

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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Order Instituting Rulemaking into the
Review of the California High Cost Fund
A Program.

Rulemaking 11-11-007
(Filed November 10, 2011)

**REPLY COMMENTS OF
THE DIVISION OF RATEPAYER ADVOCATES
ON THE ORDER INSTITUTING RULEMAKING INTO THE
REVIEW OF THE CALIFORNIA HIGH COST FUND-A PROGRAM**

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I. INTRODUCTION AND SUMMARY

The Division of Ratepayer Advocates (DRA) respectfully submits these Reply Comments pursuant to Order Instituting Rulemaking 11-11-007 (the OIR) and Rule 6.3(d) of the California Public Utilities Commission's (Commission's) Rules of Practice and Procedure.

DRA reiterates its strong support of the goals of universal service because of their critical impact on public safety and the state economy. However, as California is in the worst economic downturn since the Great Depression, the Commission must ensure basic telephone service is available in the most prudent and cost-effective way possible. As DRA and other parties have observed, the California High Cost Fund-A (CHCF-A or A-Fund) program appears to have met its penetration rate goals.¹ Therefore, DRA recommends that the waterfall mechanism should be used to ratchet down the CHCF-A companies' draw from the A-Fund over a multi-year process in order for the CHCF-A to achieve its goals in the most effective way possible.

As DRA will discuss below, the A-Fund was established to promote the goal of universal telephone service.² The A-fund should not be used as a broad support mechanism for the Small Local Exchange Carriers (Small LECs) to provide preferential, non-transparent subsidization of Small LEC affiliates' broadband and video service in the name of universal service. Nor should such service be paid for by California customers who may not have affordable broadband themselves.

DRA agrees with Verizon that the A-Fund has achieved its goals.³ Although DRA does not completely agree with all aspects of Verizon's proposal, Verizon's

¹ See, Report to the Legislature on Universal Telephone Service to Residential Customers, California Public Utilities Commission, May 2, 2003. See also, Comments of the Division of Ratepayer Advocates on the Order Instituting Rulemaking into the Review of the California High Cost Fund-A Program, February 1, 2012 (DRA Comments) at 2. See also, Opening Comments of Verizon on Order Instituting Rulemaking into the Review of the California High Cost Fund-A Program, February 1, 2012 (Verizon Comments) at 5 that states the A-Fund has met its requirements and should be phased out over a multi-year period.

² See, Decision (D.)88-07-022 as modified by D.91-05-016 and D.91-09-042.

³ Verizon Comments at 5.

Comments do mirror DRA’s proposal that the Commission use the existing CHCF-A “waterfall” cycle, adopted in Commission Decision (D.) 91-09-042, as a guide to eventually ratchet down the A-Fund.⁴

In order to help the Small LECs transition to a different regulatory environment, DRA proposes the following to help ensure a sufficient flow of revenue.

1. Allow the Small LECs to raise their monthly basic residential service rate from an average of \$18.18 per month to \$20.25 per month. Those companies currently at the \$20.25 per month rate will remain at that rate.
2. Set all Small LECs’ CHCF-A draw at 100% of their waterfall amount. Those companies not currently taking CHCF-A funds will not be eligible for any A-Fund draw.⁵ As DRA discussed in its Opening Comments, the waterfall cycle is a preferable temporary mechanism as parties have multiple years of familiarity with how this Commission approved process works.⁶
3. Allow Small LECs the option to “bundle down” their services. This pricing flexibility will provide additional revenue as the companies can package various services like broadband and video to lower costs and increase revenues.

Finally, should the Small LECs require supplemental funding for legitimate facilities that provide basic telephone service, the Small LECs can access the Rural Infrastructure Grant (RIG) program or the California Advanced Services Fund (CASF).⁷ Altogether, the above mentioned proposal should provide funds to ensure the Small LECs have sufficient revenues to continue providing good service quality to their customers.

⁴ The temporary waterfall cycle under this reinitiating will be six years: three years at 100% funding level followed by three succeeding years at 80%, 50% and 0%, respectively. DRA disagrees with the Small LECs’ opposition against phasing out the CHCF-A Fund because the Commission telephone penetration rate data clearly shows that the CHCF-A has met its goal of providing universal service to the rural areas of California.

⁵ DRA understands that the three TDS telecom companies (Happy Valley Telephone Company, Hornitos Telephone Company and Winterhaven Telephone Company now doing business as and are collectively referred to as TDS Telecom) and Frontier Communication West Coast Inc. do not rely on or are drawing from the CHCF-A..

⁶ DRA Comments at 3.

⁷ The California Advanced Services Fund (CASF) is being addressed in R.10-12-008 and was addressed in R.06-06-028.

If the Commission decides to maintain the CHCF-A Fund at any level, then DRA recommends that the Commission adopt transparency and consumer protection measures to ensure that the fund is being used prudently and efficiently.

II. DISCUSSION

A. The Commission Should Open The Small LECs' Service Areas To Wireline Competition

DRA proposes that the Commission promptly and formally open the territories of the Small LECs to wireline competition.⁸ Other parties, including Verizon,⁹ Big River,¹⁰ TDS,¹¹ CCTA,¹² and Frontier,¹³ support this position. Currently, wireless, Voice Over Internet Protocol (VoIP), and other non-wireline forms of communication services already exist in Small LEC territories.¹⁴ Opening Small LEC territories to wireline Competitive Local Exchange Carrier (CLEC) competition would further foster consumer choice. Verizon states that CHCF-A Fund subsidies, by favoring one market participant over others, harms the competitive process and therefore harms consumers.¹⁵ Big River also supports opening the Small LECs' service areas to wireline competition in order to enhance and expand customer service options consistent with legislative goals.¹⁶ Specifically, Big River states that opening the areas to competition is “not economically

⁸ DRA Comments at 15.

⁹ Verizon Comments at 3-5.

¹⁰ Comments of Big River Telephone Company, L.L.C. on Order Instituting Rulemaking Regarding California High Cost Fund-A Program, February 1, 2012 (Big River Comments) at 2-3.

¹¹ Comments of Happy Valley Telephone Company, Hornitos Telephone Company, Winterhaven Telephone Company, February 1, 2012 (TDS Comments) at 11.

¹² Opening Comments of California Cable & Telecommunications Association, February 1, 2012 (CCTA) at 2.

¹³ Comments of Frontier Communications West Coast Inc. on Order Instituting Rulemaking Regarding California High Cost Fund-A Program, February 1, 2012 (Frontier Comments) at 3.

¹⁴ See e.g. Comments of Independent Small LECs on Order Instituting Rulemaking Regarding California High Cost Fund-A Program, February 1, 2012 (Small LECs Comments) at 46; Frontier Comments at 3.

¹⁵ Verizon Comments at 5.

¹⁶ Big River Comments at 2-3.

burdensome” and is “technically feasible.”¹⁷ Big River contends it has been able to successfully co-exist, compete and interconnect with independent telephone companies in other states and that it would employ the same kind of technology to interconnect with the small Independent Local Exchange Carriers (ILECs) in California, if permitted.¹⁸ TDS recommends that for its proposed opt-out from GRC regulation by what they term “SURF” companies, facilities-based wireline competition should be allowed as long as potential competitors and SURF companies are subject to the same regulatory rules and requirements and can compete on a level playing field.¹⁹ CCTA presents findings that suggest the Small LEC territories are ripe for competitive entry which would, among other things, drive down the incentive to overspend on facilities and, ultimately, provide substantial savings to California consumers.²⁰ Frontier proposes that carriers should have a streamlined process to opt out of rate of return regulation into a more market-based competitive form of regulation that would permit a greater degree of responsiveness to customers.²¹

While DRA does not completely agree that “intermodal” competition translates into real competition for wireline service, especially in areas where only one wireline provider offers service, DRA finds that the Small LECs’ customers are no less deserving of competitive choices than those of the larger ILECs.²² For these reasons, the Commission should open the Small LECs’ service areas to competition.

B. The SURF Plan Alone Is Insufficient To Protect Customers And Prepare The Commission to Open The Small LECs’ Territories To Competition

TDS Telecom recommends that the Commission adopt a Small Rural Uniform Regulatory Framework (SURF) plan as an option for Small LECs currently regulated on

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ TDS Comments at 11.

²⁰ CCTA Comments at 2-3.

²¹ Frontier Comments at 3.

²² *See e.g.* DRA Comments at 15.

a cost-of-service-rate-of-return basis.²³ The TDS Telecom SURF plan contains 16 elements. Its goal is to “develop a streamlined process for small rural companies to move from rate-of-return regulation toward Uniform Regulatory Framework (URF) while preserving access to the CHCF-A as needed on a basis that does not require general rate cases.”²⁴ DRA generally acknowledges that the SURF plan has some attractive and intriguing elements. However, DRA suggests specific modifications to the SURF plan, as described below in sections D, E and F, to help protect rate integrity and better prepare the Commission to open the Small LECs’ territories to competition.

C. The Commission Should No Longer Rely On The AT&T Rate To Determine “Basic Service Rates”

All parties that commented on this issue, including DRA, agree on the need to de-link the urban rate from AT&T’s basic service rates since AT&T’s basic service rates are deregulated and may be de-averaged at some point in the future.²⁵ Pursuant to the URF Decision (D.06-08-030), the basic AT&T service rate is no longer capped and New Regulatory Framework (NRF) companies are allowed to geographically de-average prices. In fact, AT&T’s basic service rates have increased dramatically since rate deregulation was allowed.²⁶ Utilizing the AT&T rate to determine reasonable basic service rates is, thus, inappropriate. In addition, as DRA noted in prior comments, since the Commission issued D.10-02-016, establishing the \$20.25 basic service rate cap for the Small LECs, AT&T’s urban rate has been functionally delinked from LifeLine rates and is no longer used for Small LECs’ rate design.²⁷ Therefore, the Commission should no longer rely on the AT&T rate to determine basic service rates.

²³ TDS Comments; at 3 D.06-08-030 at Ordering Paragraph #1.

²⁴ See, DRA’s Report on Rate Increases of Verizon, AT&T Surewest and Frontier California Following Adoption of the Uniform Regulatory Framework in Decision 06-08-030 (July 29, 2008); TURN Comments at 37.

²⁵ See e.g. DRA Comments at 7; TDS Comments at 8-9; Comments of The Utility Reform Network (TURN Comments) at 32, 37-38; Small LECs Comments at 41-42.

²⁶ See e.g. DRA’s Report on Rate Increases of Verizon, AT&T, Surewest and Frontier California Following Adoption of the Uniform Regulatory Framework in Decision 06-08-030 (July 29, 2008); TURN at 37.

²⁷ DRA Comments at 7.

D. The Commission Should Not Adjust The Small LECs' Rates In Response To Changes In AT&T's Rates

Many parties recommend that a new method should be established to determine the Small LECs' basic service rate and that the Commission should not adjust the Small LECs' rates in response to changes in AT&T's rates.²⁸ DRA agrees with TDS Telecom that CHCF-A funding should be de-linked from AT&T rates and the Small LECs' rates should be capped at \$20.25.²⁹ TURN proposes decoupling from AT&T's rate and a three-year cap on basic rates.³⁰ The Small LECs suggest that AT&T's rates should no longer be a proxy for the reasonable urban rate and that the Commission should adopt \$30 as the upper limit of customer rates for CHCF-A recipient companies.³¹

DRA supports de-linking the urban rate from AT&T's rates and recommends that the Commission not adjust the Small LECs' rates in response to changes in AT&T's rates. In addition, DRA recommends keeping basic residential rates capped at \$20.25 per month.

E. The Commission Should Keep Basic Residential Rates at \$20.25 Per Month and Itemize Charges on Customer Bills

In their Opening Comments, the Small LECs stated that some of their companies' rates are already at \$20.25/month and proposed a rate ceiling of \$30.00/month³². The Small LECs' rationale for a rate ceiling is that their rates are already at \$20.25 per month.³³ However, if all federal and state surcharges, including the Subscriber Line Charge (SLC), Access Recovery Charge (ARC) and Extended Area Service (EAS)

²⁸ TDS Comments at 8-9; TURN Comments at 32, 37-38; Small LECs Comments at 41-42.

²⁹ TDS Comments at 8-9. DRA does not agree with the TDS proposal to lift the basic rate cap.

³⁰ TURN Comments at 38.

³¹ Small LECs Comments at 41-42: "The Commission should not view reasonable rural rates as a function of AT&T's rates. Rather, the Commission should implement a rate ceiling of \$30.00, including the SLC, ARC, EAS and all federal and state surcharges..."

³² Small LECs Comments at 41.

³³ This amount is in contrast to Appendix G of the Order Instituting Rulemaking Regarding California High Cost Fund-A Program, November 11, 2011 (OIR) which shows only 5 of the 14 companies with basic service rates at \$20.25 per month. The other 9 companies have monthly rates which vary from a low of \$16.05 to \$19.40.

charges, are considered, then the Small LECs' rates are closer to \$27.00 per month. The Small LECs claim that a \$30.00 rate ceiling "would supply supplemental revenue to fulfill revenue requirements established in rate cases."³⁴ DRA disagrees with this assertion as the Small LECs do not provide any support or analysis as to why this \$3 amount is needed. Therefore, DRA opposes inclusion of this \$3 per month amount in the Small LECs' basic residential rate cap.

Furthermore, DRA recommends the Commission require the Small LECs to provide a detailed listing of all charges on customer telephone bills. Under Public Utilities Code (P.U. Code) Section 2890(d)(2)(A), each ILEC is required to include separate line items for each product or service, including any taxes or surcharges, in a customer's telephone bill.³⁵ In light of this statutory requirement, DRA proposes that the basic residential rate be set at \$20.25 per month for all of the Small LECs and any additional extraneous charges such as taxes, surcharges or fees, including, but not limited to EAS, SLC or ARC, be identified as separate line items on the telephone bill. This will provide consumers with an exact itemization of their bill and require the Small LECs to identify their billing charges. DRA's proposal both benefits customers by providing clarity on the basic service rate by requiring that the fees and surcharges included in customer bills be identified in a disaggregated fashion and ensures compliance with statute

Further, under the TDS Telecom's "SURF" plan, TDS proposed that Residential and Lifeline Basic service rates remain regulated for two years. Those who are below the \$20.25 per month cap would be allowed to increase their rates in three increments over the two year period. After the two year period, rates would be deregulated.³⁶ Should the Commission adopt TDS Telecom's plan, DRA would prefer that those companies who

³⁴Small LECs Comments at 41.

³⁵Public Utilities Code (P.U. Code) Section 2890(d)(2)(A) states, "Any person, corporation, or billing agent that charges subscribers for products or services on a telephone bill shall...[i]nclude, or cause to be included, in the telephone bill the amount being charged for each product or service, including any taxes or surcharges, and a clear and concise description of the service, product, or other offering for which a charge has been imposed."

³⁶TDS Comments at 3-4.

are not at the \$20.25 per month rate be allowed the option of an incremental increase over three years.³⁷ Those companies at the \$20.25 per month rate would be capped for the same three year period. A three year period for incremental increases in rates would keep basic residential service rates affordable, protect customers against rate shock, allow the Small LECs time to prepare for competition and provide carriers with a predictable revenue flow.

F. DRA Response To “Other Services” Rates Proposed by TDS Telecom

TDS Telecom’s “SURF” plan also addressed the issue of rates for other services and include three proposals.³⁸ First, TDS Telecom proposed that the rates for other services should be deregulated upon the adoption of SURF regulation for the Small LECs.³⁹ DRA supports keeping the current rates for three years and then allowing them to be deregulated. As stated above, a three year period would keep basic service more affordable by protecting customers against rate shock, allowing the Small LECs time to prepare for competition and providing a revenue stream to the Small LECs to maintain their operations.

Second, TDS Telecom states that Residential and Lifeline Basic service must be available for purchase on a stand-alone basis. DRA supports this proposal. There should continue to be an option available for customers who seek only basic telephone service.

Third, TDS Telecom identified five services including Single Line Business, Caller ID, Call Waiting, and Non-Published Numbers that were to remain regulated for two years from the date the SURF regulation is adopted. During the aforementioned two years, the TDS Telecom companies would be able to increase rates for these services by no more than 10% per year, after which rates for these specific services would be

³⁷ Appendix G of the OIR shows that 9 of the 14 Small LECs have a basic residential rate of less than \$20.25 per month.

³⁸ Other services can be defined as other than basic residential service or lifeline and can include services such as Call Waiting, Caller ID, Call Forwarding, Single Line Business, Non-Published Numbers and others. TDS Telecom Opening Comments at 3.

³⁹ TDS Comments at p. 4, paragraph 4.

deregulated.⁴⁰ In order to maintain affordable service for Small LEC customers, DRA prefers a restriction of three years on price increases for all Other Services, and not only for the five services listed. Furthermore, during the three year period, there should be no more than a 10% increase per year and, at the end of the time period, deregulation should occur.

G. The CHCF-A Subsidies Should be Significantly Reduced as the Small LECs' Basic Wireline Infrastructure is Fully Built Out

DRA supports reduction of the size of the CHCF-A Fund for the Small LECs because their basic wireline infrastructures are functioning effectively and are essentially built out. As the Small LECs stated in Opening Comments, they have already invested substantial amounts to keep their networks up-to-date and reliable.⁴¹ The CHCF-A fund has provided the Small LECs with sufficient capital to build out their facilities and provide excellent service quality. The Small LECs noted that they have exemplary service records, and have strong compliance histories under the Commission's service quality rules, currently outlined in General Order (G.O.) 133-C.⁴² As DRA pointed out in its Reply Comments in the Service Quality OIR, R.11-12-001, "the actual service quality performance of these carriers is excellent." According to the CD report on Service quality, the Small LECs⁴³ met the Commission's G.O. 133-C service quality standards in 2010 for trouble report rates, out of service intervals, operator answering times, installation intervals, and installation commitments met.⁴⁴

⁴⁰ TDS Comments at 4.

⁴¹ Small LECs Comments at 36.

⁴² Small LECs Comments at 7.

⁴³ It should be noted that in the Service Quality proceeding, the Small LECs were referred to as GRC LECs.

⁴⁴ Reply Comments of the Division of Ratepayer Advocates on Order Instituting Rulemaking to Evaluate Telecommunications Corporations Service Quality Performance and Consider Modification to Service Quality Rules (DRA Service Quality Reply Comments) at 18.

At the same time, the Small LECs continue to make considerable requests for additional funding in infrastructure with questionable justifications. For example, in its recently filed application for review of intrastate rates and charges and rate of return, Kerman Telephone Company d/b/a Sebastian (Kerman) is seeking CHCF-A funding of \$6,490,463, which is \$3,047,427 more than what it received over the past six years.⁴⁵ From 2007 to 2012, Kerman’s CHCF-A Fund draw averaged \$3,441,943 per year, with a 2012 CHCF-A draw of \$3,444,036. Moreover, Kerman initially requested an additional \$5.8 million in upgrades in its GRC application that it claims are necessary.⁴⁶ In both cases, Kerman failed to adequately justify its request and further investigation is required if the rate case proceeds.

The Small LECs claim that the CHCF-A should “continue to fund Commission-authorized revenue requirements, including the authorized return on investments in broadband-capable network facilities as necessary in the future, in order to allow the Independent Small LECs to meet the mandate to provide telephone service at rates comparable to those paid by urban subscribers.”⁴⁷ In contrast, DRA finds that the small LECs’ facilities are already built out to the extent necessary to provide voice grade service. Therefore, DRA urges the Commission to implement DRA’s waterfall proposal which will temporarily give the Small LECs a continued source of funding to help maintain their level of quality telephone service and allow them time to become more operationally efficient.

H. Small LECs’ Use of CHCF-A Subsidies For Overinvestment

The Comments of the Independent Small LECs argue that “(t)he Commission should provide for the continued success of the CHCF-A Program funds in the

⁴⁵ General Rate Case Application of Kerman Telephone Co. d/b/a Sebastian, December 28, 2011 (Kerman GRC App) at 7.

⁴⁶ Protest of the Division of Ratepayer Advocates to the Application of Kerman Telephone Co. d/b/a Sebastian to Review Intrastate Rates and Charges and Rate of Return and Modify Selected Rates, January 26, 2012 (DRA Protest to Kerman GRC APP) at 4.

⁴⁷ Small LECs Comments at 36.

Broadband paradigm envisioned by the Connect America Fund Order.⁴⁸ The comments contend that the Commission should fulfill the Small LECs’ policy wishes “by clarifying that the CHCF-A will help fund the broadband networks of the future.”⁴⁹

DRA observes that these CHCF-A policy proposals 1) would represent a major leap, on the part of the Commission, away from the established purpose of the CHCF-A into new areas of support; 2) would provide further non-transparent subsidization of Small LEC broadband plants by Californians who may not enjoy similar universal service benefits; and 3) contradict the FCC’s intent “to eliminate the indirect funds to broadband-capable networks ... through our legacy high-cost programs which is occurring without transparency or accountability.”⁵⁰

I. The Commission Should Adopt A Precise, Transparent Network Cost Allocation Procedure

With regard to DRA’s first concern stated in H above, the Small LECs’ desire to apply CHCF-A funds to their broadband networks runs counter to the A-Fund’s explicit purpose. The CHCF-A was established “to promote the goals of universal *telephone* service” (emphasis added),⁵¹ and not as a broad support mechanism for non-rate-regulated broadband, video or other services. From DRA’s experience as a consumer advocate in Small LEC General Rate Cases, the Commission-favored process of resolving rate cases by settlement between parties (as well as rate adjustments by Advice Letter), has, as an unfortunate side-effect, avoided the adjudication of fair and transparent separations of plant expenditures between basic telephone service and non-regulated services of affiliates that rely on the same network plant. Due to carriers’ possible internal under-pricing of network access, non-regulated affiliate services, such as broadband and video, are receiving subsidization from the CHCF-A and California

⁴⁸ Small LECs’ Comments at 35.

⁴⁹ Small LECs Comments at 35.

⁵⁰ OIR at 12, citing FCC 10-58 In the Matter of Connect America Fund – A National Broadband Plan for Our Future High-Cost Universal Service Support, at 22-23.

⁵¹ P.U. Code Sec. 739.3 (c).

ratepayers. As the OIR pointedly observes, “(t)he Commission has noticed that the CHCF-A carriers have more heavily invested in plant modernization, including switching to broadband capable fiber optic networks, than their counterpart carriers that did not receive A-Fund support.”⁵² The OIR’s Appendix I illustrates the scale of this problem, with A-Fund recipient Carriers outspending their non-A-Fund counterparts on plant per access line by a factor of at least two, and more commonly by a factor of three or more, in every year between 2003 and 2009.⁵³

Small LECs’ Plant-Specific Expenses Per Line:
CHCF-A Subsidized vs. Unsubsidized

	2003	2004	2005	2006	2007	2008	2009
Avg. Plant-specific Expense per Line (A-Fund Recipient)	\$313	\$373	\$447	\$496	\$486	\$509	\$489
Avg. Plant-specific Expense per Line (Non-A-Fund Recipient)	\$96	\$113	\$126	\$136	\$127	\$159	\$201

This practice encourages A-Fund carrier over-expenditures on plants, courtesy of the unwitting largesse of California ratepayers, and should be remedied with a fair and systematic allocation of network cost burdens between regulated telephone services and the services of affiliates.

As long as ratepayer subsidies are involved, DRA recommends that regardless of what rate setting regime or transitional rate setting method the Commission adopts, a precise, transparent network cost allocation procedure will be needed. Commission sanction of these improper, non-transparent practices would legitimize a persistent network cost allocation defect in the current rate setting system.

⁵² OIR at 13.

⁵³ OIR, Appendix I, Table 4 excerpt.

J. The Small LECs’ Proposal Would Provide Preferential, Non-Transparent Subsidization Of Small LEC Affiliates’ Broadband Service

DRA’s second concern, stated in H above, is that the Small LECs’ proposal would provide preferential and non-transparent subsidization of Small LEC affiliates’ broadband service in the name of universal service. Furthermore, such subsidies would be paid for by California customers, who may themselves not have affordable or, for that matter, any broadband access themselves.

P.U. Code Section 275.6(c) states with respect to the rural high-cost programs:

“The commission shall structure the programs required by this section so that any charge imposed to promote the goals of universal service reasonably equals the value of the benefits of universal service to contributing entities and their subscribers.”

While DRA would welcome ubiquitous, affordable broadband, it is far from clear what benefits most Californians who subsidize the A-Fund for “universal service” goals might expect to receive themselves. As most Commission and FCC discussion of broadband and video deployment have been limited to *access* to these advanced services,⁵⁴ and not to actual service *penetration*, which involves broadly accessible and broadly affordable service, the term “universal service” is being mis-applied to broadband. The notion of “universal service” refers to facilitating actual adoption of a service by broad segments of the population, and not merely having cables run down the street. Applying notions of universal service to advanced services is an enormous leap, as it involves consideration of service affordability, hardware and software requirements, technical skills, and other social-cultural factors that are remote from CPUC and FCC policy control and funding capacity. These issues need resolution before the A-Fund could meet the requirements of P.U. Code Section 275.6(c).

⁵⁴ These include funds for the California Advanced Services Fund, the California Emerging Technology Fund (independent of Commission control but established through Commission-sanctioned carrier mergers), Commission reporting rules for California’s Digital Infrastructure and Video Competition Act (DIVCA), and the FCC’s developing National Broadband Plan.

a) The Small LECs’ Approach To The A-Fund Is Inconsistent With The FCC’s Underlying Approach To The National Broadband Plan And Connect America Fund

DRA’s third concern with the Small LECs’ expansive approach to the A-Fund, as mentioned in H above, is that it is inconsistent with the FCC’s underlying approach to the National Broadband Plan and Connect America Fund. As the OIR describes these plans, the FCC’s April 2010 “Notice of Inquiry” seeks to “cut inefficient funding of ... voice service [through high cost mechanisms] and refocus universal service funding to directly support modern communications networks.”⁵⁵ These planned reallocations to “*targeted investment* in broadband infrastructure” (emphasis added) are predicated on cutting inefficiencies in the existing voice service program, “without increasing the overall size of the (FCC Universal Service) Fund.” However, nearly two years later the devil remains in the details as to how that is to be accomplished. DRA is also reluctant to assume that the FCC is making de facto policy and spending decisions for state regulatory bodies, by implicitly shifting broadband deployment funding burdens from the federal High Cost Fund to state programs.

The separately filed Comments of the three Small LECs, filing as TDS Telecom, do not respond at length to the OIR’s questions about monitoring affiliate transactions, or recovering fair market rates from small carrier affiliates for access to Small LECs’ regulated, CHCF-A-supported networks.⁵⁶ TDS Comments do, however, recommend eliminating affiliate transaction reporting requirements. As these three companies do not currently file General Rate Cases or draw on the CHCF-A. The Commission’s oversight of ratepayer funds provided by affiliate transaction monitoring does not currently appear to be a concern for them. However, TDS Telecom does propose a new SURF with a continuing open door to CHCF-A support.⁵⁷ DRA is concerned that eliminating affiliate

⁵⁵ OIR at 12.

⁵⁶ TDS Comments at 10.

⁵⁷ *Id.*, at 6.

transaction reporting,⁵⁸ while maintaining carrier access to CHCF-A funds, would further reduce transparency of affiliate transactions involving A-Fund supported network investments. Increased transparency and fair affiliate payments for ratepayer-subsidized network access are needed.

b) Other Parties' Comments Echo DRA's Concerns

Other parties' comments express similar concerns to those of DRA regarding Small LEC overinvestment. In their Opening Comments, TURN and Verizon provided additional facts that show the CHCF-A fund has not only been successful and served its purpose, but now exceeds the goal of providing "universal telephone service."⁵⁹ TURN's Opening Comments indicate that the "...cost of upgrading local loops have been associated with the desire of A-Fund ILECs to provide broadband services. Thus, ratepayers (both customers of A-Fund companies and contributors to the A-Fund) have shouldered the burden of enabling broadband provision, but the ISP affiliate of the A-fund ILEC reaps the financial rewards."⁶⁰ TURN stresses the need to address "cost causation" in the deployment of expanded local loop capacity to accommodate higher data usage services.⁶¹ DRA agrees that if the CHCF-A is maintained at any level, then the Commission should evaluate new A-Fund-supported small carrier investments accordingly. In response to DRA's data requests, most of the Small LECs claimed not to be able to document the public sources or CHCF-A shares of funds for their network investments. DRA requested Small LEC project descriptions and expenditure summaries for both network upgrade projects and network expansions to reach new customers, in excess of \$500,000, since 2000. The individual carrier responses provided through the Small LECs' attorney claimed in identical language that the carrier "does not distinguish between 'network expansion' and 'network improvement' in characterizing its

⁵⁸ *Id.*, at 10.

⁵⁹ *See*, TURN Comments and Verizon Comments.

⁶⁰ TURN Comments at 25.

⁶¹ TURN Comments at 17.

construction projects,” does not track the “specific number of customers affected by each project, nor does it record the specific impact on new services or non-regulated services.” Finally, the responses claimed that the carrier “does not track the source of funding for each project.”⁶² This basic information should be available to the carriers themselves and to the Commission in order to perform meaningful separation of regulated and non-regulated costs that govern network access charges. TURN succinctly states that the “A-Fund carriers are getting the best of both worlds – voice service customers (including customers of other telephone companies that pay the A-Fund surcharge) compensate the A-Fund carriers for their inflated rate bases, and the A-Fund companies (or their broadband affiliates) get to keep most of the broadband revenues.”⁶³ In other words, the Small LECs seem to socialize their costs while privatizing their profits.

Verizon also pointed out that Resolution T-17331 demonstrated that the CHCF-A program has more than doubled in size since 2001, when the program provided \$21.9 million in subsidies, to a fiscal year 2012-2013 budget of \$49.77 million.”⁶⁴ Verizon concluded that “[i]t is inequitable and unfair to customers statewide, to continue to subsidize the profits of Small LECs while they heavily invest in infrastructure to compete against the service providers whose customers provide the subsidy.”⁶⁵

c) The Kerman Example Illustrates The Need To Adopt DRA’s Proposals Regarding The CHCF-A

Furthermore, in its current general rate case application, Kerman has requested an addition \$5.8 million in upgrades which the carrier claims is necessary due to an explosive demand for bandwidth.⁶⁶ Kerman’s rationale is the need to upgrade the current

⁶² Responses of Small LECs to DRA Data Request CHCF-A OIR-002. The identical language cited was used in the responses of Calaveras, Cal-Oregon, Ducor, Foresthill, Kerman, Ponderosa, Sierra, Siskyou, and Volcano.

⁶³ TURN Comments at 24.

⁶⁴ Verizon Comments at 1.

⁶⁵ Verizon Comments at p. 2-3.

⁶⁶ Kerman GRC App, A.11-12-011, Direct Testimony of William S. Barcus at 6.

cable connections with customers to provide service that must be capable of delivering access for broadband. Kerman further stated that within the next 3-5 years, its voice network will need to convert to a fully IP-based platform.⁶⁷

DRA agrees that, as discussed above, the Small LECs have availed themselves of the A-Fund's "universal telephone service" funds to expand from providing basic telephone service to include broadband services. However, the Commission has never ruled on this expansion in the scope for the use of CHCF-A Fund monies for the Small LECs and it appears that California ratepayers are, thus, paying for this expansion without explicit Commission authorization for this policy. It also appears that the Small LECs are utilizing the CHCF-A Fund to replace equipment and facilities that are still used and useful, such as replacing copper facilities with fiber optic facilities, to become more "broadband-capable," even if the older facilities are still functional and still have a useful life.

As TURN has correctly pointed out, California ratepayers, through the CHCF-A, are allowing the Small LECs to incorporate the expenses of broadband facilities into voice services, usually as an "upgrade." However, any revenue generated is considered "interstate" and thus not accounted for in the Small LECs' revenue requirement or offset against any CHCF-A support.⁶⁸ This must be corrected. With a 97% penetration rate, the goal of providing universal telephone service has been met.⁶⁹ Therefore, DRA believes it now time to ratchet down the size of the CHCF-A fund.

⁶⁷ Kerman General Rate Case, A.11-12-011, Direct Testimony of Mitch Drake at 4.

⁶⁸ A telephone company should not be allowed to play a shell game where the network is upgraded with ratepayer funds to provide broadband services, but where voice service revenues alone are considered by the Commission (or the FCC) when determining necessary support. Under the current system, broadband revenues are considered "below the line" and are not included in a telephone company's revenue requirement, determined in rate cases, because they come from services that are unregulated. TURN Opening Comments at 12.

⁶⁹ See, Report to the Legislature on Universal Telephone Service to Residential Customers, California Public Utilities Commission, May 2, 2003.

K. The Commission Should Still Use A Total Operations Or Total Revenue Approach To Any CHCF-A-Supported Network Investment

As discussed in the previous section on “Small LEC Use of CHCF-A for Overinvestment,” DRA supports transparency in all uses of ratepayer funds, and opposes the use of ratepayer funds to unfairly subsidize that portion of network infrastructure used for services not regulated by the CPUC, such as broadband and video services. The OIR asked whether a “Total Operations Model” should be considered in which all telecommunications services are included for ratemaking purposes.⁷⁰ DRA finds that, regardless of how a Total Operations Model or Total Revenue approach might be applied for ratemaking (and regardless of whether the rate regulation regime for Small LECs is altered or not), the Commission should still use such an approach as long as the CHCF-A continues to operate, in order to prevent misallocation of ratepayer funds.

DRA finds that an apportionment of payments by affiliates for network access, and plant depreciation, may be more simply and fairly achieved with a cost allocation method based on the data traffic volumes of respective services provided by the carrier and its affiliates. A hybrid network access charge method including revenue and data traffic could also be considered. The considerations for the Commission when adopting such an apportionment method should be to adopt other policies, either simultaneously or in a phased manner, for wireline competition and rate regulation, so that the new policies work together as a whole.

The final consideration that is important for DRA is “rate shock” for Small LEC basic telephony ratepayers. If the Commission ultimately opts for some form of rate deregulation, it is critical that basic service customers be charged a fair share for their network access. It is also important that the network for which they pay for access be *adequate* for providing basic service, and not necessarily “gold-plated” for providing all manner of advanced services like broadband and video.

⁷⁰ OIR at 34: “Alternative Questions to Consider,” Question #4.

The Commission should not leave to the Small LECs the option to raise basic service rates to push customers into bundled services, or to cross-subsidize advanced services facing competitive alternatives in the local market. This consideration depends on uncapped rates and would be a problem with or without the CHCF-A. It is therefore necessary for the Commission to devise fair network access cost shares for basic and affiliate-delivered advanced services, based on transparent investment and usage data, for each Small LEC that may opt for uncapped rates or CHCF-A access. The Commission will need reliable investment and traffic data to review periodic network access costs. This information should be discussed by parties and considered by the Commission as part of this proceeding.

L. A Decrease In Federal Monies For The Small LECs Is Not Automatic

In their Opening Comments, the Small LECs make a presumption that the Federal Communication Commission (FCC) will make adjustments to its Universal Service Funding (USF) that will result in large reductions in funding to the Small LECs by as much as \$3.2 million in the first year.⁷¹

DRA disagrees. As TURN stated in its comments, “It is unclear how quickly the the FCC’s actions will impact the A-Fund ILECs.”⁷² There shouldn’t be an automatic assumption that federal dollars will disappear or be lower than what the Small LECs are currently receiving.

While the federal subsidy may change or go down, nothing has been finalized on the federal level. Moreover, other subsidies like the Connect America Fund may provide sufficient dollars to offset any possible decrease from the FCC’s USF. DRA believes States should not be required to make the Small LECs “whole” for a decrease in federal monies. If the Small LECs need more money, then DRA recommends that the Small LECs impute dollars from affiliates, rather than the CHCF-A fund, to offset any changes during the waterfall reduction.

⁷¹ Small LECs Comment at 24.

⁷² TURN Comments at 27.

M. DRA Disagrees With The Small LECs Regarding DRA’s Proposal for the CHCF-A

DRA disagrees with the Small LECs who state the CHCF-A should not be ratcheted down.⁷³ The Small LECs state that the goals of the CHCF-A are ongoing and therefore should not be viewed as complete.⁷⁴

As DRA pointed out in its Opening Comments, the Commission data stated that there was a 97% telephone penetration rate for the State of California.⁷⁵ This data solidly supports DRA’s statement that the CHCF-A has met its goal of providing Universal Service to the rural areas of California and should be ratcheted down using the Commission’s waterfall mechanism to properly draw down an ever expanding CHCF-A that is currently expending an average per access line corporate expense of \$677, amounting to an average corporate expense of \$4.2 million per carrier.

N. The Commission Should Adopt New Monitoring Mechanisms for Affiliate Transactions

DRA agrees with TURN that the Commission should adopt new reporting requirements for affiliate transactions. As TURN clearly articulates, the point of affiliate reporting should be to visibly identify affiliate revenues for services that are provided over shared facilities, and payments made by affiliates for the use of these facilities.⁷⁶

TURN also pointed out in its comments that the OIR indicated the current affiliate transaction reports do not allow for a proper determination of whether ISP affiliates of the A-Fund ILECs are paying fair market rates for their use of the regulated networks.⁷⁷ TURN’s comments support DRA’s statement that affiliate transactions were complex and sufficiently non-transparent.⁷⁸ Therefore, as DRA previously stated, the Commission

⁷³ Small LECs Comments at 38.

⁷⁴ Small LECs Comments at 38.

⁷⁵ DRA Comments at 3. *See also*, Report to the Legislature on Universal Telephone Service to Residential Customers, California Public Utilities Commission, May 2, 2003.

⁷⁶ TURN Comments at 42.

⁷⁷ TURN Comments at 23.

⁷⁸ DRA Comments at 14.

should adopt new reporting requirements for affiliate transactions to ensure ratepayer funds are being properly expended and that A-Fund companies are paying fair market prices for the use of the regulated networks.

O. Modifications To The A-Fund Will Not Constitute A Taking Under The 5th Amendment To The US Constitution

The Small LECs claim that a modification of the CHCF-A would result in an unconstitutional taking of utility property under the 5th Amendment of the United States (U.S.) Constitution. However, the Small LECs do not have a fundamental right to obtain a subsidy from the people of California.

The Commission established the General Rate Case (GRC) process to oversee the ability of companies to obtain a reasonable rate of return, not to guarantee income to a utility. In *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989) at 308, the court stated that a State would be in violation of the takings clause of the Fifth Amendment to the U.S. Constitution only if the utility rate established by the state did not afford sufficient compensation. Presently, the utilities have already been granted sufficient revenue requirements in a GRC and a change in the A-Fund will not alter that revenue requirement. Any modification to the A-Fund will simply change a subsidy to the utilities. Although the purpose of the GRC for each of these Small LECs, in large measure, is to authorize the company to restart the subsidy process provided by the CHCF-A, none of these Small LECs has a right, under the Fifth Amendment or any other provision of the U.S. Constitution, to a subsidy from California ratepayers.

Therefore, the Commission may modify the CHCF-A and still remain within constitutional bounds.

III. CONCLUSION

DRA requests the Commission adopt the recommendations stated above.

Respectfully submitted,

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