Date: September 28, 2016

To: The Public Service Commission of Utah

From: Division of Public Utilities
Chris Parker, Director
William Duncan, Manager, Telecommunications

RE: Docket 16-R360-01 Response to Action Request dated 6/30/2016
DPU Audit of Utah Rural Telephone Companies receiving Utah USF

In June, 2016, several rural Utah telephone companies filed new tariffs increasing their residential access line rate to $18.00 per month. These filings were completed pursuant to the Commission's Notice of requirement to file a petition to amend tariff or deviate from the Utah Affordable Base Rate, dated April 18, 2016, and the Commission's Supplemental Notice dated May 26, 2016, in this docket.

This memo is filed in response the Commission's action request dated 6/30/2016.

Analysis

Tariff Change - The Division has calculated the amounts of additional revenue each company can expect to receive as a result of its tariff change. This calculation is based on the 2015 annual report to the Commission, supplemented in some cases through informal data requests to the companies. The amounts of additional revenue can be found in confidential attachment 1.

Federal USF – The Division has contacted the National Exchange Carriers Association's (NECA) regional office to determine the impacts of the tariff changes on the companies' Federal high Cost Loop (HCL) Support. According to NECA, Federal HCL support will not change as a result of the increased revenue received from end users. The Universal Service Administrative Company (USAC), that calculates Federal HCL support, already uses a base rate of $21.93/month in its calculations. The $21.93/month rate is the target rate established by the 2016 survey by the FCC as a fair floor rate. The $18.00/month rate for 2016 is just a step in moving towards the ultimate target of $21.93/month.[1] The $21.93 target rate is subject to ongoing fluctuation in response to annual survey results for average urban rates.

Division Audits and Utah USF – The Division has completed a desk audit of the 2015 annual reports of all companies receiving Utah USF and has incorporated the additional revenue received from the tariff changes in estimating potential changes to Utah USF eligibility. An important caveat to this memorandum is that the Division's review was limited to analyzing the companies' annual reports.

The annual report is completed by each company and significant variation is likely between amounts found in annual reports and the amounts that would be the product of a full evaluation of each company's accounts, operations, and financing. Thus, the annual report represents a useful guide but is merely a rough approximation of the result of a more exhaustive review. Such an exhaustive review of each company is not possible at this time. The Division does not recommend the Commission take any further action concerning these companies at this time.

In general, the results of the Division's audits fall into the following two categories:

<u>Under-earning</u> – Eight companies currently receiving Utah USF and one company not currently receiving Utah USF appear to fall into this category based on a Division-calculated reasonable ROR. It appears that the additional revenue generated from the tariff changes will not change this status.

<u>Over-earning</u> – Five Companies appear to fall into this category. In some cases it appears the over-earning is limited to affiliates with related companies that are not overearning. In those cases it is likely that inter-company allocations may not accurately reflect the costs and benefits for each affiliate. Whether a rebalancing between companies is sufficient to resolve the overearning is unknown at this time. In others, it is likely that any overearning, particularly as a result of the recent increase in the Affordable Base Rate, is immaterial. A relevant factor in the materiality determination is the administrative burden and expense of more thorough auditing relative to the amounts in question. At this point the Division is unable to say that the companies' existing rates and Utah USF support are not in the public interest.

One company appears to be substantially overearning. Given the above caveats concerning the limited nature of a review of annual reports, the Division has undertaken additional investigation of this company to ascertain the magnitude of any actual overearning. The Division will take further action it considers warranted at the conclusion of that investigation.

[1] *Connect America Fund et al.*, WC Docket No. 10-90 et al., Public Notice 31 FCC Rcd. 3393 (Results of 2016 Urban Rate Survey) ("Based on the survey results, the 2016 rate floor for voice services is $21.93,... ").

DPU Recommendations

As noted above, the Division's review of USF-recipient companies' earnings has been a limited one. In determining further actions, the Commission should consider the lack of precision in the information reviewed, the external impetus for the rise in base rates, and the low likelihood that the base rate change itself is responsible for a shift from reasonable earnings to overearning. Additionally, the Commission should consider the significant expenditure of regulatory and industry time and resources to complete a thorough review of company earnings. Weighed against the small amount of increased revenue, such an expenditure may not be in the public interest.

The Division will continue its investigation concerning any company that appears to be overearning and take action it considers necessary at the conclusion of the investigation. Depending on the circumstances, a simple offset to existing subsidies might be preferable to a full examination of the companies' revenue requirements.