Order Instituting Rulemaking to Update Surcharge Mechanisms to Ensure Equity and Transparency of Fees, Taxes and Surcharges Assessed on Customers of Telecommunications Services in California

California Public Utilities Commission

Staff Report – Part 1

June 2021

Executive Summary

This Staff Report will review the impact of market shifts and regulatory changes on the State of California's universal service program surcharges and user fee.

The State of California has six universal service programs that provide societal benefits to Californians who are deaf, disabled, low-income, live in rural locations, as well as to community institutions. The surcharges that fund these programs are assessed on the intrastate portion of telecommunications services, regardless of whether these services are transitional landlines, wireless, or Voice over Internet Protocol (VoIP). This universal service system was put in place more than 30 years ago to create a progressive funding mechanism in which end users' contributions to the universal service programs are proportional to the cost of service.

The total number of communications subscribers in the state has increased substantially over the past decade. In 2012, there were 52.8 million voice subscribers in the state. By June 2019 – the most recent data available – this increased to 56.8 million voice subscribers. Yet, over the same period, the surcharges have yielded diminishing revenues. This decline is represented by the shrinking "intrastate revenue billing base," in other words, the amount of revenue that providers report as being subject to state surcharges. The intrastate revenue billing base declined by 58% between 2012 and 2020. In 2012, the total reported intrastate revenue subject to surcharge was $15.4 billion. By 2020, it decreased to $6.433 billion.

These changes have impacted consumers and the state's universal service programs in the following ways:

- The Commission had to double the surcharge for the California Advanced Services Fund and the California High Cost Fund A just to *maintain* – not increase – the same amount of revenue they were collecting.
- The Deaf and Disabled Telecommunications Program will – in the very near term – become insolvent because of declining revenues. Unlike the other programs, the Commission is unable to increase this surcharge because of a statutory cap in Public Utilities Code Section 2881.

- Preliminary review of customer bills has identified deep discrepancies between how much users of different services and different companies pay in surcharges:
    - Customers relying on traditional voice landlines pay a disproportionate amount more – as much as 1,376% more in the example – than consumers of other services.
    - There is significant variation between the cost of a service and how much surcharge revenue is remitted for that service.
    - There is significant variation between the amount of surcharge assessed by companies offering identical services (e.g., Wireless Company A may charge twice as much as Wireless Company B).

These impacts are a result of various factors. Providers have significant flexibility in determining what portion of the services they provide are considered "intrastate." This discretion may be used to minimize the contributions to the state universal programs. Further, the Federal Communications Commission's (FCC) classification of voice, texting, and data services as "information services" currently exempts these services from being subject to the state's surcharges.

The Commission has various options to consider for improving the integrity of the surcharge mechanism.

The Commission could audit provider contributions to the universal service programs, develop additional reporting requirements, or change rules to stabilize the existing mechanism. But, given the underlying systemic issues, it is unclear if this would provide a permanent solution. The FCC could reclassify services as telecommunications services, which would make them subject to universal service obligations. The Commission could transition to a single flat-rate end-user surcharge mechanism, or a hybrid mechanism.

In the second phase of this proceeding, the Commission will review provider-imposed charges added to customer bills. These charges are separate and in addition to the various public purpose surcharges on customer bills. These charges are not always clearly identified, nor is the purpose of these charges clear. These charges have increased substantially in recent years. Numerous efforts past and present have attempted to improve the transparency and fairness of the charges added to consumer bills.

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1. Introduction

Universal service is the principle that all Americans should have access to robust, reliable communications services – including broadband connectivity – at affordable rates, regardless of where they live. Universal service policies and programs have helped make telephone service ubiquitous, even in remote rural areas.

For California, these principles are articulated in Public Utilities (P.U.) Code § 709 and 47 U.S. Code § 254 of the Communications Act. The guiding provision for the adoption of state universal service programs is 47 U.S. Code § 254(f) of the Communications Act, which states:

> *A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.*

With these requirements in mind, we review whether every provider contributes to the state's universal service programs on an equitable, nondiscriminatory basis to preserve and advance universal service in the State of California. We additionally review whether the state's surcharge mechanisms adopted are predictable, and sufficient to preserve and advance universal service within the state.

1.1. The Public Purpose Programs Supported by Surcharge Collections

The Commission is responsible for administering the state's six universal service programs and the surcharges that support them. These programs are collectively referred to as the Public Purpose Programs (PPPs). Today, the PPP surcharges are assessed on intrastate telecommunications services sold in California. These surcharges are assessed and collected by carriers as a percentage of an end user's telecommunications bill. Carriers report and remit the surcharges monthly to the Commission. The programs, set forth in P.U. Code Sections 270 to 281, are:

- Universal Lifeline Telephone Service (ULTS): provides discounted home phone and cellular phone services to qualifying households.
- Deaf and Disabled Telecommunications Program (DDTP): provides telecommunications devices to deaf or hearing-impaired consumers.
- California High Cost Fund-A (CHCF-A): provides a subsidy to 10 of the 13 small local exchange carriers (LECs) for providing telephone service to residential customers in rural high-cost areas.[1]
- California High Cost Fund-B (CHCF-B): provides a subsidy to carriers of last resort (COLRs) for providing telephone service to residential customers in rural high-cost areas.
- California Teleconnect Fund (CTF): provides a discount on select communications services to schools, libraries, hospitals, and other non-profit organizations.

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[1] Cal-Ore Telephone Company, Calaveras Telephone Company, Ducor Telephone Company, Foresthill Telephone Company, Kerman Telephone Company, Pinnacles Telephone Company, The Ponderosa Telephone Company, Sierra Telephone Company, Siskiyou Telephone Company, and Volcano Telephone Company receive CHCF-A support. Happy Valley Telephone Company, Hornitos Telephone Company, and Winterhaven Telephone Company do not currently receive CHCF-A support but may apply in the future.

- California Advanced Services Fund (CASF): supports the deployment of broadband facilities and broadband services adoption in unserved and underserved areas through project-specific grant funding.

1.2. The User Fee

In addition to the PPPs, the User Fee supports the CPUC's costs for regulating the corporations under its jurisdiction. P.U. Code § 401 et seq. authorizes the User Fee to provide funds for the Commission's annual operating budget.[2] The Commission assesses this charge on every electric, gas, telephone, water, transportation, and other utilities. For telephone corporations, this charge is calculated based on the "ratio that each corporation's gross intrastate revenues bears to the total gross intrastate revenues for the class,"[3] The Commission has further defined this to be based on a percentage of a Telecommunications Carrier's gross intrastate revenue excluding inter-carrier sales, equipment sales and directory advertising.

Unlike the PPP surcharges, which are collected monthly, the User Fee is collected quarterly.[4]

1.3. Program Charges are Separately Stated on End-Users Bills

When collecting surcharges from end-use customers in California, carriers are required to specifically identify each surcharge as separately stated line items on the customer's bill.[5] This means that carriers may not build in, include, or collect California's PPP surcharges and the User Fee through some other means.

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[2] *See* P.U. Code §§ 401-405, 431-435.

[3] P.U. Code § 432.

[4] P.U. Code § 433.

[5] See*, e.g.*,P.U.C. Section 2881(g) *The commission shall require that programs implemented under this section be identified on subscribers' bills and shall establish a fund and require separate accounting for each of the programs implemented under this section.*

1.4. The Commission's Collection Mechanism

The CPUC requires all service providers to report surcharges online monthly, through the Commission's Telecommunications & User Fees Filing System (TUFFS). Once a carrier has determined its aggregate intrastate revenues subject to surcharge for that month, the carrier enters that amount into the TUFFS system. The system then calculates the resulting surcharge amount due for each program fund. The carrier then makes payment to each fund and the User Fee by Automated Clearing House (ACH) debit through the Electronic Funds Transfer (EFT) system.

This proposal would require programming changes to the Commission's TUFFS in coordination with the Commission's Information Technology and Fiscal Services groups.

1.1. Setting the Public Purpose Programs' Surcharge Rates

To forecast annual program budget needs for each of the six PPPs, Commission staff forecasts an aggregate annual intrastate billing base from historical trends,[6] then multiplies that number by a remittance rate that achieves collection of the budgeted amount during the next fiscal year.[7] When a program's remittance rate requires an increase or decrease to reflect the program's support needs, the Commission adopts these changes via a resolution. The same process is used to establish the remittance rate for the Commission's User Fee.

[6] The "billing base" is the total intrastate revenue reported by all authorized carriers, the data of which is collected and maintained through the Commission's Telecommunications User Fee Filing System (TUFFS).

[7] For instance, if a program budget is forecasted at $50 million, and the aggregate annual intrastate billing base for all carriers is forecasted at $10 billion, then a remittance rate of 0.50% of intrastate revenue is required to support the program ($10,000,000,000 multiplied by 0.50%, equaling $50,000,000).

Unlike the other five PPPs, P.U. Code § 2881 limits the amount of surcharge revenue that may be collected for the DDTP, which may not exceed one-half of 1 percent (0.50%) of intrastate revenue, uniformly applied to an end user's intrastate telephone service.[8]

1.2. Billing Base: How Service Providers Calculate Intrastate Revenue, Surcharges, and User Fees to Support Programs

Existing law requires that all telephone corporations and VoIP providers assess and collect PPP surcharges from their end users and remit those revenues to the Commission.[9] The Commission adopted a revenue-based end-user surcharge mechanism in Decision (D.) 94-09-065[10] and D. 96-10-066,[11] which formed the foundation of the Commission's surcharge mechanism to support PPPs.

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[8] P.U. Code § 2881(g) states: "The commission shall establish a rate recovery mechanism through a surcharge not to exceed one-half of 1 percent uniformly applied to a subscriber's intrastate telephone service, other than one-way radio paging service and universal telephone service, both within a service area and between service areas, to allow providers of the equipment and service specified in subdivisions (a) to (d), inclusive, to recover costs as they are incurred under this section. The surcharge shall be in effect until January 1, 2025."

[9] *See, e.g.,* D. 96-10-066, in R.95-01-020, Rulemaking on the Commission's Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643; Investigation on the Commission's Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643. In this decision, the Commission exempted the following services from the PPP surcharges: ULTS billing; coin-sent paid calling; debit card messages; one-way radio paging; usage charges to Coin operated paid telephones; customers receiving services under existing contracts that were executed on or before September 15, 1994; and directory advertising.; *See also* General Order 153.

[10] D.94-09-065, in I.87-11-033, In the Matter of Alternative Regulatory Frameworks for Local Exchange Carriers and Related Matters.

[11] *See* D.96-10-066.

For those services that have both an intrastate[12] and interstate component, the CPUC does not prescribe one methodology to determine the intrastate revenue subject to PPP surcharges. For instance, service providers may utilize methodologies that rely on the provider's books and records, traffic studies, or a safe harbor percentage adopted by the FCC in determining its surchargeable intrastate revenue.[13] These methodologies are described further below:

- Carriers may determine California intrastate revenues using the inverse of the FCC's Federal Interstate Safe Harbor Percentage,[14] adopted by the FCC to fund federal universal service programs for the respective type of carrier.
- A carrier may develop a jurisdictional allocation through a Traffic Study[15] factor, representing the average usage patterns of the carrier's own customers, and then apply this factor to its total California revenues.

[12] "Intrastate" means a telecommunications service that originates and terminates within California. Generally, such services subject to tariff (or formerly tariffed) with the CPUC are subject to California surcharges, whereas interstate services, taxes and surcharges, and financial charges and fees, are not. Intrastate services that are subject to surcharges include, but are not limited to, residential or business lines; wireline services; pre and postpaid wireless services, and any associated services, including but not limited to custom calling features; private line service; 800/900 service; and non-recurring surcharges (such as installation and connection charges).

[13] *See*, e.g., PU Code § 285.

[14] The safe harbor methodology is an FCC-defined methodology identifying the percentage of services that it established as reasonable to be reported as interstate, which is currently set at 37.1%. See p. 40 of the 2018 Telecommunications Reporting Worksheet Instructions (FCC Form 499-A): The wireless safe harbor percentage for interstate revenue, cellular and broadband PCS telecommunications services, equals 37.1%. Therefore, the reciprocal (inverse) intrastate safe harbor equals 62.9% (or 100% minus 37.1%). The safe harbor methodology is the only methodology that the FCC presumes is reasonable and will not be subject to FCC audit.

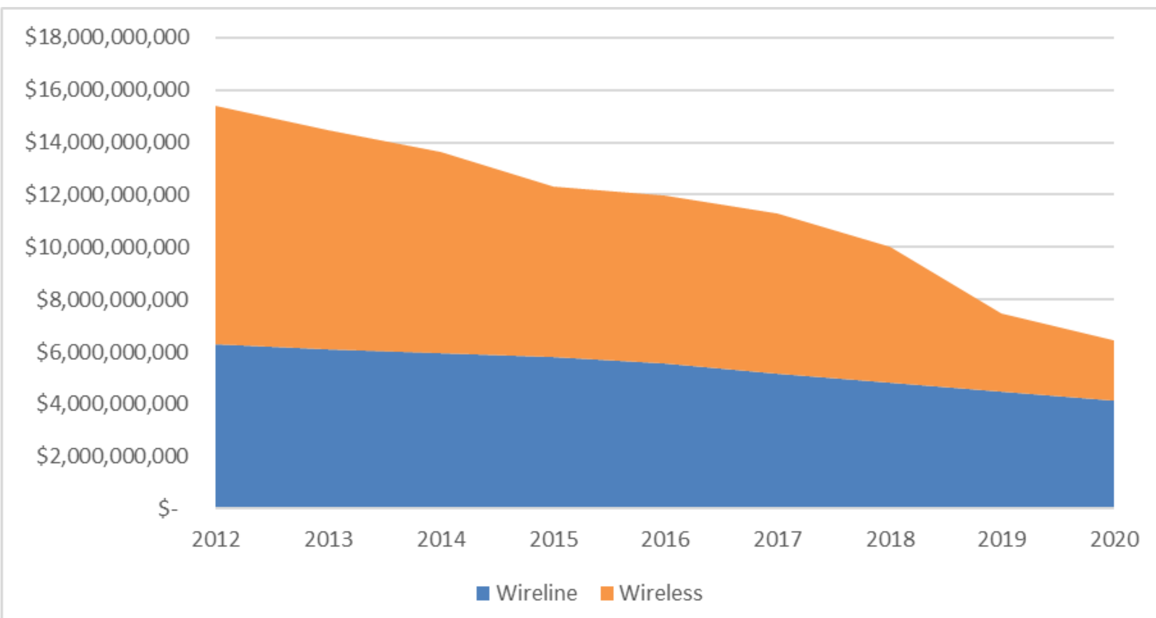
[15] A traffic study determines which percentage of calls are intrastate, versus interstate and international communications, to identify an intrastate percentage resulting from the total.

- Intrastate revenues subject to the surcharge may be calculated by a service supplier based upon books and records[16] kept in the regular course of business or for other purposes, including nontax purposes.

1.3. The Decline in Intrastate Billing Base and Program Revenue Collection

The intrastate revenue billing base declined by 58% between 2012 and 2020 (*See* Chart 1). In 2012, the total reported intrastate revenue subject to surcharge was $15.4 billion; by 2018 it declined to $10.027 billion, and in 2019, it decreased by another $2.657 billion to $7.370 billion (over 26%), and then by $937 million to $6.433 billion in 2020.

Chart 1: Intrastate "Surchargeable" Revenue by Year



Continuing to base surcharges on a declining intrastate billing base will make it necessary for the aggregate surcharge rate — currently at 7.749% of an end-user's intrastate billing — to increase.[17] While some PPPs have maintained

[16] Books and Records reflect data identifying revenue associated with intrastate versus interstate transactions as recorded on the service provider's books.

[17] *See*, CPUC Surcharge Rates: https://www.cpuc.ca.gov/general.aspx?id=1124

financial reserves because of other market shifts, some programs have required substantial surcharge rate increases, and other programs may need a surcharge increase in the coming year to remain solvent.

Because of the intrastate revenue billing base decline, some program rate increases have recently been implemented. Effective December 1, 2020, the Commission doubled the CHCF-A Program surcharge rate from 0.35% to 0.70% of intrastate revenue and nearly doubled the CASF surcharge rate from 0.56% to 1.019%.[18] These increases became necessary not because program expenses doubled, but because of the ongoing year-over-year decline in the intrastate billing base subject to surcharge. This decline has resulted in lower surcharge revenue collected for all PPPs, compared to the amount forecasted. For instance, during the period of March 1, 2018 through June 30, 2020, the CASF experienced a revenue shortfall of more than $53 million of the $154 million it was projected to collect; a 34% decline. While this program revenue decrease will be mitigated by a surcharge rate increase, it has had a significant impact on CASF's goal of extending broadband access in the state, resulting in approximately $77 million in lost surcharge revenue that – due to a statutory prohibition – cannot be recovered.[19]

The DDTP program may become insolvent by the end of the year without intervention. In Fiscal Year 2019-20, the program expenditures were $57,296,000, but the surcharge only yielded $33,228,000 in revenue. The program has remained solvent due to sizeable budget reserves, but, at this rate, the reserves

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[18] Resolution T-17705, available at: https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M349/K648/349648474.PDF; and Resolution T-17709, available at https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M349/K351/349351554.PDF.

[19] *See* P.U. Code §§ 281(d)(3), which limits the Commission from collecting more than "sixty-six million dollars ($66,000,000) per year, unless the commission determines that collecting a higher amount in any year will not result in an increase in the total amount of all surcharges collected from telephone customers that year."

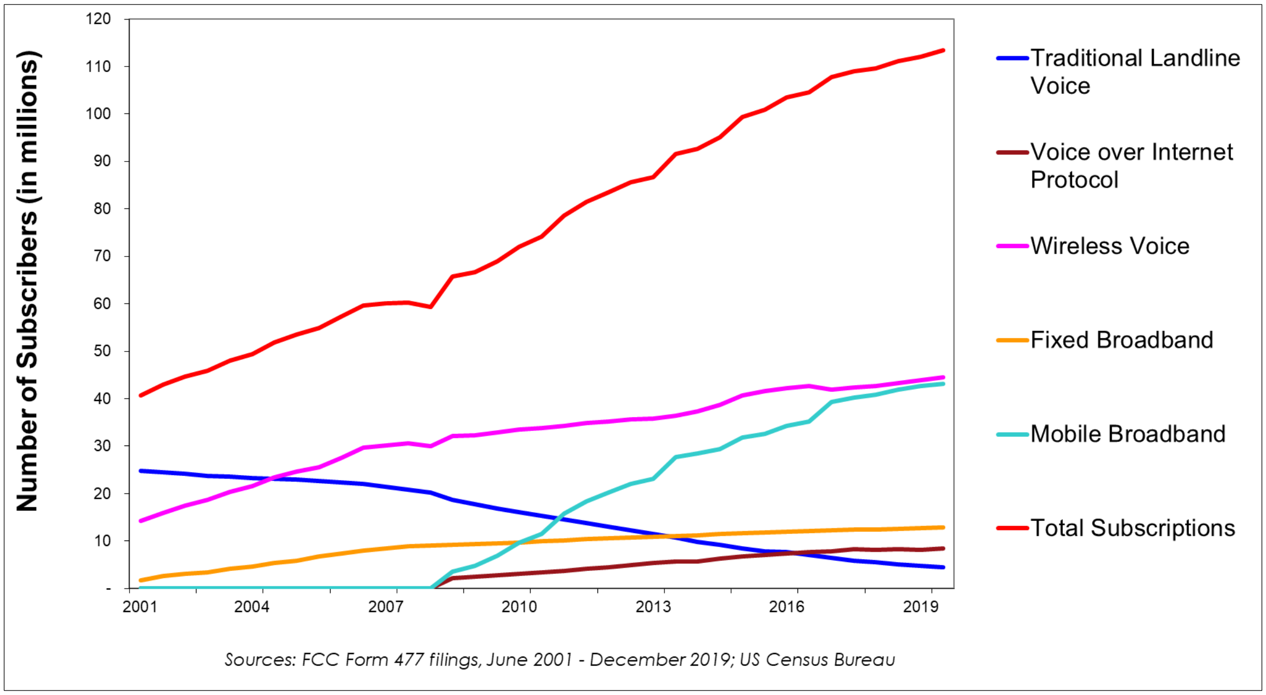
will be depleted in the coming year.[20] Unlike the CHCF-A and CASF, the DDTP surcharge rate can not be increased from the current 0.05% due to limitations set forth in P.U. Code 2881.

1.4. Market and Regulatory Shifts May Have Contributed to the Decline in the Amount of Intrastate Revenue Being Reported

Despite the substantial decline in carrier-reported intrastate revenues, there are more communications service subscriptions in the state than ever before, as illustrated in Chart 2 below. As such, it is clear the decline in intrastate revenues has not been caused by a decline in overall subscribers. Two key factors may explain this decline. First, the market continues to shift from wireline services to wireless services, and from traditional landline voice services to Voice over Internet Protocol (VoIP) services. Second, information services are reported by carriers as a larger proportion of wireless service bills, thereby reducing the overall revenue subject to intrastate or interstate surcharge.

[20] *See* Page 21 of the DDTP annual report, here: https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/Utilities_and_Industries/Communications_-_Telecommunications_and_Broadband/2019-2020%20DDTP%20Annual%20Report.pdf

Chart 2: Subscribership Trend of All Communications Services in California by Technology – June 2001 to December 2019



Wireless providers are subject to the surcharge requirement. However, the amount and proportion of wireless revenue subject to surcharge has declined precipitously for the following reasons:

- The FCC classified text messaging and data services as "information services,"[21] and thus text messaging and data services are not subject to CPUC surcharges. This contributed to an immediate and sizable decline in reported wireless intrastate revenue.
- Competition among wireless providers and market changes have caused a decline in the average cost of retail monthly voice service plans for end users, resulting in decreased reported intrastate revenue.[22]

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[21] In the Matter of Petitions for Declaratory Ruling on Regulatory Status of Wireless Messaging Service; WT Docket No. 08-7; 33 FCC Rcd 12075 (December 13, 2018) (FCC Declaratory Ruling 18-178). Effective December 12, 2018.
[22] The New Sticker Shock: Plunging Cellphone Bills - WSJ – Wall Street Journal, June 23, 2017

- The FCC classified voicemail services as information services, eliminating those services as a source of intrastate revenue for surcharge purposes, affecting both wireless and wireline revenues.[23]

In addition to the impacts of the transition to wireless-only households, subscriptions to traditional landline voice services have declined precipitously, as consumers move to Voice over Internet Protocol (VoIP) services.

- A statewide decline in traditional wireline voice subscriptions resulting in decreased intrastate revenue reporting. In 2010, there were 16.831 million traditional landline voice connections and 2.727 million Voice over Internet Protocol (VoIP) connections. By the end of 2019, the count dropped to 4.477 million traditional landline voice connections and 8.467 million VoIP connections.[24]
- This combination of factors also places a program funding burden on traditional landline end users, as most of their monthly bills are reported as "intrastate" and therefore subject to surcharges.

1.5. Surcharge Mechanisms of Other States

The National Regulatory Research Institute (NRRI) publication, *State Universal Service Funds 2018: Updating the Numbers*, provides an overview of other state universal service surcharge collection mechanisms. The publication surveys the ways in which carriers and end users contribute to their states' funds, including exploring new contribution methodologies adopted by various states to ensure their funds remain viable. This information is instructive, informing the Commission on how to examine its surcharge mechanisms.

The NRRI report identifies that 42 states and the District of Columbia provide some form of state universal service support beyond what is provided by the federal Universal Service Fund. Out of these states, 20 states charge some

[23] In the Matter of Petitions for Declaratory Ruling on Regulatory Status of Wireless Messaging Service; WT Docket No. 08-7; 33 FCC Rcd 12075 (December 13, 2018) (FCC Declaratory Ruling 18-178). Effective December 12, 2018.

[24] Federal Communications Commission Form 477 Data.

form of a per line or per connection charge. These states are listed in the NRRI table, reproduced below:

Table 1: Revenues Assessed by State[25]

Revenues Assessed	# States	States
Gross intrastate retail revenues	15	Alaska, Arizona, Arkansas, Colorado, Connecticut, DC, Georgia, Indiana, Oklahoma, Oregon, Texas, Utah, Vermont, Wisconsin, Wyoming
Net intrastate retail revenues	12	California, Illinois, Kansas, Louisiana, Maine, Michigan, Missouri, Nevada, New Mexico, New York, Pennsylvania, South Carolina
Charge per access line/ trunk	16*	Arizona,* Idaho, Illinois,* Iowa,* Kentucky,* Maryland, Minnesota, Mississippi, New Hampshire, North Carolina, North Dakota,* Ohio, Oregon, Rhode Island, South Dakota, West Virginia
Connections	4	Maine, Montana, Nebraska, New Mexico
Direct state funding	1	Washington

*Note: Telecommunications relay service (TRS) and Lifeline assessments are per line.

The NRRI also identifies that 22 states have a single, aggregated charge for all of their universal service programs. These states are listed in the NRRI table, reproduced below:

[25] Source: State Universal Service Funds 2018: Updating the Numbers, April 2019. Table 3, Page 28.

Table 2: Contribution Formulas[26]

Contribution Formula	# States	States
Single rate for all funds	18	Alaska, Arkansas, Connecticut, Indiana, Kansas, Louisiana, Maryland, Michigan, New Hampshire, North Dakota, Ohio, Pennsylvania, South Dakota, Texas, Vermont, West Virginia, Wyoming
Fund-specific rate	16	California, Colorado, DC, Georgia, Idaho, Illinois, Kentucky, Minnesota, Mississippi, Missouri, Nevada, Oklahoma, Oregon, Rhode Island, South Carolina, Wyoming
Rate by provider type	2	Arizona, Iowa
Rate per connection	4	Maine, Nebraska, New Mexico, Utah
Other	1	Washington

The NRRI study presents additional data points that may be relevant to the Commission in its review of the surcharge mechanisms:

- Oklahoma does not require fund contributors to pass the contribution on to end users, but allows them to do so.[27]
- Kansas assesses satellite service providers, largely as a result of the satellite company participation in the Connect America Fund (CAF) II auctions.[28]

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[26] Source: State Universal Service Funds 2018: Updating the Numbers, April 2019. Table 4, Page 29.

[27] Source: State Universal Service Funds 2018: Updating the Numbers, April 2019. Table 4, Page 29.

[28] Source: State Universal Service Funds 2018: Updating the Numbers, April 2019. Table 4, Page 22.

- Maine,[29] Nebraska,[30] New Mexico,[31] and Utah[32] recently implemented per connection charges as a means of stabilizing their state funds.[33]

The NRRI report attributes the declining surchargeable revenues that states, and the FCC, are experiencing to the market transition away from traditional landlines to new services that contribute less to public purpose funds. Such services include voice over internet protocol (VoIP) services; video, voice and broadband bundles; and wireless services. As such, the "funding available for state universal programs (historically based on a percentage of intrastate revenues) has changed as well, leading to a number of states refocusing their contribution methodologies from revenue to connections in an attempt to stabilize the funds without overburdening consumers."[34]

Exemplifying this transition is the Public Service Commission of Nebraska (Nebraska PSC). In 2018, the Nebraska PSC adopted a hybrid surcharge mechanism in which large customers were assessed based on intrastate revenue, but residential customers were assessed on a flat per-connection basis. However, in 2021, the Nebraska PSC – noting that residential connections and remittances have been steady – additionally adopted a flat fee for all business

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[29] *See* Maine Universal Service Fund, https://www.maine.gov/mpuc/telecom/musf/index.shtml.

[30] *See* Case NUSF-119/ PI-233, available at https://www.nebraska.gov/psc/orders/telecom/2021-05-11%20NUSF-119%20PI-233%20Order.pdf

[31] *See* New Mexico Case No. 17-00202-UT, available at https://www.gvnwusf.com/Portals/4/Documents/Orders/17-00202-UT%20Final%20Order%20Adopting%20Recommended%20Decision.pdf?ver=2018-08-24-144155-120

[32] *See* Utah Universal Public Telecommunications Service Support Fund https://le.utah.gov/interim/2019/pdf/00004904.pdf.

[33] Source: State Universal Service Funds 2018: Updating the Numbers, April 2019. Table 4, Page 31.

[34] Source: State Universal Service Funds 2018: Updating the Numbers, April 2019. Page 1.

and government customers. The Nebraska PSC declined to adopt a cap on the number of assessable lines.[35]

Additionally, according to the National Emergency Number Association (NENA), 45 states impose flat 9-1-1 surcharges on a per-line basis.[36] The California Governor's Office of Emergency Services (CalOES), which manages California's 9-1-1 system and surcharge mechanism, transitioned the 9-1-1 charge to a per-connection basis pursuant to legislation adopted in 2019.[37]

Finally, the state members of the Federal-State Joint Board on Universal Service have issued a recommendation to the Federal Communications Commission to revise the existing contribution mechanism for federal universal service programs.[38] This recommendation advocates for the inclusion of broadband services in the surcharge base, the adoption of a connections-based assessment on residential services, and a revenue-based surcharge for business services.

1.6. Federal Universal Service Fund Surcharge Mechanism

Service Providers are also required to pay a percentage of their interstate and international telecommunications end-user revenues to the FCC's Universal Service Fund (USF). This percentage is referred to as the "contribution factor." The FCC sets the contribution factor ahead of each quarter of the year, increasing or decreasing the percentage depending on the projected needs of

[35] *See*, https://www.nebraska.gov/psc/orders/telecom/2021-05-11%20NUSF-119%20PI-233%20Order.pdf

[36] NENA, the 9-1-1 Association, 9-1-1 Surcharge - User Fees by State (as of September 2020), https://www.nena.org/page/911RateByState.

[37] *See* SB 96 (Chapter 54, Statutes of 2019)

[38] https://ecfsapi.fcc.gov/file/1015153264262/2019%20State%20Members%20Recommendation.pdf

the FCC's universal service programs.[39] Wireline, wireless, and interconnected VoIP carriers support the USF.

The federal USF is a single charge that supports each of the four federal programs: Lifeline, High-Cost, Schools and Libraries, and Rural Health Care.

The USF contribution factor has more than doubled in the past 10 years. The contribution factor for the second quarter of 2021 is 33.4 percent.[40] The contribution factor for the first quarter of 2011 was 15.5 percent.[41] It is evident that the impacts the federal USF is experiencing mirror the impacts that the State's surcharge programs are experiencing. The FCC's reclassification of voicemail, texting, and Internet/data services from telecommunications services (Title II) to information services (Title I)[42] removed these services from inclusion in interstate and intrastate revenue calculations. This limits the number of services and amount of revenues contributing to federal and state universal service programs.

In 2002, the FCC opened a rulemaking to potentially revise the contribution methodology to address surcharge sustainability issues raised at the time.[43] The FCC noted:

> *[A] connection-based assessment may address the difficulty of applying regulatory distinctions inherent in the existing system to new services and technologies. By harmonizing the contribution system with the telecommunications marketplace, a connection-based assessment approach may help to ensure the stability and sufficiency of the universal*

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[39] https://www.fcc.gov/general/contribution-factor-quarterly-filings-universal-service-fund-usf-management-support

[40] https://www.fcc.gov/general/contribution-factor-quarterly-filings-universal-service-fund-usf-management-support

[41] https://docs.fcc.gov/public/attachments/DA-10-2344A1.pdf

[42] Pursuant to the Communications Act of 1934.

[43] *In the Matter of Federal-State Joint Board on Universal Service 1998 Biennial Regulatory Review - Streamlined Contributor Reporting Requirements Associated With Administration Of Telecommunications Relay Service, North American Numbering Plan*. (Dkt No. 95-116, 96-45, 98-170, 98-171, 92-237, 90-571). Action by: The Commission. Adopted: 02/14/2002 by FNPRM. (FCC No. 02-43), available at FCC-02-43A1.pdf

> *service contribution base over time. Such an approach also may provide contributors with greater certainty, reduce administrative costs, and avoid marketplace distortions, ultimately benefiting consumers.*

With this, it becomes clear that the complications and concerns with a revenue-based surcharge mechanism raised in this proceeding are longstanding issues.

1.7. Wide-ranging Surcharge Impacts on Customers

In Table 3, the Commission analyzed an assortment of consumer bills to evaluate the impact of the current intrastate surcharge mechanism on end users.

To determine the percentage of a bill that a service provider allocated to intrastate revenue, the "State surcharge paid" (Column F) is divided by the "State surcharge rate" (Column E) in effect at the time the bill was issued.[44] The resulting amount of the bill allocated to intrastate revenue (Provider Estimated Intrastate Revenue, Column G) is then divided by the "Total Bill" (Column D), with the resulting "Percent of the Bill that is Intrastate" shown in Column H.

This review showed significant variation between wireline and wireless providers in the percentage of intrastate revenue providers allocate. The percentage varies significantly depending on the provider as well as the service being offered, ranging from as high as 75% of the end user bill for traditional wireline telephone service, to 3% for facilities-based wireless services, and 0% for broadband internet access service.

[44] https://www.cpuc.ca.gov/general.aspx?id=1124

Table 3: Sample of State Surcharge Impacts on End Users[45]

Plan Information				State Surcharge			
Column A	Column B	Column C	Column D	Column E	Column F	Column G	Column H
Company	Service Type	Billing Period	Total Bill	State Surcharge Rate*	State Surcharge Paid	Provider Estimated Intrastate Revenue**	Percent of Bill that is Intrastate
AT&T	Plain Old Telephone Service (POTS)	Dec-2018	$55.51	6.94%	$2.89	$41.64	75%
AT&T	Facilities-based Wireless Service	Feb-2015	$176.45	4.64%	$0.52	$11.20	6%
AT&T	Facilities-based Wireless Service	Dec-2020	$117.64	7.749%	$0.29	$3.74	3%
Comcast	Broadband	Dec-2020	$60.00	7.749%	$0.28	$3.61	5%
Frontier	Broadband and Voice Bundle	Apr-2021	$76.88	7.749%	$0.91	$2.97	4%
Google Fi	Resold Wireless Service	Dec-2020	$46.35	7.749%	$0.91	$11.74	25%
Sonic	Broadband and Voice Bundle	Dec-2020	$74.15	7.749%	$0.62	$8.00	11%
Verizon	Facilities-based Wireless Service	Dec-2020	$81.11	7.749%	$0.21	$2.71	3%

* Surcharge rate in effect during month bill was issued.
** Providers determine the portion of their bills that is intrastate. For these bills, the amount of the bill that providers determined to be intrastate is identified by dividing the State Surcharge Revenue Paid by the Surcharge Rate in effect at the time the bill was issued.

This consumer bill review illustrates the disparity in surcharges paid by traditional wireline telephone users compared to the amount that wireless consumers pay. Wireless telephone users paid more in surcharges prior to the FCC's Declaratory Ruling 18-178.[46] The FCC ruling and the Commission's resulting action in D.19-01-029 further underscore the $2.657 billion, 26% decrease in intrastate revenue between 2018 and 2019. The reduction in wireless intrastate revenue is shown in Table 3, through the comparison of the AT&T wireless bill from 2015 compared to the AT&T wireless bill from 2020.

[45] Underlying data for Table 3 will be made available on the Commission's website.

[46] Pursuant to the FCC Declaratory Ruling, the Commission issued D.19-01-029, declining to further exercise authority under state law to assess surcharges and user fees on data and text messaging services.

The surcharges that VoIP end users pay is significantly lower, with some paying as little as $0.23 per month. The variation in surcharge revenues paid by different providers and different types of the same service could be the result of the flexible methods providers are given to determine what percentage of their overall revenues is "intrastate" versus "interstate," or otherwise not subject to surcharge at all.

The Commission additionally analyzed these bills to understand the impact on the interstate surcharge mechanism, as illustrated in Table 4. Providers determine the portion of their bills that is interstate. As done in Table 3, the amount of the bill determined to be interstate is identified by dividing the "USF surcharge paid" (Column F) by the "USF contribution factor" (Column E) in effect at the time the bill was issued.[47] The amount of the bill allocated to interstate revenue (Provider Estimated Interstate Revenue, Column G) is then divided by the "Total Bill" (Column D), with the resulting "Percent of the Bill that is Interstate" shown in Column H.

As in Table 3, Table 4 clearly indicates a variation in the percentage of interstate revenue that providers allocate, but interstate revenues make up a relatively small percentage of bills. Hence, the FCC has increased the USF contribution factor substantially to continue collecting sufficient funds for the USF.

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[47] https://www.fcc.gov/general/contribution-factor-quarterly-filings-universal-service-fund-usf-management-support

Table 4: Sample of Federal Surcharge Impacts on End Users[48]

Plan Information				USF			
Column A	Column B	Column C	Column D	Column E	Column F	Column G	Column H
Company	Service Type	Billing Period	Total Bill	USF Contribution Factor*	USF Surcharge Paid	Provider Estimated Interstate Revenue**	Percent of Bill that is Interstate
AT&T	POTS	Dec-2018	$55.51	20.10%	$0.92	$4.58	8%
AT&T	Facilities-based Wireless Service	Dec-2020	$117.64	27.10%	$0.57	$2.10	2%
Comcast	Broadband	Dec-2020	$60.00	27.10%	$0.00	$0.00	0%
Frontier	Broadband and Voice Bundle	Apr-2021	$76.88	33.40%	$1.95	$5.84	8%
Google Fi	Resold Wireless Service	Dec-2020	$46.35	27.10%	$1.95	$7.20	16%
Sonic	Broadband and Voice Bundle	Dec-2020	$74.15	27.10%	$2.53	$9.34	13%
Verizon	Facilities-based Wireless Service	Dec-2020	$81.11	27.10%	$0.61	$2.25	3%

* Contribution rate in effect during month bill was issued.
** Providers determine the portion of their bills that is interstate. For these bills, the amount of the bill that providers determined to be interstate is identified by dividing the USF Surcharge Paid by the Contribution Rate in effect at the time the bill was issued.

1.8. Potential Solutions for Commission Consideration

The Commission has various options it could consider to improve the integrity of the surcharge mechanism, as detailed here:

1. The Commission could investigate the discrepancies – illustrated in Table 3 – in contributions remitted by various companies and provider types. The Commission could develop additional reporting requirements and rule changes to stabilize the intrastate billing base. Given the systemic issues

[48] Underlying data for Table 4 will be made available on the Commission's website.

already discussed, it is unclear if this would address the underlying issues, however, in the long-term.

2. The Commission could request the FCC reclassify services as telecommunications services subject to both intrastate and interstate revenues. As the decline in intrastate revenue was accelerated due to the reclassification of voicemail, texting, and data services, this would likely significantly reverse the trends experienced in recent years. However, future FCC administrations could reclassify these services yet again, leaving the surcharge mechanism in the same unstable condition.
3. The Commission could expand the services that contribute to the billing base. For example, many parties suggest the inclusion of broadband internet access service. Additionally, as noted above, other states surcharge satellite services. This option could be considered in combination with other strategies. Should the Commission consider a flat fee, it would have to identify how to surcharge bundled services (i.e., mobile and wireline voice and broadband bundles).
4. The Commission could transition the current revenue-based surcharge mechanisms to a single flat-rate end-user surcharge mechanism. This proposed solution would consolidate the PPP surcharges and the user fee into a single per-access line (or equivalent) surcharge.[49] This may also simplify the surcharge assessment, collection, and remittance process. As previously discussed, other states have transitioned to a flat rate to stabilize their surcharge mechanisms.

[49] "Access line" could be defined as "a circuit-switched connection, or the functional equivalent of a circuit-switched connection, from an end-user to the public switched network." This would be consistent with the definition adopted in Utah. See Administrative Code 54-8b-2 Definitions. Available here: https://le.utah.gov/xcode/Title54/Chapter8B/54-8b-S2.html?v=C54-8b-S2_2017050920170701

5. The Commission could also consider a hybrid mechanism whereby large business customers are still assessed on an intrastate-revenue basis, while small business and residential customers are assessed on a flat-rate basis. As previously discussed, the Nebraska PSC initially enacted this form of surcharge mechanism, and the Federal-State Joint Board on Universal Service recommended the FCC adopt this surcharge mechanism. Commission staff does not have sufficient information at this time to assess the impact of this approach.

2. Phase 2.

2.1. Confusing Terminology and Lack of Transparency on Customer Bills

There are numerous charges on communications bills, and the bills do not always clearly identify to the customer the purpose of these charges. Numerous efforts past and present have attempted to improve the transparency and fairness of the charges added to consumer bills.

For instance, the FCC's "Truth-In-Billing Policy"[50] helps consumers detect and prevent unauthorized charges. These rules specifically require telephone service bills to provide clear, non-misleading, plain language description of the service or services rendered to accompany each charge. These unauthorized charges are often referred to as "cramming," the fraudulent practice of adding unauthorized charges to a customer's phone bill. The applicability of these protections has increasingly diminished as fewer consumers rely on traditional telephone services, migrating to wireless and Internet services.[51]

Washington State Attorney General Bob Ferguson has taken steps to enforce transparency in how fees are charged by communications companies through his "Honest Fees Initiative." Frontier Communications Northwest will pay $900,000 to the State of Washington for inadequately disclosing fees when advertising

[50] *See*, https://www.fcc.gov/general/truth-billing-policy

[51] *See* CFR Title 47 § 64.2400 for the applicability of the Truth in Billing requirements.

and selling its products, and misleading customers about internet speeds it could provide.[52] CenturyLink will pay $6.1 million to the State of Washington for deceiving consumers by telling them they would pay one price, and then charging them more. CenturyLink did not disclose three main fees: a broadcast fee of $2.49 per month, a sports fee of $2.49 per month, and CenturyLink's "Internet Cost Recovery Fee, ranging from $0.99 to $1.99 per month.[53] CenturyLink is required to stop charging its Internet Cost Recovery Fee in Washington state. And Charter will pay $255,000 to thousands of Washingtonians for failing to disclose its "Broadcast TV Surcharge" to customers who ordered the company's services online.[54]

In December 2019, Congress enacted the Television Viewer Protection Act of 2019.[55] This Act requires providers of Internet, voice, mobile, data, and television services to engage in transparent sales and billing, and not charge a consumer for using their own equipment.

The fundamental prohibition against cramming is found in P.U. Code § 2890. This statute states that "[a] telephone bill may only contain charges for products or services, the purchase of which the subscriber has authorized."[56]

In 2006, this Commission adopted Decision 06-03-013, which adopted the "Consumer Bill of Rights Governing Telecommunications Services."[57]

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[52] https://www.atg.wa.gov/news/news-releases/ag-ferguson-frontier-northwest-will-pay-900000-over-hidden-fees-misrepresentation#:~:text=OLYMPIA%20%E2%80%94%20In%20the%20latest%20action,to%20the%20State%20of%20Washington

[53] https://www.atg.wa.gov/news/news-releases/ag-ferguson-centurylink-will-pay-61-million-over-hidden-fees-affecting-650000

[54] https://www.atg.wa.gov/news/news-releases/ag-ferguson-charter-pay-255000-thousands-washingtonians-over-hidden-fee

[55] https://www.congress.gov/bill/116th-congress/house-bill/1865/text

[56] Cal. Pub. Util. Code § 2890(a).

[57] https://docs.cpuc.ca.gov/PublishedDocs/WORD_PDF/FINAL_DECISION/54293.PDF

2.2. Service Provider Fees

Traditional charges consumers pay can be categorized as follows:

- Service Fee: The advertised price of the service being provided, exclusive of additional charges, as itemized below.
- Traditional Fees: A fee charged for a specific service provided, such as an optional monthly service add-on (e.g., HBO, call blocking services, etc.).
- Transactional Fees: Charged for a specific action (e.g., late fees, service connection fees, etc.).
- Taxes: State and local jurisdictions impose taxes such as sales taxes and local utility taxes.
- Public Purpose Surcharges: Surcharges support essential public programs, such as: 911 emergency services, programs for low-income individuals and the disabled, and for connecting hard-to-serve communities.
- Regulatory Fees: The User Fee funds the staff and general operations of the Commission.

The Commission analyzed several bills to understand the total impact of the various federal, state, local and provider charges on end users, as illustrated in Table 5. It is apparent that there is significant variation in the charges that are levied on different types of services, ranging from as high as 26% of the end user bill, to as little as nothing – not a single fee or tax.

Note that Table 5 differentiates from Tables 3 and 4 by adding column E "Plan Cost" (E), with columns F "Federal Charges" and G "State Charges) showing amounts that are slightly different from the corresponding "USF Surcharge Paid (Table 2, column F) and "State Surcharges Paid" (Table 4, column F). This explains the differential in total charges compared to surcharges, which accounts for various additional but authorized charges.[58] This also conveys the impact that both state and federal charges—all inclusive—have on all ratepayers, but especially those who are still wireline consumers. For some of the Table 5 examples, the sum of plan cost plus federal, state local and service provider charges may not equal the total bill cost due to inclusion of charges such as equipment charges and various consumer add-ons.

Table 5: Sample Impact of All Charges on End User Bills[59]

Bill Information			Totals						
Column A	Column B	Column C	Column D	Column E	Column F	Column G	Column H	Column I	Column J
Company	Service Type	Billing Period	Total Bill	Plan Cost	Federal Charges	State Charges	Local Charges	Service Provider Charges	Charges as a Percent of Total Bill
AT&T	Traditional Landline Telephone	Dec-2018	$55.51	$37.00	$2.38	$3.34	$3.48	$5.10	26%
AT&T	Facilities-based Wireless	Dec-2020	$117.64	$112.50	$0.57	$0.61	$0.47	$3.49	4%
AT&T	Facilities-based Wireless	Apr-2015	$176.45	$145.00	$0.88	$0.62	$1.59	$1.27	2%
Comcast	Broadband	Dec-2020	$60.00	$60.00	$0.00	$0.00	$0.00	$0.00	0%
Comcast	Video and Broadband Bundle	Feb-2021	$245.89	$179.98	$0.61	$0.30	$3.15	$38.04	17%
Frontier	Broadband and Voice Bundle	Apr-2021	$76.88	$59.99	$2.20	$1.18	$1.49	$12.98	23%
Google Fi	Resold Wireless	Dec-2020	$46.35	$36.58	$1.95	$1.16	$1.39	$0.27	10%
Sonic	Broadband and Voice Bundle	Dec-2020	$74.15	$56.49	$2.53	$0.96	$3.64	$0.95	11%
Verizon	Facilities-based Wireless	Dec-2020	$81.11	$62.50	$0.61	$0.52	$4.32	$2.16	9%

Communications providers are increasingly adding "hidden fees" to consumer bills, as identified by a Consumer Reports examination of hidden fees in cable bills.[60] The report found that company-imposed fees add what amounts to a 24% surcharge on top of the advertised price, generating close to $450 per year per customer from company-imposed fees. Consumer Reports

[59] Underlying data for Table 5 will be made available on the Commission's website.

[60] https://advocacy.consumerreports.org/wp-content/uploads/2019/10/CR-Cable-Bill-Report-2019.pdf

estimates cable companies could be collecting an estimated $28 billion a year from charging company-imposed fees.

A Consumer Reports survey found that overall, 85% of Americans say they have encountered an unexpected or hidden fee in the past two years for a service they had used and that nearly two-thirds say they are paying more now in surprise charges than they did five years ago. The survey found telecommunications providers are the worst offenders when it comes to charging unexpected or hidden fees.

A Wall Street Journal review of consumer internet bills from across the country – and detailed in the article *Do You Pay Too Much for Internet Service?* – found that that "bills in low-income areas had a median of $10 in added internet-related fees. Bills in high-income areas tended not to have such fees. Of our bills from low-income areas, 4% were from rural areas and the rest were from more populated and urban areas."[61]

A study by GlobalData found that the actual costs of cable TV or broadband can often be upwards of 45 percent higher than the advertised price: "*In some cases, the final cost is as much as 45% over the advertised rate. For example, Xfinity's $40 'Starter Internet plus Basic' TV bundle jumps to $58 per month once the additional $18 in equipment costs are added. Prices can also vary based on location.*"[62]

Wireless companies charge similar fees. For example, most wireless consumers pay a "wireless administration fee" which AT&T describes as follows:

> *The Wireless Administration Fee helps cover a portion of costs to AT&T related to wireless service. It isn't a tax or charge required by federal, state, or local governments. This is a monthly charge for each line on your wireless account. It isn't included in your monthly plan, so you'll*

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[61] https://www.wsj.com/articles/do-you-pay-too-much-for-internet-service-see-how-your-bill-compares-11577199600

[62] https://www.globaldata.com/us-cable-and-fixed-telecom-bundle-rates-up-to-45-higher-than-advertised/

see a separate line item on your bill. The fee is currently $1.99 per line each month, but may change from time-to-time. [63]

AT&T reportedly introduced this fee to customers in 2013 at the rate of $0.61 per month and has raised it three times to the current $1.99.[64] T-Mobile and Verizon charge similar fees.[65] These fees generate substantial revenue. A cursory estimate of the impact of these fees to consumers in California indicates that if each of the state's 43 million wireless customers in the state is charged a $2.00 fee every month, this generates more than $1 billion per year in the state of California alone.[66]

Other common examples of charges providers include in addition to the cost of service are as follows:

- Cable video, Internet and phone service providers charge a "regulatory cost recovery" fee which purports to "recover the cost of certain federal, state, and/or local impositions related to voice and video service."[67] Charged monthly and varying by jurisdiction, it generally ranges from $1.00-$2.00.
- Some Internet Service Providers charge a "Internet Infrastructure Surcharge", which purports to help "cover some of the costs of maintenance of the local network."[68] Charged monthly, it generally ranges from $1.99-$3.99.
- Cable video, internet and phone companies charge rental fees for their equipment. Often times, consumers may purchase their own equipment

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[63] https://www.att.com/legal/terms.otherWirelessFeeSchedule.html

[64] https://arstechnica.com/tech-policy/2019/06/att-sued-over-hidden-fee-that-raises-mobile-prices-above-advertised-rate/

[65] Verizon: https://www.verizon.com/support/surcharges/?adobe_mc=MCMID%3D022801708694139504138320413643247088847%7CMCORGID%3D843F02BE53271A1A0A490D4C%2540AdobeOrg%7CTS%3D1609708638&mboxSession=d725544fd9ce40cdbe82f810b04fa006

T-Mobile: https://www.t-mobile.com/support/account/whats-impacting-your-bill

[66] December 2018 estimate of mobile telephony subscribers from FCC 477 data: https://www.fcc.gov/voice-telephone-services-report

[67] See for example, https://www.xfinity.com/support/articles/most-common-taxes-fees-surcharges-on-your-bill.

[68] https://frontier.com/helpcenter/categories/billing/read-and-pay-my-bill/understand-my-bill-residential/bill-sections/taxes-and-surcharges

to avoid this ongoing cost. However, some providers mandate the leasing of their equipment, despite alternatives being available.[69] Charged monthly, it generally ranges from $4.00-$15.00.

- Cable video providers charge a "Broadcast TV Surcharge" in addition to the cost of the broadcast television service they are providing. This charge is described as a "monthly fee to provide access to local channel programming. This fee is not a tax or surcharge of any kind which the government requires AT&T to collect from its customers." Charged monthly, it generally ranges from $8.99 - $16.45.

3. Conclusion

With this review of the Commission's universal service surcharge mechanisms, as well as the universal service surcharge mechanisms of other states and the FCC, the Commission is well-positioned to consider alterations or alternative funding mechanisms to address concerns with the declining intrastate billing base. Additionally, the fees that providers add onto consumer bills have increased significantly in recent years. Information obtained from for this report demonstrates an alarming issue: as providers have contributed less to programs that assist the public, they have increased fees that benefit their companies.

(END OF ATTACHMENT B)

[69] See for example AT&T Internet: https://www.att.com/legal/terms.ATTInternetConsumerFeeSchedule.html