Agenda Date: November 13, 2015
Item Number: A19

Docket: UT-151521

Company Name: Western Wahkiakum County Telephone Company

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

Recommendation

Issue an order to grant the distribution of funds no later than December 28, 2015, to Western Wahkiakum County Telephone Company (Western Wahkiakum or company) from the state universal communications services program (State USF Program). The distribution of funds of $233,070[1] includes the amount previously 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. The commission should also require Western Wahkiakum to deposit funds from the State USF Program in a specific account and provide an accounting of these funds by July 1, 2016 and January 1, 2017.

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[2] 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 Federal Communication Commission's (FCC) Order 11-161, commonly known as the FCC's USF/ICC Transformation Order.[3] This is the second year of the five year State USF Program and the commission may distribute up to $5 million annually (less commission administrative costs) to qualifying companies during each year of this transitional period.

[1] The Universal Service Administrative Company (USAC) made an adjustment in 2015 to the company's CAF baseline revenue which reduced the original calculated State USF program support for this year from $286,197 to $256,163 and would be further reduced $23,093 for an overpayment from last year attributed to the USAC adjustment resulting in a net distribution for this period of $233,070.

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

[3] *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*).

The State USF Program addresses two concerns. The first is the temporary replacement support for the TUSF pool eliminated July 1, 2014. The second is replacing the annualized cumulative reduction in support the company previously received from the federal CAFF-ICC mechanism up through and including the year for which program support is distributed.[4]

II. Discussion

Western Wahkiakum filed its petition, including financial information, on or before August 1 and meets the prerequisites for requesting program support and petition requirements in accordance with State USF Program rules. If the petition is granted, the company is eligible to receive disbursements from the fund for the discontinued TUSF pool support, the cumulative annualized reduction in support the company received from the federal CAF-ICC mechanism up through and including the year for which program support is distributed

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 (ROR) 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 operational 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.[5]

Staff used a total Washington earned ROR of 10.00 percent as a threshold test to assess the relative earning levels of the petitioning companies in order to evaluate and make eligibility recommendations. If a company's ROR is greater than 10.00 percent staff also considered the other State USF program factors. It is important to note that the FCC's current 11.25 percent

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

authorized ROR was last set in 1990[6] when it was reduced from 12.00 percent. The FCC's currently allowed ROR of 11.25 percent is pending review by the FCC.[7]

Absent an FCC decision, staff also compared the yield rates of 1990 and 2014 for the following debt instruments to establish reference points that an ROR of 10.00 percent is reasonable:

- The annual yield of 10-year U.S. Treasury securities decreased from 8.55 percent to 2.54 percent.

- Moody's yield on all industry corporate bonds rated AAA decreased from 9.32 percent to 4.16 percent.

- Moody's yield on all industry corporate bonds rated BAA changed from 10.36 percent to 4.85 percent.[8]

Staff reviewed the financial results included in the petition and found that the company's Washington 2014 total operations ROR was 10.4 percent. This is slightly higher than 10 percent but lower than the FCC's current 11.25 percent authorized rate. A corporate operations adjustment of $65,000 was made by the FCC for high-cost loop and interstate common line support mechanisms which staff adopted in calculating the company's ROR.

Staff considered the second and third factors by reviewing the company's audited financial statements. Based on the capital structure and staff calculation of return on equity (ROE), staff finds that the ROE is not excessive. The company's long-term obligations are at a low interest rate[9] and the company has access to additional low cost of debt.[10]

Staff reviewed the business plan modifications which will transition the company from voice telephone to broadband service. The company made investments in regulated plant of $4.2 million for the four year period 2011 – 2014 of which $2.7 million occurred in 2014 and is primarily for fiber to the premise construction. The investment made in 2014 represented approximately 15 percent of the company's 2013 regulated plant-in-service balance. This investment will enhance the reliability, speed and capacity of the company's broadband service as well as its telephone service offerings.

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[6] *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990)

[7] *Prescribing the Authorized Rate of Return, Wireline Competition Bureau Staff Report*, DA 13-1111, May 16, 2013, concludes that the commission should consider establishing the authorized rate of return between 8.06 percent and 8.72 percent.

[8] Source: Federal Reserve Board: H 15 Release – Selected Interest Rates – Historical Data; http://www.federalreserve.gov/releases/h15/data.htm

[9] Staff calculated a rate of 2.4 percent by taking the 12/31/2013 and 12/31/2014 balances for Current Maturities and Long-Term Debt to create an average balance for 2014 and divided 2014 fixed charge expense by the average balance.

[10] The company has access to $10.1 million for future borrowing from the Federal Financing Bank, Per Western Wahkiakum County Telephone Company audited financial statements for 2014 and 2013, Note 5.

Although the company's adjusted Washington ROR is 10.4 percent which is slightly over than the staff's recommended threshold of 10 percent, staff's analysis and recommendation took into consideration the company's business plan and capital investment program which will promote broadband services. Capital expenditures of $2.7 million in 2014 and $4.2 million for the four year period 2011 – 2014 is a significant investment for a company with approximately 1,000 access lines. Staff believes that granting the support from State USF will continue to promote the company's plan and investment in broadband service that benefit its customers.

III. Conclusion

Staff concludes that Western Wahkiakum receive State USF Program support of $233,070 which include an adjustment for last year's over payment of $23,093. The commission should also require West Wahkiakum to deposit funds from the State USF Program in a specific account dedicated to projects for operating efficiencies or the transition from the primary provision of legacy voice to broadband service. The company is also required to provide an accounting of these funds by July 1, 2016, and January 1, 2017.