

DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER REDFORD
COMMISSIONER SMITH
COMMISSION SECRETARY
LEGAL
WORKING FILE

FROM: GRACE SEAMAN

DATE: AUGUST 24, 2012

RE: 2012 IDAHO UNIVERSAL SERVICE FUND ANNUAL REPORT AND
RECOMMENDATIONS; CASE NO. GNR-T-12-07.

BACKGROUND

The Idaho Universal Service Fund (USF) rules were adopted under the general legal authority of the Telecommunications Act of 1988, Chapter 6, Title 62, *Idaho Code*, and the specific authority of § 62-610, *Idaho Code*. The Commission established a universal service fund for the purpose of maintaining the universal availability of local exchange service at reasonable rates and to promote the availability of message telecommunications service (MTS) at reasonably comparable rates throughout the state of Idaho. The USF is funded through a statewide end-user surcharge on local exchange services and intrastate MTS and Wide Area Telephone Service (WATS) type services. The USF Administrator, Ms. Anderson, submits an Annual Report to the Commission that details the program activities of the previous year and provides recommended surcharge rates to meet the next year's funding requirements. On or before September 1 of each year the Commission issues an Order in response to the Administrator's report, which will establish statewide end-user surcharges to be in effect for the twelve months beginning October 1 following issuance of the Order.

THE 2012 ANNUAL REPORT

On July 17, 2012, Alyson Anderson, the Administrator of the Idaho USF, filed her Annual Report to the Commission for the period of July 1, 2011 through June 30, 2012. The proposed USF 2012-2013 Administrative Budget is also included in the report. Staff has

reviewed the calculations, supporting documentation, and recommendations contained in the Administrator's Annual Report.

The current USF monthly surcharge rates are \$.12 per residential line, \$.19 per business line, and \$.0035 per intrastate MTS/WTS billed minute, established in 2010 and maintained in 2011. See Order Nos. 32058 and 32336. Ms. Anderson reports surcharge revenue for the year in the amount of \$1,654,166. Local exchange services contributed \$914,350 (55%), and \$739,816 (45%) was contributed by MTS/WATS services. This is a decrease in local exchange surcharge revenue of approximately \$30,761 (from \$945,111 in 2011), and a decrease in MTS/WATS surcharge revenue of approximately \$30,470 (from \$770,286 in 2011).

The Administrative expenses for the year were \$21,994. These charges include Administrator's salary, expenses, bank and brokerage fees, and \$6,750 for professional services associated with a audit completed in 2011.

The annual disbursements to the eight qualifying incumbent local exchange carriers (ILECs) remained unchanged at \$1,698,610. The ending cash balance, after applying bank charges, administrative expenses and interest received was \$38,329. For the next fiscal year, beginning July 1, 2012, the annual disbursements are expected to remain at \$1,698,610, unless the Commission approves changes to the USF funding.

2012-2013 Administrative Budget

Ms. Anderson proposes an annual administrative budget of \$17,100. This amount includes the Administrator's salary, expenses, bank and brokerage fees.

Local Residential and Business Service

As of May 1, 2012, companies reported a monthly inventory of 253,461 residential lines and 219,108 business lines, for a total of 472,569 lines. This is a net decrease in lines of approximately 41,477 (8%) with residential lines decreasing by nearly 13% and business lines increasing by almost 1%.

The newly calculated statewide weighted average rates for a one-party single line residential and business service and the corresponding threshold average rates are:

	2011 Statewide Weighted Average Rate	2012 Statewide Weighted Average Rate	125% Statewide Weighted Average Rate - 2011	125% Statewide Weighted Average Rate - 2012
Residential Services	\$21.25	\$21.66	\$26.57	\$27.07
Business Services	\$32.08	\$33.37	\$40.10	\$41.71

Switched Access Service

Long distance service providers reported intrastate MTS/WATS billed minutes of 257,750,454 compared to the 2011 reported minutes of 253,602,445, a 2% increase. Further investigation of this increase by Ms. Anderson appears to be from more accurate reporting by some companies. The statewide average switched access rate was \$0.054.

Review of Funding Adjustments—Rule 106

Ms. Anderson is required to review the residential, business, and switched access rates of the recipient ILEC companies in accordance with Rule 106. To be eligible to receive USF funding pursuant to Rule 106, IDAPA 31.46.01.106, a telephone company's average one-party, single-line rate must equal or exceed the 125% statewide weighted average line rate and the average rates per minute for MTS/WATS access rate must exceed 100% of the statewide weighted average access rate. If the difference in the company's current average rate and the statewide average threshold rate is greater than three percent (3%), and the difference in the annual revenue associated with the company's current rate and the revenue associated with the statewide average threshold rates is over \$6,000, the company may need to revise rates to meet or exceed the statewide threshold rates. Or, pursuant to Rule 106.04, and *Idaho Code* § 62-605(e)¹ the Commission on its own motion may by Order change a telephone company's USF funding in connection with the recalculation of the statewide average rates.

In this year's analysis, the Administrator discusses potential adjustments to the residential, business, and access rates per Rule 106 in greater detail in Option 2.

¹ For the purpose of calculating the weighted statewide average rates for residence and business basic local exchange service rates to enable the commission to determine eligibility for distributions to eligible telecommunications carriers from the universal service fund established pursuant to chapter 6, title 62, Idaho Code, the residence and business basic local exchange rates in effect on July 1, 2005, shall constitute the basis for such calculation, unless the commission determines that changes in basic local exchange rates subsequent to July 1, 2005, should be used for such calculation for the purpose of determining the eligibility of telecommunications carriers for distributions from the universal service fund.

ADMINISTRATOR'S OPTION

The Administrator reports that over the last several years, there has been a steady decline in both local access lines and intrastate MTS/WATs billed minutes. As a result, it is difficult to estimate the fund balance for the next fiscal year with precise accuracy. Ms. Anderson further states that, "with the increased popularity of wireless/cellular services and VoIP services, as well as the decline in the economy, it would stand to reason that the decline in both local access lines and intrastate toll minutes will continue." To determine the funding options, Ms. Anderson adjusted the current inventories by the average percentage decline from the last three years to present the four funding options as follows.

Option 1: Status Quo – Ms. Anderson reports that if current surcharge levels are maintained and no additional USF funding is authorized, the funding will increase by approximately \$50,966. The 2012-2013 USF authorized disbursements will be \$1,698,610 and the fund balance will be an estimated \$89,296 on June 30, 2013. Surcharge revenue contribution would be approximately 49% from MTS/WATS services and 51% from local exchange services.

Option 2: Adjust Funding to Meet Statewide Averages per Rule 106 and Maintain Surcharge Rates – Idaho USF Rule 106.02 outlines the requirement to continue receiving USF funding after the first year of eligibility. Ms. Anderson notes that, "recent FCC orders directly impact the switched access rates in Idaho." She refers to the *USF/ICC Transformational Order*, released on November 18, 2011 and the *Third Order on Reconsideration*, released on May 14, 2012 that adopted a national bill-and-keep methodology for inter-carrier compensation that reduced certain switched access rates." As a result of the federal mandate, Rule 106 will only be applied to local exchange services in this year's report. The following applies Rule 106 to each company currently receiving USF funding:

- ATC Communications (ATC) — should increase the local residential rate. ATC's annual USF funding would be reduced by \$38,324.
- Cambridge Telephone Company (Cambridge) — should increase the local residential rate. Cambridge's annual USF funding would be reduced by \$19,264.
- Direct Communications Rockland (Direct) — should increase the local residential rate. Direct's annual USF funding would be reduced by \$13,827.
- Fremont Telecom (Fremont) — should increase the local residential rate. Fremont's annual USF funding would be reduced by \$35,291.

- Inland Telephone Company (Inland) — no adjustments are necessary.
- Midvale Telephone Company (Midvale) — should increase the local residential rate. Midvale’s annual USF funding would be reduced by \$10,575.
- Rural Telephone Company (Rural) — should increase the local residential rate. Rural’s annual USF funding would be reduced by \$9,412.
- Silver Star Telecom — no adjustments are necessary.

Under this proposal, Ms. Anderson projects the annual USF disbursements would decrease by \$126,693 from \$1,698,610 to \$1,571,917 and the fund balance on June 30, 2013 would be approximately \$215,989. With this option, MTS/WATS services would contribute 51% of the total surcharge revenue and the local exchange services contribution would be 49%.

Option 3: Maintain Funding Levels and Increase Surcharge Rates – In this scenario, Ms. Anderson considers maintaining the USF funding levels and increasing the surcharge rates to \$.15 per residential line, \$.23 per business line, and \$.004 per intrastate MTS/WATS billed minute. The funding would increase by approximately \$376,260 and the end-of-year balance on June 30, 2013 would be approximately \$414,589. MTS/WATS service would contribute 49% of the surcharge revenue and local exchange services would contribute 51%.

Option 4: Adjust Funding to Meet Statewide Averages Per Rule 106 and Increase Surcharge Rates – In this discussion, Ms. Anderson looks at increasing the surcharge rates to \$.14 per residential line, \$.21 per business line, and \$.004 per intrastate MTS/WATS billed minute as well as adjusting the USF disbursements per Rule 106. MTS/WATS service would contribute 49% and local exchange services would contribute 51%. The funding would increase by approximately \$419,951 and the end-of-year balance would be approximately \$458,281 on June 30, 2013.

ADMINISTRATOR’S RECOMMENDATION

In the Administrator’s recommendation, Ms. Anderson acknowledges that the increased popularity of wireless and VoIP services will continue to place a downward pressure on the number of local exchange lines and long distance minutes. Additionally, the shift from standalone residential local exchange services to bundled packages will also continue. This affects the statewide average rate calculations, and thus the application of Rule 106 for the companies funded by the IUSF. Ms. Anderson states, “[i]n light of the FCC Orders and the

changes in the industry, it is becoming more difficult to evaluate the IUSF funding as it applies to Rule 106.”

The statewide average residential rates have steadily increased for more than ten years. To apply Rule 106 and require the USF-recipient companies to increase rates based on the marketing strategy of the larger telephone companies seems punitive rather than equitable. For these reasons, Staff believes Rule 106 is difficult to justify when applied to the USF annual report and funding recommendations. Staff understands that the application of Rule 106 will result in a decrease in the USF disbursements. Staff, however, believes that the best alternative is to apply the 2005 residential rate and increase the USF surcharge rates to prevent a precariously low fund balance. Therefore, Staff supports Ms. Anderson’s recommendation that the Commission adopt Option 3, maintain the company disbursements at the current level, and increase the surcharge rates to \$.15 per residential line, and \$.23 per business line, and \$.004 per intrastate MTS/WATS billed minute.” This option will approximate a 50-50 contribution of surcharge revenues from local exchange services and MTS/WATS services. The fund balance at June 30, 2013 is estimated to be \$414,589. This balance will provide a healthy three-month reserve.

STAFF ANALYSIS AND RECOMMENDATION

Ms. Anderson recommends the adoption of Option 3 over Option 2 since the recent FCC Orders contradict the application of access rates pursuant to Rule 106.02. Rule 106’s treatment of the local exchange rate should also be examined and discussed. If Rule 106 is strictly applied, six of the eight companies would be required to increase the residential local exchange rate from the current \$25.76 to \$27.07. All of the eight USF funded companies, have residential rates of \$25.76² which is lower than the latest statewide average threshold rate of \$27.07 and the difference is greater than 3% for six USF-funded companies. Staff believes consideration should be given to the factors that have contributed to the increase in the average threshold rate for residential service. A major contribution comes from the deregulated companies (that have the greatest market share and therefore the greatest impact on the statewide average) increasing its standalone residential rates, in an attempt to encourage customers to move to the more

² On September 2, 2009, Commission Order No. 30894 was issued notifying the USF recipient companies that residential rates must be increased to the statewide threshold rate of \$25.76 to continue to receive funding. All eight companies complied by increasing the residential rates.

competitively priced bundled services (that include local exchange services). These bundled services are marketed to entice customers into purchasing more services under multi-year agreements. In the last few years, companies have been successful in moving more customers from the standalone residential service to the bundled packages. Yet, the USF annual report does not reflect this activity since the companies are only required to report the standalone residential rate shown in the tariffs and price lists. Staff, therefore, agrees with Ms. Anderson's recommendation that the Commission adopt Option 3, maintain funding levels and increase surcharge rates to \$.15 per residential line, \$.23 per business line and \$.004 per intrastate MTS/WATS billed minute. This option will result in a reserve balance of \$414,589 and will provide a comfortable 3-month cushion.

COMMISSION DECISION

Does the Commission wish to approve the USF 2012-2013 budget?

Does the Commission wish to adopt the Administrator and Staff's recommended funding Option 3?

Does the Commission wish to adopt a different funding option?



Grace Seaman

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