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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking Into the Review of
the California High Cost Fund-A Program.

Rulemaking 11-11-007
(filed November 10, 2011)

**COMMENTS OF AT&T AND FRONTIER ON THE FIFTH AMENDED ASSIGNED
COMMISSIONER'S SCOPING MEMO AND RULING REGARDING THE REVIEW
OF THE CALIFORNIA HIGH COST FUND-A PROGRAM**

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February 28, 2020

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AT&T California and Frontier¹ (collectively, “Joint Respondents”), in accordance with Rule 6.2 of the Commission’s Rules of Practice and Procedure, submit these Comments on the Fifth Amended Assigned Commissioner’s Scoping Memo and Ruling (“Ruling”).

By this Ruling, the Assigned Commissioner expands the scope of this proceeding to consider using the CHCF-B fund as an additional source of funds for several purposes, including, but not limited to, the following:

1. To build capacity for communications services (voice and broadband services) in tribal, rural, low-income and underserved areas. We will explore various options, including pilots, issuing grants, and conducting technical and feasibility studies, to determine and meet the capacity need; and
2. To build communications network redundancy and resiliency for public safety purposes.

The Ruling requests comments on the following questions:

1. Use of the CHCF-A and CHCF-B funds for the purposes identified in the Scoping Memo;
2. Specific priorities and recommendations for preferred strategies that the Commission should consider to implement the purposes identified above; and
3. Procedural mechanisms that the Commission should consider to implement the purposes identified above. For example, are there factual or legal questions that require evidentiary hearings or briefs? If yes, please identify them in your comments.

¹ Pacific Bell Telephone Company d/b/a AT&T California (U 1001 C); and Citizens Telecommunications Company of California Inc. d/b/a Frontier Communications of California (U 1024 C), Frontier Communications of the Southwest Inc. (U 1026 C), and Frontier California Inc. (U 1002 C) (collectively, “Frontier”).

The Joint Respondents have serious concerns regarding the proposed suggestions for using CHCF-B funds for purposes not allowed or intended by statute or rules.

The CHCF-B program was developed in accordance with Public Utilities Code § 276.5. The fund provides subsidies to mid-size and large incumbent local exchange carriers that serve as the Carrier of Last Resort (“COLR”) offering basic local telephone voice service to residential customers in high-cost areas. The subsidies facilitate basic affordable telephone service to meet the Commission’s universal telephone service goals. In Decision 96-10-066, the Commission adopted procedures for the administration of CHCF-B and guidelines for Universal Service Rules.

The CHCF-B program as established by legislation and Commission rules is only for universal *telephone* service local rate support in designated high cost areas:

(a) The commission shall develop, implement, and maintain a suitable, competitively neutral, and broad-based program to establish a fair and equitable local rate support structure aided by universal service rate support to telephone corporations serving areas where the cost of providing services exceeds rates charged by providers, as determined by the commission. The program shall be known, and may be cited, as the California High-Cost Fund-B Administrative Committee Fund program or CHCF-B program. The purpose of the program shall be to promote the goals of universal *telephone* service and to reduce any disparity in the rates charged by those companies. Except as otherwise explicitly provided, this subdivision does not limit the manner in which the commission collects and disburses funds and does not limit the manner in which it may include or exclude the revenue of contributing entities in structuring the program.²

² Pub. Util. Code § 276.5(a) (emphasis added).

CHCF-B helps ensure that customers in high cost areas receive affordable basic telephone service. To change the program and divert funds for other purposes affects the fundamental purpose of universal telephone service, potentially requiring basic telephone rates to be de-averaged and increased dramatically in high cost areas.

Joint Respondents maintain the identified surplus in the CHCF-B program cannot be used for any purpose other than for maintaining affordable basic telephone service rates. Public Utilities Code § 276(c) expressly addresses this issue:

(c) Moneys appropriated from the California High-Cost Fund-B Administrative Committee Fund to the commission shall be utilized exclusively by the commission for the program specified in subdivision (a), including all costs of the board and the commission associated with the administration and oversight of the program and the fund.

After reviewing findings from the audit of the program, Commission Staff concluded after an extensive examination of the surplus that the funds have to be used for the purpose identified in the program and cannot be used elsewhere.³ The referenced attached Finance and Administrative High Cost Fund B Handout and Slides illustrate that the Commission thoroughly looked at options for the surplus and use of the funds.⁴ One of the proposals was for use of the surplus in CHCF-B fund in areas that are also in high fire danger Tiers 2 and 3 areas. It was proposed that the funds help offset the increasing cost of basic telephone service due to increased

³ See, Attachment A – Internal Audit Unit Report on Telecommunications Public Purpose Program - California High Cost Fund B, California Public Utilities Commission (April 26, 2017), https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/About_Us/Organization/Divisions/Internal_Audit_Unit/Audit%20Report%20-%20CHCF-A%202014-15%20FINAL.pdf.

⁴ See, Attachments B – The California High-Cost B Options for Decreasing the Fund Balance, May 2018, https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Test_Calendar/Finance%20and%20Admin%20High%20Cost%20Fund%20B%20Handout.pdf; See also, Attachment C – Michael Amato, Deputy Director Communications Division, California High Cost Fund-B Options, California Public Utilities Commission (May 30, 2018).

inspection and maintenance costs in high fire danger areas in the CHCF-B service areas. The Joint Respondents believe that the cost of telephone service is rising in the CHCF-B service areas due to the geographic nature and high fire danger while at a time of customer loss, and CHCF-B is necessary to help support and maintain affordable basic rates. The Commission Staff concluded that moving excess B Fund amounts to other Public Purpose Programs “would need . . . legislation to facilitate CHCF-B fund transfer, as the existing statute allows CHCF-B funds to be used *only* for specific programs purposes.”⁵ Building broadband capacity is not a CHCF-B program purpose.

Furthermore, the legislature has authorized a robust California Advanced Services Fund (“CASF”) that has been implemented by the Commission.⁶ This program was authorized to provide funding for broadband in unserved areas and should be the source for supporting any broadband programs. The Joint Respondents urge the Commission to use the CASF program and encourage participation in federal programs. It should be noted that CASF grants have been awarded in Tribal areas, such as The Klamath River Rural Broadband Initiative Project approved in Resolution T-17418 and is currently seeking approval for additional funding from CASF.

In summary, diverting CHCF-B funds for purposes contrary to the statutory purpose that fund cannot be done without statutory changes.

⁵ The California High-Cost B Options for Decreasing the Fund Balance, *mimeo*, at 4, May 2018, https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Test_Calendar/Finance%20and%20Admin%20High%20Cost%20Fund%20B%20Handout.pdf. (emphasis added).

⁶ Pub. Util. Code §281.

February 28, 2020

Respectfully submitted,

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ATTACHMENT A



California Public Utilities Commission

Internal Audit Unit Report on

**Telecommunications Public Purpose Program -
California High Cost Fund B**

April 26, 2017



April 26, 2017

Finance and Administration Committee
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Final Report – California Public Utilities Commission Internal Audit Report on the Telecommunications
Public Purpose Program – High Cost Fund B

Dear President Picker:

The Internal Audit Unit of the California Public Utilities Commission (CPUC) has completed its audit of the CPUC's management and oversight of the telecommunications public purpose program California High Cost Fund B as of the fiscal year end June 30, 2015.

The enclosed report is for your information and use. The findings and recommendations in our report are intended to assist management in improving the effectiveness and efficiency of management operations. Management agreed with most of our findings and provided comments that were helpful to the refinement of our analysis. Management's responses are attached in Appendix A.

We appreciated the assistance and cooperation of agency management in the conduct of this audit. If you have any questions regarding this report, please feel free to contact me at 415-703-1823 or CRD@cpuc.ca.gov.

Sincerely,

Carl Danner
Chief Internal Auditor, California Public Utilities Commission

Enclosure

cc: Commissioners
Ryan Dulin, Deputy Executive Director
Arocles Aguilar, General Counsel
Michael C. Amato, Acting Director, Communications Division
CHCF-B Administrative Committee Members

MEMBERS OF THE AUDIT TEAM

Carl Danner – Chief Internal Auditor
Benjamin Schein, CPA – Auditor in Charge

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Executive Summary

The Internal Audit Unit (IA) performed an audit of the California Public Utilities Commission's (CPUC) management and oversight of the telecommunications public purpose program, California High Cost Fund B (CHCF-B).

Our audit sought to document an understanding of the CPUC's fiscal and managerial oversight of the funds collected from ratepayers for the stated purpose of the program, including how the funds are collected, how they are managed while under the agency's custodianship, and that distributions are made strictly in accordance with the rules set forth by the governing documents of the program.

Our summary finding is as follows: With the exception of the audit requirement of PU Code §274, the CHCF-B program is in compliance with all relevant legislation and Commission Decisions. We note that PU Code §274 requires a periodic financial and compliance audit of this program. The program is also being run in a fiscally responsible and transparent manner, although we have a concern with the size of the ongoing Fund balance and outstanding loans as noted below.

Finally, this program shares some financial and accounting support systems with the California High Cost Fund A program, and some other CPUC programs and functions. These concern the utility contact information database, the surcharge reporting software, and the accounting control process for submitting requests to the Fiscal Office. Our internal audit report on the CHCF-A program provided analysis and some findings and recommendations in this regard, whose resolution will also benefit the CHCF-B and other public programs. We do not reiterate those discussions here.

Findings and Recommendations

Compliance:

1. The CPUC's operation of the CHCF-B program is in compliance with PU Code §§ 270, 271, 273, and 275, and with all currently-applicable Commission Decisions and Resolutions referenced in Appendix C.
2. The CPUC is not in compliance with the audit requirement of §274.
 - Recommendation: To attain compliance with §274, IA recommends that management address the requirement for a financial and compliance audit promptly, and then again within each subsequent three year period.

Management and Best Practices - Financial:

1. The CHCF-B program has assets that greatly exceed its current requirements. There is a surplus of about \$161 million (\$82 million in cash equivalents plus \$79 million in outstanding loans) that represents about ten years of operating expenses at current levels. There is a question under §276.5b whether the charges that were imposed on customers to create this surplus are producing benefits of a reasonably equal size.

- Recommendation: We recommend that an analysis of necessary financial reserves be undertaken by staff, and that options be presented to the Commission for its consideration as to what should be done with excess funds (e.g. customer refunds, use for other purposes authorized under the program, etc.).
2. Claims received for fiscal year 2014/15, but not paid, were not accrued in the fiscal year's accounts.
 - Recommendation: Fiscal Office and CHCF-B management should determine how best to update policies and procedures to accrue claims payable in the Fund's year-end accounting.
 3. Budget management for CHCF-B could benefit from increased attention. IA noted material errors (in the millions of dollars) in the monthly reconciliation process for the Fund.
 - Recommendation: CHCF-B management should reconcile the Fund balance on a periodic basis.

Management and Best Practices –Transparency:

We observed a number of beneficial practices here, and made no findings.

We submitted an initial draft copy of this report to the Communications and Administrative Services divisional management on February 14, 2017. Management's responses to our findings and recommendations are in Appendix A. We benefitted also from informal comments provided by agency management, while retaining our own independent responsibility for the contents of this report.

Beyond a corrective action plan, we also ask that management provide a summary of actions taken in response to this audit by December 1, 2017.

The issues in this report are based on fieldwork performed during mid to late 2016. We took opportunities to discuss our findings and recommendations with the related divisions, units, and management throughout our fieldwork, and are pleased to credit their full cooperation with our effort. A listing of documents supplied to IA is included in Appendix B.

This report is intended for the information and use of the Commission and is not intended for use by anyone other than the specified parties. However, this limitation is not intended to restrict the distribution of this report as a matter of public record.

Objective

Through our audit we sought to determine if the CPUC has complied with applicable requirements set forth in statute and in Commission Decisions and Resolutions, and established clear and documented fiduciary and managerial controls with regard to its administration of the California High Cost Fund B telecommunications public purpose program. We also sought to identify control weaknesses and inefficient operations, policies, procedures, systems, and practices.

Scope

The scope of our audit was the CHCF-B program for the fiscal year end June 30, 2015. Our testing included reviewing procedures and practices in both the Fiscal Office and the Communications Division.

Standards

We tested the CHCF-B program for compliance with applicable sections of the PU Code, Commission Decisions and Resolutions, and the State Administrative Manual (SAM). Additionally, we reviewed the program's processes and controls to determine if they are effective and efficient and operational risks have appropriate mitigation.

Methodology and Testing

We performed a risk analysis of the compliance requirements of the Fund based on the governing documents of the Fund as a means to focus our testing procedures. We interviewed program management and Fiscal Office representatives and reviewed financial records and operational documents they provided.

We performed an analysis of compliance requirements based on applicable legislation and Commission Decisions and Resolutions. A list can be found in Appendix C.

We reviewed all aspects of cash flows in and out of the Fund, including the relevant policies and practices of the Fiscal Office and the Fund's overall budgeting process (per §275.6 c (7)). We reviewed all aspects of revenue collection, including billing base calculations, surcharge percentage allocation, and the surcharge remittance system. We reviewed all manners in which money leaves the Fund. This includes administrative costs such as salaries and benefits, overhead costs both internal and external to the agency, contract allocation costs, and monthly carrier claims against the Fund.

We also performed an operational assessment of internal controls, including the documentation of program policies, practices, and controls.

We reviewed all aspects of the claims review process, and payments made to third parties under applicable contracts.

Audit Evidence and Analysis

Compliance:

As noted, the applicable standard of review for compliance was governing legislation (primarily in the Public Utilities Code) and applicable Commission Decisions and Resolutions - including (among other provisions) language governing administrative requirements and the Administrative Committee (AC); requiring that the Fund be governed in a manner that benefits the residents of the state of California, that funds be expended consistent with the Fund's mission; and that basic telephone rates paid by rural customers not exceed a set percentage of those charged to urban customers.

The highest compliance risks in our judgment included the audit requirement of §274 and the mandate to administer the Fund so that any charge imposed to support the goals of universal service reasonably equals the value of the benefits created (§276.5b).¹ Under §274, the Commission is obligated to conduct a financial and compliance audit of program-related costs and activities at least once every three years, starting on July 1, 2002. We did not find evidence of prior financial and compliance audits for this program.

Findings:

- The CPUC's operation of the CHCF-B program is in compliance with PU Code §§270, 271, and 273, and with all currently-applicable Commission Decisions and Resolutions referenced in Appendix C.
- The CPUC is not in compliance with the audit requirement of PU Code §274.

Recommendations:

- To attain compliance with §274, IA recommends that management address the requirement for a financial and compliance audit promptly, and then again within each subsequent three year period.

¹ See discussion in the Budgeting section below.

Management and Best Practices - Financial:

Budgeting:

Budgeting involves the forecasting of program funding needs and assets, tracking of inflows and outflows, and financial adjustments to maintain a reasonable level of reserves. Applicable standards for program budgeting, revenues and expenditures include PU Code Sections 270c, 273, and Decision (D.) 98-09-039. Also relevant is §276.5b, which provides that charges imposed under this program to promote universal service reasonably equal the value of the benefits that are created.

As of August 2016, the CHCF-B balance was \$161 million, including \$79 million in outstanding loans, as described below:

- \$35 million on October 20, 2008 to the General Fund to be repaid on June 30, 2018
- \$24 million on April 1, 2009 to the General Fund to be repaid on June 30, 2018
- \$10 million on June 26, 2015 to the Regional Railroad Accident Preparedness and Immediate Response Fund to be repaid on July 1, 2017
- \$10 million on August 23, 2016 to the Regional Railroad Accident Preparedness and Immediate Response Fund to be repaid on July 1, 2018

According to management, there is a possibility of a one-year postponement in the repayment of the General Fund loans.

The Fund currently pays out about \$17 million per year for claims and administration, while receiving limited revenues as noted below. Despite a one-time claim payment increase of about \$100,000 after Frontier acquired Verizon's California operations in March 2016, overall claims against the Fund have decreased by about 1% per month. In light of the gap between Fund reserves and the cash flows needed for program management (claims and administration), the Commission reduced the surcharge revenue collection percentage to 0% effective February 1, 2014.

The concern is that customers as a group have prepaid almost ten years' worth of CHCF-B expenditures at their current pace, thereby bearing a financing or opportunity cost that is not necessary to the program's operation.² Those particular customers who have been charged to create this surplus are not receiving any benefits today with regard to amounts not needed for current program operations, and may not receive associated future benefits (such as avoidance of paying surcharges) due to changes in the customer base over time, or intervening modifications to the program. Additionally, assuming that this Fund will draw down over a lengthy period of years may not be a reasonable approach with respect to support payments to an industry that continues to undergo change. The large surplus in the Fund has also resulted in multiple loans made to other government programs, with some uncertainty as to repayment dates.

² See, for example, the time value of money discussion in Office of Management and Budget (OMB) Circular A-94 (https://www.whitehouse.gov/omb/circulars_a094), and OMB Circular A-4 (https://www.whitehouse.gov/omb/circulars_a004_a-4). The OMB 2015 Discount Rates memorandum updated relevant interest rates for these purposes (<https://www.whitehouse.gov/sites/default/files/omb/memoranda/2015/m-15-05.pdf>).

In terms of working capital, an organization should maintain a liquidity balance to meet reasonable and predictable needs for the immediate future. That level can change based on such factors as the size and predictability of expenditures, as well as the timing of receipts. The Government Finance Officers Association (GFOA) recommends establishing a target balance as part of a financial plan.³ The California State Auditor (CSA) has spoken to this question in a number of its audits, including:

- 2011-121 (Probationers' Domestic Violence Payments, Pg. 64) that accepted a recommendation of a fund reserve balance of six to nine months;
- 2015-030 (State Bar of California, Pg. 68) which recommends a two months' reserve;
- 2015-102 (Central Basin Municipal Water District, Pg. 39) which references the GFOA standards.

The CPUC also has a standard for determining a working cash allowance for regulated water companies (U-16-W),⁴ and working cash is a standard utility rate case issue.

In terms of management activities, CD staff maintains a calculation spreadsheet that tracks a balance sheet for the program. However, its calculations are not reconciled, and each month's statement contained material variances. More accurate tracking would become a greater concern if the Fund's reserves were reduced so that its finances needed to be managed more closely.

Fiscal staff performs a variety of reconciliations that appropriately track financial transactions involving the Fund and the State Controller's Office, which pays program claims by providing pay warrants to participating carriers.

Finally, a review of the DoF follow-up engagement into the CPUC's budgetary practices (dated August 2014) confirmed that there are no outstanding audit recommendations related to CHCF-B (Fund 0470).

Findings:

- The CHCF-B has assets that greatly exceed its current requirements. There is a surplus of about \$161 million (\$82 million in cash equivalents plus \$79 million in outstanding loans) that represents about ten years of operating expenses at current levels. There is a question under §276.5b whether the charges that were imposed on customers to create this surplus are producing benefits of a reasonably equal size.
- Budget management for CHCF-B could benefit from increased attention. IA noted material errors (in the millions of dollars) in the monthly reconciliation process for the Fund.

Recommendations:

- We recommend that an analysis of necessary financial reserves be undertaken by staff, and that options be presented to the Commission for its consideration as to what should be done with excess funds (e.g. customer refunds, use for other purposes authorized under the program, etc.).
- CHCF-B management should reconcile the Fund balance on a periodic basis.

³ <http://www.gfoa.org/determining-appropriate-levels-working-capital-enterprise-funds>

⁴ <http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M055/K059/55059235.PDF>

Revenue:

Given that there is no surcharge currently being collected for CHCF-B, the Fund receives only minor revenues as follows:

- Investment Income – Surplus Money \$249,644.50
- Other Regulatory Fees \$ 16,210.30
- Escheat \$ 7,308.03

We found no issue with these amounts or their management. A discussion of the authority to collect revenue for the program can be found in Appendix E.

Program Expenditures:

Expenditures from the CHCF-B are mandated by its budget, proposed each year by the Administrative Committee and approved by Commission vote. The expenditures for the audit period of 2014/15 were approved in Resolution T-17399, which included a forecast of projected carrier claims.

Three general categories of expenditures were made:

1. Support payments to the participating carriers totaled \$15,389,688.01 in the audit period.
2. CPUC staff salary and other overhead expenses were categorized as State Operations, and totaled \$660,371.08 in the audit period. Of that amount, CPUC staff salaries and benefits were \$189,880.00, and other overheads and allocations were \$470,491.08.
3. Statewide Assessments totaling \$24,063.60 for the audit period were charged to the program related to Fi\$Cal and the State Controller’s Office.

Support Payments (Local Assistance)

The claims paid to participating carriers are recorded as Local Assistance, and were made as for 2014/15 for a total of \$15,389,688.01 as follows:

Carrier Support Payments Charged to CHCF-B During FY 2014/15 as Local Assistance

Carrier	Amount
Pacific Bell, dba AT&T of California	\$ 7,935,541.06
Verizon California, Inc. Contel	\$ 2,440,177.15
Citizens Telecom Co. of California	\$ 2,005,470.51
Verizon California, Inc.	\$ 1,612,407.79
Frontier Southwest, Inc.	\$ 1,239,621.96
Cox California Telecom, LLC	\$ 119,539.35
MCI Metro Access Transmission	\$ 36,930.19
	\$15,389,688.01

Using the applicable formulas, we recalculated a stratified random sample of claim payments made to carriers on a census block group basis (the geographic units for which subsidies are calculated). We noted two payment errors, and one policy change to recommend.

Due to a typographical error, MCI Metro was paid \$4,460.59 for September 2014, when the actual claim was for \$3,152.37. During the audit CD contacted MCI Metro, and a refund was paid back to the Fund in December 2016.

We also observed that the Fund is not accruing payables for claims received and not paid in the fiscal year. The SAM, Section 19305 requires that accruals be booked by state Funds. For the fiscal year under audit, all the carriers had June 2015 claims unrecorded in the fiscal year (AT&T had both May and June claims payable). Total cost to the Fund should have been recorded as \$2,081,123.74.

CPUC Overheads (State Operations)

CPUC overheads charged to the program included staff salaries and benefits totaling \$189,880.00, and other overheads and allocations totaling \$470,491.08. These various expenditures were verified individually, including tracing salary and benefit allocations to particular staff with CHCF-B responsibilities. Errors totaling \$17,352.48 had previously been found by staff in two categories, and these had already been reversed in the subsequent fiscal year’s accounts. A one-digit typo in an accounting code caused a further error of \$2,668.09, which was corrected by Fiscal Office staff when identified by IA.

The table below reports the items that comprised the other overheads and allocations.

Other Overheads and Allocations Charged to CHCF-B During FY 2014/15 as State Operations

Expenditure	Recipient	Amount
Overhead	CPUC	\$220,059.31
Intervenor Compensation	Center for Accessible Technology	\$102,689.70
External Services – Auditing	Crowe Horwath, LLP	\$ 60,472.52
External Services – Information Technology	Blue Crane, Inc.	\$ 30,987.57
Overhead	State of California	\$ 26,756.00
Strategic Planning (MTS Program)	Various	\$ 12,135.61
Overhead	Director – Communications Division	\$ 10,257.42
External Services – Legal	Sheppard Mullin	\$ 5,216.87
Legal Processing Fee	VCG	\$ 1,664.21
Overhead	Director - CSID	\$ 134.26
Late Payment Penalty	Center for Accessible Technology	\$ 117.61
		\$470,491.08

Findings:

- Claims received for fiscal year 2014/15, but not paid, were not accrued in the fiscal year's accounts.

Recommendations:

- Fiscal Office and CHCF-B management should determine how best to update policies and procedures to accrue claims payable in the Fund's year-end accounting.

Management and Best Practices – Transparency:

Consistent with the requirements of the Public Utilities Code and the SAM for effective and efficient management and the presumption that state government's activities should be operated in a transparent manner, we reviewed several aspects of the program's general management and provision of relevant information to the public.

CD management provided a description of duties performed by staff, management, the Administrative Committee (AC), and other stakeholders including Legal and senior management. All the descriptions are reasonable, and demonstrated an understanding of segregation of duties and management oversight. A detailed description of the staff activities to support the efficient operation of the CHCF-B Fund was included in the Zero Based Budget Report dated January 2015 (pages 136-138).

The CHCF-B AC has an adopted charter describing its duties and responsibilities, and includes five members – two representatives of the large local exchange carriers (the ones eligible for CHCF-B subsidy), two consumer advocates, and a representative of the Office of Ratepayer Advocates (ORA). Their role is to advise the Commission on CHCF-B matters and to propose a budget for approval. The AC also produces an annual report that includes a current balance, number of lines served by the CHCF-B eligible carriers, a budget versus annual comparison, and meeting minutes.

The CHCF-B AC meets quarterly to provide feedback as needed and propose an annual budget for Commission vote. The meetings are open to the public and are noticed on the Commission Daily Calendar.

In addition to the aforementioned CHCF-B AC, the program maintains a webpage on the CPUC's public website.⁵ Information available include fact sheets, meeting minutes, eligible carriers, links to the open proceeding, the CHCF-B AC page (which includes links to budget Resolutions), and the identity of current CHCF-B AC members. CD also maintains a public library of important Commission actions and relevant legislation on a webpage.⁶

⁵ <http://www.cpuc.ca.gov/General.aspx?id=996>

⁶ <ftp://ftp.cpuc.ca.gov/Telco/Important%20Decisions/>

Findings:

- None.

Recommendations:

- None.

Appendix A – Management Responses

State of California

Memorandum

Date: March 7, 2017

To: Carl Danner, Chief
Internal Audit Unit

From: Michelle Morales, Fiscal Office
Eric Van Wambeke, Communications Division

Subject: Telecommunications Public Purpose Program
California High Cost Fund B

The Communications and Administrative Service Divisions have reviewed the findings and recommendations from the Telecommunications Public Purpose Program High-Cost Fund-B Audit. We have provided our responses below.

Recommendation: To attain compliance with §274, IA recommends that management address the requirement for a financial and compliance audit promptly, and then again within each subsequent three year period.

Response:

The Communications Division will pursue a plan on auditing the program to satisfy the financial and compliance components of the requirement when resources and funding are available.

Recommendation:

We recommend that an analysis of necessary financial reserves be undertaken by staff, and that options be presented to the Commission for its consideration as to what should be done with excess funds (e.g. customer refunds, use for other purposes authorized under the program, etc.).

Response: CD will provide recommendations for Commission review, and is prepared to follow the Commission's directions about how to treat CHCF-B financial reserves on an ongoing basis.

Recommendation:

Fiscal Office and CHCF-B management should determine how best to update policies and procedures to accrue claims payable in the Fund's year-end accounting.

Response:

Fiscal contacts CD every June—prior to end of fiscal year—to request public purpose program claims expenditures accruals in a pre-formatted spreadsheet. On this sheet, CD reports program claims through the end of the fiscal year (June), which have not yet been paid; for claims that

have not yet been received, an estimate is given. This process has been in place since 2013, but last year's expenditure request may have not reached all Public Purpose Program fund administrators. Beginning this year, the Fiscal Office will review that all PPP funds have either payments or accruals posted for months through June, and will follow up with CD if necessary. The Fiscal Office will also review submitted accruals against payment history to ensure accruals are reasonable.

Recommendation:

CHCF-B management should reconcile the Fund balance on a periodic basis.

Response:

A reconciliation process already exists. The Fiscal Office Accounting Unit performs monthly reconciliations between SCO CalSTARS, and also SCO and the Fiscal Office checking accounting. These reconciliations are approved and signed by a supervisor. Additionally, Fiscal cannot submit the year-end financial statements to SCO without clearing all prior reconciling items. Any overrides are approved by the Department of Finance CalSTARS unit, and SCO, to ensure transaction validity.

The Internal Audit (IA) unit appreciates the comments provided by management above. IA would like to add the following observations:

On the question of the Fund reconciliation, the underlying question is whether CD (as the program's manager) has a fully accurate accounting of the CHCF-B Fund's finances at any given time, as is appropriate for a program involving substantial sums. CD does not have this capability now.

We retain our recommendation that a periodic reconciliation be performed, or an equivalent procedure through which CD will have the capability to monitor the Fund on an ongoing basis. If the Fiscal Office reconciliation will provide this capability (including disaggregated information at the Fund level), then we recommend that CD obtain and review a copy monthly.

Appendix B – Documents Reviewed

TUFFS

- User Guide
- Carrier Contact List
- Example - Variance Report

CHCF-B Administrative Committee

- Charter
- Minutes

Invoices / Invoice Tracking / Contract Request Forms

- Crowe Horwath
- BlueCrane
- M Corp
- Infiniti Consulting
- Meta Vista Consulting

Fiscal Reports

- Fund 0470 Breakdown
- Program 30 Expenditures (Overhead Costs)
- MTS Expenditures and Encumbrances
- AP Procedure Documents
- Fiscal Flow Chart
- PCA, Object, Index Code Lists
- Communications Division PCA Code “Cheat Sheet”
- State of California Pro Rata Overhead Allocation (2014/15)

Claims

- All carrier claims from July 2014 to June 2015
- Payment letters
- Claim summary spreadsheets
- Census Block Group documentation

Commission’s Zero Based Budget Report – January 2015

Appendix C – Bibliography

Legislation	PU Code	Decisions	Resolutions	SAM Manual
AB 1466, Ch. 755 (1987)	270	85-06-115	T-16018	19305
AB 3643, Ch. 278 (1994)	271	88-07-022	T-17311	
SB 669, Ch. 677 (1999)	273	94-09-065	T-17399	
SB 1276, Ch. 847 (2004)	274	95-07-020	T-17417	
SB 1364, Ch. 1364 (2014)	276.5	96-10-066		
		98-09-039		
		06-08-030		
		06-12-044		
		07-09-020		
		07-11-039		
		08-04-061		
		12-12-038		
		14-06-008		
		15-01-047		

Appendix D – Program Background

The California High Cost Fund B (CHCF-B) program provides basic rate subsidies to large telecommunication carriers of last resort (COLRs) to provide service in high cost areas of California. As a program that promotes universal service, CHCF-B helps carriers to provide rates in high cost areas comparable to rates charged in urban areas. For the period under audit (2014/15), the budget approved for the program was about \$22.4 million.

Based on an organizational risk analysis performed by Internal Audit (IA), with the assistance of CPUC management and staff, an audit of the CPUC’s public purpose programs (both in energy and telecommunications) was recommended to review the fiduciary and managerial oversight of funds that jointly comprise over \$1 billion annually. This is the second of those audits, which was approved during 2015 by the Commission’s Finance and Administrative Committee.

The Commission has a requirement under Public Utilities Code §274 to audit some of these programs every three years. In addition, there were a number of risk factors we believed warranted attention regarding this program:

- Carriers pay surcharges to support the program based on their “billing base,” which is the total annual revenues they receive from providing California jurisdictional services. Potential concerns involved knowledge of how many carriers are operating in California, what their current contact information is, the precise calculations or methods by which they were determining and reporting their billing base, and the possibility that some carriers might not be remitting surcharges they properly owe.
- Whether Fund balances are being tracked and reconciled on a regular (e.g. monthly) basis.

Historically, the Commission originally authorized the creation of a “High Cost Fund to assure that no ratepayers of any exchange carrier will face basic local rates more than 100% higher than the rates charged by Pacific [Bell] in comparable neighboring areas.”⁷ In 1987, the California Legislature required the Commission “to develop, implement, and maintain a suitable program to establish a fair and equitable local rate structure aided by transfer of payments to small independent telephone companies serving rural and small metropolitan areas.”⁸ The High Cost Fund (HCF) program was created by Decision (D.) 88-07-022 and is codified in Public Utilities (PU) Code §270. This Decision created the HCF to provide rate subsidies to carriers in difficult-to-serve areas. D.95-07-050 set proposed rules for the state’s universal service goals in response to AB 3643. D.96-10-066, OP 8 established the adjusted Cost Proxy Model for large carrier rate support. OP 8a established CHCF-B, separating it from the original HCF. OP 8h set the first surcharge rate for CHCF-B at 2.87%. The establishment of a threshold benchmark \$36.00 per line to be eligible for subsidy was established in D.07-09-020 (OP 1). D.14-06-008 (OP 1) set the cost figures per Census Block Group (CBG) in use during the audit period. Resolution T-17417 (OP 1) reduced the CHCF-B surcharge rate assessed on ratepayers to 0% effective February 1, 2014.

PU Code §270(b) states that funds in the CHCF-B program may only be expended pursuant to PU Code §§270-281 (for purposes related only to the stated goals of the program) and upon appropriation in the

⁷ D.85-06-115

⁸ Assembly Bill 1466, Chapter 755 (1987)

annual state Budget Act. PU Codes §§270-281 were codified in October 1999 as a result of the enactment of Senate Bill (SB) 669 (Stats. 1999, Chapter 677).

The CHCF-B program is currently set to expire on January 1, 2019 unless the date is extended by enacted statute.

Appendix E – Program Funding Legislation

PU Code §275(b) provides funding authority for the surcharge used to support the program. Additional support for the surcharge collection mandate includes:

“It is reasonable to fund the CHCF by a surcharge on all end-users as adopted by this decision.”⁹

“It is reasonable to exempt from the surcharge coin-sent paid calling, one-way radio paging, ULTS billing, and services provided under existing contracts.”¹⁰

“Effective January 1, 1995, all certified telecommunications utilities shall collect a surcharge of 0.5% on revenues from the expanded billing base described in this decision to fund the CHCF. Pacific [Bell] shall continue the administration of the CHCF. CACD [Commission Advisory and Compliance Division] shall work with Pacific [Bell] to establish administrative guidelines for implementation by January 1, 1995.”¹¹

“All End User Surcharge (AEUS): A funding mechanism used to collect money for Commission-mandated programs. The AEUS is applicable to all telecommunications carriers, with the exception of one-way paging companies. The surcharge is a percentage of the customers’ total expenditures on telecommunication services. The surcharge is visible on customers’ bills as a line item charge.”¹²

“Regardless of how the user fees and PPP [Public Purpose Program] surcharges are collected, the carrier is ultimately responsible for paying these amounts to the Commission.”¹³

“Carriers shall report and remit their California LifeLine surcharge revenues based on intrastate end-user billings less estimated uncollectible amounts. Carriers shall true-up their estimated California LifeLine surcharge uncollectible amounts with their actual uncollectible amounts.”¹⁴

Surcharges are assessed on intrastate billing base at a percentage defined by the Commission in Resolutions. For CHCF-B, the current surcharge rate is 0.0% as of February 1, 2014.¹⁵

The basis for the surcharge collection is the monthly intrastate billing base of the carriers. There are a number of accepted methods for computing intrastate billing base for CPUC purposes.

“The July 11, 2012 instructions from the Communications Division expressly state that reasonable methodologies include (a) the inverse of the FCC safe harbor percentage and (b) traffic studies.”¹⁶

⁹ D.94-09-065 Conclusion of Law (COL) 205

¹⁰ Ibid, COL 231

¹¹ Ibid, OP 71

¹² D.96-10-066, Appendix B, 1A

¹³ D.14-01-037, COL 12

¹⁴ General Order 153, Section 11.3.1

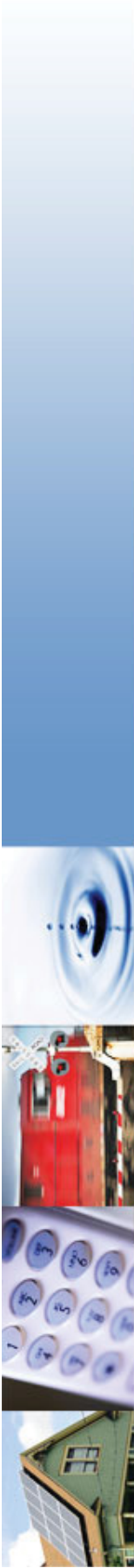
¹⁵ Resolution T-17417

¹⁶ D.14-01-037 Finding of Fact (FOF) 9

“Reasonable methodologies for calculating intrastate revenue include: inverse of FCC safe harbor percentages, traffic studies, books and records, FCC Inverse, and the methods permitted by the BOE [Board of Equalization].”¹⁷

¹⁷D.14-01-037, COL 11

ATTACHMENT B



California High Cost Fund-B Options



**Michael Amato, Deputy Director
Communications Division
California Public Utilities Commission**

May 30, 2018





April 26, 2017 Internal Audit Report

- **Findings:** The CHCF-B program has a large fund balance (\$161 Million as of August 2016)
- **Recommendation:** CD staff should perform an analysis of necessary financial reserves and present options to the Commission addressing disposition of excess funds to be used for other purposes
- **The Current Fund Balance:** Approximately \$128 million as of April 2018; including an unappropriated liquid balance of approximately \$41.4 million, and outstanding loans of \$86.4 million





Option 1: Status Quo, Allow Fund Balance to Decrease Gradually

- Total annual expenditures authorized at \$22.3 million
- It would take approximately 2 years to decrease the unappropriated (liquid) balance to zero
- It would take approximately 5.5 years to decrease the total fund balance, including unpaid loans, to zero
- No implementation steps required





Option 2: Use Program Funds to Facilitate the Commission Safety Directive for Fire Preparedness

- B-Fund carriers proposed that the excess CHCF-B program funds be used as a reimbursement to implement safety compliance measures associated with various fire prevention implementation costs
- Decision 17-12-024 sets forth fire safety rules for all companies, who have the option of passing these costs on to customers
- California fire zone maps show that affected areas are often consistent with and overlap similar geographic areas that are designated as CHCF-B eligible census block groups
- This option presents challenges in determining the level of allowable recovery and consistency with existing Commission decisions and statutes
- Option could be viewed as contrary to the conclusion about cost of recovery in D.17-12-024 (COL 9) and inconsistent with the CHCF-B statutory purpose as expressed in P.U. Code Section 276.5
- To implement, a Commission order is necessary, requiring Staff to prepare a Rulemaking Order (OIR), or, alternatively, draft a proposed Resolution





Option 3: Fund Transfer Option: Move Excess B Fund Balance Amounts to Other Public Purpose Programs

- Requires determination of the amount to transfer, and to which programs funds should the amount be distributed (i.e. all programs; some programs?)
- Some parties may question whether funds collected for rural high cost support should be used for another universal service program
- Implementation would require legislation to facilitate funds transfer, as the existing statute allows CHCF-B funds to be used only for specific program purposes





Option 4: Customer Refund Option

- Approximately 700 authorized carriers remit surcharges
- Surveyed Carriers have indicated that they will require numerous additional hours and expense of retrieving archived data, programming and testing, using already-allocated resources
- Programmable capacity to accommodate negative surcharge or refunds questionable for some carriers
- Refund would end up going to current customers for each carrier and would not necessarily go to the customers that paid the initial CHCF-B fund surcharge





Conclusion

- Communications Division recommends Option 1 status quo as fund balance has gradually decreased
- If the Commission wants to utilize CHCF-B funds in a more timely manner, then Option 3 may be a viable alternative, but this option would require legislation
- CD does not recommend Options 2 or 4, given reasons discussed in Option Paper



ATTACHMENT C

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.

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

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.

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

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.

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

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

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

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.