

Agenda Date: October 16, 2014  
Item Numbers: A1 through A15

**Dockets:** UT-141533, UT-141541, UT-141554, UT-141555  
UT-141556, UT-143023, UT-143024, UT-143025  
UT-143028, UT-143029, UT-143031, UT-143033  
UT-143034, UT-143041, UT-143042

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

Staff: Roger Hahn, Regulatory Analyst  
Tim Zawislak, Regulatory Analyst  
William Weinman, Assistant Director - Telecommunications

### **Recommendation**

The commission enter an order to grant the distribution of funds from the state universal communications service program to those company's and amounts listed in the Attachment in two increments:

- Distribute immediately the amount each qualifying company received from the former 2012 Traditional Universal Service Fund (USF) pool;
- Distribute as soon as possible in January, 2015 the amount of cumulative reduction in support from the Connect America Fund (CAF) up through and including the year for which program support is distributed.

### **I. Background**

On June 27, 2013 The Legislature passed bill 2E2SHB 1971 during the Second Special 2013 Legislative Session. The legislation addressed a number of telecommunications issues including a repeal of the sales tax exemption for residential landline phone service and establishment of the state universal communications program (State USF Program) to be administered by the Washington Utilities and Transportation Commission (commission). The state universal communications 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 transitional measure designed to offset certain revenue reductions imposed on the small companies as a result of the Federal Communications Commission (FCC) order FCC 11-161, commonly known as the FCC Transformation Order.<sup>2</sup> Up to \$5 million annually (less commission administrative costs) may be

---

<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*

awarded to qualifying companies from a universal communications account that is scheduled to terminate after five years.

On May 22, 2014, the commission issued General Order R-575 in Docket UT-131239 amending and adopting rules in WAC 480-123 to implement the State USF Program established by the legislature. The State USF Program addresses two concerns. One is the temporary replacement support for the Traditional USF pool created in Docket U-85-23 and administered by the Washington Exchange Carrier Association (WECA). The second is replacing the cumulative reduction in support the company received from the federal CAF 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 on a total Washington company books and unseparated regulated operations basis;
- b. The provider's return on equity;
- 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 operation 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>

---

*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).*

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

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

On May 23, 2014, the commission terminated the Traditional USF in Docket UT-971140 and ordered WECA to cease distributing Traditional USF pool funds to its members effective July 1, 2014. Prior to the rule change, eligible companies received monthly Traditional USF distributions throughout the year. Because disbursements from the State USF Program begin in January 2015 a cash flow issue may result for some companies that are eligible for support. Therefore, in order to address cash flow issues related to the termination of the Traditional USF, the commission's State USF Program rules allow it to grant a one-time partial distribution prior to January 2015 of State USF Program funds equal to the amount eligible companies received from the Traditional USF pool for 2012. All eligible companies shown on the Attachment petitioned the Commission to receive a distribution to partially replace monthly payments that had been previously provided from the Traditional USF. The remainder of the annual distribution comprised of the cumulative reduction in support from the CAF will be distributed in January 2015. Any disbursement of the Traditional USF in subsequent years to qualifying companies will be included with the January disbursement of the State USF Program disbursement.

## **II. Discussion**

Each company identified in the Attachment filed their petition and financial information on or before August 1 in accordance with the appropriate State USF Program rules. Staff reviewed each petition to determine that each company who received a distribution from the 2012 Traditional USF pool met the prerequisites for requesting program support, petition requirements and eligibility requirements as stated in WAC 480-123-100, 480-123-110 and WAC 480-123-120.

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 FCC on Form 481.<sup>5</sup> Staff also reviewed the allocation of common expenses to ensure regulated operations are not subsidizing nonregulated operations. Staff completed a variance analysis to identify changes in revenues and expenses and 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 company's current circumstance with respect to the status of servicing existing debt obligations.

Staff's initial analysis to determine if the companies should be eligible to participate in the State USF Program relied on reviewing the companies' earned rate of return (ROR) on regulated operations and the consolidated return on equity (ROE) of both regulated and nonregulated operations.

---

<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:

In performing a ROR analysis it is important to recall that during a workshop concerning operation of a potential state universal service fund staff presented to the commission a range of potential financial information and concepts to be used to develop potential eligibility criterion for the State USF Program.<sup>6</sup> For that presentation staff used the Federal Communications Commission's authorized ROR of 11.25 percent. For the purposes of this proceeding and presentation, staff recommends and has relied on a ROR of 10.0 percent be used as a threshold test to assess the relative earning levels of the petitioning companies in order to evaluate and make eligibility recommendations. It is important to note that the FCC's 11.25 percent authorized ROR was last set in 1990<sup>7</sup> when it was reduced from 12.00 percent to 11.25 percent and that it is currently under review by the FCC for likely reduction sometime in the near future. In fact, on May 16, 2013, a Staff Report was released by the FCC's Wireline Competition Bureau recommending that the federally authorized ROR for local exchange carriers be reduced.<sup>8</sup>

Staff believes it is prudent to use a conservative rate of return for the State USF Program. If a company is earning a ROR greater than 10.0 percent it may present other information to the commission as defined in WAC 480-123-120 (1) for the commission to consider in making a determination if it will receive a distribution from the State USF Program. The Attachment shows that all companies that received funds from the former Traditional USF pool in 2012 have a 2013 earned ROR that is below the 10.0 percent threshold that Staff considered in its analysis.

### 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. Generally, one would expect the ROE to be greater than the overall ROR on the regulated operations. However, the returns on equity for the companies being considered in this process shows that all of the petitioning companies identified in the Attachment have ROE of 6.7 percent or lower.

---

<sup>6</sup> Washington Utilities and Transportation Commission Universal Service Fund Workshop, August 14, 2012, Docket UT-100562

<sup>7</sup> *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>8</sup> *Prescribing the Authorized Rate of Return, Wireline Competition Bureau Staff Report*, DA 13-1111, concludes that the Commission should consider establishing the authorized rate of return between 8.06 percent and 8.72 percent.

Upon review and analysis as previously described, Staff has determined that all of the companies identified in the Attachment and the dockets identified above meet the requirements of WAC 480-123.<sup>9</sup> Staff finds that each company's total Washington regulated operations ROR is not greater than 10 percent, and each company's consolidated ROE for combined operations, both regulated and non-regulated, are 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 with Traditional USF support distributed in October and the remainder in January 2015.

### **III. Conclusion**

The commission should grant the request for funds from the State USF Program in the amounts set forth in the Attachment which, consistent with the commission's rules, reflect the amount received by each company previously from the former 2012 Traditional USF pool administered by WECA and the cumulative reduction in support the company received from the CAF up through and including the year for which program support is to be distributed.

Attachment

---

<sup>9</sup> Ellensburg Telephone Company dba Fairpoint Communications, Pend Oreille Telephone Company, Skyline Telecom, Inc. and Westgate Communications, LLC dba WeavTel are not in the Traditional USF pool and are only eligible for fund support associated from the federal CAF reduction. The petitions for these companies are tentatively scheduled to be presented to the commissioners at the December 11 Open Meeting.