

ORIGINAL

NEW APPLICATION



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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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COMMISSIONERS

GARY PIERCE, Chairman
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BOB STUMP
BRENDA BURNS

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IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN TELEPHONE COMPANY, AN ARIZONA CORPORATION, FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, AND TO INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR THE RATE IMPACTS OF THE FCC'S USF/ICC TRANSFORMATION ORDER

DOCKET NO. T-01072A-12-0472

1 Southwestern Telephone Company ("Southwestern Telephone"), an Arizona corporation,
 2 hereby applies pursuant to A.R.S. § 40-250 and the Commission's Rule R 14-2-103 for a
 3 determination of Southwestern Telephone's earnings and the fair value of its investment and
 4 requests that its residential rates be increased as necessary to compensate for the rate impacts of
 5 the Federal Communication Commission's November 18, 2011, USF/ICC Transformation Order
 6 ("USF/ICC Order").

7 **I. BACKGROUND**

8 On November 18, 2011, the Federal Communications Commission issued the USF/ICC
 9 Order. The USF/ICC Order transitions the outdated federal universal service programs and most
 10 inter-carrier compensation systems into a new Connect America Fund ("CAF"). The FCC's
 11 press release characterized the USF/ICC Order as "the most significant policy step ever taken to
 12 connect all Americans to broadband."

1 The USF/ICC Order will reduce inter-carrier compensation rates to zero by July 1, 2020,
2 for rate of return companies, with limited recovery from customers and partial recovery from the
3 CAF. The recovery from the CAF will phase out over time at 5% annually.

4 Southwestern Telephone is a small rate-of-return regulated Incumbent Local Exchange
5 Carrier (“ILEC”). Of particular importance to Southwestern Telephone and other rural ILECs,
6 the USF/ICC Order adds new rules that will reduce federal high-cost loop support to carriers by
7 the amount their flat-rate residential local service rates fall below a specified annual urban rate
8 floor.¹ The rate floor includes, if any, state subscriber line charges, state universal service fees,
9 and mandatory extended area service charges. The FCC’s order establishes local residential rate
10 floors of \$10.00 as of June 1, 2012, and \$14.00 as of June 1, 2013, with the floor thereafter being
11 determined annually by the FCC’s Wireline Competition Bureau, based on a nationwide
12 average.²

13 Federal and state support funding are vital to a robust telecommunications network in
14 high cost areas. To maintain federal loop support, Southwestern Telephone and other rural
15 ILECs must increase local rates to the FCC-mandated residential rate floors. Otherwise, the
16 amount of federal support funds will be reduced dollar-for-dollar for each customer by the
17 difference between the existing local rate and the new rate floor. If local rates are not increased,
18 the new FCC rules will reduce funds coming to the state of Arizona and negatively impact
19 customers living in high-cost areas in the state.

20 Low customer density makes Southwestern Telephone dependent on high-cost federal
21 support mechanisms. It is important that the company be allowed to increase local rates, to the
22 FCC determined annual rate floors, in order to maintain its existing federal support. Therefore,
23 Southwestern Telephone requests the Commission to approve local rate increases to the \$14 rate
24 floor established by the FCC’s order.

¹ 41 C.F.R § 54.318.

² USF/ICC Order paragraph 236 states the most recently available nationwide average local rate from 2008 was \$15.62.

1 **II. SOUTHWESTERN TELEPHONE**

2 Southwestern Telephone Company is a corporation duly organized and existing under
3 and by virtue of the laws of the State of Arizona. Southwestern Telephone is authorized to
4 engage in and is now engaged in the conduct of a general communications business within the
5 State of Arizona.

6 **III. SUMMARY OF REQUEST**

7 This application is made pursuant to the provisions of A.R.S. §§ 40-250 and 40-367, and
8 Commission Rule R14-2-103. The Commission last considered Southwestern Telephone's rates
9 in Docket No. T-01072B-00-0379, which resulted in Commission Decision 63685, dated May
10 24, 2001.

11 Southwestern Telephone's local residential one-party rates are \$11.25/month and local
12 residential two-party rates are \$9.60/month.³ These rates are below the federal \$14/month rate
13 floor that will go into effect on June 1, 2013. The rate floor for 2014 and thereafter will be
14 determined by an annual FCC survey.

15 Southwestern Telephone is aware that many parties, including the Commission, have
16 appealed the USF/ICC Order. However, in the meantime, Southwestern Telephone and other
17 rural ILECS must comply with all provisions of the USF/ICC Order and will remain subject to
18 the increased local residential rate floors and the corresponding losses of federal support funds.

19 Southwestern Telephone's loss of federal support funds would be particularly difficult to
20 bear. As the attached schedules demonstrate, Southwestern Telephone's return on investment is
21 already negative. Put another way, Southwestern Telephone's jurisdictional earnings are
22 negative. Losing federal support funds will only drive earnings deeper into the red.

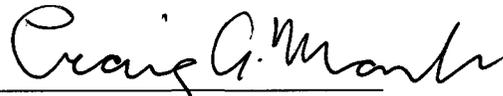
23 In connection with this application, Southwestern Telephone has filed exhibits which
24 include a schedule of the specific rate changes requested and the impact of the revenue generated
25 on the company's financial position. Southwestern Telephone asks that the Commission

³ While the subscribers have continued to pay the lower rate for two-party service, the actual service provided to each of these subscribers is one-party service.

1 determine the fair value of the company's investments for ratemaking purposes and stipulates to
2 use original cost less depreciation for those purposes. Because the next opportunity to affect
3 federal support funds is June 1, 2013, Southwestern Telephone further asks that the Commission
4 set new rates at or above the \$14.00 floor to be effective no later than June 1, 2013.

5 To facilitate processing of this application, Southwestern Telephone asks that the
6 Commission waive any provisions of Commission Rule R14-2-103 not required by the Arizona
7 Constitution and laws.

8 Respectfully submitted on November 23, 2012.

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11 

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Original and 13 copies **filed**
on November 23, 2012, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

By:


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Southwestern Telephone Company

Streamlined filing to support residential rate increase due to FCC
floor implementation and resulting HCL loss.

October 31, 2012

Southwestern Telephone Company

October 31, 2012

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Southwestern Telephone Company

October 31, 2012

REGULATED RESULTS OF OPERATIONS FOR TWELVE MONTHS ENDING JUNE 30, 2012
REFLECTS CHANGES EFFECTIVE WITH ARC AND CAF IMPLEMENTATION -- YEAR 1

	TOTAL TELEPHONE OPERATIONS	ADJUSTMENTS	Ref	ADJUSTED RESULTS	INTERSTATE	INTRASTATE
	(a)	(b)	(c)	(d)	(e)	(f)
1	Local	648,107	-1,751 #7	646,356	0	646,356
2	Universal Services Fund (USF-HCL) and Safety Net Additive (SNA)	516,941	-38,565 #6,6	478,376	0	478,376
3	Access Revenues	1,679,166	-50,245 4,7 #1,2,3	1,628,921	1,161,314	467,607
4	Billing & Collecting	34,245		34,245	14,194	20,051
5	Other Misc., Uncollectibles	60,011		60,011	25,643	34,368
6	Total Operating Revenues	2,938,470	-90,561	2,847,909	1,201,151	1,646,758
7	Plant Specific Expenses	589,067	49,286 #11	638,353	274,053	364,310
8	Plant Nonspecific Expenses	305,751	19,623 #7,8,11	325,374	160,924	164,450
9	Depreciation & Amortization Expenses	990,128	91,020 #11	1,081,148	434,699	646,449
10	Customer Operations Expenses	307,308	14,136 #11	321,444	109,980	211,464
11	Corporate Operations Expenses	368,126	23,486 #11	411,622	134,038	277,584
12	Other Operating Taxes and (Income)	35,071	113,736 1,12 #8,10,1	148,807	66,582	82,245
13	Nonregulated Adjustment (Part 69 WBL)		-309,264 #11	-309,264	0	0
14	Total Operating Expenses	2,615,451	2,043	2,617,494	870,982	1,746,502
15	OPERATING RETURN BEFORE TAXES	323,019	-92,604	230,415	330,159	-99,744
16	Slate Income Taxes (SIT) (6.97%)	19,755	-3,695 #13	16,060	23,012	-6,952
17	Federal Income Taxes (FIT) (35%)	107,044	-32,020 #13	75,024	107,501	-32,477
18	Total Operating Income Taxes	126,799	-35,715	91,084	130,514	-39,429
19	Total Expenses and Income Taxes	2,742,250	-33,672	2,708,578	1,001,506	1,707,073
20	Net Operating Income	196,220	-56,889	139,331	199,645	-60,315
21	Total Year-End Rate Base	4,138,383	0	4,138,383	1,572,768	2,565,615
22	Return on Rate Base (Ln 20 / Ln 21)					-2.4%
23	Estimated Revenue from Local Rate Increase					53,368
24	Slate Income Taxes (SIT) (6.97%)					3,720
25	Federal Income Taxes (FIT) (35%)					17,377
26	Increase in Net Operating Income					32,271
27	Net Operating Income After Increase (Ln 20 + Ln 26)					-28,044
28	Return on Rate Base After Increase (Ln 27 / Ln 21)					-1.1%

ASSUMPTIONS

Used 2011 Cost Study run dated 04/30/2012 for Part 36 separation/
Separated results based upon frozen 2000 traffic factors
Separated results based upon 6/30/2012 financials, interstate rules, adjusted for Part 64 activities
Working Capital included for all jurisdictions

Southwestern Telephone Company
Adjustments to Revenues and Expenses

Ref	Account	Description	Debit	Credit
1.	5082200	Access Revenues	554	
	5083000	Access Revenues	398	
		Exclude		952
		To remove prior period (2008) interstate revenue requirement adj.		
2.	5082200	Access Revenues	6,355	
	5083000	Access Revenues	1,525	
		Exclude		7,880
		To remove prior period (2009) interstate revenue requirement adj.		
3.	5082100	Access Revenues	41,299	
	5082200	Access Revenues		35,266
	5083000	Access Revenues	2,762	
		Exclude		8,795
		To remove prior period (2010) interstate cost study true-up.		
4.	5082200	Access Revenues		4,185
	5083000	Access Revenues		1,541
		Exclude	5,726	
		To remove prior period (2010) interstate revenue requirement adj.		
5.	5082110	Universal Service Fund	38,064	
	PPA			38,064
		To adjust for Federal HCL projected change for 2012.		
6.	5082110	Universal Service Fund	501	
	PPA			501
		To remove prior period HCL revenues.		
7.	5001000	Local Revenues	1,751	
	5082200	Access Revenues	15,034	
	5084220	Access Revenues	23,310	
	6540010	Plant Nonspecific Exp		689
		Exclude		39,406
		Year 1 FCC Order ICC intrastate and interstate revenue and expense 5% reductions.		
8.	6540011	Plant Nonspecific Exp	2,732	
	PPA			2,732
		To remove prior period (2009 & 2010) 499A interstate expense adjustments and DSL FUSC refund.		
9.	Not Used			

Southwestern Telephone Company
Adjustments to Revenues and Expenses

<u>Ref</u>	<u>Account</u>	<u>Description</u>	<u>Debit</u>	<u>Credit</u>
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10. Not Used

11.	6112004	Plant Specific Exp	1,152	
	6121004	Plant Specific Exp	9,024	
	6232004	Plant Specific Exp	32,724	
	6423004	Plant Specific Exp	6,396	
	6532004	Plant Nonspecific Exp	17,580	
	6561000	Depreciation Exp	91,020	
	6611004	Customer Operations Exp	11,532	
	6623304	Customer Operations Exp	2,604	
	6728904	Corporate Operations Exp	23,496	
	7130000	Other Operating Income	101,208	
	7240900	Other Operating Taxes	12,528	
	7990000	Nonregulated Exp		309,264

To reverse transfer of estimated Part 69 interstate expenses for WBI (Internet) to enable proper Part 36 allocation of total company expenses.

12. Not Used

13.	7220000	Federal Income Tax		32,020
	7230020	State Income Tax		3,695
	PPA		35,715	

Adjust income taxes to remove prior period amounts and for adjustments to results.

Southwestern Telephone Company
 Year 1 Estimated ICC Impact of FCC Order

Base Line of Eligible Recovery:

	Total	5% Reduction			
Interstate SWA (Includes LSS)	300,681	(15,034)	Access Revenue	Interstate	
Intrastate Terminating Access	466,191	(23,310)	Access Revenue	Intrastate Access	
Recip Comp Revenue	35,016	(1,751)	Local Revenue	Intrastate Local	
Recip Comp Expense	(13,789)	689	Plant Non-Specific	Intrastate Local	
Total Base of Eligible Recovery	788,099	(39,406)			
					AJE #7

Southwestern Telephone Company

Rate Base

As June 30, 2012

	<u>Total Company</u>	<u>INTERSTATE</u>	<u>INTRASTATE</u>
Plant in Service	\$ 18,154,231	\$ 7,765,628	\$ 10,388,603
Accumulated Depreciation	(13,564,659)	(5,975,255)	(7,589,404)
Net Plant in Service	\$ 4,589,572	\$ 1,790,373	\$ 2,799,199
Plant Under Construction	44,519	18,961	25,558
Material & Supplies	110,921	32,293	78,628
Deferred Income Taxes	(742,194)	(316,074)	(426,120)
Cash Working Capital	135,565	47,215	88,350
Rate Base	<u>\$ 4,138,383</u>	<u>\$ 1,572,768</u>	<u>\$ 2,565,615</u>

Southwestern Telephone Company
For Twelve Ending June 30, 2012

CALCULATION OF CASH WORKING CAPITAL (CWC)

CASH OPERATING EXPENSES	<u>Total Company</u>	<u>INTERSTATE</u>	<u>INTRASTATE</u>
Total Operating Expenses	\$ 2,617,494	\$ 870,992	\$ 1,746,502
Depreciation & Amortization	1,081,148	434,699	646,449
Cash Operating Federal Income Taxes	75,024	107,501	(32,477)
Cash Operating State & Local Taxes	<u>16,060</u>	<u>23,012</u>	<u>(6,952)</u>
Total Cash Operating Expenses	\$ 1,627,430	\$ 566,807	\$ 1,060,624
% LAG (30 days)	8.33%	8.33%	8.33%
TOTAL CASH WORKING CAPITAL	<u>\$ 135,565</u>	<u>\$ 47,215</u>	<u>\$ 88,350</u>

Southwestern Telephone Company

Proposed Rate Design

June 30, 2012 TTM Average Units*

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Service Description	Average Units (a)	Current Rates	2011 Annual Revenues	Proposed Rates	Proposed Revenues	Proposed Revenue	Proposed Change Percent
Basic Service							
Residence One-Party	1,614	\$ 11.25	\$ 217,890	\$ 14.00	\$ 271,152	\$ 53,262	24.44%
Residence Two-Party	2	\$ 9.60	\$ 230	\$ 14.00	\$ 336	\$ 106	45.83%
Estimated Revenue from Local Rate Increase						\$ 53,368	

Notes:

*Average units are used to capture seasonal fluctuations.

(a) No reduction made for line loss.

Year	Type	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2009	One-Party	2,916	2,982	2,964	2,492	1,759	1,556	1,481	1,443	1,449	1,609	2,179	2,498
2009	Two-Party	5	5	4	4	4	4	4	4	4	4	4	4
2009 Total		2,921	2,987	2,968	2,496	1,763	1,560	1,485	1,447	1,453	1,613	2,183	2,502
2010	One-Party	2,613	2,667	2,647	2,249	1,584	1,425	1,345	1,320	1,338	1,473	1,989	2,234
2010	Two-Party	4	4	4	4	4	4	4	4	4	2	2	2
2010 Total		2,617	2,671	2,651	2,253	1,588	1,429	1,349	1,324	1,342	1,475	1,991	2,236
2011	One-Party	2,317	2,376	2,343	2,033	1,501	1,324	1,242	1,225	1,223	1,339	1,752	1,984
2011	Two-Party	2	2	2	2	2	2	2	2	2	2	2	2
2011 Total		2,319	2,378	2,345	2,035	1,503	1,326	1,244	1,227	1,225	1,341	1,754	1,986
2012	One-Party	2,066	2,095	2,067	1,798	1,363	1,208						
2012	Two-Party	2	2	2	2	2	2						
2012 Total		2,068	2,097	2,069	1,800	1,365	1,210						