Report on the Michigan Intrastate Switched Toll Access Restructuring Mechanism

In Compliance with Public Act 179 of 1991 as Amended

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MICHIGAN PUBLIC SERVICE COMMISSION
DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS

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LICENSING AND REGULATORY AFFAIRS
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Introduction

Section 310 of the Michigan Telecommunications Act (MTA), MCL 484.2310, directs the Michigan Public Service Commission (Commission) to submit an annual report describing the operation and administration of the Michigan Intrastate Switched Toll Access Restructuring Mechanism (ARM). The MTA requires that the report include "the total amount of money collected from contributing providers, the total amount of money disbursed to each eligible provider, the costs of administration, and any other information considered relevant by the Commission."[1] Pursuant to the MTA, company-specific information pertaining to demand data, contributions, and revenue information is exempt from public disclosure. Therefore, the report focuses on the aggregate activity of the fund. The ARM became operational on September 13, 2010 and in accordance with the MTA will provide disbursements for a total of 12 years. The total initial size of the ARM, as shown below in Figure 1, was $17,539,756.57. This amount includes 12 months of disbursements equal to $15,784,390.68, $440,000 for approximated administrative costs, and $1,315,365.89 (equal to one month of disbursements) as a cash reserve.

Figure 1:
Initial Size of the ARM

One Year of Disbursements	$15,784,390.68
One Year Estimated Administrative Costs	$440,000.00
Cash Reserve = One Month of Disbursements	$1,315,365.89
Total ARM Size	**$17,539,756.57**

This is the fourth annual report issued on the operation of the ARM. The report details the process by which the implementation of the ARM occurred and data for the first four

[1] MCL 484.2310(10)

years of the activity of the ARM. This report also discusses intercarrier compensation reform at the federal level. The Commission has been and continues to be an active participant in the federal proceedings and will provide additional information to the Governor and Legislature as necessary.

History

Public Act 182 of 2009

Intrastate switched toll access charges (intrastate access charges) are part of the larger system of intercarrier compensation that providers charge to each other for originating and terminating calls on their networks. Intrastate access charges were historically under the sole jurisdiction of the states, while other components of intercarrier compensation fell under federal or joint federal-state jurisdiction. These charges were originally put into place long before newer technologies such as mobile wireless and broadband/voice over internet protocol (VoIP) existed, and in 2009 the Michigan Legislature sought to update and modernize them for today's telecommunications marketplace.

The legislative process consisted of workgroups of interested stakeholders and included telecommunications carriers and Commission Staff. Commission Staff served an educational and informational role throughout the workgroup process. On December 17, 2009, 2009 PA 182 (Act 182 of 2009) became law. Act 182 of 2009 amended Section 310 of the MTA. Prior to Act 182 of 2009, providers with over 250,000 access lines were required to set their intrastate switched toll access service rates at levels no higher than the corresponding interstate rates. Act 182 of 2009 expanded that requirement to include all providers in Michigan. Act 182 of 2009 set two separate transition paths toward this new requirement based upon whether a provider is considered eligible or non-eligible under the

Act and created the ARM as a transition mechanism for eligible providers to recover a portion of the lost revenues resulting from the reform.

Establishing the ARM

Pursuant to Act 182 of 2009 the Commission was charged with establishing "the procedures and timelines for organizing, funding, and administering the restructuring mechanism."[2] To meet that charge, the Commission issued an order on January 11, 2010, initiating the docket for Case No. U-16183 for the purpose of implementing Act 182 of 2009. In that order, the Commission sought the confidential and non-confidential data needed to calculate the size of the ARM and the appropriate contribution percentage for the ARM, and informed providers of the mandatory tariff filings to meet the requirements of the amended MTA.

In compliance with the timeline established in the amended MTA, the Commission issued an order in Case No. U-16183 on April 13, 2010 setting the total size of the restructuring mechanism and the amounts to be disbursed to each eligible provider. Detailed information about disbursement amounts is included in the *Operation of the ARM* section of this report. On May 17, 2010, the Commission issued another order in Case No. U-16183 setting the initial contribution percentage and seeking comment on an appropriate review schedule for the contribution percentage, whether to set a minimum contribution amount, and other issues related to the administration of the ARM.

On August 8, 2010, the Commission issued an order finalizing the administrative process and the methodology for contributions to and disbursements from the ARM. In accordance with the amended MTA, the Commission established September 13, 2010 as the operational date of the ARM. Initial contributions to the ARM, as well as initial revised tariff

[2] MCL 484.2310(10)

filings for eligible providers, were due on September 13, 2010. The Commission directed that the first ARM disbursements would be issued the last week of October 2010, with subsequent disbursements going out the last week of each month. The Commission also directed the Staff to continuously review the operation of the ARM in order to ensure sufficient funding and to notify the Commission should the contribution percentage need to be revised.

Federal Intercarrier Compensation Reform

Intercarrier compensation has historically been an implicit subsidy allowing providers in high cost areas to offer service at reasonable rates.[3] Carriers serving higher cost areas had traditionally been able to set their intercarrier compensation rates at levels substantially higher than providers serving lower cost areas. However, as noted earlier, significant technological changes in the industry necessitated changes to the policies governing intercarrier compensation. As described in previous reports, in late 2011 the Federal Communications Commission (FCC) adopted the *USF/ICC Transformation Order* comprehensively reforming the federal universal service fund and intercarrier compensation. The FCC adopted a uniform national bill-and-keep framework as the ultimate end state for all telecommunications traffic exchanged with a local exchange carrier. Under this framework all intercarrier compensation charges, including those charged for intrastate access, will be phased out.[4] As an initial step in this process, the FCC capped the rates for most intercarrier compensation charges and established a transition path reducing certain intercarrier compensation rates to zero.[5] The

[3] In addition to the implicit subsidy of higher intercarrier compensation rates, service to high cost areas has also been explicitly subsidized through the federal universal service fund.

[4] As a result, the implicit subsidy built into certain intercarrier compensation charges will also be phased out and providers will recover their costs from end-user rates and, where warranted, explicit universal service support.

[5] The FCC's transition path addresses terminating switched access (terminating switched toll traffic) and reciprocal compensation (local traffic), but not originating switched access (originating switched toll traffic) or special access (non-switched traffic). In the order, the FCC requested comments on how to address originating access and to-date has not issued any further orders on that topic. The FCC is also studying the current state of

FCC also adopted a recovery mechanism to provide limited recovery to providers for their reduced intercarrier compensation revenues. The FCC did not, however, preempt state intrastate access reform laws so long as such laws are not inconsistent with the FCC's reforms.

On January 12, 2012, the Commission opened a new docket, Case No. U-16943, to take comments from interested parties on whether/how Michigan's access reform or the operation of the ARM would need to be modified to be in compliance with the *USF/ICC Transformation Order*. After receiving comments and reply comments, the Commission issued an order on April 17, 2012 finding that no immediate modifications to the operation of the ARM were necessary and that there was no double recovery resulting from the FCC's recovery mechanisms. Because the FCC specifically stated that "[t]o the extent states have established rate reduction transitions for rate elements not reduced in this Order, nothing in the Order impacts such transitions…nor does this Order prevent states from reducing rates on a faster transition…"[6] the Commission found that the **originating** intrastate access reforms described in Act 182 of 2009 were not affected by the *USF/ICC Transformation Order*. The Commission also found that the transition for **terminating** intrastate access described in Act 182 of 2009 would only be superseded by the FCC's transition path for terminating rates as of July 1, 2012. Figure 2 shows the transition path[7] for intrastate switched access rates currently in effect for Michigan providers.[8]

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special access charges in a separate proceeding. The Commission continues to participate in and monitor all FCC proceedings related to intercarrier compensation reform.

[6] *USF/ICC Transformation Order*, footnote 1542.

[7] For details of the transition path from July 1, 2015 to July 1, 2020 see the USF/ICC Transformation Order, ¶801.

[8] The differentials listed in the chart are the differentials in the intra- and interstate rates in effect at the times specified in either PA 182 of 2009 or the *USF/ICC Transformation Order*.

Figure 2:
Michigan and FCC Switched Access Rate Transition

Date	Eligible Providers	Non-Eligible Providers	
		CLECs	ILECs
9/13/2010	**Originating and terminating** intrastate access rates must be no higher than corresponding interstate rates	*no action required*	*no action required*
1/1/2011	*no action required*	Reduce the differential between the July 1, 2009 **originating and terminating** intra- and interstate rates by 20%	*no action required*
1/1/2012	*no action required*	Reduce the differential between the July 1, 2009 **originating and terminating** intra- and interstate rates by 40%	*no action required*
7/3/2012	*no action required*	Reduce the differential between the Dec. 29, 2011 intra- and interstate **terminating** rates by 50%.	*no action required*
1/1/2013	*no action required*	Reduce the differential between the July 1, 2009 **originating** intra- and interstate rates by 60%	*no action required*
7/1/2013	*no action required*	**Terminating** intrastate access rates must be no higher than corresponding interstate rates	*no action required*
1/1/2014	*no action required*	Reduce differential between the July 1, 2009 **originating** intra- and interstate rates by 80%	*no action required*
7/1/2014	Reduce the differential between **terminating** end office rates and either $0.0007 (price cap carriers) or $0.005 (rate of return carriers) by one-third	Reduce the differential between **terminating** end office rates and either $0.0007 (price cap carriers) or $0.005 (rate of return carriers) by one-third	Reduce the differential between **terminating** end office rates and either $0.0007 (price cap carriers) or $0.005 (rate of return carriers) by one-third
1/1/2015	*no action required*	**Originating** intrastate access rates must be no higher than corresponding interstate rates	*no action required*
	All Providers		
7/1/2015, 7/1/2016, … 7/01/2020	Continue to follow the transition path described in the *USF/ICC Transformation Order*		

Intrastate Access Tariff Revisions

Act 182 of 2009 requires that providers' intrastate access tariffs reflect the required rate reductions. Staff reviews all tariff revisions to ensure compliance.[9] Intrastate switched toll access tariffs are made available to the public by the providers and most are also accessible online via links from the Commission's Online Tariff Index.[10] As explained previously, Michigan's access reform in Act 182 of 2009 largely aligned with the FCC's reform, but the differences between the two create some challenges. For example, Act 182 of 2009 addresses both originating and terminating switched access charges, whereas the *USF/ICC Transformation Order* only reforms terminating switched access charges. Many providers in Michigan, especially non-eligible providers, have not historically had separate originating and terminating access rates. However, now that the two are on separate transition paths, providers have to ensure that their tariffed rates meet both the MTA's requirements and the FCC requirements. In some instances providers addressed this by separating originating and terminating charges, while in other instances providers simply lowered their access rates to the lower of the originating or terminating rate requirement. An additional challenge is that Act 182 of 2009 split providers into two categories, eligible vs. non-eligible, while the FCC chose to split providers by a different set of categories, price cap vs. rate of return. The Michigan and FCC categories do not directly match up. That is, some non-eligible providers must follow the FCC's price cap transition track, while some non-eligible providers will follow the rate of return transition track. This adds complexity to the staff's review process for access tariff filings.

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[9] Section 202(b) of the MTA, which allows providers to opt out of filing certain tariffs with the Commission, specifically excludes access tariffs from opt out eligibility. All providers continue to be required to file intrastate access tariffs if they are providing that service.

[10] Commission Online Tariff Index

By September 13, 2010, all eligible providers filed revised tariffs reflecting the new intrastate access rates required by Act 182 of 2009. These providers have continued to maintain intrastate access tariffs that are in compliance with the law by revising their tariffs as necessary. Many eligible providers have moved to an exceptions-based intrastate switched access tariff. Such a tariff ensures that changes that occur in the interstate access tariff are immediately reflected in the intrastate tariff. Therefore, while some providers will continue to file revised tariffs at the dates required by the USF/ICC Transformation Order, those that use an exceptions-based tariff will largely avoid having to make additional intrastate access tariff revisions.

Non-eligible providers filed initial revised tariff pages effective January 1, 2011 reflecting, pursuant to the MTA, a reduction of at least 20 percent of the differential between the intra- and interstate rates in effect as of July 1, 2009. These providers filed the next revision effective January 1, 2012, reflecting at least a 40% reduction in the differential described in the MTA.[11] In compliance with the *USF/ICC Transformation Order*, non-eligible providers filed intrastate switched access tariff revisions reflecting the required 50% differential reduction for **terminating** rates effective no later than July 3, 2012. The third step in the MTA process required non-eligible providers to file revised **originating** access tariffs effective January 1, 2013 representing a 60% reduction in the differential as described in the law. Non-eligible providers also had to make a tariff filing effective July 2, 2013 showing **terminating** intrastate access rates no higher than corresponding interstate rates. The next intrastate tariff revision for non-eligible providers was filed with an effective date of January

[11] As noted in earlier reports, determining whether the 20 or 40% differential was met was not a simple calculation. Intrastate switched access rates are actually comprised of multiple rate elements. Providers do not necessarily use the same rate elements and/or offer the same services in both the intra- and interstate jurisdictions. Additionally, some providers charge only a composite rate while others charge based upon the various elements. Again, this may not be consistent across intra- and interstate jurisdictions even within a single company.

1, 2014 and reflected the required 80% reduction in the differential in **originating** access rates as described in the law.

Effective July 1, 2014, both eligible and non-eligible providers filed tariff revisions in compliance with *the USF/ICC Transformation Order*. Both groups of providers were required to reduce the differential between **terminating** end office rates and either $0.0007 (price cap carriers) or $0.005 (rate of return carriers) by one-third. The next scheduled tariff revision will be January 1, 2015. Commission staff will continue to monitor these revisions as they occur.

Operation of the ARM

Disbursements

Eligible providers are entitled to receive monthly disbursements from the ARM to recover a portion of lost intrastate access revenues that resulted from the rate reductions established in the amended MTA. All eligible providers have completed the necessary registration process with the State of Michigan enabling the State to issue the ARM disbursements.

To establish the initial size of the ARM, Act 182 of 2009 directed eligible providers to provide information to the Commission within 60 days from the effective date of the Act.[12] All eligible providers were required to submit 2008 intrastate access demand data and the corresponding current rate information. This information allowed Commission Staff to calculate the amount of the reduction in annual intrastate access revenues that would result from the required reduction in rates. The reduction was calculated for each provider as the difference between intrastate and interstate access service rates in effect as of July 1, 2009,

[12] MCL 484.2310(11)(a)

multiplied by the intrastate switched access minutes of use and other switched access demand quantities for 2008.

The first disbursements from the ARM were issued during the last week of October 2010, with succeeding disbursements being issued the last week of each month. Figure 3, following, shows the monthly disbursement amounts in effect for each eligible provider for the time period covered by this report, as well as the resulting total year disbursements for each provider. The disbursements remained the same through this fiscal year.

Each eligible provider has its own monthly disbursement that remains unchanged until the resizing of the ARM. The first ARM resizing was scheduled for 2014; however, due to changes in the MTA in 2014, the fund will not be resized until 2018. Public Act 52 of 2014 amended the MTA in several areas including Section 310 with a new resizing date of March 13, 2018. At such time, Commission will calculate new disbursement amounts and adjust monthly disbursements accordingly.

Figure 3: Eligible Provider Disbursements

Eligible Provider	Monthly Disbursement	Total Disbursements Oct. 2013-Sept. 2014
Ace Telephone Company (Ace)	$34,844.51	$418,134.08
Ace Telephone Company (Peninsula)	$4,806.30	$57,675.60
Allband Communications Cooperative	$505.11	$6,061.27
Allendale Telephone Company	$38,778.82	$465,345.88
Allendale Telephone Company (Drenthe)	$2,771.37	$33,256.40
Baraga Telephone Company	$15,738.06	$188,856.72
Barry County Telephone Company	$39,986.08	$479,832.98
Blanchard Telephone Company	$4,138.24	$49,658.85
Bloomingdale Telephone Company	$13,909.96	$166,919.56
Carr Telephone Company	$8,438.22	$101,258.64
CenturyTel Midwest-MI, Inc.	$188,672.43	$2,264,069.14
CenturyTel of Michigan	$406,633.15	$4,879,597.76
CenturyTel of Northern Michigan	$17,185.17	$206,222.02
CenturyTel of Upper Michigan	$93,081.04	$1,116,972.46
Chapin Telephone Company	$3,421.00	$41,052.03
Chatham Telephone Company (TDS Telecom)	$23,553.99	$282,647.89
Chippewa County Telephone Company	$6,535.00	$78,420.06
Climax Telephone Company	$2,018.47	$24,221.61
Communications Corporation of Michigan (TDS Telecom)	$18,765.76	$225,189.18
Deerfield Farmers' Telephone Company	$11,652.23	$139,826.74
Frontier Communications of Michigan	$109,614.02	$1,315,368.25
Hiawatha Telephone Company	$30,023.38	$360,280.57
Island Telephone Company (TDS Telecom)	$3,583.77	$43,005.19
Kaleva Telephone Company	$12,650.87	$151,810.41
Lennon Telephone Company	$10,100.58	$121,206.95
Michigan Central Broadband Company	$10,281.57	$123,378.86
Midway Telephone Company	$4,054.04	$48,648.54
Ogden Telephone Company	$2,434.73	$29,216.81
Ontonagon Telephone Company	$16,353.51	$196,242.17
Pigeon Telephone Company	$13,376.16	$160,513.87
Sand Creek Telephone Company	$5,852.92	$70,235.02
Shiawassee Telephone Company (TDS Telecom)	$30,127.72	$361,532.60
Springport Telephone Company	$14,417.84	$173,014.08
Upper Peninsula Telephone Company	$15,777.08	$189,324.92
Waldron Telephone Company	$2,130.26	$25,563.13
Westphalia Telephone Company	$23,516.25	$282,194.96
Winn Telephone Company	$3,012.65	$36,151.75
Wolverine Telephone Company (TDS Telecom)	$73,271.80	$879,261.61
Sum of Disbursements	**$1,316,014.04**	**$15,792,168.54**

Contributions

The ARM is sustained by a "mandatory monthly contribution by all providers of retail intrastate telecommunications services and all providers of commercial mobile service."[13] Providers are required to pay into the ARM based upon a percentage of their intrastate retail telecommunications services revenues. Each month, contributing providers are to multiply monthly retail intrastate telecommunications services revenues by the contribution factor to determine their monthly contribution into the ARM fund. The Commission has an online form available that providers are required to use and submit with each contribution.

In order to determine the initial percentage for the monthly contribution, Act 182 of 2009 required providers to report their 2008 retail intrastate revenues to the Commission within 60 days of the effective date of the Act. The Commission found that the total of all providers' 2008 retail intrastate telecommunications services revenues was $4,190,942,420.15."[14] To determine the initial contribution percentage, the total size of the ARM[15] was divided by the total 2008 retail intrastate revenues as reported. This calculation resulted in the initial contribution percentage of 0.431 percent.

Pursuant to the amended MTA, "[t]he commission may increase or decrease the contribution assessment on a quarterly or other basis as necessary to maintain sufficient funds for disbursements."[16] Given the constantly changing telecommunications market, regular review of the contribution percentage is necessary. The Commission has recalculated the contribution factor, and adjusted it five times in the past four years. These adjustments are necessary to ensure sufficient funds for disbursements and administrative costs.

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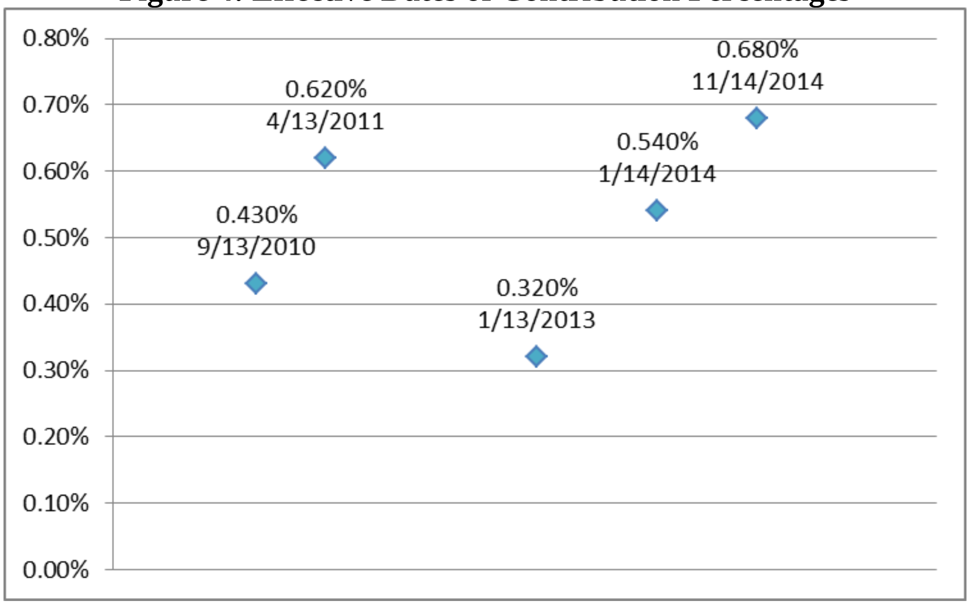
[13] MCL 484.2310(12)
[14] U-16183, Commission Order dated May 17, 2010, Page 2
[15] As noted earlier, the total size of the ARM is equal to 12 months of disbursements, plus approximate administrative costs and a cash reserve equal to one month of disbursements.
[16] MCL 484.2310(14)

Most recently, the Commission issued an Order in Case No. U-16183 on September 26, 2014 increasing the contribution percentage to 0.680 percent. This contribution percentage went into effect on November 14, 2014 and will be effective for December 2014 contributions. Figure 4 details the changes to the contribution percentage over the life of the fund. The Commission will continue to monitor the ARM and modify the contribution percentage as necessary.

Figure 4: Effective Dates of Contribution Percentages

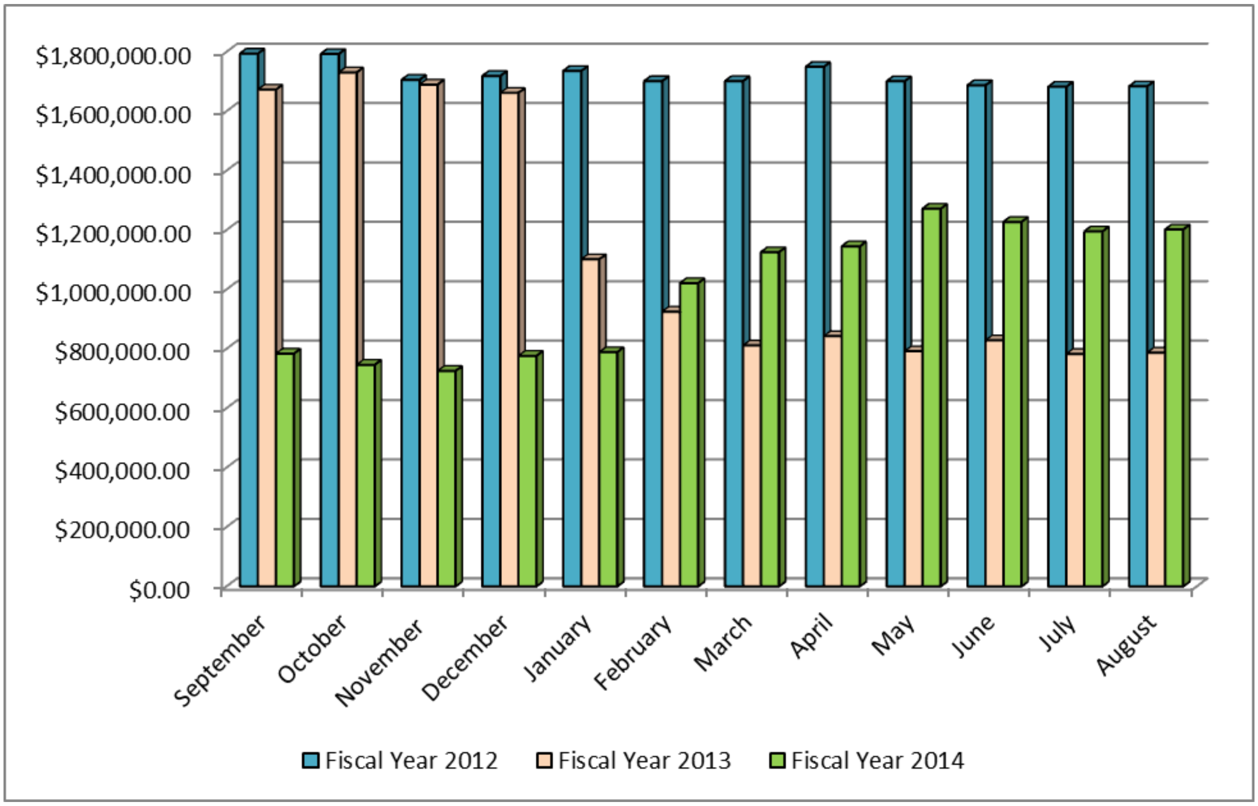


As discussed previously, providers contribute to the ARM based on retail intrastate telecommunications services revenues, exclusive of VoIP revenues. The range of contributing providers includes incumbent and competitive local exchange carriers (ILECs and CLECs), mobile wireless providers and other types of providers.[17] Contributions for the operation of fiscal year 2014 of operation totaled approximately $12 million.[18] The decrease

[17] Other types of providers include operator service providers, interexchange carriers, payphone providers, competitive access providers and toll resellers.
[18] Data represents contributions from September 1, 2013– August 31, 2014

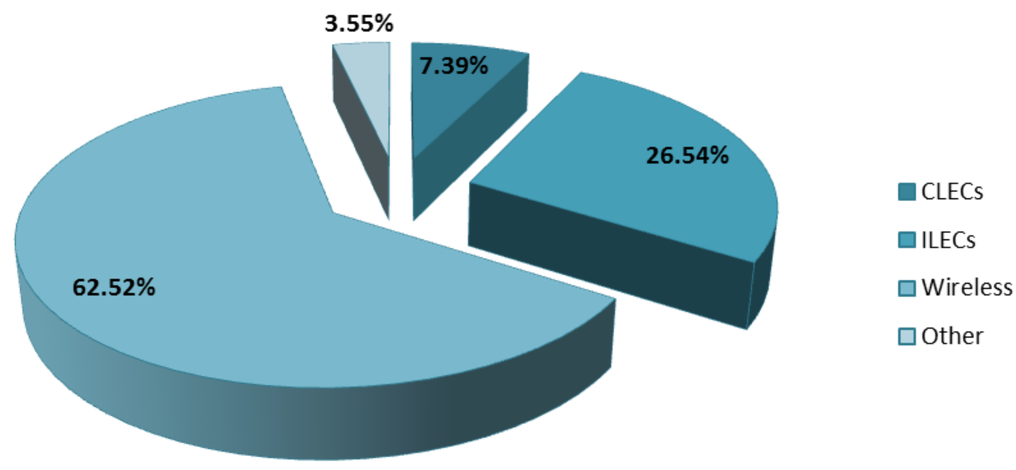
in contributions from 2013 is attributed to decreased revenues from contributing providers. See Figure 5 for a comparison of the contributions between 2012, 2013, and 2014.

Figure 5: Total Monthly Contributions



As shown in Figure 6, mobile wireless provider contributions represented over 62.5 percent of the revenue coming into the ARM during the fourth year of operation. ILEC contributions represent approximately 26.5 percent of revenues; CLEC contributions totaled just over 7 percent; and the remaining 3.5 percent of contributions come from other types of providers. These numbers are very similar to the breakdown by provider type for 2013.

Figure 6: Percent of Total Contributions by Provider Type



The Commission continues to work diligently through website updates, the CLEC licensing process, the Intrastate Telecommunications Service Provider registration process, and other direct communications efforts to ensure all providers are aware of the requirements related to the ARM. The number of monthly contributing providers has remained fairly consistent for the 2014 fiscal year, as shown in Figure 7, below. The Commission continues to monitor the providers that are and are not contributing to the ARM to confirm that all providers operating in Michigan are in compliance.

Figure 7: Number of Contributing Providers by Month

Month	Fiscal Year 2013	Fiscal Year 2014
September	248	254
October	246	246
November	244	250
December	241	248
January	242	249
February	252	249
March	252	250
April	251	246
May	250	248
June	250	246
July	249	247
August	244	241

Administrative Costs

Pursuant to the MTA, "[t]he commission shall recover its actual costs of administering the restructuring mechanism from assessments collected for the operation of the restructuring mechanism."[19] The Commission has established a section within the Telecommunications Division to administer the ARM. The Access Restructuring Fund Administration Section was officially established in January 2011 and at that time administrative costs began to be recovered from the ARM. The yearly administrative costs for fiscal year 2014 (the period October 2013 through September 2014) is $447,385.59; yielding a monthly average of $37,282.13 to account for the administration of the fund.

Act 52 of 2014

Effective March 25, 2014, Public Act 52 of 2014 amended the MTA, including changes to Section 310. The act eliminated the resizings of the ARM scheduled at 4 and 8

[19] MCL 484.2310 (9)

years of operation (September 13, 2014 and September 13, 2018) and replaced them with a single resizing effective March 13, 2018.

Public Act 52 of 2014 also amended the Commission's reporting requirements, providing that "The report shall also identify any duplicative costs or revenues that are already being recovered by eligible providers through federal access recovery charges or the Connect America Fund."[20] At this time the Commission has not identified any duplicative revenue recovery. The Commission maintains its finding in Case No. U-16943 that the possibility for double recovery does not exist until the ARM is resized. Since Public Act 52 of 2014 has eliminated the 2014 resizing of the fund, the possibility for double recovery has essentially been postponed until 2018. Furthermore, carriers certify annually to the National Exchange Carrier Association and the FCC that they have excluded revenues received from state recovery mechanisms from amounts eligible for federal recovery mechanisms.

Conclusion

To date, the Commission has implemented the requirements of the 2009 amendments to Section 310 of the MTA, along with the changes in 2014. The ARM is operational and receives contributions from required providers and disburses to eligible providers on a monthly basis. As described in this report, the total contributions to the ARM for the fourth year of operation were approximately $12 million. This, coupled with the monies remaining in the ARM at the close of fiscal year 2014, was sufficient to cover the approximately $15.8 million in disbursements, the actual administrative costs of $447,385.59, and maintain the required cash reserve.

The Access Restructuring Mechanism Administration Section continues to monitor the fund, as well as any reforms and regulations that may affect its operation. The Commission

[20] MCL 484.2310 (10)

has worked diligently to ensure that the ARM is in compliance with FCC reforms, and will continue to monitor tariff filings, contributions and disbursements for continued compliance as well. As the ARM moves into its fifth year of operation, the Commission will continue to monitor the contribution percentage to confirm that providers are contributing sufficient resources to the fund. Economic factors that influence the contribution factor include, but are not limited to: increase or decline in intrastate retail revenues from contributing providers, costs of operating the ARM, and changes to intercarrier compensation at the federal level. The Commission will notify the Legislature should changes to the ARM become necessary.