Agenda Date: November 8, 2018
Item Numbers: A1 through A15

Dockets:

UT 180642,	**UT 180643,**	**UT 180645,**	**UT 180646**
UT 180649,	**UT 180650,**	**UT 180651,**	**UT 180655**
UT 180656,	**UT 180658,**	**UT 180659,**	**UT 180660**
UT 180661,	**UT 180665,**	**UT 180670**	

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

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

Recommendation

Issue an order granting the fund distribution of $3,828,053 no later than December 21, 2018, from the state universal communications services program (State USF) in the amounts shown to companies listed in Attachment 1. The total distributed amount equals the amount of support that each company received from the 2012 state Traditional Universal Service Fund (TUSF) pool and the annualized cumulative reduction in support received from the federal Connect America Fund Intercarrier Compensation (CAF-ICC) mechanism.

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 small incumbent Class B telephone companies[1] 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 these companies as a result of discontinuing TUSF and the Federal Communications Commission (FCC) order FCC 11-161, commonly known as the FCC's USF/ICC Transformation Order.[2] This is the fifth and final year of the State USF program. The commission may distribute up to $5 million annually (less commission administrative costs) to qualifying companies during each year of this transitional period.

[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 Dock et 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*).

The State USF program addresses two concerns. The first, is temporary replacement support for the state TUSF pool eliminated effective July 1, 2014. The second, is replacing the annualized cumulative reduction in support the company previously received from the federal CAF-ICC mechanism 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.

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; and

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

Each petitioning company meets the prerequisites for requesting program support and as such, filed a petition in accordance with State USF program rules. Staff reviewed 2016 and 2017 financial data filed by each company. The submitted information was reconciled to the balance sheet and income statement from the Rural Utilities Service (RUS) Form 479 which is filed annually with the FCC on Form 481.[5] Staff also reviewed each company’s current circumstances with respect to the status of existing debt obligations.

In our analysis, staff took into consideration each company’s 2017 total Washington earned ROR based on its regulated operation and the consolidated ROE, which consists of both regulated and nonregulated operations.

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

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

[5] 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:

The commission previously accepted a 10 percent ROR as a benchmark for the purpose of granting distribution of funds from the State USF program. This benchmark is used as a threshold test to assess the relative earning levels of the petitioning companies. The 10 percent ROR is still lower than the FCC's blended 10.875 percent ROR[6] for the 2017 calendar year.

Staff considered the "Tax Cuts and Jobs Act" (TCJA)[7] impact in our analysis. If our analysis included the impact, some of the companies' ROR would increase over the 10 percent benchmark.[8] However, staff believes that it is not appropriate to include such an impact in the ROR calculation, because:

A. Previous USF analysis under this program has utilized a historical test year which has been the previous calender year. When appropriate, staff applies restatement adjustments to ensure the ROR is calculated using the test year's actual revenue and expense. The commission has accepted this approach since the program started in 2014; and

B. The FCC requires regulated companies to use the IRS's normalization method and flow back the excess deferred tax reserve over the remaining life of the plant that gave rise to the excess. Normalization of the tax impact will not commence until 2018. Please see NECA letter (Attachment 2) that requires regulated telecom companies to implement the FCC requirements.

Return on Equity Analysis:

Staff calculated each company's booked ROE using audited or certified public accountant reviewed financial statements or books. The ROE analysis enables the commission to consider the overall health of the company (i.e., regulated and nonregulated operations) before allowing the company to participate the in the State USF program. The booked returns on equity for the 15 petitioning companies identified in Attachment 1 have an ROE[9] ranging from 14.4 percent to (15.9) percent[10]. Each company's consolidated ROE is not excessive.

[6] On March 30, 2016, the FCC released the Rate-of-Return Reform Order which implemented a transitional approach to reducing the 11.25 (set in 1990) percent rate of return. Effective July 1, 2016, the authorized rate of return was reduced to 11.00 and then was further reduced to 10.75 percent effective July 1, 2017. This rate will continue to be reduced 25 basis points each July 1 until reaching 9.75 percent on July 1, 2021. *Connect America Fund et al.,*WC Docket Nos 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, Report and Order, Order and Order on Reconsiderations, and Further Notice of Proposed Rulemaking, FCC 16-33 (rel. Mar. 30. 2016).
[7] TCJA was signed into law on December 22, 2017.
[8] For most petitioning companies, the TCJA decreased federal income tax expense and accumulated deferred income tax which increased the ROR.
[9] ROE is considered a GAAP measurement and the impact of the TCJA corporate tax rate reduction is reflected in the ROE which in most cases increased the ROE.
[10] The 14.4 percent ROE for one company, is driven by its highly-leveraged capital structure. The next highest ROE is 10.9 percent.

III. Conclusion

Based on staff's review and analysis, staff has determined that all 15 petitioning companies, meet the requirements of the State USF program in WAC 480-123. Accordingly, staff concludes and recommends granting the fund distribution of $3,828,053 no later than December 21, 2018, from the state universal communications services program (State USF) in the amounts shown in Attachment 1.

Attachments (2)