The California High-Cost Fund B
Options for Decreasing the Fund Balance

Introduction

The California Public Utilities Commission's (CPUC or Commission) Internal Audit Group conducted an audit of the California High Cost Fund B (CHCF-B or B Fund), for the fiscal year (FY) ending June 30, 2015. The audit report, dated April 26, 2017, found that the CHCF-B Program has a large fund balance (i.e., $161 million as of August 2016) and it recommended that the Communications Division (CD) staff perform an analysis of necessary financial reserves, to present options to the Commission addressing the disposition of excess funds (e.g. customer refunds, used for other purposes authorized under the program, etc.). CD prepared this white paper in compliance with the audit recommendation.

Background

In Decision (D.) 08-09-042, the Commission significantly modified the CHCF-B program's subsidy support system in response to the transition to market-based pricing that had been adopted for large telephone carriers under the Commission's Uniform Regulatory Framework (URF). Two of these carriers (i.e., AT&T and Frontier) also serve as Carriers of Last Resort (COLR's) in high cost, rural areas of the state and are eligible for B fund subsidies as allowed by D.08-09-042. In that decision, the Commission increased the cost threshold level at which COLR's receive support, resulting in reduced annual subsidy needs for eligible carriers by about $300 million. In addition, the CHCF-B program subsidy has also been impacted by the year-over-year decrease in the number of landlines that COLRs serve. Consequently, the CHCF-B annual program funding (which consists of local assistance carrier claim payments and state operations expenses to run the program) decreased significantly from about $350 million per year to approximately $22 million annually over a ten-year span.

In recognizing this significant subsidy reduction, the Commission reduced the CHCF-B surcharge thereafter as the program had an accumulated reserve balance at that time of approximately $435 million. In February 2014,[1] the Commission, recognizing the B Fund balance was still rather high, further lowered the B Fund surcharge rate to its current level of 0.00%, meaning the CHCF-B program has not collected surcharges for four years.

Consequently, the CHCF-B program balance has been reduced. As shown in Table 1 below, the program has an unappropriated fund reserve of approximately $41.4 million and an array of outstanding loans of $86.4 million. In total, the CHCF-B program balance has been reduced to approximately $127.8 million as of April 2018.

Table 1

CHCF-B Program Balance	
Amount	Status
$41,413,000	Unappropriated Balance (Liquid)
$86,406,000	Amount Loaned (Five Loans)
$127,819,000	**Total Fund Balance**

[1] By the authority of Commission Resolution T-17417 dated December 5, 2013.

Table 2 below itemizes the $86.4 million from the five outstanding loans, the respective loan recipients, and associated fund transfer and scheduled repayment dates, subject to change:[2]

Table 2

Loan Amount	Loan Recipients	Transfer Date	Repayment Date
$35,000,000	General Fund	10/20/2008	12/31/2018
$24,000,000	General Fund	4/1/2009	12/31/2018
$10,000,000	Regional Railroad Accident Preparedness and Immediate Response Fund (RRAPIR)	6/26/2015	FY 2019-20
$10,000,000	RRAPIR Fund	8/23/2016	FY 2020-21
$7,406,000	Department of Forestry and Fire Protection	6/27/2017	7/1/2019
$86,406,000			

CD staff understands that the CHCF-B loans may be repaid sooner than the scheduled repayment date listed above to the extent the Commission needs funds to pay program expenses.

The CHCF-B program is currently scheduled to sunset on January 1, 2019 per Public Utilities Code Section 276.5 (Section 276.5). However, AB 1959 (Wood) has been introduced to extend the CHCF-B Fund program for four more years through January 1, 2023.

Options for Addressing CHCF-B Fund Balance

Pursuant to the Internal Audit Group's recommendation, CD staff has prepared this analysis of four options to address the surplus in the CHCF-B program balance as follows.

Option 1— Status Quo: Allow the Fund Balance to Decrease Gradually: This is the status quo option and it would allow the B Fund balance to continue to decrease gradually through monthly claim payments to the B Fund carriers and for other administrative expenses of the fund. Applying this method has resulted in the B Fund program balance decreasing from $435 million to $127.8 million over a ten-year period (i.e., 2008-2017), Some points to consider are:

- With total expenditures authorized at approximately $22.3 million per year, it would take approximately two years to decrease the unappropriated liquid balance of $41.4 million to zero, not accounting for unpaid loans.
- Considering the total fund balance including unpaid loans of $127.8 million, it would take approximately five-and-a-half more years to decrease the balance to zero at the rate of current spending.

[2] The CHCF-B Fund is not receiving interest during the pendency of these loans. However, the Commission's Fiscal Office has indicated that loan repayment will include interest paid and calculated at the rate earned by the Pooled Money Investment Account.

Implementation Steps: None required for implementing. Simply means business as usual.

Option 2 – Industry Option: Use Program Funds in High Cost Fund Areas to Facilitate Commission Safety Directive for Fire Preparedness: This option would seek to use CHCF-B program funds to reimburse B-Fund COLR recipients to comply with the requirements set forth in D.17-12-024 (R.15-05-006, Order Instituting Rulemaking to Develop and Adopt Fire-Threat Maps and Fire-Safety Regulations). The option was suggested by B Fund carriers as participants in the CHCF-B Administrative Committee. Under this option, the B fund carriers propose that the excess CHCF-B program funds could be used as a reimbursement to implement safety compliance measures associated with various fire prevention implementation costs; additional costs of mandated annual fire-prevention plan reports; and, increased frequency of vegetation trim guidelines in the high cost rural areas covered by the CHCF-B program. Although D. 17-12-024 set forth necessary safety requirements for all regulated entities, the decision concluded that there was no need to establish a cost recovery mechanism for those utilities that are not rate regulated (COL 9) and stated that those entities could pass on costs to consumers via a line-item charge. Additional factors to consider:

- There is a correlation between the maps of the California fire zones and CHCF-B service areas, so arguably the B program funds can be utilized to ensure safety regulations are being implemented in high cost areas. However, the carriers are obliged to meet the requirements of D.17-12-024 without a subsidy, as set forth in that decision.
- Before implementing this option, we would need more information and detail about costs, such as: 1) what are the annual total expenses for B Fund COLRs to comply with D. 17-12-024; 2) how such compliance expenses in non-high cost areas would be excluded from subsidy support in accordance with the statute; 3) how overheads and capitalized costs would be treated; 4) how such funding could be determined and authorized without a GRC cost of service type analyses and) whether a cap is needed or other limits are needed.
- Since non-rate regulated carriers already have full rate flexibility, they are already free to absorb the cost to comply with the Commission order or pass on the costs to consumers themselves, to either all of their customers or to the customers who reside in the fire threat regions. Also this option could be viewed as contrary to the conclusion about cost recovery in D. 17-12-024 that asserted there was no need to establish a cost recovery mechanism for non-rate regulated utilities (COL 9) and inconsistent with the CHCF-B statutory purpose as expressed in Section 276.5.

Implementation Steps: A Commission order would be necessary to implement this option. Staff would likely need to prepare a Rulemaking Order (OIR) so that a record can be established and a decision prepared by an ALJ. Alternatively, a more expedient approach would be for staff to draft a proposed resolution to adopt a Commission Directive to allow CHCF-B Program fund to be used to reimburse B Fund carriers for implementing safety directives in high cost fund areas. Legislation may also be necessary to expand Section 276.5 to explicitly cover costs for fire preparedness.

Option 3 – Fund Transfer Option: Move Excess B Fund Balance Amounts to Other Public Purpose Program(s): This option would seek to transfer excess B Fund amounts to one or more Commission Public Purpose Programs (PPPs). The transfer can be to one designated program, some, or all PPP's. Some points related to this option are:

- This option would require determination of the amount to be distributed to other public purpose programs. Presumably we would determine a base reserve and distribute funds above that level.
- A distribution calculation methodology would need to be determined. An equitable proposal may be to distribute funds on a program-weighted average basis (by comparison of each of the other five programs' relative surcharge rate), which would result in the Universal Lifeline Telephone Service (*LifeLine*) program receiving the largest share.
- Some parties may question the appropriateness of moving funds collected for rural high cost support for another universal service purpose(s)

Implementation Steps: We would need to seek legislation to facilitate a CHCF-B fund transfer, as the existing statute allows CHCF-B funds to be used only for specific program purposes.

Option 4 –Customer Refund Option: This final option would address a recommendation by the internal auditor, to have the approximately 700 authorized carriers that remit B Fund surcharges issue refunds to their respective customers, for the overpayment of CHCF-B surcharges from prior years. CD has consulted with AT&T, Frontier, and Ponderosa Telephone Company about this option's feasibility. All surveyed carriers expressed strong concerns, stating that this option would be expensive, time consuming and problematic to implement. Detailed responses from these carriers indicated that:

- A refund would require numerous hours of programming and testing, using carrier resources which are already allocated among other company projects.
- Some carriers may not have system-programmable mechanisms in place to issue a negative surcharge or surcredit.
- The estimated programming cost of a one-time refund would be as much as $5,000 per carrier and there would be an estimated one-time cost of a refund notification billing insert which would be approximately $5,000.
- Refunds would cost an estimated $0.70 per check issued
- Carriers expect that refunds would require retrieving archived data if there was a directive it goes to customers that paid the surcharge. As wireline count has declined for years, many former accounts are no longer customers. For such customers, the addresses on file are not current, which would mean funds from uncashed checks would eventually escheat to the State and waste program dollars.
- Refunds could end up going to current customers for each carrier and would not necessarily go to the customers that paid the initial B Fund surcharges that generated the high program fund balance.

CD staff is also concerned with this option. Specifically, CD would need to determine whether the Telecommunications User Fees Filing System (TUFFS) (the database used to collect surcharges) can effectively process negative surcharges. Moreover with 700 carriers involved currently with TUFFs, there is concern that a significant staff effort would need to be expended to assure all carriers comply properly with the surcharge refund. CD staff also notes that some carriers that had formerly collected B Fund surcharges are no longer in operation and would not be able to implement a refund.

Implementation Steps: A Commission order would be needed to direct carriers to implement a negative surcharge (or a credit), either on a one-time or limited- time basis, as well as to address implementation issues and related costs for making such a refund.

Conclusion

CD recommends the Option 1 (Status Quo) approach, as the B Fund balance has steadily declined over the past 10 years by about $300 million.

However, if the Commission wants to utilize CHCF-B funds in a timelier manner for other universal service programs, CD believes Option 3 (Fund Transfer Option) can be a viable alternative. This option, however, would require legislation to allow funds to be transferred.

CD does not recommend Option 2 (Industry Option) or Option 4 (Customer Refund Option), given reasons discussed above.