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INDIANA UTILITY
REGULATORY COMMISSION

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE COMMISSION'S TRIENNIEL REVIEW OF THE INDIANA UNIVERSAL SERVICE FUND	)))	**CAUSE NO. 45064**

SUBMISSION OF DIRECT TESTIMONY

The Indiana Exchange Carrier Association, Inc. ("INECA"), by counsel, hereby submits in the above referenced Cause the Direct Testimony of Chad Duval.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Direct Testimony of Chad Duval was served upon the following via electronic mail this 24th day of May, 2018:

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STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

IN THE MATTER OF THE COMMISSION'S	**)**	
TRIENNIAL REVIEW OF THE INDIANA	**)**	**CAUSE NO. 45064**
UNIVERSAL SERVICE FUND	**)**	

PREFILED TESTIMONY OF CHAD A. DUVAL

ON BEHALF OF

INDIANA EXCHANGE CARRIER ASSOCIATION, INC.

IURC CAUSE NO. 45064
PREFILED TESTIMONY OF CHAD A. DUVAL

Q. WHAT IS YOUR NAME, TITLE, AND BUSINESS ADDRESS?

A. My name is Chad A. Duval. I am a Principal at Moss Adams LLP (Moss Adams), an accounting and business consulting firm. My business address is 3121 W. March Lane, Suite 200, Stockton CA, 95219.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. My educational background includes a Bachelor of Science degree in Business Administration, with an emphasis in Statistics, from the University of Denver, in Denver, Colorado. In 1995, I was hired by GVNW Inc./Management to serve as a Consulting Analyst in the Company's Colorado Springs office. In 1998, I was promoted to Management Consultant. In 1999, I accepted the position of Manager of Strategic Pricing with US WEST Communications in Denver, Colorado. In January of 2000, I was promoted to Group Manager of Strategic Pricing. In October of 2000, I accepted the position of Director of Product Management with Vanion, Inc., a competitive local exchange carrier headquartered in Colorado Springs, Colorado. In September of 2001, I accepted the position of Senior Consultant with GVNW in Colorado Springs, Colorado. In October of 2004, I accepted the position of Senior Manager with Moss Adams in Stockton, California. In October of 2007, I became a Principal at Moss Adams in that office. In August of 2015, I was named the National Practice Leader of Moss Adams' Communications and Media practice.

Q. CAN YOU PLEASE DESCRIBE YOUR DUTIES AND RESPONSIBILITIES AS A PRINCIPAL AT MOSS ADAMS?

A. Moss Adams is a regional accounting and consulting firm with offices in major cities in the states of Arizona, California, Kansas, New Mexico, Oregon, Texas and Washington. Moss Adams' Communications and Media practice provides audit, tax, and financial and regulatory consulting services to the telecommunications industry, particularly to rural telecommunications carriers. I am the National Practice Leader of the Communications and Media practice. In that role I provide technical and strategic guidance to a team of approximately 80 professionals in our audit, tax and consulting groups. In addition, I provide consulting services to companies in several states, including state and federal universal service funding, cost separations studies, business plans, budgets, depreciation studies, regulatory policy and compliance, and management analysis on various regulatory and business issues.

Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of Indiana Exchange Carrier Association, Inc. ("INECA"). INECA, on behalf of its enumerated members,[1] is a party to the Settlement Agreement ("Settlement Agreement") on the Indiana Universal Service Fund ("IUSF") filed on May 24, 2018m in this Cause.

Q. HAVE YOU EVER TESTIFIED BEFORE THE INDIANA UTILITY REGULATORY COMMISSION OR ANY OTHER REGULATORY AGENCY?

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[1] INECA's membership includes: Bloomingdale Home Telephone Company, Inc.; Citizens Telephone Corporation; Clay County Rural Telephone Cooperative, Inc. d/b/a/ Endeavor Communications; Craigville Telephone Company Inc.; Daviess-Martin Rural Telephone Corporation d/b/a RTC Communications; Geetingsville Telephone Company Inc.; Hancock Rural Telephone Corporation d/b/a NineStar Connect; Ligonier Telephone Co., Inc.; Monon Telephone Company Inc.; Miles Communications, Inc. d/b/a Enhanced Telecommunications Corp.; Mulberry Cooperative Telephone Company, Incorporated d/b/a Mulberry Telephone Company; New Lisbon Telephone Company Inc.; New Paris Telephone Inc.; Northwestern Indiana Telephone Company Inc. d/b/a Nitco; Perry-Spencer Rural Telephone Cooperative Inc. d/b/a PSC; Pulaski White Communications, Inc. d/b/a Lightstream; Rochester Telephone Company Inc.; Southeastern Indiana Rural Telephone Cooperative Inc. d/b/a SEI Communications; Smithville Telephone Company, Incorporated d/b/a Smithville Communications; Swayzee Telephone Company, Inc. d/b/a Swayzee Communications Corp.; Sweetser Rural Telephone Company Inc.; TDS Telecom Companies (Camden Telephone Company Inc., Communications Corporation of Indiana, Communications Corporation of Southern Indiana, Home Telephone Company Inc., Home Telephone Company of Pittsboro Inc., Merchants and Farmers Telephone Company d/b/a TDS Telecom-Hillsboro., S & W Telephone Company, Inc., Tipton Telephone Company Inc., Tri-County Telephone Company Inc., West Point Telephone Company, Incorporated); Washington County Rural Electric Telephone Cooperative Inc. d/b/a Tele-Media Solutions; and Yeoman Telephone Company Inc.

A. Yes, I previously testified before the Indiana Utility Regulatory Commission (the "Commission") during the 2015 Triennial Review of the IUSF in Cause No. 44681 on behalf of INECA. In addition, I have testified before the California Public Utilities Commission, the Colorado Public Utilities Commission, the Georgia Public Service Commission, the Public Utilities Commission of Nevada, the North Dakota Public Service Commission, the Oklahoma Corporation Commission, the Oregon Public Utilities Commission, the Public Service Commission of Utah, and the Wyoming Public Service Commission. Further, I regularly consult with carriers around the country on issues related to universal service funding, both at the state and federal levels.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to support maintaining the status quo with the current IUSF until at least the Commission's next triennial review. In this testimony I will: explain the original purpose of the IUSF and how that purpose is still being served today, outline the ongoing reforms of federal universal service funding that continue to create uncertainty for INECA's member companies, discuss how the IUSF is an integral component in keeping local rates just, reasonable and affordable for customers in rural areas of Indiana, and address the purpose and scope of the triennial review and explain why it is recommended that the Commission maintain the status quo.

Q. PLEASE PROVIDE THE BACKGROUND PROMPTING INECA TO FILE DIRECT TESTIMONY IN THIS CAUSE.

A. The Commission's March 17, 2004 Order in Cause No. 42144 approved a settlement agreement that created the IUSF. The IUSF settlement agreement included a periodic review of the IUSF on a triennial basis, stating:

> The primary purpose and scope of the reviews shall be: (1) to ensure that the operations of the IUSF are meeting the Commission's objectives of preserving and advancing universal service within the state of Indiana; (2) to ensure that universal service is continuing to be made available at rates reasonably comparable to rates for basic residential and single-line business local exchange service in urban areas, and that are just, reasonable and affordable; (3) to ensure that the processes, funding levels, size, and

the operation and administration of the IUSF remain adequate and sufficient; and (4) to review the operation of the IUSF relative to the federal universal service fund as may be appropriate.[2]

On March 21, 2018, in furtherance of the aforementioned review process, the Commission issued an Order in Cause No. 45064, scheduling a prehearing conference and defining a preliminary, but non-exhaustive issues list to be addressed in the context of the 2018 Triennial Review.

Q. CAN YOU SUMMARIZE THE FCC'S ONGOING REVIEW AND REFORM OF INTERCARRIER COMPENSATION FOR RATE-OF-RETURN CARRIERS?

A. In its 2011 USF/ICC Transformation Order,[3] the FCC ordered the unification of interstate and intrastate terminating switched access rates over two years, which was completed in 2013, and a further seven year transition of interstate and intrastate terminating switched access rates to bill and keep ($0.00 per minute of use). Interstate originating switched access rates were also frozen at the levels in effect at the time. At the same time, the FCC instituted a new end user charge, the Access Recovery Charge (ARC), to help offset the reduction in switched access revenues as a result of the rate phase down. In addition, the FCC froze interstate switched access revenues and intrastate terminating switched access revenues at their 2011 level[4] and provided for a 5% annual phase down in these revenues. The phased down annual revenues are referred to as the annual revenue baseline.

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[2] *In The Matter of the Investigation on the Commission's Own Motion Under Indiana Code § 8-1-2-72, Into Any and All Matters Related to the Commission's Mirroring Policy Articulated in Cause No. 40785 and the Effect of the FCC's Mag Order on Such Policy, Access Charge Reform, Universal Service Reform, and High Cost or Universal Service Funding Mechanisms Relative to Telephone and Telecommunications Services Within the State of Indiana*, Cause No. 42144, pp. 11-12 (Ind. Util. Reg. Comm'n March 17, 2004).

[3] *Connect America Fund et al.*, WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663 (2011) (*2011 USF/ICC Transformation Order and/or FNPRM*), *aff'd sub nom*, *In re: FCC 11-161*, 753 F.3d 1015 (10th Cir. 2014).

[4] Interstate switched access revenue was frozen at the revenue requirement submitted to the FCC in the 2011 switched access tariff filing, which was effective on July 1, 2011. This revenue requirement is the average of the forecasted revenue requirement for each company for 2011 and 2012. Intrastate terminating switched access was frozen at the revenue billed from October 1, 2010 through September 30, 2011 and collected by March 31, 2012.

As a result of this freeze and phase down of interstate and intrastate terminating switched access revenues, and the phase down of interstate and intrastate terminating switched access rates, the FCC implemented the Connect America Fund Intercarrier Compensation (the "CAF ICC") support to provide cost recovery for the difference between the annual revenue baseline and the switched access revenues received from interexchange carriers and ARC revenue received from end users. Any shortfall in cost recovery from the annual revenue baseline is made up from CAF ICC support, less the 5% annual phase down in the annual revenue baseline. CAF ICC support is a joint interstate and intrastate cost recovery mechanism, so a portion of this support is assigned to offset reductions in intrastate terminating switched access revenues.

In the *FNPRM*, the FCC indicated that it was further analyzing its authority to regulate intrastate originating switched access and that it would address reform of originating switched access in a future order. The FCC has yet to address reform of intrastate originating switched access. However, in a Public Notice dated September 8, 2017, the FCC sought further comment to refresh the record on intercarrier compensation reform related to the network edge, tandem switching and transport, and transit.[5] In doing so, the FCC made it clear that it continues to consider further reforms to terminating and originating intercarrier compensation rates, both of which could impact the intrastate revenues of the INECA member companies as the result of mirroring interstate rates discussed below. There is no way to know for sure what the FCC will do if and when it addresses further reform of intercarrier compensation.

Q. HOW HAS THE FCC'S REFORM OF TERMINATING SWITCHED ACCESS IMPACTED SWITCHED ACCESS REVENUES IN INDIANA?

A. First and foremost, the 5% annual reduction in intrastate terminating switched access revenues from 2011 levels ensures that intrastate terminating switched access revenues decline by 5% every year. This 5% annual reduction takes effect each July 1, so effective July 1, 2018, intrastate terminating switched access revenues will be approximately

[5] See DA 17-863, released September 8, 2017.

69.83% of what they were at the same point in 2011. Any reduction beyond the 5% annual phase down is recovered from CAF ICC support. This 5% annual reduction will continue unless and until the FCC modifies the annual phase down, which the *FNPRM* indicated could increase at some point in the future.

In addition to the annual phase down of intrastate terminating switched access revenues, intrastate originating switched access revenues could be impacted as well. Commission policy and the Indiana Code[6] support the mirroring of intrastate rates and interstate rates, which is consistent with the FCC's *2011 USF/ICC Transformation Order* for terminating switched access. However, depending on the FCC's treatment of intrastate originating switched access, it is possible that further reductions in intrastate switched access revenues will occur at some point in the future. Of significant concern is the fact that the FCC has maintained a $2 billion budget for universal service funding for rate-of-return carriers, including CAF ICC support. As a result of this cap on federal universal service funding, rate-of-return carriers have seen significant reductions in high-cost support disbursements relative to the amount of support that is determined based on individual carrier costs. Unless the FCC considerably increases its budget for rate-of-return USF, it is highly likely that there will not be sufficient funding for the reductions in originating switched access if and when the FCC implements its reform.

Q. CAN YOU SUMMARIZE THE FCC'S ONGOING REVIEW AND REFORM OF UNIVERSAL SERVICE FUNDING?

A. Yes. There has been a significant amount of USF reform over the last several years. This started with the 2*011 USF/ICC Transformation Order*, in which the FCC implemented a variety of reforms to universal service funding for rate-of-return carriers. An overall limitation on the amount of High Cost Support that a rate-of-return carrier can receive was implemented at $250 per line per month, beginning in 2012. The National Average Cost Per Loop that determines how much High Cost Loop Support ("HCLS") a company

[6] Indiana Code § 8-1-2.6-1.5(c)(2) provides, "the commission shall consider the provider's rates and charges for intrastate access service to be just and reasonable if the intrastate rates and charges mirror the provider's interstate rates and charges."

receives was frozen effective July 1, 2015, which results in a Pro-Rata Adjustment (reduction) in support to maintain the FCC's HCLS-specific budget.

In March of 2016, the FCC issued the *Rate-of-Return Reform Order*, in which it adopted a variety of reforms to universal service funding for rate-of-return carriers. It implemented the Alternative Connect America Cost Model ("A-CAM") as an optional replacement of legacy high-cost support mechanisms. The A-CAM provides a fixed amount of support for a 10-year funding period, from 2017 through 2026, in exchange for meeting specific broadband buildout obligations. In adopting the A-CAM, the FCC increased funding for rate-of-return carriers by $2 billion over the 10-year funding period (approximately $200 million per year), but this additional funding is only available to A-CAM electing carriers and some carriers are actually receiving less support from the A-CAM than they were under the legacy rate-of-return support mechanisms. Of the 33 study areas served by INECA member companies, 11 elected A-CAM support while the remaining 22 chose to stay on legacy rate-of-return support.[7]

The *Rate-of-Return Reform Order* also established a new funding program for broadband only service, called Connect America Fund Broadband Loop Support ("CAF-BLS"). CAF-BLS replaces Interstate Common Line Support ("ICLS"), by continuing to provide support for the portion of the local loop that is assigned to interstate in the jurisdictional separations process, while also providing support for broadband only local loops. Doing so closes a loophole in federal funding for the cost of the local loop, in which rate-of-return carriers were obligated to provide broadband in order to be eligible for federal universal service funding, but did not previously receive support for broadband only loops. CAF-BLS recipients must also meet specific broadband deployment obligations. However, the FCC did not provide any additional funding for CAF-BLS, so the support provided for broadband only loops is also subject to the $2 billion annual budget for rate-

[7] The 11 study areas that elected A-CAM support are: Bloomingdale Home Telephone Co., Camden Telephone Company, Inc., Communications Corporation of Indiana, Communications Corporation of Southern Indiana, Home Telephone Company of Pittsboro, Inc., Home Telephone Company of Waldron, Inc., The Merchants and Farmers Telephone Co., Inc., S & W Telephone Company, Inc., Tipton Telephone Company, Inc., Tri-County Telephone Company, Inc., West Point Telephone Company, Inc.

of-return high-cost support. As a result, the FCC implemented a Budget Control Mechanism ("BCM") to ensure that annual support does not exceed the budget, by reducing or deferring HCLS and CAF-BLS to meet the annual budget. The result of the BCM is that HCLS will be approximately 84.48% of the calculated amount[8] in the 3rd quarter of 2018, while CAF-BLS will be approximately 87.65%.[9]

In addition, the *Rate-of-Return Reform Order* implemented a variety of other reforms of rate-of-reform high-cost support. The Operating Expense Limitation establishes an upper limit of annual operating expenses that a rate-of-return carrier may include in its annual high-cost support filings. The Capital Investment Allowance establishes an upper limit of annual investment in loop plant, as well as a per-location cost limitation, that a carrier may include in its annual high-cost support filings. The *Rate-of-Return Reform Order* also established a process for the elimination of high-cost support in areas served by a qualifying competitor, although this provision has yet to be implemented. Further, the Rate-of-Return Reform Order re-prescribed the interstate authorized rate of return to 9.75% through a six-year transition from 11.25%, in equal annual increments of 0.25%. As of the date of this testimony, the interstate authorized rate of return is 10.75%. Finally, the *Rate-of-Return Reform Order* included a *Further Notice of Proposed Rulemaking* ("FNPRM"), which outlined a series of further potential reforms to be addressed by the FCC.

In its latest *USF Reform Modification Order*,[10] dated March 23, 2018, the FCC addressed a variety of outstanding matters and clarifications from prior orders. The most extensive change in this order was the identification of costs that have been deemed ineligible for recovery through federal high-cost support, including personal expenses, expenses unrelated to operations and corporate luxury goods. While most of the items deemed

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[8] The BCM is applied to HCLS after the application of the HCLS-specific pro-rata adjustment, which is currently estimated at 79.61% for the 3rd quarter of 2018. The result of these two adjustments is that the support provided is 67% of the amount required based on an individual carrier's reported costs.

[9] The BCM for CAF-BLS does not result in an actual reduction in support. If a carrier provides broadband only service, the BCM for CAF-BLS is recovered through the rate for this service. If a carrier does not provide broadband only service, the BCM for CAF-BLS is deferred for two years and included in support for that year.

[10] This order has not been named at this time, so I am referring to it as the *USF Reform Modification Order*.

ineligible for recovery have not been common practice for the INECA member companies, there are certain items that have historically been deemed eligible for recovery that will no longer be supported. Some of the items that are no longer eligible for recovery include food and beverage for certain company events, charitable contributions, memberships in professional organizations and associations, and public relations related expenses.

In addition to these limitations, the *USF Reform Modification Order* provided additional funding for both A-CAM and legacy rate-of-return carriers. The order increased funding for A-CAM carriers by approximately $365 million over the 10-year funding period in return for additional broadband buildout obligations. It also provided relief of the BCM for legacy rate-of-return carriers for the period from July 1, 2017 through June 30, 2018 (Tariff Year 2018/2019), but did not address periods before or after those dates. This will provide an estimated $180 million in one-time funding for these carriers, which is likely to be paid in the 4th quarter of 2018 or the 1st quarter of 2019.[11] On May 1, 2018, the Universal Service Administrative Company ("USAC") announced that the Budget Control Mechanism for Tariff Year 2018/2019 is estimated to be 15.52%, so the relief will be short lived and the reduction in support continues to increase. In addition, the *USF Reform Modification Order* implemented an inflationary factor into the calculation of the Operating Expense Limitation implemented in the *Rate-of-Return Reform Order* and also updated the calculation of the FCC's Corporate Operations Expense Limitation to include broadband only lines.

Finally, the *USF Reform Modification Order* included a Notice of Proposed Rulemaking ("NPRM") that identifies a variety of USF-related issues that the FCC still intends to address. These items include: a review of the high-cost support budget for rate-of-return carriers, a potential new offer of A-CAM support for carriers still receiving legacy rate-of-return support, further funding for existing A-CAM recipients, establishing a threshold

[11] Based on publicly available information from the Universal Service Administrative Company, INECA member companies will receive approximately $3.195 million in one-time relief from the BCM. I will later discuss the overall impact that the BCM has, and likely will continue to have, on INECA member companies.

of support that would not be subject to the BCM, additional broadband deployment obligations for legacy rate-of-return carriers, and other miscellaneous items that could impact the amount of federal high-cost support that rate-of-return carriers receive.

Q. HOW HAVE THESE FCC REFORMS OF UNIVERSAL SERVICE FUNDING IMPACTED COST RECOVERY FOR THE INECA MEMBER COMPANIES?

A. I have performed an analysis of the impacts of both the HCLS-specific Pro-Rata Adjustment and the overall Budget Control Mechanism on the HCLS support received, or projected to be received, by the 33 INECA member companies from 2016 through 2018. This analysis is based on information produced by USAC and the National Exchange Carrier Association ("NECA"). The analysis begins with the amount of HCLS that each company is projected to receive after the impact of the HCLS-specific Pro-Rata Adjustment, as the pre-adjustment support is not as readily available. I calculated the pre-adjustment support by dividing the post-adjustment support by the Pro-Rata Adjustment factor for the year. I then included the estimated Budget Control Mechanism impact for the year based on quarterly, semi-annual, or annual estimates available on USAC's public website. Finally, the HCLS-specific Pro-Rata Adjustment and the Budget Control Mechanism impacts on HCLS are added together to determine the estimated annual reduction in HCLS, which is intended to provide recovery for intrastate costs. For the period from July 1, 2017 through June 30, 2016, I removed the impacts of the Budget Control Mechanism, as the FCC has announced that it will make companies whole for this time period.

The results of this analysis are summarized in the following table for all INECA member companies combined.

Table 1

Adjustment	2016	2017	2018
Pro-Rata Adjustment	$ (3,694,634)	$ (5,427,619)	$ (5,948,388)
Budget Control Mechanism	$ (404,527)[12]	$ (1,095,448)	$ (1,798,645)

[12] The Budget Control Mechanism was not instituted until September 1, 2016, so the impact is limited to 4 months.

Total	$ (4,099,160)	$ (6,523,066)	$ (7,747,033)

What this analysis shows is a significant and growing reduction in federal HCLS that is designed to help recover the intrastate portion of costs associated with the provision of local loops in the highest cost areas of Indiana. In 2016, INECA member companies faced a shortfall of $4,099,160 between the amount of support calculated using the FCC's HCLS algorithm and the amount of support that they actually received. This shortfall increased to $6,523,066 in 2017 and is projected to be $7,747,033 in 2018. Both the HCLS-specific Pro-Rata Adjustment and the Budget Control Mechanism have increased at a rapid pace and will continue to do so unless the FCC significantly increases its budget for High-Cost support, something which it is considering but it is not certain if and when it will do so, and by how much it may increase the budget. At approximately $12 million for 2018, an estimated 65% of the total IUSF is being used just to make up for reductions in federal HCLS. This is up from approximately 34% in 2016 and 54% in 2017. This paints a stark picture that shows just how important the IUSF is in maintaining rates that are just, reasonable and affordable for customers served by the INECA member companies.

Q. HOW WILL THESE FCC REFORMS OF UNIVERSAL SERVICE FUNDING CONTINUE TO IMPACT COST RECOVERY IN INDIANA?

A. Recovery of intrastate costs is a joint proposition between the FCC and the Commission. Intrastate costs are recovered through the combination of local rates, intrastate switched and special access rates, federal High Cost Loop Support or A-CAM support, federal Connect America Fund Intercarrier Compensation support, and the IUSF. To the extent that the FCC continues to make significant reforms to federal universal service support, reductions in federal support could shift more of the intrastate cost recovery burden to rate payers in Indiana, or other methods of ensuring universal service such as the IUSF. It is also true that increases in federal support could provide additional funding for intrastate costs, but there is no way of knowing for sure how the scales will eventually tilt until the FCC completes its ongoing reforms of federal high-cost support. Until that time, the INECA member companies believe that it is prudent to maintain the IUSF in its current form and only make changes to this vital program once there is greater certainty of support available from the FCC.

Q. WHAT IS CURRENTLY HAPPENING WITH INTRASTATE SWITCHED ACCESS MINUTES OF USE FOR THE INECA MEMBER COMPANIES?

I performed an analysis of 24 INECA member companies that are recipients of IUSF support and who were able to provide five years of historical intrastate switched access minutes of use for the years 2013 through 2017. What this analysis shows is that intrastate originating switched access minutes of use are in significant decline. The total intrastate originating minutes of use in 2013 was almost 42.9 million and by 2017 had declined to just over 29 million. This is an average annual reduction of more than 8% per year. Each lost minute of use means lost intrastate revenue for the INECA member companies. This is concerning because the INECA member companies currently have no way to recover this lost revenue, and, unless the FCC or the Commission comes up with a significantly greater budget for CAF ICC or IUSF, there may be no means of recovering this lost revenue in the future if and when intrastate originating switched access is reformed.

Q. ARE THE INECA MEMBER COMPANIES EXPERIENCING A SIMILAR REDUCTION IN THEIR INTRASTATE SWITCHED ACCESS REVENUE REQUIREMENTS?

A. No. I performed a similar analysis, this time of 20 INECA member companies[13] that receive IUSF support and were able to provide five years of historical intrastate switched access revenue requirement data for the years 2013 through 2017. What this analysis shows is that intrastate switched access revenue requirements are in decline, but not at the same pace as intrastate switched access minutes of use. The total intrastate switched access revenue requirement for the INECA member companies has declined from

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[13] The number of INECA member companies included in each of the referenced analyses varies due to the ready availability of data from each company to perform that particular analysis.

approximately $3.54 million in 2013 to $2.86 million in 2017, an average annual reduction of nearly 3.7%. This is concerning because intrastate switched access minutes of use, and therefore the revenues derived from those minutes, are declining faster than the associated revenue requirement, leaving a greater portion of the costs to be recovered from sources other than per minute of use access charges.

Q. ARE THE INECA MEMBER COMPANIES EARNING RATES OR RETURN THAT ARE HIGHER OR LOWER THAN THE RATE OF RETURN CAP IN INDIANA?

A. No. I performed an analysis of 25[14] INECA member companies that receive IUSF support and were able to provide five years of historical IUSF Qualifications Test data for the years 2013 through 2017. Rather than look at any individual year, which can be skewed by anomalies (for example, 2017 may be skewed due to the financial statement impacts of the *Tax Cuts and Jobs Act* on deferred income tax expense), I developed a five-year average rate of return for each company and all 25 companies in total. Of the 25 companies, only one was found to be earning more than the rate of return cap of 11.50% based on a five-year average. The remaining 24 companies earned less than 11.50% on average, including 10 companies that had negative rates of return for the five-year period.

Q. IS THE IUSF CURRENTLY MEETING THE COMMISSION'S OBJECTIVES OF PRESERVING AND ADVANCING UNIVERSAL SERVICE WITHIN INDIANA?

A. Yes. The IUSF serves an important role in providing intrastate cost recovery for the high cost of providing service in rural and areas of the state. This funding assists the rate-of-return carriers in these high cost areas to continue to build and maintain communication networks that are consistent with those in more urban areas of Indiana. As a result, customers throughout the State of Indiana have access to high quality local exchange and switched access services at rates that are just, reasonable and affordable. While the

[14] See Footnote 13.

INECA member companies would like to have even more IUSF support, to bridge some or all of the shortfall identified above, they are also understanding of the burden that doing so would place on rate payers in the State of Indiana.

Q. IS UNIVERSAL SERVICE IN INDIANA CONTINUING TO BE MADE AVAILABLE AT RATES REASONABLY COMPARABLE TO RATES FOR BASIC RESIDENTIAL AND SINGLE-LINE BUSINESS LOCAL EXCHANGE SERVICE IN URBAN AREAS AND AT RATES THAT ARE JUST, REASONABLE AND AFFORDABLE?

A. Yes. All of the recipients of IUSF have rates for basic residential and single-line business local exchange service that are consistent with the IUSF benchmark local rates to be eligible for IUSF support. This benchmark rate was established, and continues, to ensure that universal service is provided in Indiana at rates that are consistent with rates in urban areas and are just, reasonable and affordable. In addition, each of the INECA member companies has maintained residential rates that are consistent with the FCC's benchmark local rates to be eligible for the full amount of HCLS available (after the application of the Pro-Rata Adjustment and Budget Control Mechanism).

Q. DO THE PROCESSES, FUNDING LEVELS, SIZE, AND OPERATION AND ADMINISTRATION OF THE IUSF REMAIN ADEQUATE AND SUFFICIENT?

A. Yes, Solix, the IUSF administrator, the IUSF Oversight Committee, and the Commission perform regular monitoring functions to ensure that the processes, funding levels, size and operation of the IUSF remain adequate and sufficient. Solix, the IUSF administrator, provides quarterly financial reports on the status of the fund and performs an Annual Report of Activity in which it provides a management discussion and analysis and unaudited financial statements. The last Annual Report of Activity for the IUSF for calendar year 2017 was submitted to the Commission by Solix on February 15, 2018.[15]

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[15] *See In the Matter of Issues Relating to Universal Service and Lifeline Assistance Fund Administration Articulated in Cause Nos. 40785, 42144, and 43082, and the Provisions Set Forth in HEA 1279, Codified as I.C. § 8-1-36,* Cause No. 42144-S3.

In addition to receiving reports from Solix and recommendations from the IUSF Oversight Committee, the Commission conducts a triennial Qualifications Test and Triennial Review of the IUSF, which is the subject of this Cause. The most recent Qualifications Test was performed in 2016 for calendar years 2013, 2014, and 2015 to determine the amount of IUSF support for which each of the recipients is eligible.

Finally, an independent audit of the IUSF is conducted periodically. The most recent independent audit was conducted by Hurlbert CPA LLC for the years ending December 31, 2015 and December 31, 2016, which was issued September 21, 2017. The Auditor's Report concluded that, "In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the IUSF administered by Solix as of December 31, 2016 and 2015"; that "Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses."; and that "The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards." The Auditor's Report was reviewed by the members of the IUSF Oversight Committee and determined to be a comprehensive and completely satisfactory independent audit.

Q. PLEASE EXPLAIN THE PUBLIC INTEREST BENEFITS THAT WOULD ACCRUE IF THE COMMISSION WERE TO APPROVE THE SETTLEMENT AGREEMENT.

A. One primary public interest benefit that would accrue upon Commission approval of the Settlement Agreement is that the Commission and parties would not devote time and resources on an extended proceeding regarding issues that would likely need to be revisited when the FCC completes its reforms of originating switched access and federal universal service funding. In addition, the public interest is served when carriers that serve high cost areas have sufficient financial resources to ensure that rates are just, reasonable and affordable.

Q. WOULD APPROVAL OF THE SETTLEMENT AGREEMENT PRECLUDE ANY CHANGES TO THE IUSF PRIOR TO THE COMMISSION'S NEXT TRIENNIAL REVIEW?

A. No. As provided in Section 14.B of the Settlement Agreement, any interested party may bring issues before the IUSF Oversight Committee or the Commission at any point prior to the next triennial review if it believes that changes to the IUSF are necessary. The IUSF Oversight Committee meets on a regular basis in order to take up any issues that may arise. As a result, changes to the IUSF could occur at any time between the effective date of the Settlement Agreement and the next Triennial Review.

Q. WHAT DO THE SETTLING PARTIES RECOMMEND FOR THE IUSF?

A. The Parties to the Settlement Agreement recommend that the IUSF be continued under the status quo until the next triennial review, currently scheduled to commence in 2021. By that time, it is currently anticipated that the FCC will have completed the development and implementation of its reforms of intercarrier compensation and federal universal service funding, or at least developed greater consistency in support, which will allow the Commission the opportunity to ensure that the impacts on intrastate revenues are fully understood and incorporated in the 2021 triennial review of the IUSF. While the INECA member companies also believed this would be the case between 2015 and 2018, the FCC has made significant strides on the reforms of high-cost support in the intervening years and is currently working on further reforms. At the time of the 2015 IUSF Triennial Review, the first of two significant high-cost support reform orders had not yet been released. These orders have now been released and the FCC has issued a *Notice of Proposed Rulemaking* to address outstanding issues, so the likelihood of resolution before the 2021 IUSF Triennial Review is now even greater.

Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.

A. The IUSF is currently meeting the Commission's objectives of preserving and enhancing universal service in the State of Indiana, as evidenced by the availability of high quality telecommunications services throughout the state. Universal service in Indiana continues to be provided at just, reasonable and affordable rates, consistent with those provided in urban areas as a result of the ongoing application of the IUSF benchmark rate. The processes, funding levels, size and operation and administration of the IUSF remain adequate and sufficient, as documented in the Annual Audit of the fund, the Solix Annual Report, the 2018 IUSF surcharge increase, and the extension of the Solix contract to continue to administer the fund. The Commission's identified goals of the triennial review have been met, so it is in the public interest to close the current triennial review.

The amount of IUSF that the Parties require is highly dependent on sources of revenue that are impacted by the actions of the FCC, including both intercarrier compensation and federal universal service funding. The FCC continues to review potential reforms of originating switched access services (including intrastate rates) and the associated CAF ICC support, as well as HCLS and A-CAM, portions of which are treated as intrastate revenue in the determination of IUSF. Of major consideration by the FCC at this time is the overall budget for high-cost support for rate-of-return carriers, which has a direct and meaningful impact on the IUSF. As a result of these ongoing reforms and their potential impacts on the IUSF, the Parties recommend that the Commission approve the Settlement Agreement to maintain the status quo until the next triennial review, scheduled for 2021. Doing so will allow the FCC the time necessary to complete its ongoing reforms, and the Commission the ability to fully weigh the impacts of such reforms on the IUSF.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

VERIFICATION

The undersigned affirms under the penalties of perjury that the facts stated in the foregoing testimony are true to his best information and belief.

Chad A. Duval

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