

**BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

In the Matter of

Rulemaking to consider amending and adopting rules in WAC 480-120, telephone companies, and WAC 480-123, universal service, to implement legislation establishing a state universal communications service program.

Docket No. UT-131239

**REPLY COMMENTS
OF
THE WASHINGTON INDEPENDENT
TELECOMMUNICATIONS ASSOCIATION:
DATA PRESENTATION
AND RECOMMENDATION**

September 4, 2013

INTRODUCTION

The Washington Independent Telephone Association ("WITA") stated in its earlier comments that it would provide data in support of its recommendations to the Commission. That is the purpose of this set of Reply Comments. In addition, these Reply Comments provide a refined recommendation on the operation of the new state universal service fund.

In creating the new Washington universal service fund, the Legislature expressed a deep concern that the fund was needed to address potential rate instability and cessation of service concerns.¹ Specifically, the Legislature stated:

The state has long relied on incumbent local exchange carriers to provide a ubiquitous incumbent public network as carriers of last resort. Significant changes are occurring in the communications marketplace These changes are adversely affecting the ability of some communications providers to continue to offer communications services in rural areas of the state of Washington at rates that are comparable to those prevailing in urban areas. These changes, absent explicit federal and state universal service support for such communications providers, may lead, in the short term, to unreasonable telephone service rate increases or cessation of service for some Washington consumers. Therefore, it is in the best interest of the state to ensure that incumbent local exchange carriers are able to continue to provide services as the carrier of last resort.

The presentation that follows will demonstrate that the Legislature's concern is well founded.

RECOMMENDATION

To address the concerns about potential rate instability and possible interruption or cessation of service,² WITA recommends that the Commission adopt an approach to the state universal service fund that takes the following three steps:

(1) First, replace on a dollar-for-dollar basis what each eligible company is receiving from what has been called the "traditional USF." This is a revenue neutral step and addresses possible rate

¹ See, ESSB 1971, Section 201.

² See, ESSB 1971, Section 203(3)(b)

instability or cessation of service by making it certain that this revenue stream will continue to go to the eligible companies and not erode as access minutes decrease.

(2) Second, replace the CAF reductions,³ which are the reductions in intercarrier support (largely access related) that the Federal Communications Commission has instituted. This step addresses rate instability by not making the financial status of the rural carriers even worse as years pass by.

(3) Third, address, in part, the possible rate instability or interruption or cessation of service through a stratified approach of replacing lost access revenue.

As contemplated by WITA, a stratified approach uses distribution ratios predicated on each company's Commission approved "revenue objectives" in the Washington Exchange Carrier Association ("WECA") pooling process, stratified by regulated rate-of-return results. This third step is not to be taken as advocating for a "make whole" type of approach. Indeed, the size of the new state universal service fund is insufficient to "make whole" a reasonable rate-of-return.

What the use of a stratified step accomplishes is to recognize that because of call termination and access bypass issues eligible companies have been placed in precarious financial condition over the past few years. Using the stratified approach recognizes the inverse relationship that the less a company is earning, the more likely it is that there will be rate instability or service interruption or cessation. In other words, this is the logical connection that, for example, when a company is earning a negative rate-of-return, it is more likely that its customers will face rate instability or service cessation or interruption than a company that has a positive rate-of-return. And, that a company with a low positive rate-of-return is more likely to see its customers encounter these problems than a company with a high rate-of-return. The discussion below will provide more details surrounding this concept.

³ CAF stands for "Connect America Fund." It is the mechanism created by the Federal Communications Commission as a component of "glide path" to a zero terminating intercarrier compensation rate. The mechanism calls for the prior years CAF support to be reduced by five percent each year.

DISCUSSION

1. The potential for rate instability or interruption or cessation of service exists.

The Legislature correctly recognized that there is a potential for rate instability in rural service areas. Set out below as Table 1 is a depiction of potential local rate increases needed to bring rural companies up to the current authorized rate-of-return of 11.25 percent.⁴

Table 1

Company	Cat. 1.3 Working Loops*	ROR %	Required to Reach 11.25% ROR (\$)	Monthly Local Rate Increase Needed (\$)
Asotin	1,121	0.57%	444,329	33.03
Ellensburg	15,517	4.40%	1,490,987	8.01
Hat Island	75	-3.96%	43,971	48.86
Hood Canal	996	-83.89%	1,024,817	85.74
Inland	2,465	3.11%	1,103,939	37.32
Kalama	2,534	-9.98%	1,292,381	42.50
Lewis River	5,045	-1.56%	1,253,471	20.70
McDaniel	3,697	1.47%	1,020,059	22.99
Pend Oreille	1,772	-4.14%	578,444	27.20
Pioneer	708	2.08%	1,073,558	126.36
Rainier Connect	3,212	-40.73%	1,976,225	51.27
Skyline	171	4.71%	290,682	141.66
St. John	591	7.35%	1,223,603	172.53
Tenino	3,071	-10.70%	1,462,484	39.69
Toledo	1,949	1.91%	1,557,782	66.61
Wahkiakum	1,065	0.99%	1,040,807	81.44
Whidbey	11,024	-4.60%	8,159,340	61.68
YCOM	8,833	-0.68%	1,542,477	14.55
TOTAL	63,846	-2.21%	26,579,349	34.69

*Year End 2011. The 2012 year end Cat. 1.3 Working Loops will be publicly available October 1, 2013. It is expected that the loop count will be lower, so that the Monthly Local Rate Increase will be higher. In addition, since Cat. 1.3 Working Loops include official lines, these results understate the actual effect on local rates.

⁴ The 11.25% rate-of-return is the federal rate-of-return for the NECA Pool and is the standard this Commission adopted for purposes of WAC 480-120-339.

The rate-of-return numbers and the amounts required to reach 11.25% ROR (columns C and D) are derived from the RLEC Model, Attachment 2, developed by Commission Staff.⁵ The RLEC Model, Attachment 2, was populated with 2012 data. Thus, this represents the most current view of each company's twelve month financial results from its regulated operations.⁶ There are two items to note. First, nine of the eighteen companies have net operating losses. Second, the aggregate return for all eighteen companies is a negative 2.21 percent.

To test what happens under a different rate-of-return, for the companies listed in Table 1, the aggregate rate base, calculated from the RLEC Model, Attachment 2, results for each company, is \$91,217,013. Applying a one percent factor to this aggregate rate base is equivalent to \$912,170.13. This means that even if the allowed rate-of-return is reduced to an eight to nine percent range, the potential for rate instability remains very high. For example, approximately 24 million dollars is needed at a nine percent allowed rate-of-return and more than 23 million dollars is needed at an eight percent allowed rate-of-return. Please note that these figures do not take into account the on-going CAF reductions that have occurred and will continue to occur.⁷

When reduction in CAF support is taken into account, the needed revenues are even greater and the potential for local rate increase and rate instability rise. Table 2, set out on the next page, depicts the local monthly rate increases when CAF reductions are taken into account.

⁵ Please note that these numbers have not been adjusted for proforma or restating adjustments. For example, several of the companies have increased their residential rates due to the "urban rate floor" requirements of the FCC. To illustrate, Kalama's residential rate increased from \$12 per month to \$14 per month on May1, 2013. Kalama had 1,804 residential lines at that time. This would produce a proforma adjustment of \$43,296 ($\$2 \times 12 \times 1804$). This amount could be offset by other factors such as the CAF reductions. However, even if it is not offset, the effect in Table 1 is to reduce the monthly rate increase to \$41.08, which is still an unacceptable level. The basic point about the potential of rate instability does not change. The results can be expected to be similar for the other companies.

⁶ A gross-up multiplier of 1.5 was used for the effect of federal income tax. This multiplier was used for simplicity and probably slightly understates the effect of federal income tax. The actual formula for this factor is $1/(1-x)$ where "x" is the company's actual tax rate. Gross receipts tax has not been included in the multiplier for this illustration.

⁷ The 2012 financial results do recognize the first six months of the first step of CAF reduction, but not the entire amount.

Table 2

Company	Cat. 1.3 Working Loops*	ROR %	Required to Reach 11.25% ROR (\$)	CAF Reduction (\$)**	2014 CAF Reduction (\$)	Monthly Local Rate Increase Needed (\$)
Asotin	1,121	0.57%	444,329	21,688	10,338	35.41
Ellensburg	15,517	4.40%	1,490,987	214,057	99,070	9.69
Hat Island	75	-3.96%	43,971	390	181	49.49
Hood Canal	996	-83.89%	1,024,817	40,890	18,925	90.75
Inland	2,465	3.11%	1,103,939	119,273	55,202	43.22
Kalama	2,534	-9.98%	1,292,381	72,806	33,696	46.00
Lewis River	5,045	-1.56%	1,253,471	51,351	23,766	21.95
McDaniel	3,697	1.47%	1,020,059	70,295	32,534	25.31
Pend Oreille	1,772	-4.14%	578,444	105,686	48,914	34.47
Pioneer	708	2.08%	1,073,558	44,300	20,503	133.99
Rainier Connect	3,212	-40.73%	1,976,225	47,973	22,203	53.09
Skyline	171	4.71%	290,682	33,894	15,687	165.82
St. John	591	7.35%	1,223,603	25,089	11,612	177.71
Tenino	3,071	-10.70%	1,462,484	71,031	32,875	42.50
Toledo	1,949	1.91%	1,557,782	86,377	39,977	72.01
Wahkiakum	1,065	0.99%	1,040,807	75,264	29,050	89.60
Whidbey	11,024	-4.60%	8,159,340	232,337	107,530	64.25
YCOM	8,833	-0.68%	1,542,477	105,722	48,930	16.01
TOTAL	63,846	-2.21%	26,579,349	1,418,423	650,993	37.39

*Year End 2011. The 2012 year end Cat. 1.3 Working Loops will be publicly available October 1, 2013.

** 2012 and 2013 combined reduction. Both this column and the 2014 CAF Reduction Column are based on NECA Report 2013 ICC CAF Data Collection for each company.

As a result, the potential increase in the monthly residential rate is higher than anyone would reasonably expect to pay.

Table 3 sets out what each company's residential rate is today compared to what the potential residential rate would be without support. Table 3 is set out on the next page.

Table 3

Company	Existing Residential Rate*	Potential Residential Rate*
Asotin-Asotin	\$16.20	\$51.61
Anatone	\$14.00	\$49.41
Ellensburg	\$14.00	\$23.69
Hat Island	\$15.00	\$64.49
Hood Canal	\$14.00	\$104.75
Inland-Dewatto	\$22.00	\$65.22
Prescott	\$16.50	\$59.72
Roslyn	\$14.00	\$57.22
Uniontown	\$15.00	\$58.22
Kalama	\$14.00	\$60.00
Lewis River	\$26.00**	\$47.95**
McDaniel	\$14.30	\$39.61
Pend Oreille	\$14.00	\$48.47
Pioneer	\$14.00	\$147.99
Rainier Connect	\$14.00	\$67.09
Skyline	\$19.50	\$185.32
St. John	\$14.00	\$191.71
Tenino	\$14.00	\$56.50
Toledo	\$21.00***	\$93.01***
Wahkiakum	\$14.00	\$103.60
Whidbey	\$14.00	\$78.25
YCOM	\$16.00	\$32.01

*Does not include the Subscriber Line Charge, E-911 assessment or sales tax.

** Based on flat rate extended area service (EAS)

*** Assumes one EAS route.

These local service rates are not sustainable. The case for universal service support is clear. The Legislature's concern about unreasonable local rate increases is well founded.

In addition to pointing out the potential for rate instability, these numbers also demonstrate the potential for interruption or cessation of service. In many cases, the monthly rate set out above would lead to a situation where the customers would likely stop using telephone service as unaffordable. This could lead to a spiral that, in turn, could result in a company being financially unable to meet its carrier of last resort obligations, and may not even

be able to stay in business.

(2) Access bypass and call termination issues have endangered the ability of rural incumbent local exchange carriers to fulfill carrier of last resort obligations.

In the past, the rural companies have each enjoyed a stellar reputation for providing excellent service. Indeed, this ability to provide excellent service is an important aspect of what has set them apart. Even though the rural companies still provide excellent service, their reputations have been tarnished; perhaps irreversibly. This damage has been caused by the interexchange carriers and their subcontractors engaging in what is known as "least cost routing." What has happened, as is well documented, is that call completion problems have been on the rise over the past several years.⁸ Despite action by the Federal Communications Commission on the subject,⁹ the problem continues without signs of significant relief.

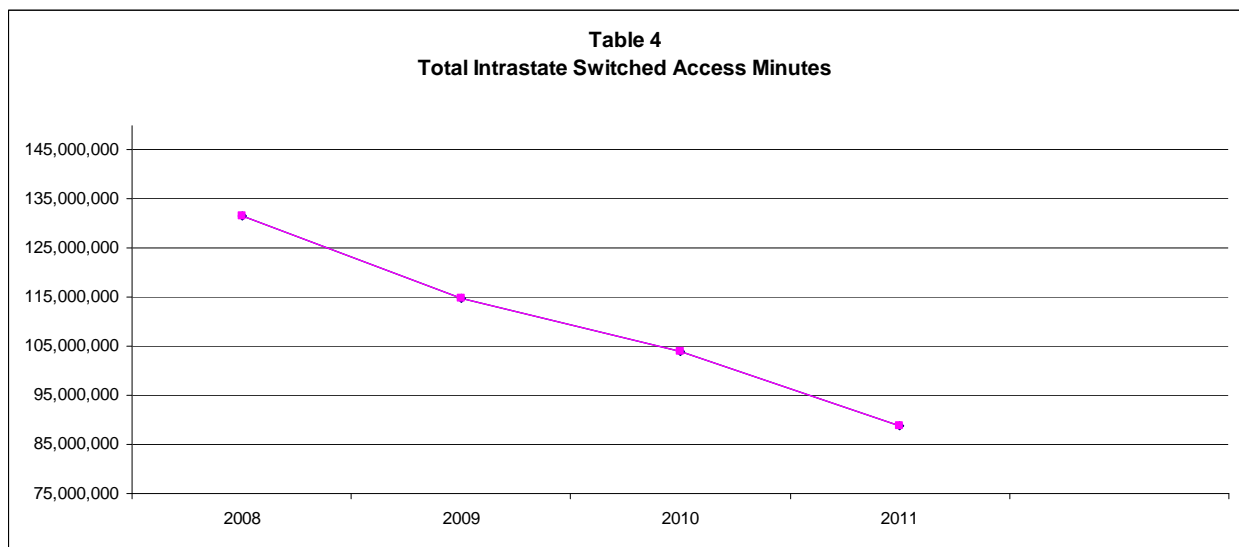
Even though the call termination problem is correctly recognized as a form of access avoidance actively pursued by the least cost routers trying to avoid access charges, the problem is perceived by customers as the local company's inability to complete calls to them. As a result, some customers have actually discontinued service in favor of often spotty wireless service or inferior VoIP based service. The reason is that the wireless service and VoIP service are not perceived to have the same type of problem.

In addition to the damage to rural carriers' reputations, call termination and other forms of

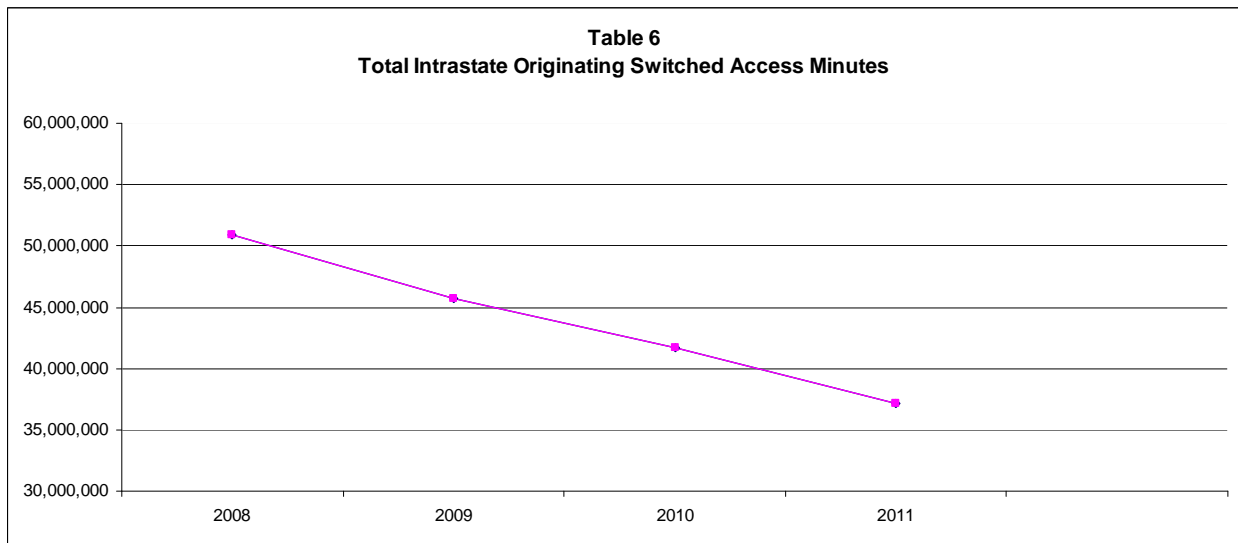
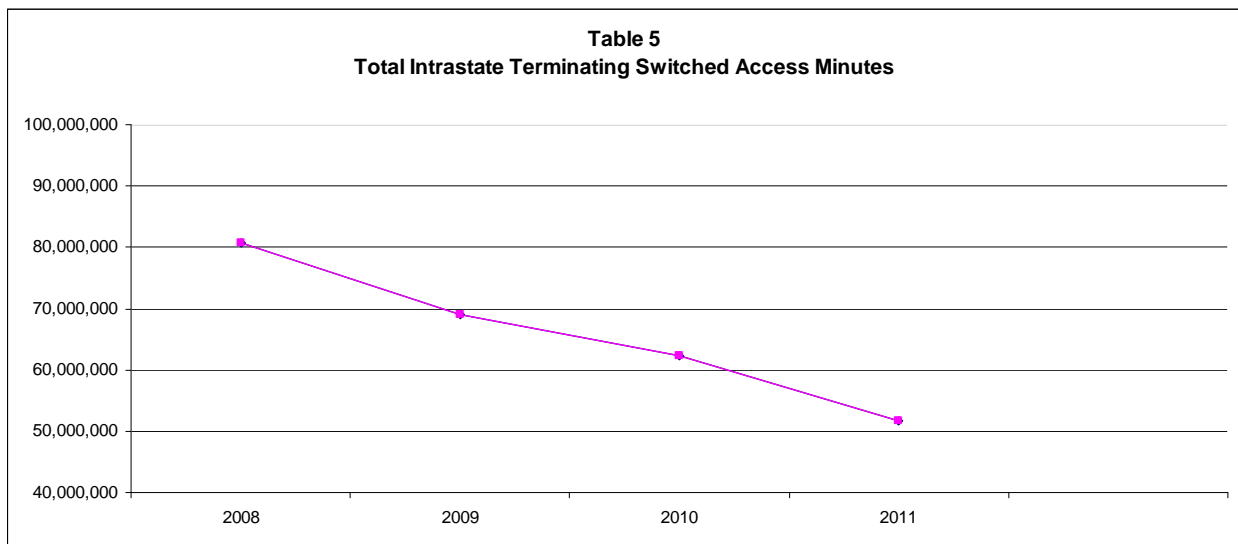
⁸ See, *In the Matter of Rural Call Completion, Notice of Proposed Rulemaking*, WC Docket No. 13-39, FCC 13-18, (Rel. Feb. 7, 2013). Comments of Colorado Telecommunications Association, Idaho Telecom Alliance, Montana Telecommunications Association, Oklahoma Telephone Association, Oregon Telecommunications Association, Washington Independent Telecommunications Association.

⁹ See, *In the Matter of Developing an Unified Inter-carrier Compensation Regime, Establishing Just and Reasonable Rates for Local Exchange Carriers*, CC Docket No. 01-92, WC Docket No. 07-135, *Declaratory Ruling*, DA 12-154 (Rel. Feb. 6, 2012).

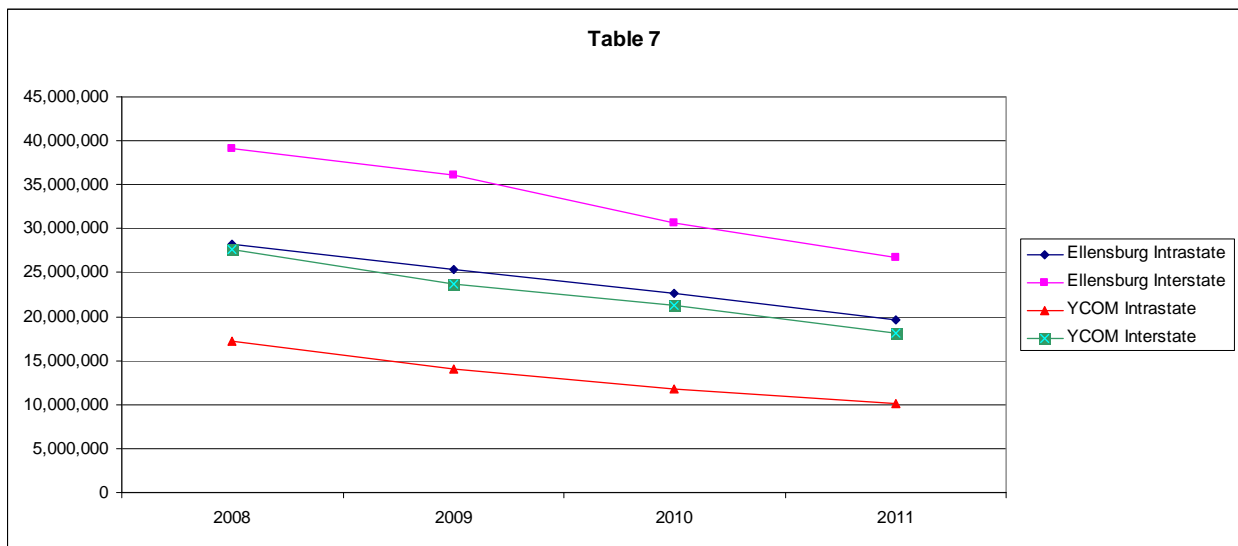
access bypass have substantially eroded access revenues. Access revenues have been an important source of financial support for the public switched telecommunications network and carrier of last resort obligations. This erosion can be most clearly seen by looking at what has happened to intrastate access minutes over the past few years. Set out below in Tables 4, 5 and 6 are the access minutes as reported to the Washington Exchange Carriers Association ("WECA") beginning with 2008.¹⁰ The first table is total intrastate switched access minutes. The second table shows intrastate terminating switched access minutes. The third table demonstrates what has occurred with intrastate originating switched access minutes. As demonstrated by these tables, the intrastate switched access minutes have been decreasing at a substantial rate. This means the revenues have also been decreasing.



¹⁰ For the years in which CenturyLink participated in the WECA pools, the numbers have been adjusted to remove the minutes associated with CenturyLink. Therefore, these tables show what has happened to the eighteen rural carriers that are listed in Table 1.



WITA also reviewed interstate switched access minutes to be sure that this intrastate access minute decline was not just a transition of intrastate minutes to interstate minutes. To do so, WITA asked the companies to report their interstate patterns as well. From the data provided, it does not appear that there has been a substitution of interstate minutes for intrastate minutes. In fact, there have been substantial reductions in interstate minutes as well. As an example, Table 7 sets out the interstate minutes for Ellensburg and YCOM, which show a combined reduction in billable access minutes - both interstate and intrastate.



Therefore, it is clear that intrastate access minutes have declined due to aggressive bypass activity. It is not a jurisdictional shift.

In Washington, intrastate switched access charges consist of two sets of elements. One set was intended to recover non-traffic sensitive costs. The other set was intended to recover what was viewed as traffic sensitive costs. The revenues from non-traffic sensitive charges are pooled through the WECA process. The traffic sensitive charges are company specific and are handled by each company on a stand-alone basis. For many of the companies that are set out on Table 1, the traffic sensitive charges constitute the majority of the charges that would be assessed on each access minute. For example, in 2010 the WECA terminating rate for non-traffic sensitive charges, known in the past as the carrier common line charge and more recently as the interim universal service charge, was \$0.05791. This compares to the 2010 composite intrastate, terminating traffic sensitive rate for Hood Canal, for example, of \$0.088979 per access minute. For some companies, the split is about even. An example is The Toledo Telephone Co., Inc. which had a composite terminating intrastate traffic sensitive switched access rate in 2010 of \$0.059843.

Looking at the results for the WECA pool, the revenues from for the non-traffic sensitive access charges for the eighteen companies listed on Table 1 declined from \$5,815,852 in 2007 to \$3,109,726 in 2010, a loss of \$2,706,126. This means that conservatively, the overall loss in access revenue to the eighteen companies listed on Table 1 was in the neighborhood of 5.4 million dollars over just this short period of time. This alone is greater than the 5 million dollar size of the new state universal service fund.

As a note, the reason the time period of 2007 to 2010 is chosen is that the baseline period for CAF calculations begins October 1, 2010 and extends through September 30, 2011 and then CAF recovery began in 2012. The size of the access loss from 2007 to 2010 demonstrates that any recovery for access reduction from the state universal service fund would not be a duplication of recovery through the CAF, given the amounts involved.

(3) Application of WITA's recommendation.

As set forth above, WITA's recommendation is that under the new Washington universal service fund each eligible carrier's distribution be calculated in three steps. The first step is the replacement of the traditional universal service revenue. The second step is the replacement of the CAF reductions, which are intercarrier compensation revenues reduced by actions of the Federal Communications Commission. The third step is to utilize a stratified approach based upon rate-of-return factors for the loss of access minutes of use that has occurred in recent years. The stratified approach recognizes that there is an increasing risk for rate instability or interruption or cessation of service associated with the increase in the difficulty of the financial condition faced by the rural company.

In the tables that follow, WITA is proposing stratification criteria that would weight a

negative rate-of-return with 100%; a 0-5% rate-of-return at 50%; a rate-of-return of more than 5%, but less than 11.25%, at 25%; and, a 0% factor for an 11.25% or greater rate-of-return. It should be noted that based on 2012 data there is no company listed on Table 1 that is over 11.25% rate-of-return. In fact, the highest three earned rates-of-return are 7.46%, 4.71% and 4.4%. These eighteen companies are not companies that are over-earning.

Table 8 sets out the calculation of the distribution ratio. The calculation of the distribution ratio is based on the Commission approved revenue objectives used in the WECA pooling process other than the originating carrier common line revenue objective. Thus, there are two revenue objectives that are used: the traditional USF revenue objective and the interim USF revenue objective. The 2010 revenue objectives are used, which are based on 2007 revenues. This is chosen to be consistent with the calculation of lost access revenues, discussed above. Both of these revenue objectives have been approved by the Commission. Table 8 is set out on the next page.

Table 8

Company	Stratification	WECA Revenue Objectives (\$)*	Distribution Ratio
Asotin	0.5	77,150	0.012320
Ellensburg	0.5	567,430	0.090615
Hat Island	1	9,082	0.001450
Hood Canal	1	161,020	0.025714
Inland	0.5	171,195	0.027339
Kalama	1	293,802	0.046918
Lewis River	1	326,556	0.052149
McDaniel	0.5	157,933	0.025221
Pend Oreille	1	312,122	0.049844
Pioneer	0.5	58,646	0.009365
Rainier Connect	1	356,831	0.056984
Skyline	0.5	52,523	0.008388
St. John	0.25	19,241	0.003073
Tenino	1	521,341	0.083255
Toledo	0.5	247,900	0.039588
Wahkiakum	0.5	226,721	0.036206
Whidbey	1	1,761,317	0.281271
YCOM	1	941,191	0.150302
TOTAL	N/A	6,262,001	1.000002

*After stratification is applied. The overall revenue objective before stratification was \$7,879,218. These are the WECA traditional USF and interim USF revenue objectives.

Given the cap on the size of the fund, there has been far more access loss than can be accommodated in step three. As noted above, the access loss is conservatively estimated to be in the range of 5.4 million dollars. Therefore, the distribution ratio is applied to the net available funds in the state universal service fund, not the entire access revenue loss. WITA calculates that for the first year of the fund, after following the first two steps of WITA's recommendation (replacement of traditional USF support and replacement of CAF reductions), there will be \$1,700,651 in state universal service funds available. The distribution ratio is applied to that amount and the resulting distributions are calculated on that basis.

Table 9 sets out what the projected universal service support distribution would be under WITA's recommended approach. This is offered as an illustration since the final 2012 distributions of the traditional USF have not been calculated yet as the processing of pool adjustments for 2012 has not been completed. Again, the three steps of the recommendation are as follows: (1) replace Traditional USF support dollar for dollar; (2) replace CAF reductions; and (3) replace lost access revenue on a stratified basis.

Table 9

Company	Traditional USF Support (\$)*	CAF Reduction (\$)**	2014 CAF Reduction (\$)	Lost Access Revenue (\$)***	Washington USF Support (\$)
Asotin	60,030	21,688	10,338	20,952	113,008
Ellensburg	0	214,057	99,070	154,104	467,231
Hat Island	2,081	390	181	2,466	5,118
Hood Canal	40,420	40,890	18,925	43,731	143,966
Inland	81,899	119,273	55,202	46,494	302,868
Kalama	81,383	72,806	33,696	79,791	267,676
Lewis River	4,839	51,351	23,766	88,687	168,643
McDaniel	81,497	70,295	32,534	42,892	227,218
Pend Oreille	0	105,686	48,914	84,767	239,367
Pioneer	15,477	44,300	20,503	15,927	96,207
Rainier Connect	70,867	47,973	22,203	96,910	237,953
Skyline	0	33,894	15,687	14,265	63,846
St. John	4,690	25,089	11,612	5,226	46,617
Tenino	78,182	71,031	32,875	141,588	323,676
Toledo	118,099	86,377	39,977	67,325	311,778
Wahkiakum	146,630	75,264	29,050	61,574	312,518
Whidbey	314,133	232,337	107,530	478,344	1,132,344
YCOM	82,706	105,722	48,930	255,611	492,969
TOTAL	1,182,933	1,418,423	650,993	1,700,654	4,953,003

* Calendar Year 2012. Taken from records of the Washington Exchange Carrier Association. Subject to true-up.

** 2012 and 2013 combined reduction - taken from NECA reports for each company.

***Calculated from Table 8 - each company's distribution ratio x \$1,700,651.

For illustration purposes, Table 10 shows what happens as CAF reductions grow. On Table 10 is a possible set of distributions for the fund year beginning July, 2015, following the three step recommendation. The result demonstrated on Table 10 is that as CAF reductions grow, there is less coverage of lost access revenues.

Table 10

Company	Traditional USF Support (\$)*	CAF Reduction (\$)**	2014 CAF Reduction (\$)	2015 CAF Reduction (\$)	Lost Access Revenue (\$)***	Washington USF Support (\$)
Asotin	60,030	21,688	10,338	9,821	13,333	115,210
Ellensburg	0	214,057	99,070	94,117	98,064	505,308
Hat Island	2,081	390	181	172	1,569	4,393
Hood Canal	40,420	40,890	18,925	17,979	27,828	146,042
Inland	81,899	119,273	55,202	52,442	29,586	338,402
Kalama	81,383	72,806	33,696	32,011	50,775	270,671
Lewis River	4,839	51,351	23,766	22,578	56,436	158,970
McDaniel	81,497	70,295	32,534	30,907	27,294	242,528
Pend Oreille	0	105,686	48,914	46,468	53,942	255,010
Pioneer	15,477	44,300	20,503	19,478	10,135	109,893
Rainier Connect	70,867	47,973	22,203	21,093	61,669	223,804
Skyline	0	33,894	15,687	14,903	9,078	73,561
St. John	4,690	25,089	11,612	11,031	3,326	55,748
Tenino	78,182	71,031	32,875	31,231	90,099	303,418
Toledo	118,099	86,377	39,977	37,978	42,842	325,274
Wahkiakum	146,630	75,264	29,050	27,598	39,182	317,724
Whidbey	314,133	232,337	107,530	102,154	304,394	1,060,547
YCOM	82,706	105,722	48,930	46,484	162,658	446,500
TOTAL	1,182,933	1,418,423	650,993	618,443	1,082,210	4,953,003

* Calendar Year 2012. From WECA records

** 2012 and 2013 combined reduction - taken from NECA reports for each company.


***Calculated from Table 8 - each company's distribution ratio x \$1,082,208.

CONCLUSION

WITA respectfully requests that the Commission adopt the methodology and recommendations that have been set forth in these Reply Comments or some variation thereof that closely resembles WITA's recommendations. WITA believes that such steps are necessary in order to meet the legislative goal of avoiding rate instability or interruptions or cessations of service.

Respectfully submitted this 4th day of September, 2013.

WASHINGTON INDEPENDENT
TELECOMMUNICATIONS ASSOCIATION

By: 
Betty S. Buckley, Executive Director