

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of

Skyline Telecom, Inc.,

Petitioner

Requesting distribution of funds from the state universal communications services program created in RCW 80.36.650

DOCKET UT-141470

ORDER 01

ORDER GRANTING
DISTRIBUTION OF FUNDS FROM
THE STATE UNIVERSAL
SERVICE COMMUNICATIONS
PROGRAM

BACKGROUND

- 1 On May 22, 2014, the Washington Utilities and Transportation Commission (Commission) issued General Order R-575 in Docket UT-131239 amending and adopting rules in Washington Administrative Code (WAC) 480-123 to implement the state universal communications service program (State USF Program) established by the legislature.¹ The State USF Program addresses two concerns. The first is the temporary replacement support for the universal service support pool (Traditional USF) 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 Connect America Fund (CAF) Phase 1, up through and including the year for which program support is distributed.²
- 2 A company is eligible to receive distributions from the State USF Program if the company can demonstrate that absent such additional funding, its customers are at risk of rate instability, service interruptions, or cessations.³ An eligible company will receive a

¹ RCW 80.36.650, *et seq.* establishes a state universal communications services program to support small incumbent telephone companies serving high-cost rural areas of Washington. This program is a transitional program that partially offsets reductions of the small companies' intrastate terminating access revenues implemented by the Federal Communications Commission (FCC) in its order FCC 11-161. The program makes available an annual fund of up to \$5 million to provide distributions to qualifying companies and is scheduled to terminate after five years.

² WAC 480-123-120(2).

³ WAC 480-123-120(1) defines the factors the Commission will use to determine if a provider has demonstrated that its customers are at risk of rate instability, service interruptions, or cessations. To make that determination, the Commission will consider the provider's earned rate of return on a total Washington

distribution not to exceed the sum of the amount the company received from the Traditional USF for 2012 and the cumulative reduction in support the company received from the federal CAF Phase 1.

3 On May 23, 2014, the Commission terminated the Traditional USF in Docket UT-971140 and ordered WECA to cease distributing Traditional USF funds to its members effective July 1, 2014. Skyline Telecom, Inc. (Skyline or Company) 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.

4 On July 22, 2014, Skyline filed a petition to receive support from the State USF Program for 2015.

5 Staff reviewed the Company's Petition, including related work papers, and has determined that the Company meets the requirements of WAC 480-123. Staff finds that the Company's total operations rate of return is not excessive.

6 Skyline is affiliated with North-State Telephone Company (North-State) and Oregon Telephone Corporation (Oregon Telephone). Both affiliates provide incumbent local exchange telecommunications services in Oregon. The consolidated return on equity, both regulated and non-regulated, for Oregon Telephone is 38 percent for the 2013 calendar year. Although the return on equity is high, staff considered and gave weight to the following factors:

- The three operating entities are highly leveraged; their debt is held by Rural Utility Service (RUS) borrowers, and their use of funds is subject to restrictions in their RUS loan covenants. These restrictions require written authorization in advance by the majority of RUS note holders and bank note holders to loan or extend credit to an affiliated company unless it meets a minimum total asset ratio as defined in the loan covenants. Oregon Telephone does not meet the minimum total asset ratio.
- The three companies are current on both their principal and interest payments to RUS.

company books and unseparated regulated operations basis, the provider's return on equity, the status of the provider's existing debt obligations, and other relevant factors including, but not limited to, the extent to which the provider is planning or implementing operational efficiencies and 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.

- Staff has looked at a hypothetical capital structure of 50 percent debt and 50 percent equity. Using that hypothetical capital structure, Oregon Telephone's return on equity is 9 percent.

7 Skyline filed a supplement to its petition stating that the switches currently serving the Mt. Hull and Silverton exchanges have limited capabilities and the company believes both central office switches need to be replaced or significantly upgraded to ensure quality service is available to its customers. The Company also states that in order to provide acceptable levels of broadband service, both exchanges need fiber cable enhancements to remote switching modules. The project cost for Mt. Hull is \$331,000, and Silverton is \$438,000.⁴ The company plans to make these replacements over multiple years or seek additional financing to replace the facilities.

8 After reviewing the factors for eligibility, staff believes that Skyline has demonstrated that its financial circumstances place its customers at risk of rate instability. While the consolidated return on equity is high, the factors outlined above explain why the return on equity should not be preclude the company from receiving State USF Program funds during this period.

9 Skyline is only eligible to receive approximately \$50,000 in 2015 from the State USF Program. In Skyline's supplement, the company proposes to use the funds for these projects, with the monies held in a separate account. Reports would be provided to the Commission to demonstrate where the money is spent and how the money was used to help fund, at least in part, the contemplated projects.

10 Staff recommends that the Commission find the Company eligible for State USF Program support in the amount of \$ 49,581, to be distributed in January 2015.

DISCUSSION

11 We agree with Staff that the Company has demonstrated its eligibility for a distribution from the State USF Program for 2015. Even though the consolidated return on equity is high, the parent company is highly leveraged, and loan covenants would make it difficult to invest additional equity in Skyline. The Company has demonstrated that its earned rate of return on regulated operations is at a level that reflects a risk of rate instability or service cessation. It has also demonstrated that the company infrastructure requires upgrades to reduce the risk of service cessation and provide quality service. We find that a distribution in the amount of \$ 49,581 from the State USF Program is in the public

⁴ Staff followed-up with the company regarding its need to replace both switches and how additional financing would be obtained. The company met with the switch manufacturer's representatives and they believe total replacements may not be needed and the lives of the switches can be extended to offer more advanced services through upgrades. The approximate cost of the upgrades is approximately \$150,000 to \$200,000.

interest, is consistent with the purposes underlying the regulation and applicable statutes, and should be granted and distributed by January 15, 2015.

FINDINGS AND CONCLUSIONS

- 12 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington vested by statute with the authority to regulate public service companies.
- 13 (2) Skyline Telecom, Inc. is a local exchange company as defined in WAC 480-120-021 and a public service company subject to Commission jurisdiction.
- 14 (3) Skyline Telecom, Inc. has demonstrated that its total operations rate of return is not excessive.
- 15 (4) Skyline Telecom, Inc. has demonstrated that its earned rate of return on regulated operations is at a level that demonstrates a risk of rate instability or service cessation.
- 16 (5) Skyline Telecom, Inc. has demonstrated that its infrastructure requires upgrades to reduce the risk of service cessation and ensure reliable quality service is maintained.
- 17 (6) Skyline Telecom, Inc. is eligible to receive funding from the State USF Program in the amount of \$ 49,581, and the funds will be disbursed by January 15, 2015.
- 18 (7) Skyline Telecom, Inc. is required to deposit funds from the State USF Program in a separate account dedicated to the described projects and provide an accounting of such funds by July 1, 2015, and January 31, 2016.

ORDER

THE COMMISSION ORDERS:

- 19 (1) Skyline Telecom, Inc.'s request for funds from the State USF Program for 2015 in the amount of \$ 49,581 is granted, and the funds will be disbursed by January 15, 2015.

- 20 (2) Skyline Telecom, Inc. is required to deposit funds from the State USF Program in a separate account dedicated to the described projects and provide an accounting of such funds by July 1, 2015, and January 31, 2016.
- 21 (3) The Commission retains jurisdiction over this matter for purposes of effectuating this order.

DATED at Olympia, Washington and effective December 11, 2014.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

PHILIP B. JONES, Commissioner

JEFFREY D. GOLTZ, Commissioner