

Agenda Date: June 6, 2006
Item Number: A-1

Docket Number: UT-060670
Company Name: Beaver Creek Telephone Company

Staff: Bob Shirley, Telecommunications Policy Analyst
Tim Zawislak, Regulatory Analyst

Recommendation

Issue an Order in Docket UT-060670 granting Beaver Creek Telephone Company's petition for waiver of notice and filing dates as set forth in paragraph 8 of the Washington Carrier Access Plan as approved in Docket UT-971140, and establish an initial WECA pool revenue objective of \$496,961 with an expiration date of December 31, 2007.

Background

Silverton is a remote community in eastern Snohomish County that does not have telephone service. Beaver Creek Telephone Company (BCTC) is prepared to provide service on June 30 under a tariff filed May 30.

This matter was before the commission on May 17 with a recommendation for a WECA revenue objective of \$571,431. At that time, the commission asked staff to examine the prudence of the actions of the company, examine more closely the investment already made by BCTC, and examine the reasonableness of its anticipated expenses. The commission also requested that staff examine other instances of companies entering the WECA pool and compare those entrances with the request of BCTC.

Staff has completed the requested examination and recommends downward adjustments of \$74,470 to BCTC's requested WECA revenue objective. The attached spreadsheet and notes explain the adjustments.

Analysis

Staff has requested and examined company documentation of actions and expenditures to determine whether BCTC acted prudently in choosing to serve the Silverton area, and whether it acted prudently in the choices of equipment purchased to serve the area.

BCTC has invested \$2,327,722 (funds spent or owed to vendors) to provide the residents of the Silverton area with access to telecommunications services that are reasonably comparable to those services provided in urban (and rural) areas, at rates that are reasonably comparable to rates charged for similar services in urban (and rural) areas.

The Decision to Serve Silverton Was Prudent

Staff has reviewed BCTC's history before the commission; a timeline of major events is provided as an attachment.

As discussed in staff's May 17 memo, ITL approached commission staff in April 1999, and offered to serve Silverton when ITL learned through a newspaper account that the commission was interested in finding a telephone company to serve Silverton. Staff responded favorably to ITL's offer. At the time of registration of ITL's subsidiary, Beaver Creek Telephone Company (BCTC), staff informed the Commission that "[t]his represents the first registration in decades of a local exchange carrier that has as its initial purpose service of unserved areas in rural Washington."

When BCTC petitioned for designation as an eligible telecommunications carrier (ETC) in docket UT-990392, staff informed the commission:

[BCTC] plans to construct new service to Silverton and Hobart (Devil's Club exchange), two presently unserved areas. These areas will almost certainly be found to be high-cost areas and designation as an ETC is the prerequisite to collection of federal high-cost support. ETC designation is also necessary and required for participation in the federal program for low-income support, Lifeline and Link Up.

Designation as an ETC will assist Beaver Creek as it pursues funding options with the Rural Utility Service (RUS) of the U.S. Department of Agriculture. Several other small local exchange companies operating in Washington State borrow from the RUS to finance construction.

In 2000, the commission approved a settlement in the merger of US WEST and Qwest that included a requirement for the new company, Qwest, to withdraw its opposition to the use of above-cost access rates to support construction of telecommunications service in areas previously outside of telephone exchange areas.

Throughout the period 1999 to 2001, BCTC made considerable efforts to serve Silverton, including obtaining a Rural Utility Service (RUS) loan for that purpose. The commission was aware of the effort to obtain the RUS loan.

In early 2003, the commission opened docket UT- 030228 to determine whether the company's ETC designation and telecommunications registration should be revoked due to inactivity. At the time, staff encouraged BCTC to complete the effort to serve Silverton or to abandon the effort so that other options could be pursued. BCTC elected to continue with the project and in December 2004 the company installed 90% of the plant and equipment necessary to provide service. (The 90% represents all the plant and equipment except the switch and related electronic equipment.)

In 2005, ITL sold BCTC to its current owners, who also operate four rural exchanges in Oregon and Idaho under the management of Oregon Telephone Corporation (OTC). The Federal Communications Commission (FCC) approved the transfer of ownership in January 2006, after the commission commented that "[t]he WUTC believes that the proposed transfer of control will increase the likelihood that those [unserved] communities will have access to reliable local service in the very near future." Also,

“[p]roviding basic service to these unserved communities has been a longstanding goal of regulators and policy makers in Washington.”

Based on this record indicating the commission’s interest in telecommunications service for the community of Silverton, staff concludes that BCTC, under former and current owners, acted prudently when it determined to invest in plant and equipment to serve Silverton.

The Equipment Chosen Represents Prudent Investment

Staff has examined whether BCTC has been prudent in the equipment chosen to serve Silverton. As stated above, the commission was aware that BCTC planned to finance construction of plant and equipment with loans from RUS. Loan requirements of RUS include approval of the plant and equipment to be installed and a public bidding process to determine the cost of construction.

Staff was not involved in the RUS process that extended from 2001 to the present, apart from occasional contact with BCTC and RUS. Throughout the period 2001-2005, it has been staff’s belief the requirements and safeguards used by RUS would be sufficient to ensure that the project would result in service to customers, while providing assets that RUS could foreclose on if BCTC failed to meet its obligations.

Prior to this petition, staff did not look at alternative technologies that could be used by BCTC to serve Silverton, but in researching the matter staff has found that BCTC considered and rejected at least one more expensive technical approach. As a general rule, staff has not investigated or approved engineering decisions of companies. In particular, because the project is funded by RUS based on RUS’s standards, staff did not review the engineering decisions, including choice of telecommunications technology.

BCTC faced unusual engineering challenges in the Silverton area. As stated at the May 17 meeting, because the road to Silverton runs through a national forest and next to a river, BCTC was required to use unusual trenching techniques to bury cable closer to the road than is usual. The combination of environmental standards and technical standards required experimentation to determine the best method that was acceptable to both RUS and the county permitting authorities. Additionally, the service is provided to an area with no electric utility service so the project had to be engineered to operate with power at only one end of the cable. The lack of electric power along the route required the purchase of equipment that would not ordinarily have been used for a project of this nature.

Staff concludes based on the information provided to us, including information received related to the RUS loan contract, that the choices made by BCTC were prudent.

Quality of Service: Wireline, Wireless, and Satellite

The investment in the equipment chosen to serve Silverton relates directly to the quality of service for residents. Residents of Silverton will receive wireline telephone service that is comparable in quality to that received by other rural (and urban) consumers and at rates

comparable (but generally higher) to the rates paid by other rural (and urban) consumers. It meets the RUS standards in the Washington State Telecommunications Modernization Plan (an RUS plan required by federal law) to promote information and advanced telecommunications services. For example, the RUS plan requires that all new construction be capable of providing DSL service (the FCC also encourages recipients of federal universal service support to purchase equipment that is capable of providing information services and advanced telecommunications services).

The commission has a de-facto standard for service that can reasonably be described as the level of service provided by all wireline carriers in Washington. This is sometimes described as “five 9s.” That is, a customer will receive a dial tone 99.999% of the time. This is the standard in urban and rural, including remote, areas.

Additionally, the commission has a standard for wireless quality of service: the quality of wireless (i.e., commercial mobile radio service, or CMRS) service is sufficient to warrant ETC designation of wireless companies so that federal universal service funds will be available to wireless ETCs for investment in their networks. It is important to note, however, the quality of wireless service has not yet been viewed as sufficiently good enough to be considered a substitute for wireline service.

On May 17 the question was raised whether the relatively small number of customers in Silverton could be served reasonably with commercially available Globalstar satellite telephones and services. Staff discussed this with BCTC and the company, which is familiar with Globalstar service, and finds it inadequate to meet customer expectations. It also does not meet RUS standards.

Staff spoke recently over a Globalstar connection to a resident of a similarly remote area and the experience included words dropped repeatedly, confusing delay throughout the duration of the conversation, and ultimately a lost connection. The purpose of the call was to obtain information to provide to the commission, and the result was that staff reported inaccurate information to the commission and the inaccuracy was directly related to the extremely poor quality of the satellite telephone service. This most recent experience was no better than staff has experienced over several years.

In comparison to both wireline and wireless service, mobile satellite service is inferior to the point that it is not a reasonable substitute for wireless service, let alone wireline service.

Provision of Mobile Satellite Telephone Service

In 1999, no consideration was given to inviting a satellite company to participate in the WECA pool. At that time, only long-standing, rural independent telephone companies participated in the WECA pool.

In 1999, no satellite company had requested to be an ETC that could draw on federal support to pay costs not covered by customer payments. There was in 1999 (as is the case

today) no state universal service fund under the direct control of the commission with authority to purchase satellite telephones and pay monthly bills for consumers. If there are no legal impediments, the commission apparently could admit a mobile satellite telephone company to the WECA pool as a means of providing a source of funds to meet the operating costs associated with serving customers in Silverton. Based on published prices, and assuming the satellite telephone provider could limit customers' ability to exceed some pre-determined number of minutes per month, the cost would be less than the cost BCTC will incur to provide service.

A decision to provide WECA pool support for below-standard mobile satellite telephone service to Silverton because that service is substantially less expensive than service from BCTC would be a decision to have two standards for quality of service in Washington. Assuming this is permitted by state law, staff nevertheless recommends against such a decision until such time as the commission can determine the consequences such a decision would have beyond Silverton.

BCTC Expenses

Staff has undertaken a review of the expenses to date of BCTC and its projected expenses for the first year of operation.

BCTC has invested \$2,327,722 to date in plant and equipment. This investment consists mostly of investment in cable and wire facilities and in a switch. Staff recommends no adjustments to these already incurred expenses.

Staff has reviewed the projected expenses for BCTC. Our conclusion is that investments made to date, and most projected expenses are reasonable. Staff has recommended adjustments to corporate operations expenses, federal income tax expenses, and accumulated depreciation. The adjustments contribute to the reduction in the WECA revenue objective recommended in this memo in comparison to the May 17 recommendation.

The expenses for BCTC are consistent with what we know of the expenses of similar-size companies.

It is important to note that most of the expenses (as distinguished from investment in cable and wire, and a switch) are projected expenses, and in view of the fact that BCTC will begin receiving payments from the federal universal service fund in October 2007, staff continues to recommend that the WECA revenue objective established for BCTC expire on December 31, 2007. Prior to that expiration, staff will review actual expenses and operations of BCTC and as appropriate we will recommend changes to rates based on actual expenses.

Entrance to the WECA Pool

Staff has reviewed the history of the WECA pool since 1987. Most recently, the pool entrance and exit requirements were set in 2000 through the settlement in docket UT-971140. Since that settlement, two companies have entered the pool, M&L Enterprises,

d/b/a Skyline Telephone, and LocalTel, a competitive local exchange company (CLEC) operating in the Wenatchee area.

M&L Enterprises WECA Revenue Objective of \$51,300

M&L provides service to about 100 homes on Mt. Hull, north of Tonasket. M&L undertook serving that area at the behest of the commission. M&L entered as a local exchange carrier (LEC) prior to its approval by the FCC for treatment as an incumbent local exchange carrier (ILEC). In 2001, the commission granted M&L a WECA pool revenue objective of \$51,300. The WECA revenue objective set for M&L did not include funds to ameliorate the effects of the lag in receipt of federal support.

Computer 5, Inc. (d/b/a LocalTel) WECA Revenue Objective of \$597,753*

LocalTel provides service in the Wenatchee area (e.g., Entiat, Leveanworth, Pateros) over plant and equipment leased from Qwest and Verizon, as well as its own equipment. LocalTel entered the WECA pool in 2003 with a revenue objective of \$597,753. LocalTel's revenue objective was calculated to offset the effect of a regulatory decision made by the commission, pursuant to FCC requirements. Entrance to the WECA pool eliminated a price squeeze that LocalTel would have faced without revenue (from the pool) to offset price increase from its suppliers and competitors, Qwest and Verizon.

The commission deaveraged rates for unbundled network element (UNEs) loops supplied by Qwest and Verizon to competitors. In LocalTel's case, the result was that LocalTel was expected to pay UNE loop rates that in many instances cost more than LocalTel charged its retail customers. At the same time, LocalTel's competitors and suppliers of UNE loops, Qwest and Verizon, were not permitted to raise retail rates to reflect the deaveraged cost of UNE loops.

If LocalTel had not been permitted to enter the WECA pool, it would have had to abandon approximately 4,000 customers in order to cut its cost-per-customer below the retail rates it could reasonably charge and still compete with the retail rates of Qwest and Verizon. Had LocalTel not been permitted to enter the WECA pool, and had it abandoned 4,000 customers, each of those customers could have been served by Qwest or Verizon without any investment in plant or equipment by those companies.

BCTC's Entrance to the WECA Pool

Staff has considered BCTC's revenue objective as compared to those of M&L and LocalTel. BCTC's revenue objective is significantly greater than M&L because it includes 18 months without federal high-cost loop (HCL) support. After December 2007, the WECA revenue objective for BCTC should be about \$66,800, slightly more than M&L's \$51,300.

BCTC's revenue objective of \$496,961 (including accommodation of the 18 month federal support lag) is comparable to the \$597,753 WECA revenue objective for LocalTel. However, LocalTel receives support to offset a regulatory decision, not to ensure service in an area where service would not otherwise be provided.

Whether as a comparison to amount or purpose, entrance of BCTC into the pool is not inconsistent with the entry of the other two companies permitted into the WECA pool since 2000.

Federal Support and the Initial WECA Revenue Objective

The bulk of federal support BCTC will receive is provided on a lagged basis. The \$496,961 recommendation for the initial WECA revenue objective includes \$428,293, an amount equal to the anticipated annual of federal HCL support. Staff's recommendation is for an initial revenue object that expires on December 31, 2007; the expiration will force the company to file for a new revenue objective at that time and at that time the commission may adopt a new WECA revenue objective that excludes the amount associated with federal HCL support.

In arriving at the recommendation, staff considered whether it is reasonable to expect BCTC to operate for 15 to 18 months without receipt of federal HCL support or any compensating state support. This mechanism, with its lag, has little or no effect on existing carriers, but acts as a significant impediment, if not a barrier, to entry for new carriers seeking to serve new exchanges.

The lag in federal support was known, or could have been known, to BCTC in 1999. However, to the best of staff's knowledge, the reimbursement process, including the lag, was created under circumstances in which the more than 1,000 companies affected by the lag were never subjected to a period of 15 to 18 months during which funds to support high-cost service were not available. Staff's conclusion is that in order for the service to be sustained in Silverton, the initial WECA revenue objective should include an amount sufficient to offset the effects of the lag in HCL support payment.

Customer Rates

At the commission's request, staff reviewed its consideration of the appropriate initial residential and business rates. The highest rates in the state are \$26.00 for residential service and \$_____ for business service charged by Lewis River. The rate in nearby Granite Falls is \$_____ and \$_____ for residential and business service. Lewis River has a larger calling area than Silverton (residents will only be able place a local call within the exchange), and Granite Falls has local calling to, among other locations, Everett.

BCTC has filed a tariff with rates of \$25.00 and \$35.00 per month. The WECA revenue objective recommended by staff anticipates revenue from the charges filed by BCTC.