DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE

DRAFT REPORT

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 Number 12-999-10

April 5, 2013

CONTENTS

I. EXECUTIVE SUMMARY

Over the past decade the telecommunications marketplace has seen significant changes. In many areas, customers are able to get basic telephone service from a number of different companies. Services that were once considered a luxury, like wireless and broadband, have become accessible to most Utah consumers, and primary for many.

The Universal Public Telecommunications Service Support Fund ("UUSF") was originally created to make basic telephone service available and affordable to all Utah customers. The fund provides companies offering service in high-cost areas a subsidy from all telephone customers. The greatest number of these customers is found in more urban areas of Utah. The mechanisms of the state fund, paired with the Federal Universal Service Fund ("FUSF"), worked well when there was only one telecommunications provider that offered voice services in a given area.

Originally, the state fund mirrored the FUSF, giving subsidies for basic phone service. In November 2011 the Federal Communications Commission ("FCC") began a major overhaul of the existing rules dealing with universal service. The FCC is transitioning the federal funds to support broadband instead of voice services, with an eventual phase-out of subsidies for voice service.

Whether, and to what extent, the UUSF should also be changed to reflect changing markets and technologies are appropriate and necessary questions for policymakers. If the current statute and rules remain, the size of the fund will likely increase over time as companies in high-cost areas continue to lose federal subsidies for basic telephone service. Additionally, regulatory treatment of telecommunications companies may increasingly fail to account for realities existing in the marketplace. This report provides background on universal service programs and commentary on various options for changes to Utah's universal service program identified by the Utah Public Service Commission ("Commission"), the Utah Division of Public Utilities ("Division"), and other commenters.

II. BACKGROUND

The Utah universal service program was originally designed to mirror federal support programs to provide reasonably priced basic phone telephone service in areas where it would otherwise be uneconomical to do so. Companies serving in high-cost areas of Utah were eligible for subsidies from the federal USF. Any gaps in that funding were to be covered by the UUSF.

On November 18th 2011, The Federal Communications Commission ("FCC") released an extensive order that is fundamentally changing the distribution of federal funds to rural telephone companies. On November 2, 2012 Utah's Commission opened a docket to consider changes to the UUSF. This report is a response to the Commission's request for evaluation of various potential changes to the UUSF to reflect changing federal programs, technology, and markets.

The result of the recent federal changes will likely be the loss of revenue to rural telephone companies. Because the FCC and the telephone industry are still evaluating the details of the changes, the extent of revenue loss to rural telephone companies is unknown at this time. Under current Utah law (Utah Code §54-8b-15), and corresponding Public Service Commission Rules, decreased revenues will be recovered by increased disbursements from the UUSF. Increased disbursements would be funded by increasing the surcharge rate applied on telephone bills to all consumers in the state, to the extent the current surcharge provides inadequate funding.

The Division has compiled information and comments from interested parties on this topic. This report includes that compilation and Division commentary. The report is subject to modification by the Commission. The Division does not advocate any position or specific proposal.

III. GLOSSARY OF TERMS

CLEC – Competitive Local Exchange Carrier – A company providing telephone service using a combination of its own facilities and lease facilities from Century Link. Most CLECs serve in CenturyLink service area.

COLR – Carrier of Last Resort – An obligation assumed by a telephone company requiring service to any customer in the company's certificated area.

ETC – Eligible Telecommunications Carrier – Designation by the Public Service Commission allowing a company to receive funds from both the FUSF and UUSF.

ILEC – Incumbent Local Exchange Carrier – A traditional wireline carrier serving a defined geographic area. In Utah, CenturyLink and 16 rural telephone companies are ILECs.

Lifeline – A subsidy available to qualifying individuals for discounted telephone service. The subsidy is discounted from the phone bill and the company is reimbursed from the UUSF. The current subsidy is $3.50 per month.

RLEC – Rural Local Exchange Carrier – Another term for an ILEC serving a rural portion of the state.

VOIP – Voice Over Internet Protocol – Voice telephone service provided over the internet. VOIP is delivered in two methods:

Fixed VOIP – Provided by companies such as Comcast from a fixed location.

Nomadic VOIP – Provided by companies such as Vonage, SKYPE or Magic Jack. Consumers can place a voice call from any location that has a high speed internet connection.

IV. HISTORY OF FEDERAL UNIVERSAL SERVICE FUNDS

The FUSF is an integral part of 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 has outpaced regulation.

The Communications Act of 1934 made the theory of universal telecommunications service the policy of the federal government. It also 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…"[1] Universal service was a commitment, but rules and explicit funding mechanisms did not appear until decades later

In 1996, Congress enacted the Telecommunications Act creating the FUSF and amending the 1934 Communications Act.[2] The 1996 Telecommunications Act ("Act") established several principles related to the FUSF. These principles include:

[1] 47 USC § 151

[2] The notion of universal service was arguably first advanced as long ago as 1907. See Steven G. Parsons and James Bixby, Universal Service in the United States: A Focus on Mobile Communications, 62 Fed. Comm. L.J. 119, 123-24 (2009).

providing quality services at "just, reasonable, and affordable rates";[3] providing "advanced telecommunications and information services" to consumers in all regions of the nation, including rural, low-income and high-cost areas;[4] and providing an "equitable and nondiscriminatory contribution" to universal service by all telecommunications service providers.[5]

Only telecommunications carriers designated as "eligible" under the Act may receive FUSF monies.[6] "A carrier that receives such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."[7] This has meant that a telecommunications carrier must use the FUSF solely on its regulated services (i.e., basic telephone service) not its non-regulated services (e.g., broadband and Internet) through FUSF payments. Under the Act, "states may adopt regulations not inconsistent with the [FCC's] rules to preserve and advance universal service."[8]

V. HISTORY OF STATE UNIVERSAL SERVICE FUNDS

Prior to the establishment of the UUSF in 1997, the goal of universal telephone service was promoted through a number of explicit and implicit mechanisms. The explicit support mechanisms included a variety of programs providing funding to telephone companies. In Utah, a precursor to the UUSF was established in 1990

[3] 47 U.S.C. § 254(b)(1).

[4] 47 U.S.C. § 254(b)(2)-(3).

[5] 47 U.S.C. § 254(b)(4).

[6] 47 U.S.C. § 254(e). See also 47 C.F.R. 54.5 (defining "eligible telecommunications carrier").

[7] 47 U.S.C. § 254(e). See also 47 C.F.R. 54.7 (stating same).

[8] 47 U.S.C. § 254(f).

with a surcharge rate of $.05 per minutes of use on intrastate telecommunication wireline services.

Implicit mechanisms provided untargeted support through various pricing and cost allocation policies meant to keep the cost of basic telephone service low. These included above cost pricing for various services, which allowed for below cost pricing for other services or services in high-cost areas. 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. This increased revenues for rural carriers for switching, enabling lower rates for basic telephone service while roughly maintaining the carriers' overall returns.

With the enactment of the UUSF and the explicit support provided by it through UUSF 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, to varying extents, the lost revenues resulting from rate reductions or rate rebalancing.

State Universal Service Defined

As understood today, the concept of universal service 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 federal Telecommunications Act of 1996 contains an explicit commitment to preserving and expanding universal telephone service, and makes clear that both state and federal regulators have significant responsibilities to ensure universal service goals are met. In 1997, the Utah Legislature codified the public policy goal of universal service through the establishment of the UUSF to, "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).

In codifying the public policy goals for universal service the Legislature was specific in defining "Basic Residential Service" and what services would be eligible for support from the UUSF. Subsection 54-8b-2(2) of the Utah Code defines Basic Residential Service as:

> (2) "Basic residential service" means a local exchange service for a residential customer consisting of:
> (a) a single line with access to the public switched network;
> (b) touch-tone or the functional equivalent;
> (c) local flat-rate unlimited usage, exclusive of extended area service;
> (d) single-party service;
> (e) a free phone number listing in directories received for free;
> (f) access to operator services;
> (g) access to directory assistance;
> (h) access to lifeline and telephone relay assistance;
> (i) access to 911 and E911 emergency services;
> (j) access to long-distance carriers;
> (k) access to toll limitations services;
> (l) other services as may be determined by the commission; and
> (m) no feature.

VI. CURRENT STATUS OF STATE UNIVERSAL SERVICE FUNDS

A. WHO CONTRIBUTES TO STATE USF

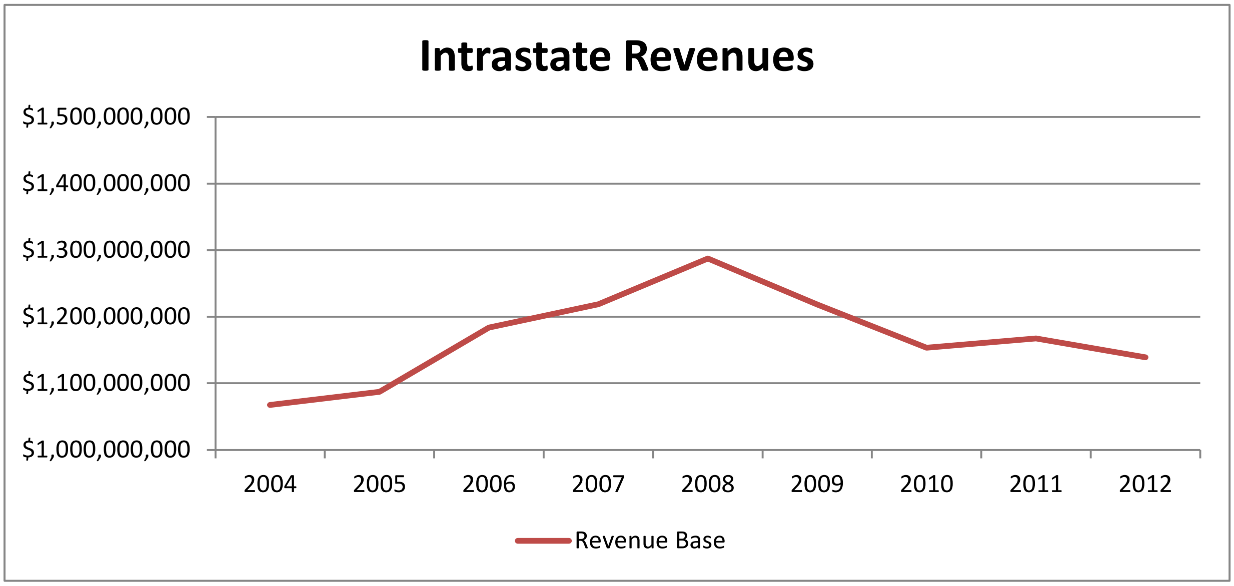
Utah Code Subsection 54-8b-15(10) defines who should contribute to the fund. Currently all ILECs, CLECs, toll resellers and wireless companies contribute to the fund. Some VOIP providers contribute, some do not.[9] As stated previously, the original charge on customer phone bills began as a minute of use at a set amount. In June of 1998 the rules were changed so the amount charged would be a percentage of intrastate revenues. This charge would be applied to all telephone bills for residents in the State of Utah. The chart below shows the original amount was set at one percent of all intrastate revenues. Over time this percentage has fluctuated to meet the need for high-cost support from a high of one percent to a low of one-quarter of one percent in 2009. The current rate is one percent.

Historical Chart of Contribution Rates

Date	Rate
June 1, 1998	1.00%
January 1, 2000	0.67%
September 1, 2001	0.34%
November 3, 2003	0.90%
July 20, 2006	0.50%
October 1, 2008	0.45%
November 1, 2009	0.25%
September 1, 2011	1.00%

The surcharge rate is applied to intrastate revenues as reported by the companies that pay into the fund. After several years of increasing intrastate revenues, recent years have seen that revenue declining.

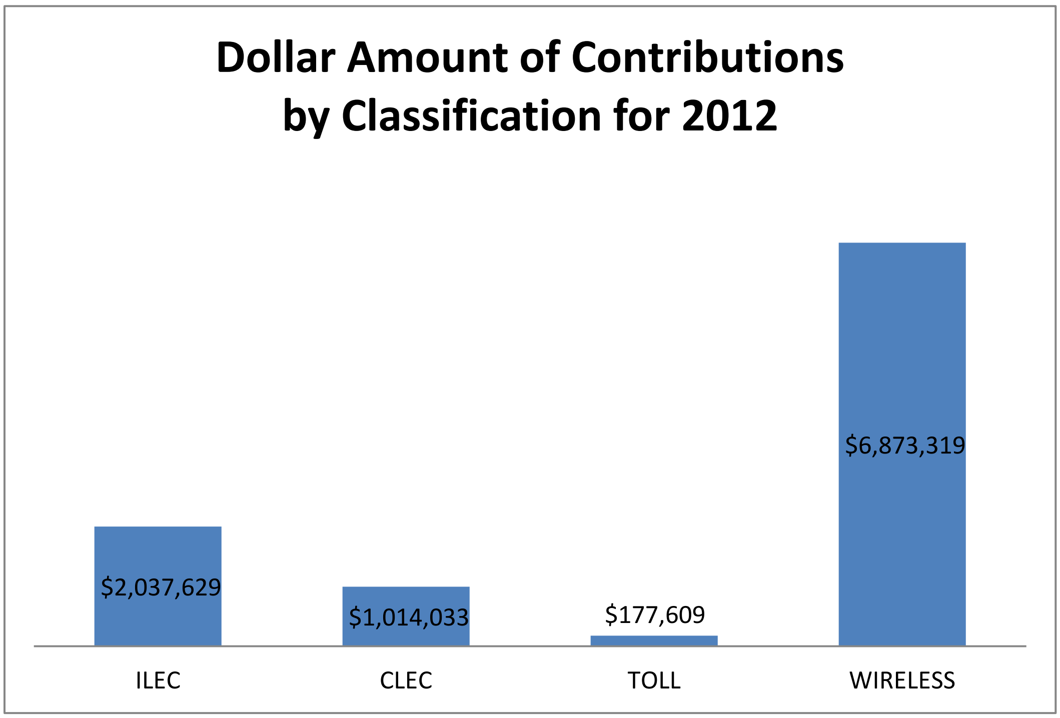
[9] There is some dispute about the current status of the law relative to required contributions from VOIP providers. While some providers pay, the Division has reason to believe that various other VOIP providers with a variety of technologies do not contribute to the UUSF. Currently paying VOIP providers claim to be paying voluntarily, not conceding the applicability of the charge to their services.



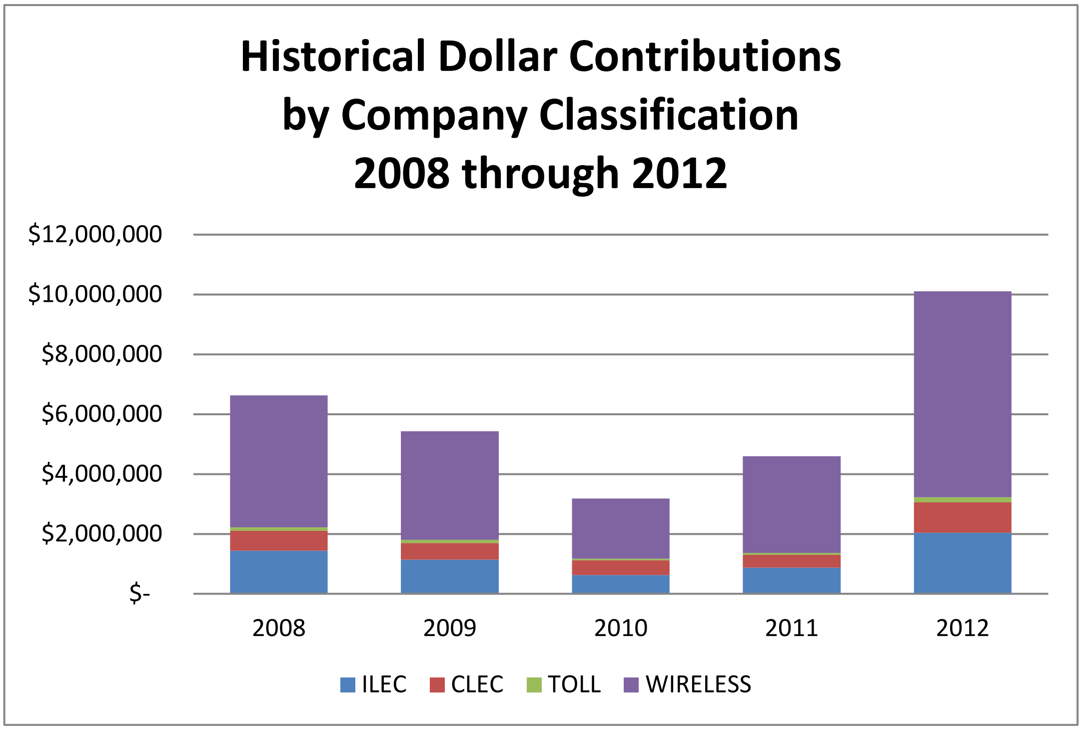
While this revenue decline may have some cyclical component, it is likely impacted by declining use of traditional telephony products as consumers move to VOIP.

Originally, the premise behind UUSF was to have an explicit subsidy where all wireline customers paid into a fund to offset a portion of the costs to rural areas of the state. With the dramatic increase in wireless phone service in the last decade, proportional contributions to the UUSF have changed from being closely split between urban wireline ILECs and wireless companies. Today wireless companies are the largest contributors to the UUSF, making more than seventy percent of contributions.

In 2012 total contributions into the UUSF were $10.1 million. As the table below illustrates, wireless carriers contributed $6.78 million of the total. $2.04 million was paid by ILECs while just over $1 million was paid by CLECs. Toll resellers contributed the lowest amount at $177, 609.



Since 2008 the lion's share of the funds contributed to the UUSF have come from wireless carriers. The table below shows the total dollars paid each year and the amounts by each company classification broken out. Even with declining fund requirements in 2009 through 2011, wireless carriers were the largest contributors into the UUSF.

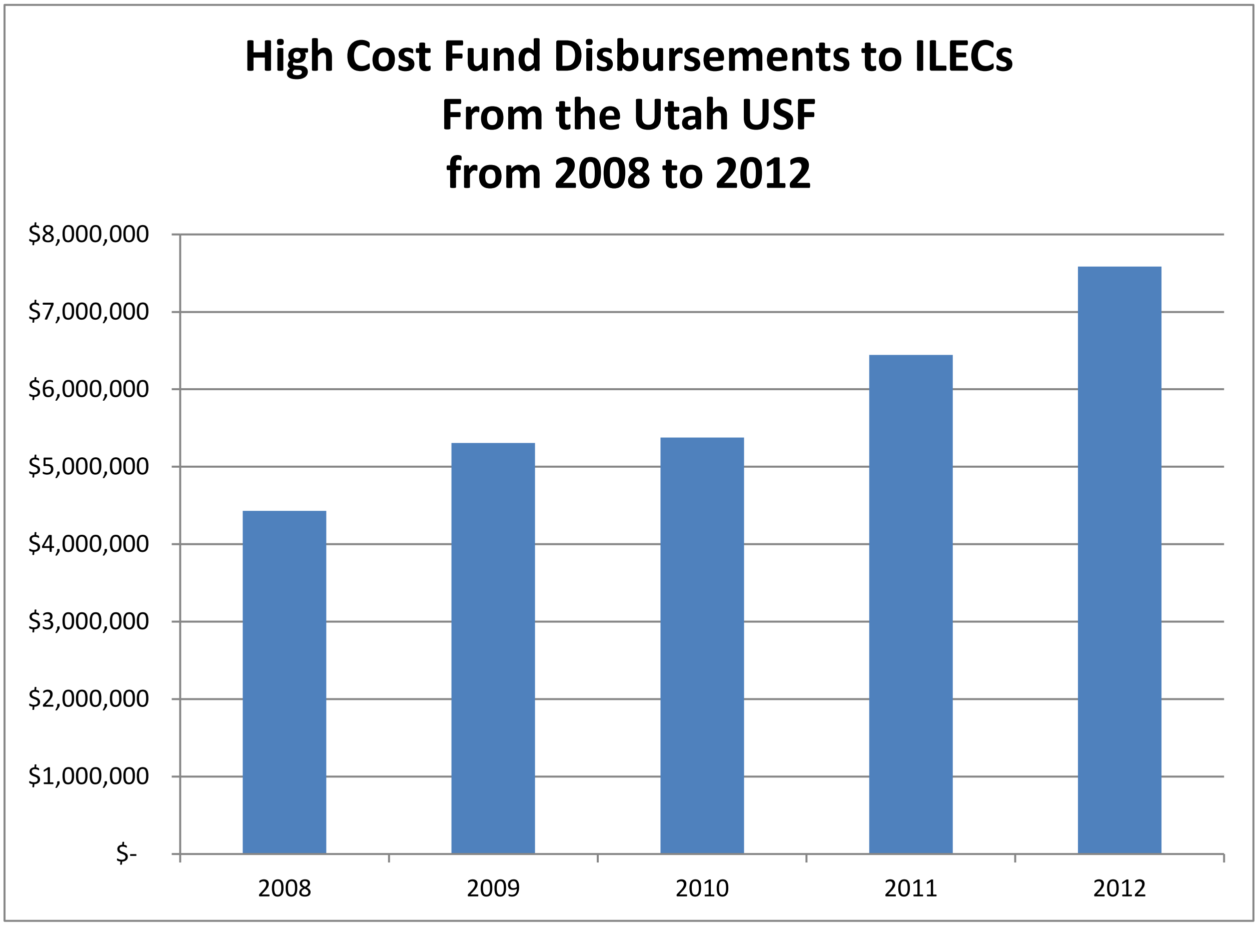


B. COMPANIES THAT RECEIVE STATE USF

High-cost Funds

Public Service Commission rule R746-360-6 defines the companies that are eligible to receive funds. Currently, eleven of the sixteen RLEC's in Utah receive funds from the UUSF.

Because of the nature of universal service goals and the stated policy of ubiquitous availability of specified telecommunications services delivered at an affordable price, all disbursements for high-cost funds go to RLECs. With the funds from UUSF the rural phone companies have been able to provide telecommunication services that are comparable to those in urban Utah. The table below shows the total dollars provided to RLECs for high-cost support from 2008 to 2012.



In 2012, rural phone companies received from the state fund approximately $8 million dollars. With increased competition from wireless providers, upgrades to more advanced technologies, and a variety of other factors, the UUSF has seen an increase year to year in the funds distributed to rural phone companies. From 2008 to 2012 the increase is almost 71%. With the ambiguity in the regulations for federal high-cost support the trend of increased disbursements may continue.

Lifeline

The UUSF also funds the Lifeline program. This program provides a credit of $3.50 per month to qualifying individuals. The consumer receives the credit on each monthly phone bill, and the UUSF reimburses the telephone company for the credit. Currently all ILECs receive funds for Lifeline customers.

VII. UTAH USF POLICY

The Commission, as a result of an inquiry from the Utah State Legislature, opened a docket to study and report on the need for possible changes in UUSF laws or rules arising from the changes in the FCC Order. The Commission specifically asked participants to examine the following policy options:

- Increase UUSF payments over time as necessary to offset corresponding decreases in federal USF support available for basic telephone service;
- Increase the UUSF contribution base by including, for example, broadband providers;
- Expand the telecommunication revenues to which the UUSF surcharge applies, beyond intrastate telecommunications revenues;
- Limit the amount of UUSF support available, e.g., using a sliding scale up to a capped amount of support per line;
- Restrict the types of service costs for which UUSF support is available;
- Establish eligibility for UUSF support on the basis of total company revenues, including revenues of cable/wireless/internet affiliates;
- Impute a set amount of revenue to each telephone corporation, representing the revenue potential of each of its lines, in determining UUSF support eligibility;

- Eliminate the UUSF;
- Redirect the UUSF to broadband support; and
- Other alternative responses as suggested by interested parties.

During the course of the comment period, parties suggested two other alternatives:

- Increase the use of one-time distributions from the fund;
- The use of proxy cost models to determine disbursements from the fund.

The Commission asked interested parties to file comments on these topics and other items the participants felt were important to understanding the status of the UUSF and potential impacts of changes.

Comments were filed with the Commission by the Office of Consumer Services ("OCS"), CenturyLink, Utah Rural Telephone Association ("URTA"), AT&T, Verizon, AARP, Salt Lake Community Action Program ("SLCAP"), and Comcast. In the pages below the Division provides a summation of the comments. Attachment 1 is a summary of the specific position of each organization.

<u>Increase the Fund over time</u>

Background:

With the federal changes for universal service, increasing the fund over time would naturally follow from maintaining current provisions. UUSF covers the funding gaps for high-cost areas when the rates charged customers and revenues from the federal government are not sufficient. With a decrease in federal subsidies, UUSF payments would increase.

Submitted Comments:

With the potential decreases for high-cost support to RLECs from the FCC's Reform Order, one option for the state is to basically leave the current rules and regulations intact and not change anything. Because most of the companies receiving UUSF are rate-of-return regulated, any material decreases in federal funding would be ultimately replaced by UUSF. Most participants filing comments were not in favor of increasing the UUSF over time. Many pointed out that the decreases in federal funds were not intended to be replaced by state funds. Additionally, companies argued that a "make whole approach" is not sustainable and may result in large increases in the state fund, placing a large burden upon providers and customers who pay the UUSF surcharge. Other companies indicated that the FCC in its reform order established other mechanisms besides state funds to replace the revenues lost by the changes to federal USF.

URTA was the one organization that believed it was consistent with the goals of universal service to offset loss of revenue on the federal side with money from the UUSF. URTA suggested "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 supported intrastate costs. Reduction or elimination of federal high-cost support necessarily creates a degradation of intrastate cost recovery."

Because companies are still trying to understand the full impact of the federal changes to their revenues, it is difficult to accurately determine the timing or magnitude of funding gaps. It is possible that the UUSF would not see significant increases in requested funds because the federal reductions are not material. Conversely, the UUSF and the revenues paid to companies could plausibly double or triple in the coming years if current UUSF policies remain unchanged. Regardless of the impact of the federal funds reductions, the UUSF surcharge rate will likely increase as many consumers move away from traditional telephony services.

Increase the UUSF contribution base

Background:

Current regulations arguably do not require broadband-only providers and VOIP providers to contribute to the UUSF. Increasing the UUSF contribution base to include services other than telephone service is one alternative to increase the funds available to the UUSF. This could be done by including broadband, VOIP, and related services.

Submitted Comments:

Comcast and Verizon argued that because the purpose of the Fund is to support only basic local exchange telephone service, there is no reasonable basis for requiring broadband and VOIP customers and companies to fund those local exchange telephone services. They contend broadband services and the customers that use them should not be subject to new fees solely to support traditional voice services and the historical analog voice business model. Expanding the base and placing these new fees on broadband companies would deprive consumers of the benefit of competition by requiring them to pay for the basic phone services of a competitor.

Expand the telecommunication revenues to which the Fund surcharge applies

Background:

Current law indicates that only intrastate revenues are subject to the surcharge for the UUSF. Intrastate revenues are a result of calls that originated and terminated within the state of Utah. By rule, interstate long distance calls, broadband services, and other various services are excluded from the surcharge. To offset the expected increase in funding requirements from the UUSF, the rules could be modified to include revenues that are currently excluded.

Submitted Comments:

Most commenters would oppose proposals that increase the burden on Utah's consumers and businesses making contributions to the UUSF. The operation of the UUSF is similar to the Federal USF in that the collection and distribution of funds must be nondiscriminatory and competitively and technologically neutral. Given technological change since 1997, it is not clear just how, if at all, this directive applies to new services, such as VOIP, that provide two-way voice communication.

Other perspectives offered are that a move to broadband connection-based contributions is not prohibited by the FCC.[10] The FCC has an open docket to examine the contribution methodology for FUSF and a connection-based contribution methodology is one of the options under review.

<u>Limit the amount of Fund support available</u>

Background:

[10] The exact impact of FCC policies on the state fund is debatable. To the extent a state provision runs directly afoul of a federal provision, the state may be foreclosed from certain remedies. However, a state has more discretion when its aims differ from, but do not conflict with, the FCC.

Current law does not limit the size of the UUSF. If the revenue shortfalls for high-cost areas continue to increase, those funding gaps would be reimbursed by the UUSF. This escalating need for fund support to cover high-cost areas occurred with the FUSF. The FCC took various measures to limit the amount of fund support, including capping the FUSF, using proxy cost models, and implementing reverse auctions. If the Legislature was interested in capping the UUSF to limit the amount of fund support available, any number of methods used on the federal level could be implemented here. Depending on methods chosen, considerable regulatory work may remain after legislative action.

Submitted Comments:

Limiting the amount of fund support was an option with conflicting viewpoints. AARP strongly indicated that UUSF should not become a "blank check" urging establishing accountability mechanisms for UUSF use. It suggested that carriers genuinely need the subsidies to provide affordable service. Verizon was emphatic that support should be provided only in geographic areas where no unsubsidized competitor is already providing service. Verizon contends that wireless service, where available, should be treated as a comparable service for this purpose. In a multi-provider market, says Verizon, any area served by an unsubsidized provider should be assumed to be an area that can be served economically, i.e., where rates cover the cost of providing service.

URTA commented that adopting a limit or sliding scale to UUSF support has consequences for rate of return carriers and their regulatory framework in Utah. In essence, because the UUSF is designed to make up the residual between a company's revenues and a reasonable rate of return, limiting UUSF payments would necessarily prevent a company from achieving a reasonable rate of return. This would overturn the longstanding rate-of-return regulatory regime followed in the state. URTA expressed concerns that it is not appropriate to eliminate state rate-of-return regulation in a proceeding that is designed to respond to federal USF reforms.

Restrict the types of service costs for which Fund support is available

Background:

UUSF policy is clear that support is for basic telephone service. With the convergence of networks and customers' use of voice and broadband blending, allocating costs specific to basic telephone service is challenging. One method to restrict the types of service costs for which UUSF support is available would be to create a proxy cost model. The model could use costs from companies throughout the state giving a benchmark to use to determine the appropriate level of support. Another option to restrict the type of service costs is the use of allocation factors between basic (regulated) and other (unregulated) services.

Submitted Comments:

With current market conditions and technological advances, there is a convergence of basic telephone service networks and broadband and cable networks: multiple services are easily provided over the same network infrastructure. This convergence muddies UUSF administration by requiring companies and regulators to determine what portion of a network and its accompanying expenses and revenues is used for basic telephone service and what portion of the network is providing unregulated services. URTA members, through funds received from the UUSF, have, in an effort to provide reliable phone service comparable to urban areas, replaced copper facilities with fiber optic cables. Given the difficulty of pricing and separating revenues and expenses on such networks, there is concern that the UUSF has been funding growth in unregulated services, rather than solely the basic telephone service allowed by law.

The nature of modern networks may make it difficult restrict types of service costs for which support is available. The same fiber optic cable facilities support all of the services of many companies. Care must be taken not to artificially break-up the costs supported. For example, a limitation of support to investment ignores maintenance and depreciation costs over time.

The current UUSF statute is designed to support basic telephone service, but as a result of the convergence in telecommunications networks, it is becoming increasingly difficult to accurately determine costs attributable to basic phone service. Other than URTA, most commenters felt that continuing a limit to basic phone service was in the public interest at this time.

CentruryLink suggested a forward-looking cost model to determine which costs should be attributed to basic phone service. A cost-model is a complex method of establishing a per-line amount of support available to a carrier. While it avoids some of the difficulty of separating costs, it must be developed with care and be responsive to different operating conditions of each company. Establishing such a model would require considerable regulatory activity and industry input.

Although no other party advocated using a cost model, Verizon agreed that it is apparent that the methods currently used to calculate the amount of distributions from UUSF may no longer be appropriate. AARP argues for rigorous analysis of costs and revenues associated with carriers' provision of voice services to ensure that subsidies are prudently provided.

<u>Establish eligibility for Fund support on the basis of total company revenues</u>

Background:

As noted, the same fiber optic cable that allows a telecommunications company to provide basic phone service can be used to provide many other services. Often, the RLECs have established affiliate corporations that offer the non-regulated services to customers. Current UUSF rules suggest the only revenue that can be analyzed is the Average Revenue Per Line by ILECs. This means non-regulated services, i.e. video, broadband, etc., are not included in the calculation. While separating expenses can be problematic, the same is not true for revenues; companies should have separate line items or affiliate companies who charge for the various services. One option is to evaluate regulated and non-regulated revenues together to determine support.

Submitted Comments:

The parties filing comments did not really discuss this option in detail other than to illuminate the challenges in looking at total company revenues.

OCS believed evaluating eligibility for UUSF support on the basis of total company revenues has some merit, but also some challenges. A fundamental issue in evaluating eligibility is proper allocation of shared facilities used to provide both regulated and non-regulated services. OCS asserts that it should be a bedrock principle underlying eligibility for UUSF support to verify proper allocation of costs to non-regulated services and companies using the same facilities as those used in providing telephone service seeking UUSF support.

URTA suggested the prohibition by the Communications Act of 1934's, prohibition of 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, in URTA's estimation, overturn this longstanding prohibition. The common thread in both OCS' and URTA's comments is that a total company revenue evaluation would merely be a proxy of some sort for the type of regulatory evaluation of the revenues and expenses of basic telephone service that currently occurs.

<u>Impute a set amount of revenue to each telephone corporation</u>

Background:

Current law requires the Commission to establish an affordable base rate ("ABR") that companies should be charging their customers. (Utah Code §54-8b-15(7)(b)). The premise is that the ABR will be close to what customers are paying in urban areas of the state for basic telephone service. When evaluating disbursements for UUSF, the Division has imputed the revenues that should be received if the company is charging the ABR.

Submitted Comments:

As a general practice, imputation of revenues happens if a carrier is charging lower than the ABR. Verizon and Comcast both agreed that a carrier should not receive support from the Fund if it is charging unreasonably low local service rates, i.e., rates below a new affordable rate benchmark that the Commission should establish. If a carrier chooses not to increase its retail rates to the benchmark (for example, to avoid losing landline customers who might take other services), the Commission should impute the additional revenues the carrier would obtain were it to price its services at the ABR. An equivalent decrease in the level of support for which the carrier might otherwise be eligible would follow.

URTA maintained imputation of a set amount of revenue to each telephone company would require a rational and nondiscriminatory basis of imputation. URTA argues it is difficult to conceive of a rational basis of imputation of revenue given the geographic, demographic and other types of differences among telephone companies. Notwithstanding, imputation is currently done by the Commission for voice service using its benchmark rate. Whether this approach should be applied to other services is a question for policy makers.

Eliminate the Fund.

Background:

The UUSF was created to provide reliable basic telephone service to all of Utah. With the rapidly changing telecommunications landscape, the importance of basic telephone service is diminished by reliable broadband connections and other technologies and applications. The federal government is transitioning federal subsidies from high-cost areas to its Connect America Fund that will begin to support broadband connections. Because market dynamics are making broadband more vital, arguments could be made that UUSF has served its stated purpose and the need for the fund is decreasing.

Submitted Comments:

Most of the organizations filing comments felt that it was unwise and premature to eliminate the fund at this time. With the changes happening at the federal level to USF support, rural phone companies and other telecommunications providers are dealing with significant changes and laboring to understand impacts of the new regulations. Further, many long-term capital investments have been made on the basis of past federal and state revenues, with federal revenues now likely to diminish in the coming years. Staying the course and having some kind of UUSF until a clearer picture of the total impacts from the federal changes was the general consensus among commenters.

Verizon did argue the point that the UUSF is established to "preserve and promote universal service within the state by ensuring that customers have access to affordable basic telephone service." Verizon argues that because of extensive intermodal competition that has developed over the intervening years since creation of the UUSF, the original purpose of the UUSF has been met and the program is no longer necessary. The company suggests that customers in Utah have access to affordable basic telephone service rendering the fund no longer necessary to meet its stated purpose.

While OCS did not advocate elimination of the UUSF, OCS also believes that high-cost support provided by the UUSF should not be necessary in perpetuity.

Redirect the Fund to broadband support

Background:

Basic phone service has been achieved for much of Utah's citizenry. Today, the market is changing. Reliable broadband connections are vital for economic growth and a sustained quality of life. The federal government is beginning the task of transitioning FUSF to broadband. To meet the demands of a changing competitive market, transitioning the UUSF to support broadband is an option to deal with federal universal service changes.

Submitted Comments:

Redirecting the fund to broadband support was another area where there seemed to be a fair amount of consensus between the parties. Most of the parties either felt it was premature to redirect the UUSF to broadband support or opposed the idea entirely. The reasons discussed were:

- Current state law limits the use of the UUSF for basic telephone service. (Of course, the Legislature is free to change this should it wish to);

- Basic residential phone service is regulated whereas broadband services are not;
- Lack of understanding of the gaps between federal funding for broadband support and the costs of deploying broadband to underserved areas; and
- An immediate change to a state broadband fund leading to gaps in funding for voice service in truly high-cost areas.

URTA was the only commenter that felt the case for including broadband services as a universal service is compelling. URTA would support an effort to consider how to include broadband services as part of the UUSF. In CenturyLink's opinion, because voice and broadband services are continuing to converge to a single network there might be a point in the future when the UUSF may need to include broadband. Should the Legislature wish to support broadband services in the future, it will likely need to provide an orderly and reasonable transition period.

Other Policy Questions with UUSF

Besides the policy questions asked by the Commission, there were other items that commenters felt should be considered when reforming the current UUSF program. They were Carrier of Last Resort Obligations ("COLR"), one-time distributions from the UUSF, and proxy cost models. Each policy will be discussed briefly below.

Carrier of Last Resort

Carrier of last resort obligations require a company to offer service within a defined geographic location to anyone that wants basic phone service. COLR principles have existed for a number of decades and generally are a requirement for ILEC companies who were monopoly telephone providers. COLR works in a monopoly environment because low-cost customers of the monopoly provider can subsidize those high-cost customers. Because of competition, local exchange providers can no longer rely on surpluses from low-cost consumers. If the UUSF stays same or is transitioned into some other method of regulation, CenturyLink argued that COLR obligations should exist only where UUSF funds are received.

One Time Distributions from UUSF

Commission rules allow for the UUSF to provide one-time funding for high-cost projects. Project costs are generally shared by the company, the consumer, and the UUSF. Using a formula depending on project costs, a total contribution amount is calculated. The current rules have a total cap of $10,000 per line. CenturyLink argued that one-time distributions should still be included in any UUSF policy. If the fund was used for broadband support, one-time distributions could be a method to increase investment in unserved and underserved areas of Utah.

Proxy Cost Models

This alternative was suggested by Century Link. As discussed earlier in this paper, it would be a method of limiting or restricting the disbursements from the fund, and establishing a per line or per consumer subsidy for high-cost areas. This represents a regulatory conclusion that a line will, or should, cost roughly the amount set by proxy. While imprecise given companies' varying operating environments, this approach benefits from predictability.

VIII. DIVISION ANALYSIS & CONCLUSION

The ever-changing telecommunications landscape is putting certain pressures on state policies, such as the UUSF. Changing federal regulations, the convergence of networks providing multiple services and applications, and transformation of the competitive landscape all make a static universal service program difficult to administer for regulators and hard to mesh with shifting markets and technology for companies. Policymakers are wise to consider how to address telecommunications needs and structures going forward.

While the Legislature will at some point likely need to change the UUSF to address these changes and needs, the change must be well-conceived and allow for continuity of operations, particularly for rural carriers. Rural carriers have used these funds to secure loans for capital improvements. Immediately removing UUSF payments for basic telephone service would have significant negative impacts to rural carriers. This is particularly so given the industry-wide significant subscriber losses landline carriers are experiencing.

Current UUSF policy limits the support in high-cost areas to basic phone service. Because of this limitation, the total impact to consumers in the state of Utah has remained at or below one percent of total intrastate revenues. This relatively low cost and the unpredictability of federal changes' effects on the UUSF and companies' need for it may indicate maintaining the UUSF in its current state is wise, at least in the near term. However, more and more services are becoming available over more and more platforms, suggesting future change will be warranted.

Most of the proposals offered and commented on in this docket are variations on a theme: how to reduce current support for basic telephone service while perhaps providing new support in recognition of technological changes and needs. To that extent, it may ultimately matter very little which method is chosen so long as the end result is a measured removal of existing supports and the targeted provision of new ones. Thus, the Division does not find it helpful to weigh in on particular methods of support, especially given their nascent quality. Individual methods may benefit certain industries and interests but the public interest can be served in a variety of ways. Broadly, the Division sees the need for a gradual, well-timed transition away from existing supports to new, targeted ones, if needed.

Ultimately, telecommunications companies are likely to provide broadband services in the future with relative indifference toward user-based applications, whether voice, video, or other modes of communication. In addition, policymakers need to recognize that it is becoming increasingly difficult to separate costs between traditionally regulated services (voice), and unregulated services (internet, video).

As this trend continues, the state would be well-served to manage this transition with a particular focus on the availability of broadband service. Traditional rate of return regulation may be ill-suited to development of broadband infrastructure. Indeed, in the event policy makers see the need for incentives for universal broadband service, they may wish to consider economic development-type incentives, taxes, and other mechanisms to achieve universal service ends for advanced technologies.

ATTACHMENT 1