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MEMORANDUM

TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

ORIGINAL

DATE: March 21, 2014

RE: IN THE MATTER OF THE APPLICATION OF VALLEY TELEPHONE COOPERATIVE, INC. 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-01847A-13-0457)

Attached is the Staff Report for Valley Telephone Cooperative, Inc.'s application to increase residential rates as necessary to compensate for the rate impacts of the Federal Communications Commission's Universal Service Fund/Intercarrier Compensation ("FCC's USF/ICC") Transformation Order.

Staff recommends approval of Valley Telephone Cooperative, Inc.'s request to increase its monthly residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC.

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Originator: Wilfred Shand

Arizona Corporation Commission

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SERVICE LIST FOR: VALLEY TELEPHONE COOPERATIVE, INC.
DOCKET NO.: T-01847A-13-0457

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

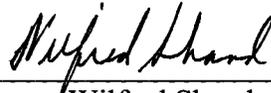
**VALLEY TELEPHONE COOPERATIVE, INC.
DOCKET NO. T-01847A-13-0457**

**IN THE MATTER OF THE APPLICATION OF VALLEY TELEPHONE COOPERATIVE,
INC. 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**

MARCH 21, 2014

STAFF ACKNOWLEDGMENT

The Staff Report for Valley Telephone Cooperative, Inc. (Docket No. T-01847A-13-0457) was the responsibility of the Staff member listed below.



Wilfred Shand
Public Utility Analyst Manager

EXECUTIVE SUMMARY
VALLEY TELEPHONE COOPERATIVE, INC.
DOCKET NO. T-01847A-13-0457

On December 19, 2013, Valley Telephone Cooperative, Inc. (“Valley Telephone” or “Applicant”) filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission’s (“FCC’s”) November 18, 2011, Universal Service Fund/Intercarrier Compensation (“USF/ICC”) Transformation Order (“USF/ICC Order”) pursuant to Arizona Revised Statutes (“A.R.S.”) §§ 40-250 and 40-367.

Staff recommends approval of Valley Telephone Cooperative, Inc.’s request to increase its monthly residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC’s November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund (“FUSF”) funds that may flow to Valley Telephone pursuant to the FCC’s rules;
- The increase will minimize/reduce the amount of future rate increases; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff further recommends that any future rate increase applications filed by Valley Telephone be processed per full A.A.C. R14-2-103 requirements, not streamlined.

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Introduction

On December 19, 2013, Valley Telephone Cooperative, Inc. (“Valley Telephone” or “Applicant”) filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission’s (“FCC’s”) November 18, 2011, Universal Service Fund/Intercarrier Compensation (“USF/ICC”) Transformation Order (“USF/ICC Order”) pursuant to Arizona Revised Statute (“A.R.S.”) § 40-250. A.A.C. R14-2-103(A)(1) requires specific financial and statistical information be filed with a request by a public service corporation doing business in Arizona for a determination of the value of the property of the corporation and of the rate of return earned. Valley Telephone submitted, as recommended by Staff, a streamlined filing which included the following exhibits to support the requested increase in residential rates:

- Adjusted 2012 Results
- Adjustments
- Year 2 FCC Order ICC Impact
- Rate Base
- Working Capital
- Rate Design

On January 6, 2014, the Applicant filed an Amendment to its Application to include Schedules that were inadvertently omitted from the docketed copy of its Application. The Applicant submitted a Supplemental Filing on January 29, 2014. On January 30, 2014, the Applicant filed a Notice of Errata to correct its Supplemental Filing.

Background

Valley Telephone is an Arizona non-profit, member-owned, cooperative. Valley Telephone is authorized to engage in and is engaged in the conduct of a general communications business within the State of Arizona. The Commission last considered Valley Telephone’s rates in Docket No. T-01847A-12-0485, which resulted in Commission Decision No. 73872, dated May 8, 2013.¹ Valley Telephone is a small rate-of-return (“RoR”) regulated incumbent local exchange carrier (“ILEC”).

On November 18, 2011, the FCC issued the USF/ICC Order. The USF/ICC Order transitions the outdated federal universal service programs and most intercarrier compensation systems into a new Connect America Fund (“CAF”). The FCC’s press release characterized the

¹ Decision No. 73872 authorized Valley Telephone to raise its residential local service rates to \$14.00/month, effective June 1, 2013.

USF/ICC Order as “the most significant policy step ever taken to connect all Americans to broadband.”

In its USF/ICC Order, the FCC stated that it will reduce intercarrier compensation rates to zero by July 1, 2020, for RoR companies, with limited recovery from customers and partial recovery from the CAF. The partial recovery from the CAF for the reduction in ICC rates will phase out over time at 5 percent annually. The USF/ICC Order adds new rules that will reduce federal high-cost loop support (“FHCLS”) to carriers by the amount their flat-rate single line residential local service rates fall below an FCC-specified local service rate floor. The rate floor includes state subscriber line charges, state universal service fees, and mandatory extended area service charges, if any are assessed. The FCC’s order establishes single line residential local service rate floors of \$10.00 as of June 1, 2012, \$14.00 as of June 1, 2013, with the floor thereafter being determined annually by the FCC’s Wireline Competition Bureau, based on a nationwide average. To date, the FCC has not established the June 1, 2014 local service rate floor. The FCC is conducting a survey of urban rates for fixed voice residential services, required by the USF/ICC Transformation Order. The information collected in this survey will be used to establish a rate floor for voice services that eligible telecommunications carriers (“ETCs”) receiving high cost loop support (“HCLS”) or frozen high-cost support must meet in order to receive their full support amounts.

To maintain FHCLS, Valley Telephone and other rural ILECs must increase single residential local rates to the FCC-mandated residential rate floor. Otherwise, the amount of FHCLS funds will be reduced dollar-for-dollar for each customer by the difference between the existing single line residential local rate and the new rate floor. Valley Telephone’s current residential local service rate of \$14.00 is equal to the current rate floor. Therefore, with this application, Valley Telephone seeks Commission approval to raise its residential local service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC .

Consumer Services

On January 30, 2014, the Commission’s Corporations Division responded that Valley Telephone is in Good Standing. A review of Consumer Services database from January 1, 2010 to current revealed that only one complaint was filed in 2011. The lone complaint was for a Quality of Service issue, specifically, an outage complaint. That complaint has been resolved and closed. No opinions were received for Valley Telephone Cooperative, Inc.

Public Notice

On February 28, 2014, Valley Telephone filed an affidavit of Customer Notice indicating that notice was mailed on February 14, 2014, to all of Valley Telephone’s Arizona residential customers.

Compliance

A check of the Utilities Division Compliance Section database showed that Valley Telephone is in compliance with all items.

Operating Income Statement

Valley Telephone submitted Regulated 2012 Results of Operations information in its streamlined filing. The submitted information was accepted without adjustment for the purposes of this streamlined application.

Operating Revenue and Expenses

According to the information provided by the Applicant, Valley Telephone Total Intrastate Operating Revenues for 2012 were \$4,637,184. Subcategories of Total Intrastate Operating Revenues are noted below:

Local	\$564,175
USF-HCL ² & Safety Net	\$3,378,696
Access Revenues	\$357,824
Billing and Collection	138
Other	\$336,351

The Company also provided information that stated that its Total Intrastate Operating Expenses for 2012 were \$3,949,059. Subcategories of Total Intrastate Operating Expenses are noted below:

Plant Expenses	\$1,003,882
Depreciation & Amortization	\$1,744,127
Customer Operations	\$236,563
Corporate Operations	\$613,661
Other	\$350,826

Operating Income

As provided by the Applicant, Valley Telephone's intrastate operating revenue before taxes for 2012 was \$688,125 and its net operating income was \$270,875.

² Universal Service Fund – High Cost Fund

Rate Base

According to Valley Telephone, its intrastate rate base is \$17,933,103, as stated in the table below:

Valley Telephone				
Rate Base - 2012				
		Adjusted		
		Total Company	INTERSTATE	INTRASTATE
Plant in Service		\$61,182,792	\$24,060,246	\$37,122,546
Accumulated Depreciation		(\$32,094,397)	(\$12,708,843)	(\$19,385,554)
Net Plant in Service		\$29,088,395	\$11,351,403	\$17,736,992
Plant Under Construction		\$581,726	\$228,765	\$352,961
Material & Supplies		\$514,681	\$159,418	\$355,263
Deferred Income Taxes		-	-	-
Customer Deposits		(\$9,425)	(\$3,706)	(\$5,719)
Other Long Term Liabilities		(\$1,085,301)	(\$471,133)	(\$614,168)
Cash Working Capital		\$189,363	\$81,589	\$107,774
Rate Base		\$29,279,439	\$11,346,336	\$17,933,103

Customer Base

Valley Telephone reported 1,685 residential lines and 451 business lines in its 2012 Utilities Annual Report submitted on March 3, 2013.

Revenue Requirement

As stated above, the Applicant's filing was based on a streamlined basis and does not contemplate rate adjustments based on revenue requirement analysis.

Rate Design

The Applicant did not propose a rate design as required by A.A.C. R14-2-103. The Applicant is seeking to increase its residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC.

The Applicant's filing only contemplates changes to residential local exchange rates to compensate for the rate impacts of the FCC's USF/ICC order. With this filing, Staff will only address the monthly increase of all residential local exchange service rates of \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC.

Staff Analysis

Staff did not perform a regulatory audit of the information submitted by Valley Telephone. However, Staff reviewed the information filed in the context of the FCC's November 18, 2011 USF/ICC Order, which is intended to transition the federal universal service programs and certain intercarrier compensation reductions into a new CAF.

Staff has analyzed this application in terms of whether there were fair value implications. For the purposes of this matter the Applicant stipulated to the use of original cost less depreciation as the basis for a determination of its fair value rate base. The Applicant states that its intrastate rate base is \$17,933,103. The Applicant provided information that indicates that its Total Intrastate Operating Revenue for 2012 was \$4,637,184. According to the Applicant, the annual revenue effect of the increase in residential local telephone service rates to \$19.00 is \$104,370. Valley Telephone's return on rate base would increase from 1.51 percent to 2.09 percent. In the Applicant's Supplemental Filing, Valley Telephone indicated that the annual revenue effect of the increase in residential local telephone service rates to \$17.50 is \$73,059. At the \$17.50 residential local service rate, Valley Telephone's return on rate base would be 1.92 percent, versus 2.09 percent if the residential rate floor is set at \$19.00 per month. Compared to the Applicant's total revenues, any revenue impact from this rate increase would be small and any impact on the Applicant's FVRB would be de minimus.

Staff's Recommendations

Staff recommends approval of Valley Telephone Cooperative, Inc.'s request to increase its monthly residential local exchange service rate from \$14.00 to the lesser of \$19.00 or the 2014 local service rate floor established by the FCC. Staff further recommends that the rate increase become effective on the rate floor compliance date, as determined by the FCC, to address the impact of the FCC's USF/ICC Order.³ Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the FUSF funds that may flow to Valley Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increases; and

³ The rate floor compliance date is the date (currently June 1) on which the local service rate must equal or exceed the FCC rate floor so a company receiving federal high-cost loop support may continue to receive all of its authorized Federal Universal Service Fund revenues.

- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff further recommends that any future rate increase applications filed by Valley Telephone be processed per full A.A.C. R14-2-103 requirements, not streamlined.

Staff has reviewed the rate application and the federal rule changes that have prompted the rate application. Staff concludes that the costs appear reasonable and appropriate under the unique circumstances of this case. However, Staff's recommendation in these unique circumstances should not be viewed as precedent for the processing of future rate case applications.