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Office of Consumer Services

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To: The Public Service Commission of Utah

From: The Office of Consumer Services
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Date: July 28, 2011

Subject: In the Matter of the Consideration of the Role of Patronage when Determining Rate of Return, Affordable Base Rate, and Support from the Utah Universal Public Telecommunications Service Support Fund for Certain Telephone Corporations (11-2528-01).

Background

This issue of patronage payments was raised in a recent South Central Utah Telephone Associations, Inc, (SCUTA) case. SCUTA applied for state Universal Service Fund (USF) support on November 2, 2010 and amended its application on December 2, 2010. On March 1, 2011 the Division of Public Utilities (DPU or Division) filed a position statement in that docket delineating several points of concern and particularly stating its beliefs regarding patronage payments. The Division opined that the issues of cost of capital and allowed rate of return as they are related to patronage payments are complex and affected more than SCUTA. The Division listed several areas of investigation that should be examined and recommended that the Commission open a separate rule making docket to fully address this matter.

On June 27, 2011 the Commission issued the Notice of Agency Action in the present docket opening the investigatory process requested by the Division. In that notice the Commission stated that it will consider the role of patronage when determining rate of

return, affordable base rate and state USF support for certain telephone companies. The Commission listed five issues of current focus in the docket and ordered that any party entering an appearance file a preliminary position statement by July 28, 2011 addressing the issues to be treated in these proceedings.

Discussion

The Office of Consumer Services is concerned with the interests of both the contributors and the recipients of USF funds; the interests of the residential and small commercial customers; the effect of the USF on rural telecom customer rates; and the regulations and practices of other telecom providers throughout the state.

With these concerns in mind, the Office takes the following positions and offers additional questions on the 5 issues presented in the Commission's June 27, 2011 Notice of Agency Action.

1) Clarifying the definition of patronage.

Patronage payment is income received by a telephone cooperative that is returned to its member and the amount of the patronage is based in some way on each member's patronage of the cooperative's services. The Office believes that the calculation and payment of patronage varies among cooperatives and will depend on the specific terms and conditions each cooperative has in place for membership in the cooperative and for payment of patronage. Therefore, in order to correctly define patronage payment and understand how patronage may interact with other issues such as payments from the USF fund, rates of return or affordable rate base, the Commission should fully understand each cooperative's calculations and uses of patronage payment.

As a starting point, the Commission should require the cooperatives to submit documentation outlining their terms and conditions of membership, methodology of patronage accruals and terms and conditions of patronage payments. In addition to these documents, the Commission should also request each cooperative to submit a summary statement of these documents and a description of the life cycle of patronage funds showing how member investments are obtained, tracked and eventually paid with patronage.

2) Should a telephone corporation's support from the State USF fund be reduced proportionate to the amount of patronage paid.

Several issues need to be understood in order to properly answer this question. First, a complete understanding of the workings of patronage payments (as described in question #1) is necessary. Second, whether the patronage income is derived solely from regulated telephone service or whether it relates to other business ventures should also be taken into account. Finally, any examination of whether patronage payments should proportionately reduce USF support should also include an examination of whether

dividend payments should proportionately reduce USF support. The ultimate question is what constitutes proper use of state USF funds and whether return to any type of equity provider is properly included.

3) Should a telephone corporation's support from the State USF Fund be eliminated if patronage paid exceeds support from the State USF fund.

See the response to #2 above.

4) The role of patronage when determining rates of return.

Rates of return and return on equity are typically calculated based on an assessment of risk and expected investor return, among other factors. These factors may be different for different business structures (i.e. cooperatives as compared to investor-owned utilities). However, rates of return are currently calculated for rural telecom companies in Utah based on an assumed capital structure with implied equity greater than actually exists in some cases. Thus, any consideration of the role of patronage in determining rate of return would need to include a full examination of the methodology for determining rate of return for these companies. Otherwise, the Commission would not be evaluating the complete picture. This methodology is used as a proxy in order to incent debt reduction, provide funds for capital improvements and other reasons. Singling out patronage for additional scrutiny without also examining these other rate of return issues could result in unintended consequences.

5) The role of patronage when determining affordable base rates.

At present, patronage does not play a role when determining affordable base rates. The question is whether, as some have suggested, patronage payments are an indirect way of reducing the affordable base rates. The Office proposes that the Commission needs the answers to the questions we raised in question #1 in order to understand the interaction of patronage payments and affordable base rates.