



USF Reform Order & Budget Controls

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Chad Duval, Partner
Moss Adams LLP

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The only constant is change...



USF Reform Modification Order

- *Report and Order, Third Order on Reconsideration, and Notice of Proposed Rulemaking* (FCC 18-29), released March 23, 2018
 - Report and Order
 - Expenses ineligible for recovery through High-Cost Support and Interstate Ratemaking
 - Additional support for A-CAM carriers
 - USF Collections



USF Reform Modification Order

- *Report and Order, Third Order on Reconsideration, and Notice of Proposed Rulemaking (FCC 18-29)*, released March 23, 2018
 - **Third Order on Reconsideration**
 - **Budget Control Mechanism for 7/1/17 – 6/30/18**
 - **OpEx Limitation – Inflation Adjustment**
 - **Corporate Operations Expense Limitation**
 - **Transfer of Exchanges**
 - **Waiver Requests**
 - **Effect of A-CAM on Budget for Legacy RoR Carriers**



USF Reform Modification Order

- *Report and Order, Third Order on Reconsideration, and Notice of Proposed Rulemaking* (FCC 18-29), released March 23, 2018
 - Notice of Proposed Rulemaking (“NPRM”)
 - CAF Support for RoR Carriers
 - RoR Budget/New Model Offer/Collections
 - Increasing Broadband Deployment & Efficient Use of Resources
 - A-CAM Funding/New A-CAM Offer/Threshold RoR Support/Deployment Obligations
 - Other Reforms
 - Monthly Per Line Limit on Support/100% Overlap/CapEx & OpEx Limitations/Etc.





Report & Order: Ineligible Expenses

Ineligible Expenses: High-Cost Support

- High-Cost Support Recovery
 - Support shall be used “only for the provision, maintenance, and upgrading of facilities and services for which the support is intended”
 - FCC relied upon state monitoring and annual certifications
 - Unless misuse of USF made federal monitoring necessary
 - Recent waiver requests, audits, and enforcement actions caused concern
 - Result was the October 2015 Public Notice “reminder” list of eligible expenses
 - 2016 *Rate-of-Return Reform Further Notice* sought comment
 - Certain costs not previously explicitly excluded from cost recovery



Ineligible Expenses: High-Cost Support

- 3 Broad Categories of Ineligible Expenses
 - Personal Expenses
 - Expenses Unrelated to Operations
 - Corporate Luxury Goods
- Each category specifies types of expenses not eligible for support
- List is not comprehensive
 - Prohibition on any expenses “not used only for the provision, maintenance, and upgrading of facilities and services for which the support is intended”
 - Carriers must make a determination on all expenses



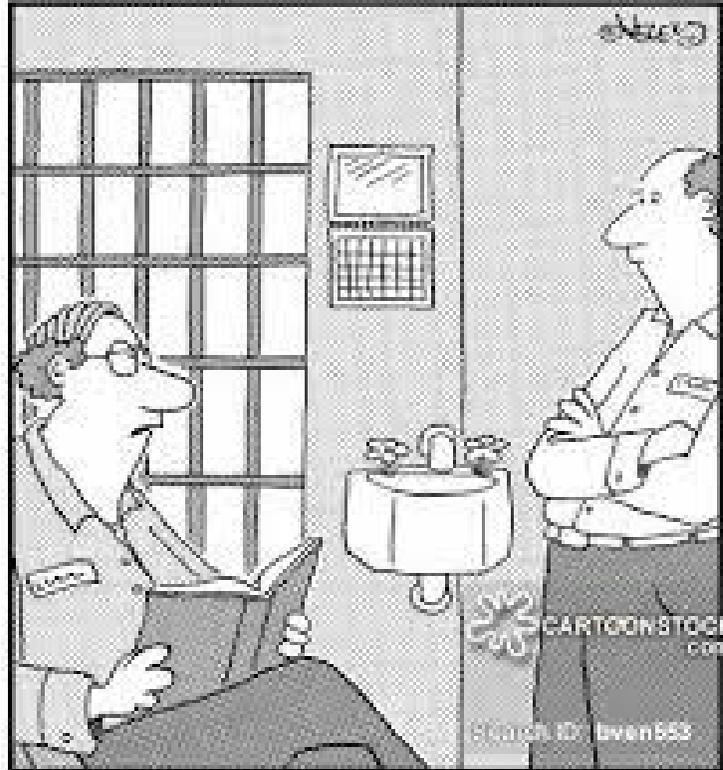
Personal Expenses

- **Employees, board members, contractors, and others affiliated with the ETC**
 - **Personal Travel**
 - **Personal Vehicles**
 - **Housing (rent/mortgages/housing allowances)**
 - **Childcare**
 - **Employee gifts**
 - **Entertainment-Related Expenses, including food & beverage**

* Caution that recovery of personal expenses “may constitute outright fraud, waste, and abuse on the Fund, subjecting employees, executives, and board members to personal civil and criminal liability.”



Personal Expenses – Accountability...



"When I was hired, the boss asked if I could handle a job with lots of accountability, and like an idiot, I said 'Yes!'"



Personal Expenses

- **Vehicles**
 - Vehicles jointly used for personal and legitimate purposes
 - Only recover the portion “incurred in connection with the provision, maintenance, and upgrading of supported services and facilities for which high-cost support is intended”
- **Housing**
 - Housing allowances strictly prohibited, with one very narrow exception
 - Temporary/seasonal lodging for employees providing service in remote areas with rugged terrain and extreme weather conditions where no other lodging is available
 - Analogous to per diem travel expenses for lodging



This is rugged, remote and extreme weather...



Personal Expenses

- **Employee Gifts**
 - “undisputed that gifts to employees may not be recovered through high-cost support”
 - Personal events (birthdays/weddings/child birth/etc.)
 - Holiday Gifts
 - Retirement gifts
 - Bonuses treated as taxable compensation are allowed, so long as incurred in the provision, maintenance and upgrading of supported services



Personal Expenses

- Entertainment, Food & Beverage
 - Meals to celebrate personal events explicitly excluded
 - Other excluded items referenced:
 - Client or vendor meetings
 - Attendance at board meetings
 - Annual meetings
 - Employee recognition
 - Parties/Picnics
 - Meals for business-related travel may qualify as a reasonable per diem travel expense
 - Cafeterias, lunch rooms and vending facilities explicitly excluded



Expenses Unrelated to Operations

- Expenses Unrelated to Operations include, but are not limited to:
 - Political Contributions
 - Charitable Donations
 - Membership Fees/Dues for clubs/organizations
 - Penalties/Fines for statutory or regulatory violations
 - Penalties/Fees for late payments on debt, loans or other payments
 - Public Relations & Corporate Image Advertising (Account 6720)



Expenses Unrelated to Operations

- **Membership Fees/Dues for clubs/organizations**
 - **Types of clubs/organizations precluded:**
 - **Social**
 - **Service**
 - **Recreational/athletic**
 - **Trade Associations & Organizations**
 - **Including those that provide professional certifications such as state bar or CPA associations**
 - **“May not recover membership fees in organizations that engage in lobbying”**
 - **Presumably includes state and national telecommunications associations**



Corporate Luxury Goods

- Corporate Luxury Goods include, but are not limited to:
 - Artwork & objects of aesthetic value
 - Corporate aircraft
 - Watercraft
 - Other off-road vehicles
 - Consumer electronics for personal use
 - Tangible properties for entertainment purposes (i.e. – Pool Table)
 - Kitchen appliances
 - Limited exception for allowed temporary or seasonal lodging



Corporate Luxury Goods

- Corporate Aircraft, Watercraft & Off-Road Vehicles
 - Excluded to the extent used by executives & board members
 - Allowed to the extent used by technicians to reach remote areas to install, inspect or repair facilities
 - “We caution ETCs that they may only recover from high-cost support that portion of aircraft, watercraft, and other vehicle expenses used for the provision, maintenance, and upgrading of supported facilities, not expenses used for the benefit of corporate executives and board members.”
 - Expenses will be closely scrutinized
 - Retain records of use to justify recovery



Corporate Luxury Goods

- **Consumer Electronics**
 - Certain items “analogous to personal expense or an entertainment expense” (not recoverable)
 - Video Games
 - Televisions
 - Radios
 - Certain items “may serve valid business purposes” (work use is recoverable)
 - Laptop computers
 - Monitors
 - Smart phones or other hand-held devices



Ineligible Expenses: Interstate Ratemaking

- **Historical treatment of expenses**
 - Section 201(b) of the Communications Act
 - Only reasonable investments and expenses recovered through interstate rates
 - Historically enforced through “used and useful” standard
- **Changes/updates in Report & Order**
 - Amends rules to provide guidance on “used and useful” standard
 - Defines 2 broad categories of investments and expenses
 - Ordinary Course of Business
 - Customary for Similarly Situated Companies
 - LECs are free to rebut the presumption to justify recovery (factual showing)



Ineligible Expenses: Interstate Ratemaking

- Personal Expenses
 - Presumed not used and useful in the ordinary course of business
- Additional benefits to employees or board members
 - Examples include: gifts, housing allowances and childcare
 - If not taxable, presumed not used and useful unless customary for similarly situated companies
 - If taxable, subject to “presumption-free” review under used and useful standard
 - Temporary housing may qualify as a legitimate business expense, subject to “presumption-free” review



Ineligible Expenses: Interstate Ratemaking

- Food & Beverage
 - Examples include: work and work-related travel & cafeterias and dining facilities
 - Work and work-related travel expenses not considered personal expenses
 - Presumed not used and useful unless customary for similarly situated companies
 - Per diem travel expenses are commonly-accepted business expenses
 - Work-related entertainment (parties and picnics) presumed not used and useful unless customary
- Entertainment
 - Presumed not used and useful unless customary for similarly situated companies
 - Common business practice but are subject to potential abuse



Think this...



Not this...



Ineligible Expenses: Interstate Ratemaking

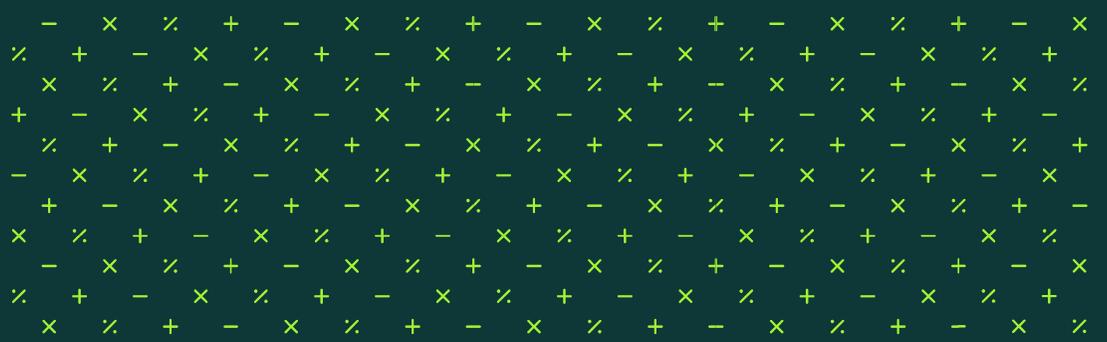
- Expenses Unrelated to Operations
 - Certain expenses are presumed not used and useful
 - Political contributions/membership fees & dues in clubs & organizations/penalties or fines
 - Historically excluded from interstate rates
 - Other expenses are presumed not used and useful unless customary for similarly situated companies
 - Membership fees for professional organizations (i.e. - state bar or accounting societies)
 - Certain expenses raise the potential for abuse:
 - Charitable donations/scholarships/sponsorships of conferences or community events



Ineligible Expenses: Interstate Ratemaking

- Corporate Luxury Goods
 - Examples include: aircraft, watercraft, off-road vehicles, artwork, etc.
 - Although some are customary, subject to potential abuse
 - Presumed not used and useful unless customary for similarly situated companies
 - Aircraft & Off-Road Vehicles: carriers may overcome the presumption, so long as use is limited to work-related purposes
 - Artwork: FCC acknowledges that office artwork is a common business expense and should not place excessive burdens on ratepayers
 - Expenses not logically related to offering voice or broadband service
 - Examples include: recreational equipment and consumer electronics
 - Not used in the ordinary course of providing service, so not used and useful





Report & Order

Additional Support for A-CAM Carriers

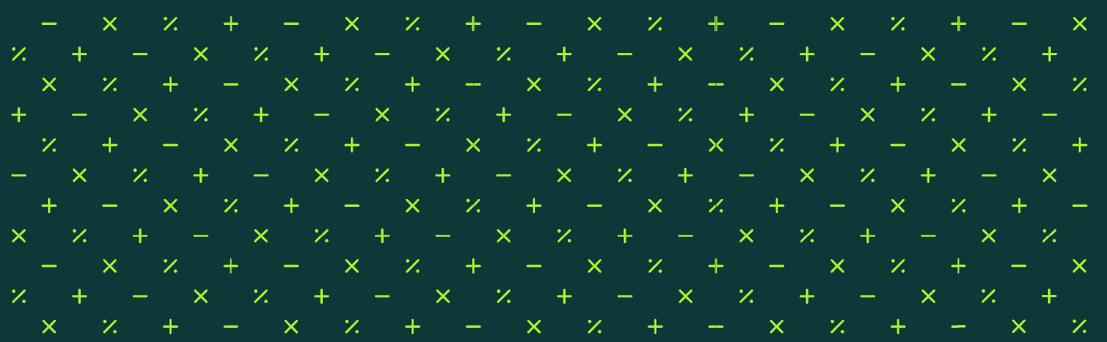
- Support at \$146.10 per location
 - Funds all eligible locations for costs $> \$52.50$ and $\leq \$146.10$ for 10 years
 - Additional buildout obligations
 - No additional locations, just increased speed requirements (i.e. – 10/1 Mbps to 25/3 Mbps)
 - Optional election
 - WCB to release a public notice with revised support and buildout obligations
 - Carriers will have 45 days to accept
 - If all A-CAM carriers elect, provides $\approx \$36.5\text{M}$ annually
 - One-time lump sum payment for 2017
 - USAC to collect additional funds going forward



USF Collections

- **Historical Collections**
 - USAC collected \$1.125B/quarter for 2012-2017, even if greater than demand
 - Avoided dramatic shifts in FUSC during CAF implementation
 - On 11/1/17, WCB directed USAC to retain excess cash & not consider in 1Q2018 FUSC
 - USAC estimated it would have \$129M reserve as of 12/31/17
 - **Report and Order changes**
 - Direct USAC to continue collecting at no less than \$1.125B/quarter until further notice
 - Allows USAC to build reserves to accommodate support transitions (CAF II/MF II/Etc.)
 - Increased collections for 2Q2018 – 4Q2018
 - 1Q2018 contributions based on estimated demand of \$1.06B





Third Order on Reconsideration

Budget Control Mechanism

- **Eliminates the Budget Control Mechanism for 7/1/17 – 6/30/18**
 - **NTCA Petition for Reconsideration claimed that support was not sufficient to maintain reasonably comparable rates for voice and broadband services**
 - **2017 FCC Form 481s: 27 companies could not meet reasonably comparable broadband rates**
 - **BCM for this period is \approx \$180M (13% reduction in support)**
 - **USAC and WCB to calculate amounts withheld as a result of BCM**
 - **Lump sum payment to fully fund support claims for this period**
 - **Payment in 2nd full quarter after the effective date of this order (likely 4Q2018)**
 - **Funding to first come from reserves, and then additional contributions**



OpEx Limitation - Inflation Adjustment

- Implements an inflation adjustment in the OpEx Limitation
 - NTCA Petition for Reconsideration argued that carriers would be subject to the cap through no fault of their own due to inflation
 - GDP-CPI based adjustment
 - Same factor as Corporate Cap and Rural Growth Factor
 - Applicable for 5 years and then revisited
 - Implemented beginning with expenses incurred in 2017
 - Administratively burdensome to recalculate 2016, as 2018 HCLS payments have begun
 - 2017 factor will be compounded by 2016 factor to account for inflation of 2016 expenses



Corporate Operations Expense Limitation

- Includes CBOLs in the calculation of the corporate operations expense limitation
 - NTCA Petition for Reconsideration argued that limitation was inappropriately low because it did not include corporate expenses for CBOLs
 - Corporate operations expense limitation calculation is based on the number of lines served
 - 2016 RoR Reform Order did not amend the calculation when implementing support for CBOLs
 - Rule will presumably be in effect in advance of 7/31/18 filings



Other Elements

- Clarifies support provided to transferred exchanges
 - Declines to eliminate the “Parent Trap Rule” as requested by Madison Telephone
- Denies request for clarification of waiver requirements
- Dismisses as moot NTCA’s request for clarification of A-CAM support





Notice of Proposed Rulemaking (NPRM)

Notice of Proposed Rulemaking (NPRM)

- Major elements addressed
 - CAF Support for RoR Carriers
 - Increasing Broadband Deployment
 - Other Reforms
 - Monthly per-line limit on support (\$250)
 - 100% competitive overlap process
 - Reforms of legacy support mechanisms
 - CapEx and OpEx Limitations
 - Accounting for leases





Budget Control Mechanism

Budget Control Mechanism



"We need to cut our budget in half, and then by another 90% just to be on the safe side."



Budget Control Mechanism

- USAC released BCM for tariff year 2018-2019 on May 1, 2018
 - RoR Budget = \$2.0B
 - Total Demand for RoR Support = \$2.227B (\$227M over budget)
 - CAF-ICC/A-CAM/AK Plan = \$763M
 - Support available for HCLS & CAF BLS = \$1.237B
 - Forecasted HCLS & CAF BLS Demand = \$1.464B
 - Overall Budget Adjustment Factor = 84.4789% (reduction of 15.52%)



Budget Control Mechanism

- Different factors apply to HCLS and CAF BLS (Per Line & Pro-Rata)
 - HCLS
 - Per Line = \$19.27 or \$1.61/month
 - Pro-Rata = 89.09%
 - CAF BLS
 - Per Line = \$27.77 or \$2.31/month
 - Pro-Rata = 91.66%





Questions?

Thank you!

Chad Duval, Partner
chad.duval@mossadams.com
209-955-6124