Agenda Date: December 11, 2014
Item Number: A3

Docket: UT-143022

Company Name: Ellensburg Telephone Company dba FairPoint Communications

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

Recommendation

Issue an order granting the distribution of funds from the state universal communications service program (State USF Program) no later than January 15, 2015, to Ellensburg Telephone Company dba FairPoint Communications (Ellensburg or company). The distribution of funds in the amount of $313,127 reimburses the company for the cumulative reduction in support from the Federal Communications Commission's (FCC) Connect America Fund (CAF) Phase 1 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 establishing the State USF Program 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[1] serving high-cost rural areas of Washington. Financial support from the program is a five year transitional fund designed to offset certain revenue reductions imposed on the small companies as a result of the FCC's order FCC 11-161, commonly known as the FCC Transformation Order.[2] The commission may distribute an annual amount of $5 million (less commission administrative costs) to qualifying companies during this transitional period.

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. The first is the temporary replacement support for the elimination of intrastate access rate element, or the Traditional USF pool, created in Docket U-85-23 and administered by the Washington Exchange Carrier

[1] Class B companies that are affiliates of CenturyLink are not eligible for state universal communications program funds.
[2] *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*).

Association (WECA). The second is replacing the cumulative reduction in support the company previously received from the federal CAF disbursements up through and including the year for which program support is distributed.[3]

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.

The commission will consider the following factors to determine eligibility:

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.[4]

II. Discussion

Ellensburg filed its petition, including financial information, on or before August 1 in accordance with the appropriate State USF Program rules. Ellensburg did not receive Traditional USF pool support and is only eligible to receive disbursements from the fund replacing the cumulative reduction in support the company received from the federal CAF Phase 1 up through and including the year for which program support is distributed.

Staff determined that the company met the prerequisites for requesting program support, petition requirements, and eligibility requirements of WACs 480-123-100, 480-123-110 and 480-123-120. Staff reviewed the company's petition, including the financial and operational results of the petition, and has determined that the company meets the requirements of WAC 480-123.

The company filed a supplement to its petition expressing concern about the age of the infrastructure in the Ellensburg service area, which could lead to interruptions in service. To address this condition, at least in part, the company is planning on introducing new technologies to provide service. This effort will be part of the transition from legacy voice telephone service

[3] WAC 480-123-120(2)
[4] WAC 480-123-120(1)

to services provided by Voice over Internet Protocol (VoIP). State USF Program support will be expended for specific projects designed to meet the goals of developing operational efficiencies and supporting the transition from legacy voice telephone service to broadband and other advanced services.

The proposed project provides for VoIP services and a power distribution addition. This includes the improvement to the capacity and capability of existing facilities and a release software upgrade to the company's Metaswitch. Additionally, there is a power distribution project driven by the upgrade of IP Core and Edge Router equipment to avoid service interruptions since existing power distribution is almost at exhaustion. The estimate for these projects is $382,800.

The supplement also states that Ellensburg will commit to depositing funds distributed from the State USF Program into a special fund for these projects to ensure construction expenditures are made in 2015. The company will also provide an initial detailed report of the projects status, including expenditures and project progress by July 1, 2015, and a final report no later than January 31, 2016.

Staff's review of the financial results included in the petition found that the company's 2013 total operations rate of return exceeds 10 percent. Staff determined this resulted from a decrease in the regulated net plant balance due to reduced capital expenditures (CapEx) additions that are lower than the annual depreciation expense added to accumulated depreciation. CapEx can vary significantly year-over-year due to a number of factors, e.g., storm damage, equipment upgrades, and deployment of new technology. Staff is concerned the reduction of net rate base has occurred at a time when the transition of telecommunications services are transitioning to new technologies, primarily VoIP. Additional information concerning the company's capital expenditures in 2014 and the projected capital expenditures for 2015 was requested from the company. The company provided 2014 CapEx (10 month actual and 2 month forecast), which totaled approximately $1.9 million as compared to $850,000 in 2013. In addition, approximately 60 percent of the 2014 CapEx spend relates to broadband growth which meets one of the objectives of the State USF Program of transitioning from legacy voice telephone service to broadband service. Staff also received the 2015 budgeted CapEx, which is approximately $1,200,000 including the projects the funded by the State USF Program.

Ellensburg is owned by FairPoint Communications (FairPoint) which emerged from Chapter 11 bankruptcy proceedings on January 24, 2011. FairPoint's consolidated total long-term debt was $918 million as of the end of 2013.[5] FairPoint's total stockholders' equity is has a deficit balance resulting in a negative consolidated return on equity of all business units, both regulated and non-regulated.

Based on the prior analysis and company responses, staff believes customers may be put at risk of rate instability, or service interruptions or cessations, absent a distribution from the fund. Accordingly, staff concludes and recommends that Ellensburg should be eligible to receive State USF Program support in the amount of $313,127, to be disbursed to the company in January

[5] FairPoint Communications 2013 Annual Report, pages 11, 12 and 35. Ellensburg does not have any long term debt on its balance sheet.

2015.

III. Conclusion

The commission should grant the request for funds from the State USF Program in the amount of $313,127, which, consistent with the commission's rules, reflects the cumulative reduction in support the company received from CAF Phase 1 up through and including the year for which program support is to be distributed. The commission should also require Ellensburg to deposit funds from the State USF Program in a specific account dedicated to the described projects and provide an accounting of such funds by July 1, 2015, and January 31, 2016.