

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



FILED

9-26-14
04:59 PM

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

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

**OPENING BRIEF
OF THE OFFICE OF RATEPAYER ADVOCATES**

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September 26, 2014

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I. INTRODUCTION

Pursuant to the schedule set forth in the Joint Assigned Commissioner and Administrative Law Judge Scoping Ruling dated May 14, 2014, the Office of Ratepayer Advocates (ORA) submits this Opening Brief addressing the Phase I issues remaining in this proceeding.

In this Rulemaking, the Commission is considering changes to how the California High Cost Fund-A (CHCF-A or A-Fund) is administered. The Amended Scoping Memo and Ruling of Assigned Commissioner dated March 18, 2014 (Amended Scoping Memo) sets forth the issues to be resolved in the Opening Briefs, which include whether broadband revenues or profits should count towards the intrastate revenue requirement of the regulated carrier, and whether the Commission should standardize costs in considering the Small Independent Local Exchange Carriers' (Small LECs') revenue requirement. ORA does not here address every issue listed in the Amended Scoping Memo, and its silence does not indicate assent or dissent with the positions of the other parties.

ORA maintains two recommendations¹ in Phase I of this proceeding, which were set forth in ORA's Opening Testimony and Reply Testimony, submitted on July 11, 2014, and August 15, 2014, respectively. First, the Commission should count the net broadband revenue received by each Small LEC's broadband affiliate against the revenue requirement for each Small LEC as a condition of participating in the CHCF-A Program. Second, the Commission should adopt the Federal Communications Commission (FCC) corporate expense guidelines in order to limit the Small LECs' corporate operations expenses to a reasonable level for A-Fund subsidy calculations.

II. JURISDICTION

ORA's recommendations are squarely within the scope of this Rulemaking, which includes whether "all communications services including landline telephone service, broadband, VoIP, etc. [should be] included for ratemaking purposes", and whether to standardize "acceptable cost levels" among the Small LECs.² These issues were also listed as issues for evidentiary hearings in the March 18 Amended Scoping Memo.

These issues are well within the jurisdiction of the Commission. The Commission is required to administer the CHCF-A to provide revenue support utilizing rate-of-return regulation over the designated rural carriers pursuant to Public Utilities (PU) Code Section 275.6(a). This includes regulating the A-Fund carriers' "reasonable" investments in broadband-capable facilities, as well as ensuring that the carriers' A-Fund support is not "excessive."³ The A-Fund carriers are further required to provide information to the Commission specifically regarding the generation of revenues from the provision of Internet access service by either the A-Fund carrier or its broadband-related affiliate.⁴

¹ A third recommendation relating to standardizing the Small LECs' return on equity costs was stricken from ORA's Opening Testimony and moved to Phase II of this proceeding or a General Rate Case (GRC), where it will be considered sometime next year. The ALJ Ruling dated August 11, 2014 found that ORA's recommendation was "more appropriate for Phase II and/or the individual rates cases" and "ORA will not be harmed because the chapter in question and its analysis can be introduced later."

² OIR (R.) 11-11-007, p. 28 and p. 34.

³ PU Code Sections 275.6(c)(5), (c)(6), and (c)(7).

⁴ PU Code Section 275.6(e).

As a condition of participating in the CHCF-A program, carriers are required to subject themselves to rate-of-return regulation and to the Commission’s full authority to regulate telephone corporations under the Public Utilities Code, and to be the carrier of last resort.⁵ Rate-of-return regulation means the Commission must determine the carriers’ revenue requirement, which is the amount necessary for the carriers to recover reasonable expenses and to have an opportunity to earn a Commission-determined rate of return on its rate base.⁶ Rate base includes all the plant and equipment reasonably necessary to offer voice service as well “advanced services” (i.e., broadband).⁷ A necessary part of the revenue requirement analysis includes all sources of revenue.

Furthermore, the Commission may regulate every public utility and do all things, whether specifically designated or not, which are necessary and convenient in the exercise of its jurisdiction.⁸ The Commission is generally authorized to calculate the revenue requirement and utilize rate-of-return regulation to design a rate structure that affords the carriers a “fair opportunity” to recover their revenue requirement from ratepayers. The Legislature has delegated to the Commission the responsibility to determine exactly how it will carry out its mandate to calculate rate base and revenue requirements. In the process of making this calculation, the Commission is authorized to obtain information regarding broadband revenues from the carriers or their affiliates.² It follows logically that the Legislature authorized the Commission to use the broadband revenue information that it obtains in the course of its work.

However, even if imputation of broadband revenues and standardizing corporate expenses are not specifically enumerated powers within Section 275.6, those are ancillary functions that are both “necessary” and “convenient” to the Commission in carrying out

⁵ PU Code Section 275.6(d).

⁶ PU Code Section 275.6(b).

⁷ PU Code Section 275.6(b)(2).

⁸ PU Code Section 701.

² PU Code Section 275.6(e).

its duty to calculate a reasonable revenue requirement to ensure that ratepayer support from the A-Fund is not excessive.¹⁰

III. NET BROADBAND REVENUE IMPUTATION

The Legislature passed Senate Bill (SB) 379 in 2012 and codified it as Public Utilities Code Section 275.6. The legislative history lists the bill’s purpose as “to align California’s universal service program with recent changes at the federal level and thereby preserve about \$25 million of federal support for building broadband networks.”¹¹ Among other goals, the legislative history indicates that one goal is “to support investment in today’s modern broadband technology” by permitting reasonable investments by the A-Fund carriers in the delivery of broadband-capable facilities to be placed in rate base.¹²

When the Legislature was considering SB 379, the CPUC and ORA raised an objection “to providing ratepayer-funded subsidies for broadband facilities without giving the CPUC authority to consider the revenue a rural company earns from unregulated services delivered with the same broadband facilities that the CHCF-A would subsidize.”¹³ The bill analysis noted that these concerns were addressed by the addition of two amendments to the bill: 1) an amendment that requires the CPUC to ensure that support to A-Fund carriers is “not excessive” so that customer impact is limited¹⁴; and 2) an amendment that requires A-Fund carriers to provide the CPUC information about revenues from unregulated broadband revenues, which the carriers might otherwise assert they are not required to provide.¹⁵

¹⁰ Similarly, the issue of opening the Small LECs’ territory to competition is listed in the OIR and the Amended Scoping Memo, but not specifically enumerated in Section 275.6, and is also fully within the Commission’s jurisdiction to consider.

¹¹ SED Exhibit 1-B, Bill Analysis by Senate Energy, Utilities and Communications Committee, SB 379 - Fuller, As Amended: August 20, 2012.

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* Codified as Section 275.6(c)(7).

¹⁵ *Id.* Codified as Section 275.6(e).

Consistent with these amendments, the Commission included in this proceeding the issue of whether to count broadband revenues towards the A-Fund carriers' intrastate revenue requirement. The Commission should count net broadband revenues when calculating the A-Fund carriers' revenue requirement. Imputing the net broadband revenues would have the effect of increasing net revenues for the Small LECs and thereby decreasing the A-Fund subsidies needed to meet their revenue requirements. This will help ensure that the subsidies are not "excessive."

Each September or October, the Small LECs file revenue and expense data with the Commission in order to adjust prior year revenues and expense data, which impacts the carriers' A-Fund subsidy for the following year.¹⁶ The Communication Division (CD) annualizes the data and performs a means test calculation with the data.¹⁷ This is done by dividing Net Revenue by Rate Base to calculate the Rate of Return (ROR) for the carrier.¹⁸ Currently, if the ROR is below 10%, CD makes no adjustment to the A-Fund subsidies for the following year. Imputing broadband revenue would have the effect of increasing the Net Revenue used to calculate the ROR for the carriers.

It is important to note that ORA is recommending imputing net broadband revenues, which is the same as "profits." This means that reasonable broadband expenses should be deducted from gross broadband revenues to arrive at the net revenue. The Commission is authorized to request information regarding broadband revenues, and should use that authority to ensure that the information is accurate, so that carriers are not inflating broadband expenses in order to impute smaller net revenues in calculating the regulated company's A-Fund draw.

The Small LECs provided net broadband revenue information in response to a TURN data request regarding net broadband revenues. However, ORA used gross broadband revenues reflected in the data request response as a basis to illustrate the

¹⁶ SED Exhibit 8, ORA Opening Testimony p. 1-3.

¹⁷ *Ibid.*

¹⁸ *Ibid.*

proposed methodology for imputing broadband revenues on A-Fund subsidies. The one-page spreadsheets provided by the Small LECs do not contain sufficient information to determine whether the net broadband revenues are accurate, particularly as they are unverified and un-audited.¹⁹ In any event, this proceeding is not the proper forum to verify the accuracy of the A-Fund carriers' broadband revenue information, because the amount of each Small LECs' separate A-Fund subsidy will not be calculated in this proceeding.

ORA's recommendation is intended to fulfill the legislative mandate to ensure the carriers' A-Fund subsidies are not "excessive." The A-Fund subsidizes the investments needed to build and maintain broadband-capable networks. Fairness is achieved by ensuring that revenue derived from those networks is used to offset the costs of building and maintaining them.

IV. STANDARDIZING CORPORATE EXPENSES

The Commission also included in the OIR and Amended Scoping Memo the issue of whether to standardize costs in considering a Small LEC's revenue requirement. ORA's recommendation to adopt the FCC standards for corporate expenses falls squarely within the scope of "costs" that make up the Small LECs' revenue requirement.

ORA's recommendation has gained some urgency in light of recent events. The Legislature approved a bill, Assembly Bill (AB) 1693, which would have severely limited the timeframe for the CPUC to complete the General Rate Cases (GRCs) for each of the Small LECs. On September 20, 2014, the Governor vetoed AB 1693.²⁰ However, the Governor requested that the CPUC create a General Rate Case Plan to encourage timely completion of the Small LECs' GRCs, which ORA supports. In order to timely complete the GRCs, it is critical that the Commission adopt the FCC corporate expenses limits to set a standard on what is deemed a reasonable level of corporate operations

¹⁹ Dr. Roycroft relied upon these spreadsheets in his testimony for illustrative purposes; however, he also recommended that the A-Fund carriers' affiliated broadband service providers should be subject to a thorough broadband expenses audit. TURN Exhibit 14, p. 5.

²⁰ http://gov.ca.gov/docs/AB_1693_Veto_Message.pdf

expenses. As ORA explained in its testimony, doing so will simplify the GRCs by providing clear guidance to the Small LECs.

California has not adopted any “bright line” standards for what constitutes a reasonable level of corporate operations expenses.²¹ Currently, the Commission considers the Small LECs’ corporate expense projections as part of the carriers’ GRC process, to determine whether they are reasonable or should be reduced.²² Adopting the FCC standards should serve to reduce the amount of litigation over these determinations, and to simplify potential settlement negotiations.

The FCC standards are simple and easy to apply. They are:

1. For study areas with 6,000 or fewer total working loops the monthly amount per loop shall be
 - a) $\$42.337 - (.00328 \times \text{number of total working loops})$, or (b) $\$63,000 / \text{number of total working loops}$, whichever is greater;
2. For study areas with more than 6,000, but fewer than 17,887 total working loops, the monthly amount per loop shall be $\$3.007 + (117,990 / \text{number of total working loops})$; and
3. For study areas with 17,887 or more total working loops, the monthly amount per loop shall be $\$9.56$.²³

It is reasonable to adopt the FCC standards here because they further the FCC’s goals of fiscal responsibility and accountability in providing “High Cost Loop Support” and “Interstate Common Line Support.” The FCC found that “the amount of recovery of corporate operations expense...should be limited to help ensure that carriers use such support only to offer better service to their customers through prudent facility investment and maintenance.”²⁴ The FCC adopted these “more modest” reform proposals in order to

²¹ Exhibit 7, p. 2-1.

²² *Ibid.*

²³ *FCC Report And Order And Further Notice Of Proposed Rulemaking*, FCC 11-161, rel. November 18, 2011, ¶ 232.

²⁴ *Id.* at ¶ 229.

extend the limit on recovery of corporate operations expense, while also updating the formulae for limiting the eligibility of corporate operations expenses because they had not been revised since 2001.²⁵

These FCC standards are reasonable to adopt because they have been designed with the current economics of rural areas in mind; as the FCC found, “updating the formula based on more recent cost data will ensure that it reflects the current economics of serving rural areas and appropriately provides incentives for efficient operations.”²⁶ Moreover, adopting these standards in California will serve to greatly simplify and shorten the determinations that must be made in the upcoming Small LEC GRCs.

V. CONCLUSION

The Commission should adopt ORA’s recommendations to impute net broadband revenues when calculating a Small LEC’s revenue requirement and subsequent A-Fund subsidy. The Commission should also require use of the FCC’s corporate expense limits when performing these calculations.

Respectfully submitted,

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September 26, 2014

²⁵ *Id.* at ¶ 230.

²⁶ FCC 11-161, ¶ 231.