Kira M. Slawson (7081)
Stanley K. Stoll (A3960)
BLACKBURN & STOLL, L.C.
Attorneys for Utah Rural Telecom Association
257 East 200 South, Suite 800
Salt Lake City, Utah 84111
Telephone: (801) 521-7900
Fax: (801) 578-3579

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Consideration of Potential Changes in the Regulation of the Utah Universal Public Telecommunications Service Support Fund, in Response to Recent Changes in the Federal Universal Service Fund Program	Docket No. 12-999-10

COMMENTS OF THE UTAH RURAL TELECOM ASSOCIATION

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The Utah Rural Telecom Association ("URTA") welcomes the opportunity to provide these initial comments addressing potential changes in the regulation of the Utah Universal Service Public Telecommunications Service Support Fund ("UUSF")[1] in response to changes to the federal Universal Service Fund ("USF") high cost programs in the above captioned docket.

URTA is the statewide association of independently-owned telephone companies providing a broad array of telecommunications services in the rural areas of the State of Utah. The members of URTA are: All West Communications, CentraCom Interactive, Direct Communications Cedar Valley, Emery Telcom, Gunnison Telephone Company, Manti Telephone Company, South Central Utah Telephone Association, Strata Networks and Union Telephone Company. URTA provides these comments on behalf of its members to help the Utah Public Service Commission ("Commission") determine what if any actions should be taken to address the impact of federal USF changes made and expected to be made by the Federal Communications Commission ("FCC").

I. Executive Summary

The URTA members are, by and large, recipients of high cost support from the Utah Universal Service Fund, and have been for several years since the inception of the fund. The URTA

[1] Utah Code Ann. Section 54-8b-15

members use UUSF funds to provide robust and advanced telecommunications services to rural high cost areas of the state where it would be cost prohibitive to provide such service without universal support. UUSF funds, together with other sources of capital, have been used by URTA members to construct and maintain the legacy (copper) telecommunications network that is used to provide the advanced telecommunications services. This network requires continued support from the UUSF so that it can be effectively maintained and operated.

The deployment of technologically advanced telecommunications services in the rural areas of Utah provides schools, libraries, health care facilities, businesses and residential customers with landline telecommunications services and high speed broadband services, permitting them to connect to other businesses, residents and the internet. The telecommunications network infrastructure provided by URTA's members enables the entire state of Utah to compete as a premier global business destination to attract new companies and industry to Utah thereby promoting economic development throughout the entire state. Maintenance of the UUSF program provides financial support to high cost areas of the state and is critical to the continued economic development of Utah.

While Utah, along with the rest of the world, has seen an enormous increase in wireless technology, wireless services are not a substitute for traditional wireline universal service infrastructure and service. While wireless service complements wireline service in terms of voice, wireless service cannot substitute for the reliability and dependability of a wireline service, especially in extreme situations, such as natural disasters, where traditional wireline service is powered from central offices that have ample backup generator capabilities. Additionally, while the use of mobile broadband has increased dramatically, wireless capability

and capacity simply cannot be expected to satisfy the forecasted end-user demand for broadband services.

Moreover, wireless service providers rely on a robust wireline infrastructure to transmit wireless signals collected from antennas and sent to mobile collection and switching offices. In rural areas of Utah, this wireline infrastructure is provided by the URTA members. The reality of today's telecommunications world is that wireline infrastructure is required and is the key foundation for Utah's universal service policy.

Federal universal service policy has the goal of allowing rural areas of the nation to have access to comparable universal services at comparable rates. The Commission and the Utah Legislature should continue to apply this principle to rural areas of Utah compared with services available on the Wasatch Front. The ultimate goal of Utah universal service policy should be to provide adequate incentives for investment so that every residence, business and government location has access to fiber optic cable infrastructure and the services that can be provided over fiber optic cables in order to reap the economic and social benefits a 21st century network offers. Any changes to the state's universal service policy should recognize this fact and prepare for the future, but should be carefully considered in light of the changing federal landscape.

The URTA members strongly recommend the Commission and Legislature adopt the following principles for state universal service policy:

1. Rate of Return and Carrier or Last Resort
2. Residual Ratemaking
3. Wireless options are not a substitute to wireline infrastructure
4. Comparable Services at Comparable Rates
5. Infrastructure Goal: Optic Fiber Placed Deep into Distribution Networks

Additionally, the URTA members are supportive of the ultimate expansion of the UUSF to include broadband service as a state-funded universal service. However, URTA believes that the state of Utah should maintain the UUSF as it has been until the industry receives further clarification from the FCC on its support of broadband services.

II. Foundations of Universal Service Policy in Utah

A. State Universal Service Defined

As understood today, the concept of universal services as a public policy goal means ubiquitous availability of specified telecommunications services delivered at an affordable price so that every household is able to connect to the telephone network if it chooses to do so. The Telecommunications Act of 1996 enacted by the U.S. Congress contains an explicit commitment to preserving and expanding universal telephone service, and makes it clear that both state and federal regulators have significant responsibilities in ensuring the universal service goals are met. In 1997, the Utah Legislature codified the public policy goal of universal service through the establishment of the Utah Universal Service Fund ("UUSF"), codified as Section 54-8b-15, Utah Code Anno., to, *inter alia*, "preserve and promote universal service within the state by ensuring that customers have access to affordable basic telephone service." Utah Code Ann. § 54-8b-15(6)(b).

B. History of State USF

Prior to the establishment of the UUSF, the goal of universal telephone service was promoted through a number of explicit and implicit mechanisms. The explicit support mechanisms included Lifeline Assistance and Link Up America, Telecommunications Relay Services, Dial Equipment Minutes (DEM) Weighting and Federal Long Term Support (LTS). In

Utah, a universal service fund was established in 1990 with a surcharge rate of $.05 per MOU on intrastate telecommunication wireline services. This was accomplished in connection with the rebalancing of switched access charges for inter-exchange carrier ("IXC") for access services provided by the rural carriers.

Implicit mechanisms provided untargeted support through various pricing and cost allocation policies that were intended to keep the cost of basic telephone service low. These included above cost pricing for carrier access services, business services, and pricing for vertical services. In Utah, switched access rates in rural areas were maintained at levels substantially greater than cost, in many cases substantially higher than $0.10 per minute of use in order to maintain affordable basic telephone services.

With the enactment of the UUSF and the explicit support provided by it through USF contributions and disbursements, rates for services such as carrier access, and the resulting revenues, which had previously supported universal basic telephone service, were lowered significantly. The UUSF replaced, in part, the lost revenues resulting from rate reductions or rate rebalancing.

The UUSF Contribution Factor assessed on intrastate telecommunications has historically been as follows:

USF Rate Changes		
EFFECTIVE		
DATE	RATE	DOCKET
	1/2 cent per min	
6/1/1998	0.0100	
1/1/2000	0.0067	
9/1/2001	0.0034	01-R360-02
11/3/2003	0.0090	03-R360-01
7/20/2006	0.0050	06-R360-01
10/1/2008	0.0045	08-R360-01
11/1/2009	0.0025	09-R360-01
9/1/2011	0.0100	11-R360-04

As noted above, the historical high, and current, contribution factor expressed as a percentage is 1% applied to the billed retail rates for intrastate telecommunications services. The low was ¼ of 1% between November1, 2009 and September 1, 2011. The percentage amount of the surcharge in Utah, when compared to those of other states, is on the low end of the range of contribution factors.[2]

C. Benefits of State USF

The public interest benefits of the UUSF program are enjoyed by the end-user customers throughout the entire state of Utah. Rural companies provide ubiquitous and robust telecommunications services to their residential customers, however the vast majority of the telecommunications business of rural companies serves business customers and, therefore, promotes economic development throughout Utah. As a result of the deployment of technologically advanced telecommunications services in the rural areas of Utah, schools, libraries, health care facilities, businesses and residential customers with high bandwidth requirements throughout the state of Utah are able to enjoy access to modern telecommunications infrastructure that enables communication with the reliability of a wireline network connection. According to the Governor's Office of Economic Development's (GOED) Annual Report for 2012, the GOED Vision Statement is that "Utah will lead the nation as the best performing economy and be recognized as a premier global business destination."[3] In order to accomplish this, the Governor's Office of Economic Development recognizes four objectives that need to be met: 1) Strengthen and grow existing Utah businesses, both urban and rural; 2) Increase innovation, entrepreneurship and investment; 3) Increase national and international

[2] See NRRI Survey of State Universal Service Funds 2012, by Sherry Lichtenberg, Kafui Akyea, and Phyllis Bernt, Report No. 12-10, July 2012, www.nrri.org.
[3] Utah GOED Annual Report 2013, p2, (http://business.utah.gov/site-media/page-media/files/AnnualReport2012.pdf).

business; and 4) Prioritize education to develop the workforce of the future. None of these objectives can be met without a robust and statewide modern telecommunications wireline network. The services provided, in part, by Utah's rural telecommunications providers enable the state of Utah to compete with other states to successfully attract new businesses and enterprises to Utah. The UUSF program provides critical financial support to high cost areas of the state. Without UUSF support it would not be economically or financially viable to serve business and residential customers in those high cost areas of the state.

D. Regulatory Design Fosters Close Monitoring of Universal Service Policy

Current recipients of UUSF support are incumbent local exchange carriers that operate as rate-of-return regulated utilities. As the Commission is well aware, rate-of-return regulation is a form of regulation that allows the Commission to examine the investment and expenses associated with regulated activities. In the course of seeking UUSF support, carriers are required to provide proof demonstrating the need to receive financial assistance from the state administered UUSF program.[4] While the Commission's application and review process is in need of improvement, the basic fact remains and should remain throughout any state reforms—recipients of UUSF support are required to demonstrate their financial need before support is disbursed.

The Commission should not change the requirement for rate-of-return companies to demonstrate financial need. The current process ensures the public interest is met for UUSF distributions. The URTA members believe this process is fair and provides reasonable safeguards for the public in ensuring that support is delivered to improve universal service throughout the state. While it may be appropriate to consider reforms to UUSF distribution

[4] While the Commission administers the UUSF program, funds that are ultimately distributed to carriers come from users of the network in the form of a mandatory contribution. Thus, the UUSF does not draw on any general revenues of the state—instead funds are generated from end-user fees from users of communications services.

methods and procedures, as indicated below, URTA recommends that any such reforms be addressed in a later phase of this docket, once the federal regulatory landscape has been revealed.

E. Rate of Return Regulation

The FCC, many states and the industry include rate-of-return as part support calculation methodologies. Historically, carriers subject to economic regulation must earn enough to cover the cost of operation and provide a fair return to investors. Case law provides guidance for determining an appropriate return level and the factors which should comprise the level. FPC v. Hope Natural Gas Co., [320 US 591] 320 U.S. 591, 602-605 (1944) ("Hope"). Hope counsels that the return level for a particular utility investment should be substantially equivalent to returns of other investments involving a similar level of risk, and "be sufficient to assure confidence in the financial integrity of the enterprise, as to maintain its credit and to attract capital. Hope, 320 U.S. at 603. At the same time it is recognized that the interests of ratepayers require "the lowest possible return consistent with overall responsibility to provide modern, efficient service at reasonable rates...."American Telephone and Telegraph Co. (Docket No. 19129), 38 FCC 2d 213, 226 (1972).

There may or may not be attenuation in the application of Hope when it comes to support payments. However, in the FCC's Further Notice of Proposed Rulemaking (FNPRM) accompanying the 2011 Connect America Fund Order (FCC 11-161), the FCC explained the relationship of the interstate rate-of-return to support and concluded "it is appropriate at this time to reexamine the rate of return as part of comprehensive reform of the universal service fund."

For regulation of carriers subject to rate of return regulation, the FCC applies a "Unitary Rate of Return"—that is a single rate of return for all carriers. The unitary rate of return is in

lieu of requiring each carrier to determine a rate of return based on its own capital structure, including making a case for the appropriate cost of capital.

Some states, including Utah, have historically determined a rate of return for individual carriers based on the carrier's company specific cost of capital. Cost of capital is generally a weighted average of the cost of debt, cost of preferred stock equity and the cost of equity. With respect to the cost of debt, the cost is the weighted cost of debt (to weight the diverse interest rates applicable to individual debt issuances or loans). The cost of equity capital also includes related income taxes to allow the targeted cost of equity to be achieved notwithstanding the payment of income taxes associated with the return related to the cost of equity.

There is no movement in FCC proceedings to disassociate the cost of capital element of plant investment costs comprising part of support. It is appropriate that Utah support also include cost of capital.

1. Carrier of Last Resort ("COLR")

As part of being regulated in Utah under a rate-of-return regime, carriers accept the obligation to operate as a carrier of last resort ("COLR"). Being a COLR requires carriers to offer universal services throughout a service territory subject to specific regulations.[5] The requirements of being a COLR come as part of a regulatory contract that includes rate of return. The public interest is served and will continue to be served in rural areas of Utah by continuing to tie COLR duties with the carriers' opportunity to earn a reasonable rate of return on their investments. Without carrier of last resort responsibilities, companies who do business in high cost areas will be able to cherry pick, resulting in some areas remaining unserved.

F. Residual rate making for regulated state services

[5] For example, line extension tariffs approved by the Commission require the payment by the end-user customer to recover extraordinary infrastructure investment to a particular location.

Perhaps the best known examination of residual ratemaking in the common carrier telecommunications context came in a 1990 decision of the District of Columbia Circuit of the U.S. Court of Appeals, *Crockett Tel Co. v. FCC*, 963 F.2d 1564 (D.C. Cir. 1992). In Crockett the court upheld the ruling by the FCC that a state's use of the intrastate ratemaking methodology known as "residual" ratemaking—a process through which an average schedule carrier's intrastate revenue requirement is ascertained by subtracting the carrier's interstate cost recovery under average schedule settlements from its total revenue requirement—does not constitute an impermissible jurisdictional separations methodology. In 1989, Mid-Plains Telephone Company filed a petition with the FCC seeking an order declaring that Wisconsin's use of the residual ratemaking method constituted an unlawful jurisdictional separation. The FCC denied the petition in its Order.

Following is a summary of residual ratemaking in the Average Schedule context provided by the D.C. Circuit in Crockett.

1. Average Schedules and Residual Ratemaking

Although the Commission has formally adopted only the Part 36 cost-based jurisdictional separation method under Sec. 221(c), it has nonetheless permitted some companies, including petitioners, to "estimate some or all of their costs through the use of an 'average schedule' which adopts generalized industry data to reflect the cost of a hypothetical exchange company" for purposes of figuring their interstate rates. NARUC, 737 F.2d at 1127. The "average schedule" allows companies to avoid the expense and effort of cost studies, and instead rely on industry-wide averages developed from information gathered by the National Exchange Carrier Association (NECA). *Id.*

This interstate ratemaking method has a significant impact on jurisdictional separations. Though average schedule ratemaking has never been formally adopted as a separation methodology, it does label a certain portion of total costs as interstate costs. Unsurprisingly, several states have come to rely on average schedules for their own intrastate ratemaking purposes. Just as the states subtract from the total cost base of a Part 36 carrier that part determined by FCC regulation to be interstate, many states deduct from the total cost base of an "average schedule" company that part attributed by the average schedule to interstate usage and treat the residuum as intrastate. Such is the case in Utah. This intrastate ratemaking method is known as "total company" or "residual" ratemaking. Put simply, a residual ratemaking state assumes that the intrastate revenue requirement is equal to the company's total revenue requirement less revenues deemed by the average schedule to be interstate.

Following is an example of residual ratemaking juxtaposed with the alternatives of the “pure cost method” where interstate revenue requirements are determined based on cost instead of Average Schedules, Residual Costing which the court calls Pure Averaging and, finally, mixing average schedule and costing which is what the petitioners wanted to do.

2. Situation 1: Pure Cost Method

Suppose a carrier has total costs of $ 100; it has a right to recover these costs in rates set by appropriate authorities. It conducts a Part 36 jurisdictional cost study annually and ascertains that $25 of the $100 is due to interstate service, and, consequently, $75 is due to intrastate service. It is entitled to receive those sums from the appropriate customers under rates set by governmental authorities. There is no dispute. In sum:

Total Costs	$100
Interstate Costs	$ 25

Intrastate Costs	$ 75
Total Allowed	$100

3. Situation 2: Pure Averaging

Now suppose that Carrier chooses to go on the average schedule system for obtaining its interstate payments. Its true costs are still the same as above. Yet, suppose the average schedule allows $35 for interstate service. Residual ratemaking by the states would simply take Carrier's total costs ($100) and subtract the amount recovered from the average schedule ($35) and, thus, allow Carrier to recover $65 in intrastate charges.

Total Costs	$100
Interstate Average	$ 35
Residual Costs	$ 65
Total Allowed	$100

Carriers argue that by allowing only $65 in intrastate recovery—by reducing the amount allowed by $10 because of the use of the average schedule—states are really taking jurisdiction over revenues actually flowing from interstate commerce (as ascertained by the Part 36 cost method analysis) and, thus, overstepping their jurisdictional bounds.

4. Situation 3: Mixing Average Schedules and Cost Methods

A carrier seeks to use the average schedule on the federal level while employing the cost method on the state level allowing Carrier more cost basis in total ratemaking than its actual costs:

Total Costs	$100
Interstate Average	$ 35

Residual Costs	$ 75
Total Allowed	$110

Thus, a carrier using the average schedule to calculate costs of interstate service but determining actual costs for intrastate ratemaking could be provided with a total base for rate calculation exceeding 100 percent of its costs.

Based on the foregoing, Utah has been a residual ratemaking state with safeguards in place to assure that intrastate ratemaking does not exceed 100 percent of costs. Utah applies its ratemaking after interstate costs and revenues are accounted. Thus, Utah is the anchor jurisdiction for rate of return.

G. Wireless service - complementary service for wireline universal service policy in Utah

For purposes of state universal service policy, URTA submits that wireless services are not a substitute for traditional wireline universal service infrastructure and service. In terms of voice service, wireless services certainly complement wireline service, but wireless service cannot substitute for the reliability and dependability of a wireline service, especially in extreme situations where traditional wireline service is powered from central offices that have ample backup generator capabilities. As carriers migrate to Voice over Internet Protocol ("VoIP") service and place more fiber into their distribution infrastructure, these backup capabilities are extended to fiber nodes. Thus, if a customer has power at her residence, either from the power grid or from battery or backup generation, VoIP communication services remain operational.

Moreover, as customers are becoming increasingly reliant on broadband connections for their communication needs, wireless capability and capacity simply cannot be expected to satisfy the forecasted end-user demand for broadband services. Wireless technology is a shared

technology that is limited by available spectrum. Increasing customer demands with regard to business broadband needs, video streaming, and multiple devices in each end user location simply cannot be met with wireless technology.

Additionally, wireless service providers rely on a robust wireline infrastructure to transmit wireless signals collected from antennas and sent to mobile collection and switching offices. In rural areas of the state, this wireline infrastructure is provided by the URTA members. Consequently, wireline infrastructure, and principally optic fiber cabling, is the only long-term infrastructure solution for universal service in Utah. As demonstrated above, without a robust wireline infrastructure Utah simply cannot compete as a viable destination for business and industry. The result of these market-based facts, compels the Commission to reaffirm the necessity of wireline networks in rural areas of the state as the key foundation for Utah's universal service policy.

H. Comparable Services at Comparable Rates

One hallmark of federal universal service policy is the goal to enable rural areas of the nation to have access to comparable universal services at comparable rates.[6] For purposes of state universal service policy, the Commission should encourage the Legislature to apply this principle to rural areas of Utah compared with services available on the Wasatch Front.

The ultimate goal of Utah universal service policy should be to provide adequate incentives for investment so that every residence, business and government location has access to fiber optic cable infrastructure and the services that can be provided over fiber optic cables. Granted, URTA members recognize that this goal cannot be obtained in the short- or medium-term, but in the long-term view of the economic capacity of the state and the quality of life for residents, fiber

[6] 47 USC § 254(b)(3)

optic infrastructure is a business and economic necessity. Any changes to the state's universal service policy should recognize this fact and prepare for the future.

1. Need for a Broadband Transition

The Public Utility and Technology Committee of the Utah State Legislature has requested information from the Commission regarding possible actions that the State may consider in response to the federal USF reforms, and one item in the Commission's inquiry is whether the UUSF should be redirected to support broadband. URTA believes that ultimately the UUSF should be reformed to support broadband infrastructure. In the 21st century the quality of life and economic well-being of Utah's residents is directly contingent upon their connectivity to the rest of the country, and the rest of the world. URTA's 14 independent telephone company members collectively serve approximately 80 percent of the state's geography, a rural expanse of diverse topology, natural resources, and opportunities for business, recreation, and life. Directing the UUSF to support broadband as well as traditional voice service will ultimately help ensure that the people of Utah have access to telecommunications services that have become as vital and as expected as electricity.

Rural areas of the country are arguably the most in need of the fastest and most reliable broadband networks at speeds far beyond the baseline 4/1 Mbps definition established by the FCC. Real-time, HD video-based remote healthcare and education, the ability to run a business from anywhere at any time, and staying connected with friends and family members around the world are just the "tip of the iceberg" of reasons why rural residents and businesses in Utah need universal access to broadband and assurance that their broadband networks will continue to advance and evolve as their needs become more advanced. As demonstrated herein, Utah's

economic development and success as a global business destination are dependent upon a strong and ubiquitous statewide telecommunications network.

Ultimately, URTA members support an expansion of the state universal service policy to support broadband, so this vision may come to fruition. From URTA's perspective, the FCC's reforms take rather than give, and signs of a new slow/fast digital divide are already showing. Innovators will target the areas with the highest likelihood of return on investment with new technology and applications (urban areas), and anyone on the wrong side of slow/fast divide will be at a disadvantage in education, health care, business, public safety, and basic communication.

However, while the FCC in the *USF/ICC Transformation Order* released November 18, 2011, has made broadband a required offering by eligible telecommunications carriers, the industry is in the process of working with the FCC to determine how that requirement will be sufficiently funded. As demonstrated below, the FCC seems to have adopted a "*do more with less*" mandate that is not economically feasible for rural carriers.

While this unfunded mandate is being fleshed out with the FCC, URTA members need assurance that federal and state support will be sufficient and predictable so that they can plan long-term investments in advanced networks which will be in the best interest of everyone in the state. Therefore, URTA believes it is imperative that Utah study the options available to it, but delay any action on a transition of state UUSF to broadband until we have a clearer understanding of how the FCC plans to fund broadband as a universal service.

II. Brief History of Federal USF Policy

The Federal Universal Service Fund is entrenched in the history of telecommunications in the United States. The definition of universal service established by Congress in the

Communications Act of 1934 has remained constant, but the FCC's interpretations of how to *achieve* universal service are in a nearly constant state of flux particularly in the last twenty years as technological advancement outpaces regulation. The concept of universal service started as an AT&T marketing campaign, "One system, One company, Universal Service;" first mentioned in AT&T's 1909 annual report.[7] This definition of universal service fit accordingly with AT&T's "natural monopoly" on telephone service, networks and equipment at a time when it was believed that AT&T could do better alone what any number of firms could do in competition. Hence, *one system,* built and operated by *one company* can provide *universal service;* whereas multiple systems with multiple companies cannot because that would be inefficient in the economic sense.

The Communications Act of 1934 brought the theory of universal service of telecommunications under the wing of the Federal government, and created the Federal Communications Commission for the purpose of "regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States without discrimination on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges…"[8] Universal service was a commitment, but rules and explicit funding mechanisms did not appear until decades later.

It wasn't until 1985 that the FCC created USF rules to promote universally available telephone services at reasonable rates. The rules provided interstate assistance to high-cost local

[7] Sterling, C. H., Brent, P. W., & Weiss, M. B. H. (2006) *Shaping American Telecommunications*: *A History of Technology, Policy, and Economics.* Mahwah, New Jersey. Lawrence Erlbaum Associates, Inc. "The position of the Bell System is well known. It is believed that the telephone system should be universal, independent and intercommunicating, affording opportunity for any subscriber of any exchange to communicate with any other subscriber of any other exchange…It is not believed that this can be accomplished by separately controlled or distinct systems nor that there can be competition in the accepted sense of competition."
[8] 47 USC § 151

exchange carriers ("LECs") by allowing LECs with loop costs above a specified assistance threshold to allocate a percentage of those loop costs to the interstate jurisdiction. Another form of universal service funding emerged a year earlier, in 1984: the End User Common Line charge, the first iteration of today's Subscriber Line Charge (SLC). For the first time, end users paid directly for a portion of the non-traffic sensitive costs associated with access to the PSTN over the local loop.

The Telecommunications Act of 1996 ("1996 Act") brought universal service policy front and center in Federal policy. It codified the historical commitment of the FCC and state regulators to promote universal service by ensuring that consumers in all regions of the nation have access to affordable, quality telecommunications services. The Federal-State Joint Board was created and tasked with recommending changes to existing regulations (including defining the services that should be supported) to help advance the principles of universal service. Most importantly, and most relevant to today's transition of USF from telephone-centric to broadband-centric, Congress defined the principles of universal service:[9]

1. Quality and rates
2. Access to advanced services
3. Access in rural and high cost areas
4. Equitable and nondiscriminatory contributions
5. Specific and predictable support mechanisms
6. Access to advanced telecommunications for schools, health care, and libraries
7. Additional principles as the Joint-Board and FCC determines are necessary and appropriate for the protection of the public interest, convenience, and necessity

[9] 47 USC §254(b)

The 1996 Act furthermore defined universal service as "an evolving level of telecommunications services that the Commission shall establish periodically under this section, taking into account advances in telecommunications and information technologies and services."[10] The 1996 Act established a contributions methodology whereby carriers contribute to the fund, and clarified that only designated ETCs are eligible to receive Federal USF support for "the provision, maintenance, and upgrading of facilities and services for which the support is intended."[11] The 1996 Act also left the door open for states to establish their own consistent USF contribution and distribution mechanisms, definitions, goals, and regulations to help preserve and advance universal service within the state. In terms of supported services, the 1996 Act distinguished between common-carrier "telecommunications service" (regulated) and "information service" (exempt from regulation), a distinction that has been problematic for regulators since the Internet boom began shortly after the 1996 Act.

The subsequent Universal Service Order released by the FCC in May 1997 began implementing the requirements of the 1996 Act: it established new mechanisms for providing universal service support payments to carriers, established new methods for telecommunications service providers to contribute to programs. The Universal Service Order required that to the extent possible, universal service support be *explicit*, rather than *implicit*, meaning that all support mechanisms funded through the USF be recovered by end users of interstate and international services rather than a system of cross-subsidies made popular during AT&T's regulated monopoly era.

Some changes to the fledgling USF were made in the 2001 Multi-Association Group Order ("MAG Order") after the associations representing rural rate-of-return carriers submitted a

[10] 47 USC §254(c)(1)
[11] 47 USC §254(d) and (e)

proposal addressing numerous issues in both the USF and ICC programs. The MAG Order modified the FCC's rules for rate-of-return carriers, and sought to foster efficient competition and pricing in the access service market. The FCC aligned the interstate access rate structure more closely with the manner in which costs are incurred, and created a new universal service mechanism, Interstate Common Line Support ("ICLS"), to replace the implicit support in interstate access charges with explicit support that is portable to all ETCs. ICLS ensures that rate-of-return carriers will recover their common line revenue requirements, including their authorized rate of return, while continuing to provide their customers with quality, affordable service in accordance with the core principles of universal service.

Over the next decade, the USF program became more convoluted and less applicable to modern networks, and the FCC attempted a series of reforms that were unsuccessful and frustrated by the statutory limitations of the 1996 Act whereby information services could not be supported with USF. Rural rate-of-return carriers could however use high-cost support to build dual-purpose telephone and broadband networks, which significantly helped expand broadband in some of the most remote places in the country. Under a different regulatory structure and competitive focus, large price cap carriers lacked the incentive to deploy broadband in high cost rural areas, and the result by 2010 was the so-called "rural-rural divide" that became a central focus of the National Broadband Plan and the USF/ICC Transformation rulemaking proceeding.[12]

The FCC's National Broadband Plan was a directive of the American Recovery and Reinvestment Act of 2009 and included the recommendation that all Americans should have access to broadband with minimum speeds of 4/1 Mbps, a target that the FCC called

[12] The National Broadband Plan at 141 explains, "roughly half of the unserved housing units are located in the territories of the largest price-cap carriers, which include AT&T, Verizon and Qwest, while about 15% are located in the territories of mid-sized price-cap companies such as CenturyLink, Windstream and Frontier."

"aggressive."[13] Many of the recommendations in the National Broadband Plan were carried out in the *USF/ICC Transformation Order,* or modified slightly. The National Broadband Plan recommended, "The FCC should manage the total size of the USF to remain close it its current size (in 2010 dollars) in order to minimize the burden of increasing universal service contributions on consumers;" and "The FCC should eliminate the legacy High-Cost program, with all federal government funding to support broadband availability provided through the CAF."[14] Of the more extreme recommendations, the National Broadband Plan recommended phasing out per-minute origination and termination access rates and requiring rate-of-return carriers "to move to incentive regulation"[15] The National Broadband Plan also recommended that the FCC comprehensively reform and expand the USF contributions base, but the FCC's efforts to achieve this goal have stalled after an April 2012 rulemaking proceeding failed to progress past the comment cycle. Throughout the National Broadband Plan's section on USF and ICC, the FCC mentions the challenge of reforming the programs to include broadband when broadband is not a supported service. Essentially, the FCC's own plan for a broadband-centric USF exposed the agency's primary weakness: it *cannot* regulate broadband.

Nearly a year after the National Broadband Plan was released the heavy-lifting and preparing for the *USF/ICC Transformation Order* began in earnest. The FCC released the USF/ICC Reform NPRM on February 9, 2011 which kicked off a relentless fury of comments, reply comments, alternative plans, industry alliances, and panic-stricken assumptions until the *USF/ICC Transformation Order* itself was released on November 18, 2012. Within weeks, stakeholders from across the industry had filed petitions for reconsideration and lawsuits; many of the petitions for reconsideration are still pending, few have been resolved, and the appeals

[13] National Broadband Plan, pg. 135
[14] National Broadband Plan, pg. 136
[15] National Broadband Plan, pg. 147

case is moving slowly through the 10th Circuit Court of Appeals in Denver, Colorado. Among the numerous arguments presented in the appeals briefs, the RLEC industry and wireless carriers are focusing heavily on the FCC's statutory limitations regarding broadband services.

III. Changes to Federal USF Policy: November 2011 Order and FNRPRM

The *USF/ICC Transformation Order* comprehensively altered essentially every aspect of high-cost support and access recovery for RLECs across the nation, with further changes yet to come once the FCC addresses a number of pending issues that are up for reconsideration or brought to light in the *Further Notice* that accompanied the *USF/ICC Transformation Order.* The URTA members were not spared from these reforms and they feel their impacts in various degrees.

From the URTA perspective, a summation of all of the changes that are currently being implemented or will likely be implemented in the near future is, quite simply, *do more with less.* As the changes begin to take effect, URTA members anticipate that both the "more" and the "less" in this equation will escalate dramatically.

The FCC set forth to modernize "decades-old assumptions" and "ill-equipped" USF and ICC mechanisms that have become irrelevant as a result of the rapid pace of broadband adoption and technological advancement; close loopholes in the programs that were prone to waste, fraud, and abuse; and nudge both service providers and consumers into the all-broadband era.[16] The FCC furthermore established myriad new reporting requirements to make Eligible Telecommunications Carriers ("ETCs") more accountable to the public and the fund administrators, to alleviate concerns that USF support was not being used efficiently or productively. The FCC constructed new funding silos for price cap carriers, wireless carriers,

[16] USF/ICC Transformation Order, ¶ 6

Tribal wireless carriers, yet-to-be-determined carriers serving extremely remote areas, and rate-of-return carriers, with defined budgets for each category.

For rural rate-of-return carriers, the predominant changes come in one of three forms: caps, cuts, or new obligations. This reform Cerberus is of the utmost concern to URTA members: even if an RLEC is not bitten by cuts or caps *right now*, the RLEC must operate in a state of perpetual fear that it is only a matter of time. The obligation to build more broadband with less funding is already nipping at the heels of the RLECs as they struggle to rearrange strategic plans in light of the new and pending rules and evaluate dwindling capital investment options.

A. Capped Budgets

First, the entire budget for high-cost support is now capped at $4.5 billion per year until 2017: this cap is set at "the same level as the high-cost program for Fiscal Year 2011."[17] The capped fund is established to achieve the FCC's goals of fiscal responsibility and fund predictability. Within the $4.5 billion budget, RLECs are designated $2 billion per year, but the $2 billion includes *both* high-cost USF support and the new access recovery mechanism created to help offset rapid ICC loses. With the new obligation to deliver broadband capable of 4 Mbps download, 1 Mbps upload ("4/1 Mbps") upon reasonable request, RLECs now have to do much more with roughly $1 billion less in funding than under the previous rules.

B. USF and ICC Support is to be Cut Annually

Second, RLECs face ongoing cuts to the available capped funds, both on the USF side and the ICC side. The two *most* profound funding cuts for RLECs are attributed to (1) the Quantile Regression Analysis ("QRA") methodology limiting RLEC high-cost loop support ("HCLS"); and (2) the transition to bill-and-keep coupled with an annual reduction in eligible access charge recovery. The original iteration of QRA was presented in the *FNPRM*, and the

[17] USF/ICC Transformation Order, ¶ 18

proposed cuts were drastic, unpredictable, nearly immediate, and based on variables that did not accurately portray an RLEC's costs. Upon receiving considerable backlash from the RLECs and a fairly negative peer review by other economists, the FCC revamped the QRA methodology and released an updated version on April 25, 2012. A total of 283 RLECs faced reduced HCLS in the first version, but only 106 in the second version; the second version phased-in the cuts rather than abruptly applying the full cuts in July, 2012 as originally intended. The second version also expanded the depth of the methodology to account for a wider range of independent variables, and will "redistribute" approximately $55 million to all of the carriers who are not subject to the regression-based cuts. The new and old versions of QRA consistently kept the ninetieth percentile as the demarcation line where the FCC determines whether or not an RLEC is making prudent and frugal spending decisions compared to its "similarly situated" peers. Even with the so-called improvements to the methodology, the RLEC industry has relentlessly pressured the FCC, Congress, and even the White House to consider the real impacts of QRA on rural providers and their consumers and the resulting economic impact on rural areas.[18] As it stands now, the FCC has tasked the Wireline Competition Bureau ("WCB") with reformulating QRA on an annual basis without providing the industry an opportunity to comment on proposed changes, which makes strategic planning utterly impossible for RLECs.

On the ICC side, the *USF/ICC Transformation Order* requires all RLECs to transition to the "bill-and-keep" methodology where access rates are zero. RLECs have a nine-year schedule to reduce terminating end-office rates to zero cents per minute in 2020. As access is a critical piece of RLEC revenue, this reform is troubling. The FCC established the Recovery Mechanism ("RM") to *help* offset the losses, but not make the RLEC whole. Transitional support from the

[18] Chariton Valley letter to President Obama (November 9 , 2012)
https://prodnet.www.neca.org/publicationsdocs/wwpdf/111312cv7.pdf

RM decreases by 5% each year and the decrease could accelerate pending future FCC decisions. Although the FCC claims that "consumers bear the burden of the inefficiencies and misaligned incentives of the [previous] ICC system, they are the ultimate beneficiaries of ICC reform,"[19] in fact, rural consumers are already beginning to bear the burdens of the FCC's new ICC regulations, as RLECs are now essentially required to raise end-user rates though the Access Recovery Charge ("ARC") to help offset access losses previously paid by other carriers.[20]

C. New Obligations: Do More with Less

The third significant change resulting from the *USF/ICC Transformation Order* is that a plethora of new public interest and compliance obligations have been placed upon the RLECs despite the fact that both USF and ICC are on a path to extinction. URTA members receiving USF support must continue to offer voice service, now redefined as "voice telephony service" to reflect changes in technology and the growing popularity of VoIP.[21] The FCC declined to preempt state Carrier of Last Resort ("COLR") obligations, but also encouraged states to "review their respective regulations and policies in light of the changes we adopt…"[22] The URTA members note that the Commission is undertaking this precise type of review in this docket.

In addition to tweaking the definition of voice service, upholding state COLR and encouraging states to make changes of their own, the *USF/ICC Transformation Order* also requires for the first time that ETCs provide broadband at 4/1 Mbps—price cap carriers are required to provide broadband to *all* consumers on a build-out timeframe, and RLECs are required to provide broadband *upon reasonable request.* The challenge for RLECs lies in the fact that rural broadband networks are expensive to build and operate, and achieving 4/1 Mbps

[19] USF/ICC Transformation Order, ¶ 859
[20] USF/ICC Transformation Order, ¶ 36
[21] USF/ICC Transformation Order, ¶ 76-77
[22] UFS/ICC Transformation Order, ¶ 82-83

may require significant upgrades for many companies—but with capped and cut USF and ICC, planning and carrying out projects of this scale may be impossible. This will not only put the RLEC at risk of losing funding if it cannot meet the public interest obligations in the *USF/ICC Transformation Order*, but it will put the RLEC at a competitive disadvantage and harm consumers.

In addition to the public interest requirements, RLECs also have extensive new reporting requirements, many of which are still unclear, still awaiting Office of Management and Budget ("OMB") approval, and a real source of consternation for RLECs particularly throughout 2012 as reporting requirement dates and instructions have changed, been delayed, or remain ambiguous. The requirement to submit annual financial reports is a significant concern for private-held RLECs who do not make their financial information public, for example. A Petition for Reconsideration of this requirement was submitted by Comporium in December, 2011, but the FCC has still not addressed this issue.[23] The reporting requirements are costly and require the assistance of consulting, legal and engineering firms; some reports are redundantly required to be submitted to multiple agencies; and the first round of reports due on July 2, 2012 caused considerable confusion.

D. Pending and Future Changes

The list of pending and future changes that RLECs are bracing for is nearly as severe as the list of changes mentioned above, and the Rural Associations as well as members of Congress have been consistently warning the FCC to pause, take a deep breath, and wait for the impacts of the November 2011 *USF/ICC Transformation Order* and April 2012 *Benchmark Order* to be fully understood and analyzed before compelling any more caps, cuts, and new obligations on

[23] Petition for Clarification and/or Reconsideration filed by Rock Hill Telephone Company dba Comporium, WC Docket No. 10-90, December 29, 2011.

the industry.[24] Among the further changes mentioned in the *FNRPM*, the following have a severe impact on RLECs:

1. Application of QRA to Interstate Common Line Support ("ICLS")

In the FNPRM, the FCC "conclude[s] that we should also limit recovery of excessive capital and operating costs through the interstate common line support mechanism," and seeks comment on implementing limitations for ICLS.[25] One of the options the FCC puts forth is "run a single regression using the total interstate revenue requirement for each carrier," and the alternative option is "use the decrease in cost per loop resulting from the regressions used to limit HCLS to limit a carrier's interstate revenue requirement."[26]

2. Interstate Rate of Return Represcription

The FCC uses the fact that the 11.25 percent authorized interstate rate of return has not been updated in 20 years as the basis for the conclusion that "it is appropriate at this time to reexamine the rate of return as part of comprehensive reform of the universal service fund."[27] Reducing, and even eliminating, rate of return was a recommendation in the 2010 National Broadband Plan. Even though the FCC has appeared to have tabled this issue for the time being, it is still very much a threat. Reducing or eliminating rate of return in the midst of the other drastic funding cuts and caps mentioned above would be nothing short of financially devastating for RLECs.

3. Undefined Connect America Fund for Rate-of-Return Carriers:

[24] April 2012 letters from House and Senate.
[25] USF/ICC Transformation Order FNPRM, ¶ 1085
[26] USF/ICC Transformation Order FNPRM, ¶ 1087
[27] USF/ICC Transformation Order FNPRM, ¶ 1044

Phase I of the Mobility Fund and Phase I of the Connect America Fund for price cap carriers have already been carried out, with Phase II of both programs moving right along, on schedule. The FCC has not yet designed or released a proposed framework for the $2 billion RLEC Connect America Fund. The FCC has expressed desires to move all ETCs to an auction-based "market-driven" model for the distribution of Connect America Fund support. The uncertainty regarding the RLEC Connect America Fund further frustrates investment in rural broadband networks.

IV. URTA Comments on Possible Responses to Federal Reforms

URTA recommends the Commission examine various aspects of state universal policy in a staged approach using phases to address specific policies. A staged approach is reasonable and is in the public interest because while state reforms are necessary to complement the federal reforms, many of the federal reforms are still pending and the exact outcome of these complex reforms and their impact on URTA members is unknown at present.

At present, URTA believes there are two phases to this proceeding. The first phase of this docket should begin with discussions regarding UUSF reformation while waiting to see how the FCC changes will ultimately impact telecommunications carriers and industry. The state UUSF should not be redesigned until all parties know the full impact of the federal changes. Once the federal changes have been fleshed out, the state of Utah and its telecommunications providers will be better equipped to identify what reforms are actually needed and will better understand how to implement those reforms in conjunction with the federal USF program.

URTA provides the following comments on the specific possible responses raised in the Request for Comments.

A. Increase the UUSF to offset corresponding decreases in Federal USF

It is fully consistent with federal and state universal service policy to have the state offset decreases in Federal USF caused by reform of the federal USF programs. Historically, interstate universal service support has primarily served to support intrastate costs. For example, federal high cost loop support by rule must be used to meet the intrastate revenue requirement of the beneficiary. Similarly, Local Switching Support initially reflected a shift of intrastate switching costs to the interstate jurisdiction (as implicit support) and then to the federal universal service high cost fund (as explicit support).

Reduction or elimination of federal high cost support necessarily creates a degradation of intrastate cost recovery. It is appropriate for state universal service funds to step in to fill the void. Reliance on UUSF support to offset federal USF decreases is also consistent with the residual rate making conducted by the state and conforms to how the state universal service policy is conducted by the Commission. After accounting for interstate costs and associated revenues, the need of a requesting carrier is determined based on total regulated interstate and intrastate costs and revenues.[28]

B. Increase the UUSF contribution base by including broadband providers

Much of the emphasis of the FCC's reforms, including those related to universal service, raise broadband as an important goal and soon an important duty of ETCs. While the FCC has made broadband a required offering by ETCs, the telecommunications industry is in the process of working with the FCC to determine how those broadband requirements will be funded. URTA recommends that the state of Utah study and consider potential reforms to the UUSF, but delay any specific state reforms until the FCC has specifically determined how broadband as a universal service will be funded at the federal level.

[28] Utah PSC Rule R746-360-8

C. Expand the telecom revenues to which the UUSF surcharge applied beyond intrastate telecom revenues

URTA notes that historically, courts have ruled that states cannot apply intrastate USF contribution factors to interstate telecommunications revenue. However, the FCC has recently ruled, on a prospective basis, that states may extend their universal service contribution requirements to future intrastate revenues of nomadic interconnected Voice over Internet Protocol ("VoIP") service providers, so long as a state's particular requirements do not conflict with federal law or policies. Furthermore, a move to a connections-based contributions methodology is not prohibited by the FCC. In fact, the FCC has an open docket to examine the contribution methodology for federal USF and a connection-based contributions methodology is one of the options under review. URTA members recommend the Commission study the merits of moving to a connections-based methodology for UUSF funding.

D. Limit the amount of UUSF support available (i.e. sliding scale up to a capped per line amount)

Caps have existed for interstate high cost support along with, for high cost loop support, a sort of sliding scale based on the national average cost per loop. Stemming from the *USF/ICC Transformation Order*, interstate high cost support caps and sliding scales are currently undergoing a process effecting streamlining and refinement.

Adopting a limit or sliding scale to UUSF support has consequences for rate of return carriers and their regulatory framework in Utah. Since state ratemaking is residually based, limiting UUSF may have the consequence of preventing the rate of return regulated carrier from the opportunity to earn it prescribed rate. This would overturn the longstanding rate-of-return

regulatory regime held in the state. It is not appropriate to eliminate rate-of-return regulation in this proceeding that is designed to respond to federal USF reforms.

Thus, this possible response has little to do with federal USF reforms and does not provide for cost recovery of universal service based costs. The current Commission procedure to examine each applicant's request for UUSF support provides the Commission with the protection that the UUSF will not become unmanageable.

If the Commission wanted to establish a set of cost-recovery standards to encourage efficiency, the URTA members recommend that there is a mechanism to seek a waiver of these standards based on a case-by-case review of the particular facts presented by the applicant.

E. Establish eligibility for fund support on the basis of total company revenues including non-regulated affiliates

The prohibition by the Communications Act of 1934, as amended, against cross-subsidization establishes a wall between regulated and non-regulated operations. Inclusion of the revenue of non-regulated affiliates in establishing eligibility for fund support would overturn this longstanding prohibition. .

The regulation of non-regulated affiliate revenues is problematic for a variety of reasons. First, if non-regulated activities are to be considered, the question of scope must be addressed. The only non-regulated activities that can reasonable be included are those activities that are within the carrier's service territory and that use the infrastructure of the regulated carrier. Second, it must be realized that the non-regulated activity also has costs and revenues. The affiliate's revenues must be net of affiliate costs—this raises the question of how to "regulate" and "non-regulated" activity. Consider for example that if a carrier was offering IPTV over regulated broadband connections, then the programming and associated costs must be included if

one were to seek to include revenues from the non-regulated affiliate. Of course, some non-regulated activities are not profitable and by including net revenues in the UUSF determination, there can be instances where the non-regulated is supported through the UUSF mechanism.

As a result of these issues, and because of the uncertainty regarding the FCC's funding of broadband service, URTA suggests that the state of Utah and the Legislature should engage in further discussion and study regarding: 1) expansion of the UUSF to include broadband services; 2) contribution methods related to broadband services; and 3) disbursement methods related to broadband services, but should delay UUSF reforms until the FCC has finalized the reforms to the federal USF program.

F. Imputing a set amount of revenue to each telephone company

Imputation of a set amount of revenue to each telephone company would require a rational and nondiscriminatory basis of imputation. It is difficult to conceive of either a rational basis of imputation of revenue given the geographic, demographic and other types of differences among telephone companies. Notwithstanding, imputation is done by the Commission for voice service using its benchmark rate. The question is whether this same approach should be used for broadband services. Clearly, under any imputation methodology, the Commission should allow for case-by-case exceptions based on external conditions and or extenuating circumstances examined within a discrete application of support.

G. Eliminate the state UUSF fund

Now is a time when URTA members in Utah will experience decreases in federal high cost support. Elimination of the UUSF at the same time would significantly weaken the ability of the Utah carriers to continue to improve service or even provide it at all in some cases. Reductions

in federal support that has historically supported intrastate activities should never cause the state to shy away from its responsibility to provide adequate opportunities to improve the communications infrastructure in rural areas of the state.

H. Redirect the fund to support broadband

As discussed above, URTA submits that the case for including broadband services as a universal service is compelling. The proposed action to redirect the fund to support broadband should be viewed as a transition from the current voice network to a broadband infrastructure. URTA supports the effort to consider how to include broadband services as part of universal service in Utah. It should be recognized that UUSF funds already indirectly support broadband deployment of URTA members through replacement of copper facilities with fiber optic cables. This replacement is needed to prepare for the future in rural areas of the state.

Expansion of coverage to support broadband in rural areas is desirable if adequate funding is available and expansion and maintenance of fiber optic infrastructure is not harmed.

I. Restrict the types of service costs for which support is available

The nature of the URTA members' networks makes it difficult and problematic to restrict types of service costs for which support is available. The same fiber optic cable facilities support all of the services of an RLEC.

Historically, types of services for which support is available have been associated with the types of services delineated by the FCC's Part 36 Jurisdictional Separations and Part 69 Access Charge rules. For example, no support currently flows to interstate Special Access.

Care must be taken not to artificially break-up the costs supported. For example, a limitation of support to investment belies the relationship of maintenance and depreciation costs over time.

V. Conclusion

Continued economic development and growth in the state of Utah is dependent on an advanced statewide telecommunications wireline network. The UUSF is critical to the maintenance and development of that network. URTA commends the PSC and the Legislature for commissioning this study and preparing Utah for the future. URTA believes that a transition to broadband support by the UUSF is necessary, but strongly recommends that state reforms be delayed until there is clarification from the FCC on the federal USF program.

Respectfully submitted this 30th day of November, 2012.

BLACKBURN & STOLL, LC

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Stanley K. Stoll
Kira M. Slawson
Attorneys for Utah Rural Telecom Association

CERTIFICATE OF SERVICE
Docket No. 12-999-10

I hereby certify that on the 30th day of November, 2012, I served a true and correct copy of Utah Rural Telecom Association's Entry of Appearance and Comments via e-mail transmission to the following persons at the e-mail addresses listed below, and was emailed to each individual who received (via email) the PSC Request for Comments and Notice of Technical Conference:

Division of Public Utilities
Bill Duncan
wduncan@utah.gov

Division of Public Utilities
Assistant Utah Attorney General
Justin Jetter
jjetter@utah.gov

Office of Consumer Services
Michelle Beck
Eric Orton
Cheryl Murray
mbeck@utah.gov
eorton@utah.gov
cmurruy@utah.gov

Office of Consumer Services
Assistant Utah Attorneys Generals
Paul Proctor
pproctor@utah.gov

/s/Kira M. Slawson