioning broadband. Skyline has reduced its long-term debt from 62 to 45 percent of its total capital structure since 2013.

⁹ 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.

¹⁰ Corporate operations expense decreased 39 percent in 2016 from 2015 as a result of a consultant contract in 2015 that was not in effect in 2016.

Operational Efficiencies and Business Plan Modifications:

The goal of the State USF program is to transition from a company's dependency on voice to broadband services. Last year, Skyline was approved to receive state USF program support of \$78,642 with conditions, granted in Docket UT-160951, Order 01, dated November 10, 2016. The company is required to incur \$78,642 in capital expenditures during the calendar year of 2017 prior to distributing funds. This designated fund was intended to assist the company's effort to install a 30 mile aerial fiber build in the Silverton exchange. As of October 31, 2017, the company has not incurred any capital expenditures for this project and funds have not been distributed.

According to the company, the construction has not begun since it does not have a meet-point agreement yet with Frontier Communications Northwest, Inc. (Frontier). Such an agreement will provide the internet backbone using "Ethernet Transport." It is staff's understanding that preliminary discussion is under way. The company has also received a bid for construction of the aerial fiber build and has inquired about pole attachment agreements with the power company (Snohomish County PUD) and Frontier.

III. Conclusion

Staff concludes and recommends that Skyline receives a delayed distribution from the State USF program support in the amount of \$92,091, only if it meets the following conditions:

1. The company provides staff with an officer approved 2018 capital budget plan of approximately \$450,000 for the project to install a 30 mile aerial fiber build in the Silverton exchange which will be used to support broadband. The budget plan must be submitted to staff for review at least 30 days prior to the beginning of construction.
2. Construction must begin in 2018. Once the company provides notification and documentation to staff that construction has started, program funds will be distributed.
3. The commission requires that Skyline submits a progress report to staff no later than January 31, 2019. The report must include cost detail of the capital expenditures and a narrative how the program funds received further the goal of State USF.