Legislative Audit Office Pre-audit Report

Universal Service Fund

January 2018

Prepared by
Franceska Cassell
Dana L. McNeil

Audit reports are available on the Unicameral's Web site (www.nebraskalegislature.gov) or can be obtained from the Legislative Audit Office at (402) 471-1282.

LEGISLATIVE AUDIT OFFICE
Nebraska Legislature
State Capitol • Box 94604 • Lincoln

TABLE OF CONTENTS

INTRODUCTION AND CONCLUSIONS

In March of 2017, the Legislative Performance Audit Committee (Committee) directed the Legislative Audit Office (Office) to conduct an audit of the Nebraska Universal Service Fund (USF). In November 2017, the Committee approved the modification of the audit to a pre-audit. A pre-audit is a smaller project and the contents are generally more descriptive rather than evaluative. The Office requested the modification because, for the most part, data was not available at the level that would allow us to provide detailed analysis of the various USF programs.

In this report we address the issues legislators were interested in when the audit was approved. Essentially, those issues are: how the program works and how decisions are made, where the money is going, and how Nebraska compares to other states. Following is a summary of what we found.

How the Program Works

Nebraska's Universal Service Fund was established in 1997 to make sure that all Nebraskans have equal access to affordable telephone and internet services regardless of where they live. The USF is funded by a surcharge on Nebraskans' bills for cell and landline telephones. The USF funds four programs that serve rural Nebraska (including rural hospitals) and low income Nebraskans.

Overall, we found that when the Legislature passed the Nebraska Telecommunications Universal Service Fund Act it gave wide latitude to the Public Service Commission (PSC) to create and regulate programs to further the goal of universal service. By doing so, the Legislature largely handed over policy decisions to the PSC.

In terms of how the USF surcharge is set, we found that the primary factor the PSC considers when it determines the USF surcharge is maintaining the stability of the fund.

Tracking how Universal Service Fund Dollars are Used

Legislators we spoke with in developing the scope of this pre-audit were primarily concerned about whether USF dollars were being used exclusively for universal service purposes *in Nebraska*—particularly by large companies that do business in other states in addition to Nebraska. We determined this concern likely centered on the High-Cost program because it is, for the most part, a direct subsidy for companies providing services in rural areas. While we found no way to track High-Cost funds to specific expenses (the PSC does not require that kind of documentation from companies), we did find that the PSC made changes to the High-Cost program in 2015 because Commissioners had similar concerns about ensuring that Nebraska funds are spent to provide services in Nebraska. Since 2015, the three large multi-state companies that receive High-Cost dollars must file project-based applications and have PSC approval in order to access 80% of the funds allocated to them. We found that of the $24 million allocated to these companies for the projects, 26% had been spent.

Nebraska's Surcharge Compared to Other States' Surcharges

Legislators were also interested in how the rate Nebraskan's pay on their phone bills compares to other states. There was particular concern about a study that rates Nebraska's taxes for wireless services as some of the highest in the country. We found that understanding that ranking was more complex than a simple rate comparison.

First, as shown in Figure A, states have many different ways of assessing taxes on wireless services and the state USF surcharge is only one component of that assessment and is only used in some states. Different types of taxes and tax rates can significantly change a state's wireless tax picture. For example, Washington has no USF surcharge, but its overall wireless tax rate is higher than Nebraska's. In contrast, Alaska, which has a higher USF surcharge and higher local sales taxes than Nebraska, ranks lower in the overall wireless rating because it has no state sales or city occupation taxes on telecommunications.

Figure A. Wireless Tax Rates: A Comparison of Nebraska and Two Other States

State	Type of Tax	Rate	Comments
Nebraska	State sales tax	5.50%	Access & intrastate
	Local sales tax	1.63%	Lincoln (1.75%) & Omaha (1.5%)
	City business and occupation tax	6.13%	Avg. of Omaha (6.25%) & Lincoln (6.0%)
	State USF	4.37%	6.95% times FCC safe harbor
	Wireless 911	1.01%	$.45 per month
	TRS	0.04%	$.02 per month
	Total Transaction Tax	**18.67%**	
Washington	State sales tax	6.50%	Access, interstate and intrastate
	Local sales tax	2.65%	Olympia (2.3%) & Seattle (3.0%)
	B&O/Utility Franchise—local	7.50%	average
	911—state	0.56%	Olympia (9%) & Seattle (6%) average
	911—local	1.57%	$.25 per month
	Total Transaction Tax	**18.78%**	$.70 per month
Alaska	Local Sales Tax	2.50%	Avg. of Juneau (5%) & Anchorage (0%)
	Local E911	3.81%	Anchorage—$.150 Juneau—$1.90
	State USF	7.23%	11.5% FCC safe harbor
	Total Transaction Tax	**13.54%**	

Source: Scott Mackey and Joseph Henchman, "States' Wireless Tax Burdens Continue to Increase," *State Tax Notes*, November 21, 2016.

Second, the USF surcharge is paid on both wireless and wireline (landline) telephone services. The other taxes discussed in the report on wireless services do not fund universal service, and we do not address them further in this report. We found that the categories of services various states fund both with a USF and in other programs vary significantly. No two states are exactly alike and only a few states are similar to Nebraska.

SECTION I: Nebraska's Universal Service Fund

In this section we provide brief background on the Public Service Commission and the concept of universal service. We then give an overview of the Universal Service Fund and describe each of the four Universal Service Fund programs. The report goes into significant detail about the High-Cost Program because much of the interest in the USF surrounded that program.

The Public Service Commission

The Public Service Commission (PSC or Commission) was created by amendment to the Nebraska Constitution in 1906. Originally called the Nebraska State Railway Commission, the Commission was renamed in 1972. The Commission is made up of five elected members who serve six-year terms. The PSC is a quasi-judicial agency with the power to hold hearings and issue orders.

The Commission is charged with regulation of several industries but this report focuses on its regulation of telecommunication carriers. Within the PSC, the Nebraska Universal Service fund is administered in its own department, the NUSF (Nebraska Universal Service fund) Department.

Universal Service

Broadly speaking, universal service is the idea that every person should have reasonably equal access to affordable telephone and internet services. The concept developed in the 1930s as a way to make sure everyone had a telephone. Prior to the federal Telecommunications Act of 1996, phone companies internally subsidized local telephone networks by shifting costs from local service to other areas like long distance and business services. After the 1996 act, the internal subsidies were replaced with legally created support mechanisms. The federal act allowed states to adopt mechanisms to supplement federal universal service supports.

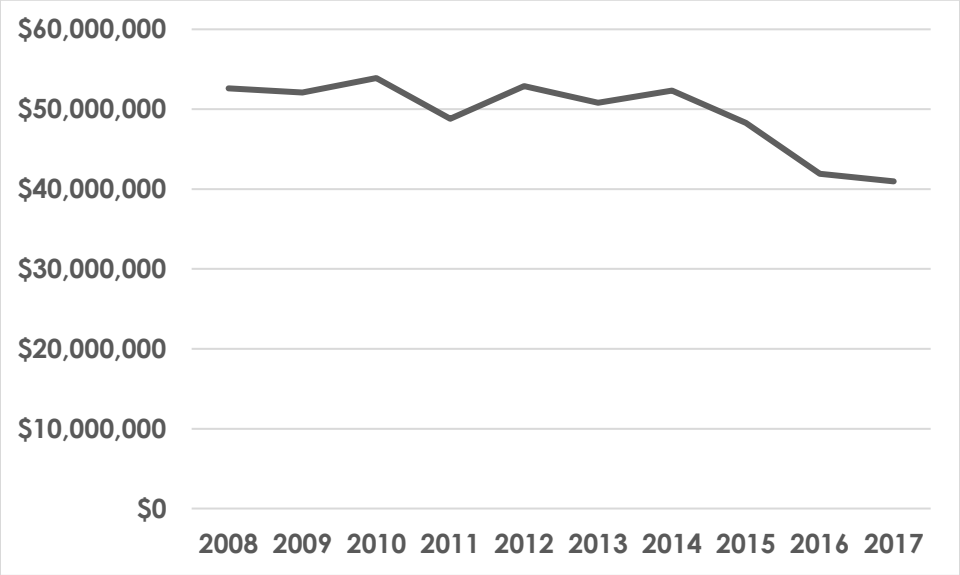
The Nebraska Telecommunications Universal Service Fund Act (the Act), which creates the Nebraska Universal Service Fund (USF), does not define universal service, but does contain a number of policy principles related to achieving it, including:

- quality services must be available at just, reasonable, and affordable rates;
- all regions of the state should have access to broadband services;
- all consumers, including low-income consumers, should have reasonably similar services (local and long distance telephone, as well as broadband) at similar rates without regard to whether they live in rural/urban or high-cost/low-cost areas; and
- all telecommunications providers should contribute to universal service equally, and the fund itself must work in a way that preserves and advances universal service and is are specific, predictable, and competitively neutral.

The Nebraska Universal Service Fund

The USF is funded by a charge on Nebraskans' telephone and cellphone bills. Internet and interstate services are not subject to the surcharge. As Figure 1.1 shows, the fund has experienced a significant decrease in the last few years. PSC believes this is because of bundled package rates and because companies are allocating more revenues into services not subject to the surcharge.[1]

Figure 1.1. Total Universal Service Funds (2008-2017)



Source: Prepared by Audit Office using information provided by PSC.

The Nebraska Telecommunications Universal Service Fund Act (LB 686, 1997) authorizes the Universal Service Fund and gives the Public Service Commission wide latitude to create services and programs to advance universal service. During debate on the legislation, several Senators were concerned that providing too much direction in the bill would tie the hands of the PSC. They believed that the PSC, not the Legislature, had the technical expertise to develop the USF as well as to transition the telecommunications companies into a competitive market. Other Senators were concerned that Nebraska needed to act quickly by putting a skeleton bill in place so that federal decisions would not cause rate increases in High-Cost areas. Several amendments were debated that included measurable standards, but few were adopted.

Only one program was created in the act: the Nebraska Telephone Assistance Program (NTAP), which provides support for telephone access to low-income households. The other USF programs—the Broadband Program, the High-Cost Program, and the Rural Telehealth Program—were created by the Commission.

Figure 1.2 shows the amount of the fund the PSC has allocated to each program since 2008. The High-Cost program is allocated by far the largest portion of the USF, between 80 and 93 percent of the fund depending on the year. While the funds allocated to the

[1] Public Service Commission (PSC), email to auditors, November 27, 2017.

NTAP and Telehealth programs have remained steady, the High-Cost and Broadband programs have fluctuated overtime, as the fund has fluctuated.

Figure 1.2. Allocated Universal Service Fund Funding by Program (2008-2017)

Year	High-Cost	Broadband	Telehealth	NTAP	N-USF Total
2008	$48,700,000	$2,500,000	$900,000	$500,000	**$52,600,000**
2009	$45,700,000	$5,000,000	$900,000	$500,000	**$52,100,000**
2010	$47,500,000	$5,000,000	$900,000	$500,000	**$53,900,000**
2011	$42,400,000	$5,000,000	$900,000	$500,000	**$48,800,000**
2012	$42,500,000	$9,000,000	$900,000	$500,000	**$52,900,000**
2013	$40,402,000	$9,000,000	$900,000	$500,000	**$50,802,000**
2014	$41,940,000	$9,000,000	$900,000	$500,000	**$52,340,000**
2015	$38,373,200	$8,492,000	$900,000	$500,000	**$48,265,200**
2016	$36,026,530	$4,500,000	$900,000	$500,000	**$41,926,530**
2017	$35,564,924	$4,000,000	$900,000	$500,000	**$40,964,924**

Source: Prepared by Audit Office using information provided by PSC.

Following is a description of each program.

Universal Service Fund Program 1: The High-Cost Program

When the Universal Service Fund was created, 84% of Nebraska's households lived in only 730 square miles of the State; the remaining 16% were spread over 74,000 square miles.[2] Because providing service in areas where few people live is more expensive, the High-Cost program subsidizes telecommunications companies to ensure that telecommunications and information service rates (i.e. phone and broadband internet) are affordable throughout Nebraska.

Essentially, USF support is used in places where there is no business case for service without a subsidy. According to PSC estimates, absent the High-Cost subsidy, the cost to companies to provide service varies significantly by area. PSC provided the Audit Office with a sample cost of providing service (to the service provider) in several different population densities, as shown in Figure 1.3. The model is not used to estimate what the cost to customers would be.[3]

Figure 1.3. Cost to Provide Service, by Household Density

Household Density (Households Per Square Mile)	Cost to provide service (per month)
7,635.92	$2.69
5,186.30	$5.16
46.23	$20.24
8.37	$57.59
.11	$571.52

Source: Prepared by Audit Office with information provided by PSC.

For context, the census tracts around the Capitol are the most household dense census tracts in the state. They have household densities of 7261.90, 6842.86, and 5197.96. The least populous (in terms of households) census tract in Nebraska, the Cherry County census tract 9559, has a household density of .13.[4]

In order to be eligible for the high-cost program (or any USF program), a carrier must be designated by the PSC as an eligible telecommunications carrier (ETC). ETC is a designation created by federal statute as a condition for receiving federal high-cost funds, which is also used by the PSC for state support. ETCs have special obligations to their customers and to the PSC. They must commit to offering specific "supported services", must only charge a specific rate,[5] serve everyone in a designated area, and meet financial and other reporting requirements.

---

[2] Population distribution has remained relatively steady in the intervening years, at least up to the latest census. 16% of Nebraskans are spread out over 75,444 square miles, and the other 84% live in 834 square miles. PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p. 31; PSC, email to auditors, October 24, 2017.

[3] PSC, emails to auditors, October 24, 2017 and October 25, 2017.

[4] Note: The information the PSC provided to the Audit Office used 2000 census data, however, these numbers are from the 2010 census.

[5] The benchmark rate, which will be discussed later.

Only one eligible telecommunications carrier receives high-cost support for each area of service; that carrier must own and operate the facilities (including lines) that the services are provided through. The PSC has a process by which a competitor could apply to become the provider, but the Commission has never received a petition from a competitor. The PSC told us that this may be because competitors do not have networks built out enough, or they are not interested in taking on the obligations the eligible telecommunications carrier.

Types of High-Cost Companies

The High-Cost program divides eligible telecommunications carriers into two groups, price cap carriers and rural rate of return carriers.[6] According to the PSC, federal regulators created the differentiation between the types of companies because price cap carriers are much larger; regulators wanted to give the large companies an efficiency incentive to increase earnings.[7]

The Commission also recognized that it is harder to ensure that price cap carriers are using Nebraska's USF dollars solely to advance universal service in Nebraska. In a 2015 order, the PSC stated:

> In addition, due to the multi-state operations of price cap carriers, it can be difficult for the Commission to track the use of NUSF support for the expansion of broadband access deployed by price cap carriers in Nebraska.[8]

Because of this concern, for the last two years, price cap carriers receiving USF funds have been subject to additional restrictions and requirements. Figure 1.4 shows allocations for price cap and rate of return carriers for 2016 and 2017.

[6] Nebraska's three largest companies, Century Link, Windstream, and Frontier (also known as Citizens Telecommunications of Nebraska) are price cap carriers. All other eligible telecommunications companies in the State are considered rural rate of return carriers.
[7] PSC, meeting with auditors, July 12, 2017.
[8] *In the Matter of the Nebraska Public Service Commission, on its Own Motion, to Administer the Universal Service Fund High-Cost Program*, Application No. NUSF-99 (Order Seeking Further Comment and Setting Hearing), June 16, 2015, p 5.

Figure 1.4. High-Cost Carrier Allocations (2016-2017)

Program	2016 Allocation	Percent of High-Cost Allocation		2017 Allocation	Percent of High-Cost Allocation	
Price Cap Grants	$9,468,348	26%	53%	$14,545,441	41%	52%
Price Cap Ongoing Support	$9,830,782	27%		$3,998,795	11%	
Rate of Return Carriers	$16,727,400	46%		$17,020,688	48%	
Total High-Cost	**$36,026,530**			**$35,564,924**		

Source: Prepared by Audit Office using information provided by PSC.

Price Cap Carriers

Price cap carriers are treated differently in the model used for allocation of USF dollars. Price cap carriers are subject to the same levels of support they were receiving in 2015. Rate of return carriers support levels are updated annually.

Perhaps more importantly, most of the funds that price cap carriers receive are treated, in part, like a grant program. Specifically, a portion of the funds allocated to price cap carriers can only be accessed if the carriers apply for funding for broadband projects. These funds are allocated specifically to each of the carriers and remains allocated to them until they are approved for a project.[9] Currently, 80% of the funds they receive must be applied for. The other 20% may be utilized for the companies' ongoing costs, which must be used for "provision, maintenance, and upgrading of facilities". In 2016, the allocation was split 50/50 for grant and funds for on-going costs.[10]

The majority of the price cap grant dollars have not been spent. Of the $24,013,789 approved for grants in 2016 and 2017, $6,208,180 (26%) has been approved for projects.[11] As shown in Figure 1.5, no company has been approved for projects totaling more than 35% of their allocated funds.

The PSC told the Office that the transition to the project grant process is likely responsible for the low levels of funding used in 2016 and 2017. They expect the funding will be spent more quickly now that the approval process issues have been resolved.[12]

[9] PSC, email to auditors, November 15, 2017.
[10] PSC, meetings with auditors, July 26, 2017 and November 1, 2017; PSC, emails to auditors, October 31, 2017 and November 2, 2017.
[11] The unspent grants for 2016 and 2017 amount to 18% of the total USF ($14,509,830 of $82,891,454).
[12] PSC, letter to auditors, December 28, 2017.

Figure 1.5. Percent of Allocated Funds Used by Companies

Company	Percent of 2016 and 2017 Funds Used for Projects	Percent of 2016 and 2017 Allocation Remaining
Citizens Communications	30%	70%
Century Link (Qwest)	34%	66%
Century Link (United Telephone of the West)	0%	100%
Windstream Communications	22%	78%
Total Allocated	**30%**	**70%**

Source: Prepared by Audit Office with information provided by PSC.

The price cap grants that were used during the two-year period supported nine projects for the three companies (Figure 1.6). These projects affected 14,480 households, most of which were in the Hastings project area.

Figure 1.6. Price Cap Grant Projects

Company	Project Area	Support	Households
Frontier (Citizens)	Franklin County	$1,116,000	279
Windstream	Hardy	$190,895	113
Windstream	Filley	$633,999	199
Windstream	Burr/Cook	$436,971	398
Windstream	Hastings	$141,539	10,841
Windstream	Swedeburg	$80,830	2,286
Century Link (Qwest)	St. Paul	$3,377,799	303
Century Link (Qwest)	Pender	$230,146	61

Source: Prepared by Audit Office with information provided by PSC.

Rate of Return Carriers

In contrast to price cap carriers, as long as rate of return carriers are serving high-cost populations, they receive an amount of funds to be used for ongoing expenses and investment based on PSC calculations.[13] Data is not collected by the PSC about the specific projects that rate of return carriers invest in. Instead, all carriers (including price cap carriers) must annually file a report of one year's investment and expense data and one year's projected investment and expense data. In addition, each company must fill out a form to report investments, revenues, and expenses.[14] This information is validated by third party auditors who conduct annual audits as required by law.[15] The PSC uses the

[13]As of December 19, 2017, the PSC is considering whether to change the way it disperses funds to rate of return carriers. PSC, letter to auditors, December 28, 2017.
[14] The PSC also analyzes company data during an annual process that certifies companies as eligible telecommunications carriers so they can receive federal and state USF support. PSC compares investment and expense data to support received in order to determine if carriers are using support for the intended purpose. PSC, email to auditors, September 26, 2017. PSC, meeting with auditors, September 12, 2017.
[15] PSC, meeting with auditors, September 12, 2017.

form to determine whether company costs are reasonable[16] and to make changes to PSC policy.[17] According to the PSC, not all states require this level of information from carriers; some states require that companies simply attest that they are using the dollars for universal service purposes.[18]

How the High-Cost Funds are Allocated

To determine how much of the High-Cost funds will be allocated to each provider, the PSC utilizes what they call a Support Allocation Methodology (SAM or methodology). The SAM compares costs that companies incur for providing services in rural High-Cost areas to the statewide costs. The purpose of the methodology is to ensure that companies that serve more customers in rural High-Cost areas receive more USF funds than companies with fewer High-Cost customers.[19]

The SAM uses data from the 2000 census to determine population density.[20] The state is divided into service areas with similar population densities. The SAM uses a cost model called the Benchmark Cost Proxy Model (BCPM or model) to determine the average cost of providing service to the local customer in each of the areas. The model compares an estimate of the area's average cost of providing service to the local customer to a standard revenue amount for provision of service (the benchmark cost). When the cost for the service area is more than the benchmark cost, the PSC multiplies the difference by the number of households to calculate the amount of support needed in that support area. The results are aggregated to create a base support amount for each company determined by the areas they serve.[21]

Because USF funds are limited, the figure calculated during this step is not what the company actually receives. Instead, the SAM aggregates the amounts calculated for the service areas to determine a total amount of support for the state (statewide base). The statewide base is compared to the company base support amount which determines the proportion of the statewide support the company is entitled to. For example, if the model calculates that a company should receive $400,000 and service across the state should cost $40,000,000, the company would receive 1/100th of the money that is available for the High-Cost program.[22]

After the figure is determined for companies based on their High-Cost service areas, the PSC conducts an additional recalculation. The PSC reviews reporting forms to ensure that a company is not receiving more than would be reasonable. The form review includes an

[16] PSC, meeting with auditors, July 26, 2017.
[17]PSC, meeting with auditors, September 12, 2017.
[18] PSC, meeting with auditors, September 26, 2017.
[19] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p. 32.
[20] As of the 2018 funding year, the model will use 2010 census data. PSC, letter to auditors, December 28, 2017. PSC, meeting with auditors, July 26, 2017.
[21] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, pp. 32-33.
[22] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p. 33.

examination of the company's reported expenses,[23] investments,[24] and revenues (this includes any support from the Federal Universal Service fund).[25]

Companies are only eligible to receive N-USF support up to a capped amount of earnings. The final step in the calculation is to determine, using the reporting form, if they are entitled to support and how much (if they have not been capped out). Currently, rate of return carriers are subject to an 11% earnings cap with earnings updated annually. Price cap carriers are also subject to an 11% earnings cap, but it is based on levels of support frozen in 2015.[26]

[23] The PSC uses another model to see if the company's expenses are more than they should be. If it is determined that they are too high the company is given a chance to explain in writing why their expenses are reasonable. If the commission is not satisfied by the answer the company is given a chance for a public hearing to determine whether the expenses on the reporting form should be changed.
[24] Some companies' investment data is reviewed on a three year cycle because they may not make large investments every year.
[25] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, pp. 43-44; PSC, meeting with auditors, September 12, 2017.
[26] PSC, meeting with auditors, July 26, 2017; PSC, email to auditors, September 26, 2017.

Universal Service Fund Program 2: Broadband Program

The Broadband Program has undergone several changes in the past few years, as can be seen in Figure 1.7. On the following page, Figure 1.8 lays out the allocations made for each of the three types of support provided since 2008.

In 2008, the PSC created a dedicated wireless program to fund tower construction in areas without adequate coverage. In 2011, the Commission modified the program to emphasize funding wireless providers who were committed to providing wireless broadband services. In 2012, the Commission created the Nebraska Broadband Pilot Program (NEPB), allowing both eligible wireless and wireline carriers to access the fund for broadband capital projects. In 2014, the Commission combined the wireless broadband program and the NEPB, under the Nebraska Universal Service Broadband Program.

However, in 2016 the Commission determined that continuing to fund different services and technologies in the same program was problematic. Instead, the commission reinstated the wireless broadband program, providing grants only to wireless carriers. The Commission did not fund a grant program for wireline carriers in 2016, but it did allocate some High-Cost funds for price cap carries to be used for broadband projects.[27] According to the PSC, the use of High-Cost funds for grants for broadband projects alleviates the need for a separate wireline broadband grant program.[28]

Figure 1.7. Timeline of Broadband Program Changes

Year	Program Change
2008	PSC creates dedicated wireless program.
2011	PSC modifies wireless program to provide support mostly to wireless broadband services.
2012	PSC creates NEPB to provide funding for wireline broadband.
2014	PSC merges wireless and wireline programs.
2015	PSC creates broadband adoption program.
2016	PSC splits wireless and wireline programs, funding only wireless. Wireline funding continues through High-Cost program. Last year of broadband adoption program.

Source: Prepared by Audit Office with information received from PSC.

[27] PSC, email to auditors, December 6, 2017.
[28] PSC, meeting with auditors, November 1, 2017.

Additionally, in 2015 and 2016, the PSC allocated $500,000 for a broadband adoption program to provide assistance to low-income Nebraskans and Nebraskans who had yet to adopt broadband.[29] Eight grants were awarded to providers during this time.[30] Because of funding concerns, the Commission did not allocate any funds for the adoption program in 2017.

Figure 1.8. Broadband Allocations (in millions)

Program	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Wireless/ Wireless Broadband	$2.5	$5.0	$5.0	$5.0	$5.0	$5.0			$4.0	$4.0
Broadband Deployment (NEPB)					$4.0	$4.0	$9.0	$8.0		
Broadband Adoption								$0.5	$0.5	
Broadband Total	**$2.5**	**$5.0**	**$5.0**	**$5.0**	**$9.0**	**$9.0**	**$9.0**	**$8.5**	**$4.5**	**$4.0**

Source: Prepared by Audit Office using information provided by PSC.

[29] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p. 25.
[30] PSC, meeting with auditors, July 12, 2017.

Universal Service Fund Program 3: Telehealth Network

Since 2004, the PSC has funded the Nebraska Statewide Telehealth Network (NSTN). The NSTN connects rural and critical access hospitals throughout Nebraska to hub hospitals in Grand Island, Kearney, Lincoln, Norfolk, North Platte, Omaha, and Scottsbluff.[31] Telehealth allows local access to specialists in fields like radiology and endocrinology, reducing the need for patients to travel to urban areas for care.[32] Additionally, the NSTN also has a video conferencing component to support educational and training needs.[33]

The annual funding maximum for the program is set by PSC order.[34] The PSC currently allocates $900,000 per year for Telehealth funding. Funding for the NSTN is provided to hospitals that are eligible for USF funding in preapproved amounts. NUSF money is supplemental to federal telehealth funding; in order to be eligible hospitals and facilities must receive federal funds before applying for state funds.[35] In FY 2016-2017, PSC dispersed $660,000 of the allocated funds.[36]

Eligible services and equipment are also determined by Commission order.[37] Federal funding is used to help pay for the cost of digital transmission lines, called T-1 lines. Rural hospitals pay the telecommunications provider a $100 monthly fee to connect the T-1 line, the remainder of the monthly costs is paid from the USF to the service provider.[38] USF money can also be used for other necessary components to run the network such as routers, firewalls, and bridges. These items are not subsidized by federal funds.[39] Carriers that receive NUSF funds for telehealth are subject to PSC audit requirements.[40]

---

[31] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p.27.
[32] Ibid.
[33] Ibid.
[34] 291 NAC 10-004.03D.
[35] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p.27; 291 NAC 10-004.03C.
[36] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2017, p.24.
[37] 291 NAC 10-004.03B.
[38] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p.27.
[39] Ibid.
[40] Ibid.

Universal Service Fund Program 4: Nebraska Telephone Assistance Program

The Nebraska Telephone Assistance Program (NTAP) assists eligible low income Nebraskans in obtaining telephone services (landline or cell phone) by lowering their monthly service rates. The USF allocates $500,000 for the NTAP program each year. NTAP works in tandem with support from the federal universal service fund. Participants receive a total of $12.75 off their monthly bill: $9.25 in federal support and $3.50 in support from the state USF. The federal credit can be applied to broadband service; state USF support can only be used for telephone services because the statute does not include language allowing use for broadband services.[41]

Currently, 6,493 Nebraskans receive NTAP support.[42] In order to qualify for the program, a member of the subscriber's household must participate in certain public assistance programs[43] or have an income at or below 135% of the federal poverty level.[44] Enrollment has been declining since 2015. PSC believes this is likely due to an annual recertification process, where the PSC works with the Department of Health and Human Services to verify whether individuals continue to be eligible for NTAP. However, PSC also collaborates with DHHS, agencies for the aging, housing authorities, and other agencies to identify and notify Nebraskans who are eligible to participate.[45]

[41] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p. 29; Public Service Commission, meeting with auditors, July 12, 2017.
[42] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2017, p. 26.
[43] The programs are (1) Medicaid; (2) SNAP; (3) SSI; (4) Federal Public Housing Assistance; (5) LIHEAP; (6) Children's Health Insurance Programs; (7) TANF; (8) National School Lunch Free Lunch Program
[44] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2017, p. 25.
[45] PSC, *Annual Report to the Legislature on the Status of the Nebraska Telecommunications Industry*, September 2016, p.30.

SECTION II: Decision Making Structure and How Assessment is Determined

In this section, we provide an overview of the decision making structure of the Public Service Commission and how it regulates telecommunications carriers under the Universal Service Fund Act. We also discuss how the Nebraska Universal Service Fund surcharge, or assessment, is determined.

Regulation of Telecommunications Carriers and the Nebraska Universal Service Fund Generally

The Nebraska Telecommunications Universal Fund Act (Act) gives the Public Service Commission (PSC) broad powers to regulate the Nebraska Universal Service Fund through its quasi-judicial process and through regulation, as the agency deems appropriate.[46] Specifically, the language of the Act gives the PSC the ". . . authority and power to issue orders carrying out its responsibilities and to review the compliance of any eligible telecommunications company receiving support for continued compliance with any such orders or regulations adopted pursuant to the Act[.]"[47] Additional language empowers the PSC to ". . . determine the standards and procedures reasonably necessary, adopt and promulgate rules and regulations as reasonably required, and enter into such contracts with other agencies or private organizations or entities as may be reasonably necessary to efficiently develop, implement, and operate the fund".[48]

The Act requires the PSC to have an annual hearing to set the level of the fund for the following year, including a reasonable reserve. Additionally, Neb. Rev. Stat. § 75-101 *et seq*, which regulates the PSC generally, directs the PSC to adopt and promulgate rules and regulations for the government of its proceedings, including rules of procedure for notice and hearing. These rules are promulgated at 291 NAC Chapter 1. According to the PSC, the agency's constitutional authority under Section IV-20, exempts it, to some extent, from the normal rulemaking process under the Administrative Procedure Act.[49] Rulemaking takes place after a Commission decision (order) but is sometimes delayed due to uncertainty about whether a program will continue to be funded.[50] Administrative regulations governing the universal service fund are found at 291 NAC Chapter 10.

Commission proceedings may be initiated either by application of a carrier or interested party or by the PSC itself in order to take action against noncompliant carriers.[51]

---

[46] See Neb. Rev. Stat. §§ 75-109 and 75-109(1).
[47] Neb. Rev. Stat. § 86-324(2)(b).
[48] Neb. Rev. Stat. § 86-325.
[49] Neb. Rev. Stat. §§ 84-901 to 84-932. PSC, meeting with auditors, November 1, 2017. See also Neb. Rev. Stat. § 75-110(2).
[50] PSC, meeting with auditors, November 1, 2017.
[51] PSC, email to auditors, November 20, 2017. See also Neb. Rev. Stat. §§ 75-110.01, 75-111, 75-118, and 75-118.01.

When an application is received from a carrier, an evidentiary hearing is held before a majority of the five elected commissioners, after appropriate legal notice. The commissioners are similar to judges in that they can make findings of fact and determinations of law and a written record is established.[52] Some examples of these types of hearings are: eligible telecommunications carrier (ETC) applications, broadband funding applications, and waiver applications.[53]

Similarly, funding issues are disposed of in hearings initiated by the PSC. The present high-cost fund was a result of a proceeding opened by the Commission on its own motion to determine how network costs should be determined.[54] Not all hearings are this formal or have opposition but are held to update or clarify previously unaddressed issues. For example, a carrier might file a motion for reconsideration or rehearing if its costs were not considered properly pursuant to an earlier order establishing a cost model.[55]

The PSC cited the following two cases that discuss its powers:[56]

> *Thompson v. Heineman*, in which the court ruled that: "The Public Service Commission (PSC) has independent legislative, judicial, and executive and administrative powers over common carriers, which powers are plenary and self-executing. Absent specific legislation, the PSC's enumerated powers over common carriers are absolute and unqualified."[57]
>
> *Schumacher v. Johanns*, in which the court ruled that: "Regulation of the telecommunications industry is a complex field as to which the PSC has special expertise and constitutional authority. The fact that the standards set forth in the [Nebraska Telecommunications Universal Service Fund Act] permit the exercise of discretion by the PSC reflects this reality. To require more explicit and definite standards could impede or prevent effective regulation."[58]

Nebraska Universal Service Fund Assessment

As stated above, the level of the fund is set each year after a hearing. According to the PSC, until the future change to a connections-based assessment, the Commission sets the surcharge based on obtaining sufficient funds to meet the objectives for the fund.[59] It has generally remained at 6.95 percent, except from October 1, 2005 to April 1, 2007, when it was 5.75 percent.[60]

---

[52] PSC, email to auditors, November 20, 2017.
[53] Ibid.
[54] Ibid.
[55] Ibid.
[56] Ibid.
[57] 289 Neb. 798 (2015).
[58] 272 Neb. 346 citing *Citizen's Utility Ratepayer Bd. v State Corporation Comm'n*, 264 Kan. 363, 956 P.2d 685 (1998).
[59] Paul Hammel, "Nebraska Plans to Start Collecting Flat Fee for Each Phone Connection," *Omaha World Herald*, November 21, 2017. PSC, email to auditors, November 27, 2017.
[60] PSC, email to auditors, November 21, 2017.

Maintaining stability in the assessment base was the primary factor the Commission considered in deciding to adopt the connections-based surcharge. The PSC made this decision after three years of study and soliciting comments from internet and phone companies.[61] "The [Nebraska Universal Service Fund] has experienced a significant decline in assessable revenues, which appears to be largely due to bundled package rates and the ability for carriers to allocate more of their revenues to non-assessable services."[62] This mirrors the situation at the federal level: the federal universal service contribution factor rose from 5.71 percent in the second quarter of 2000 to 18.8 percent in the fourth quarter of 2017.[63]

[61] Paul Hammel, "Nebraska Plans to Start Collecting Flat Fee for Each Phone Connection," *Omaha World Herald*, November 21, 2017.
[62] PSC, email to auditors, November 27, 2017.
[63] Ibid.

SECTION III: Overview of Other States

In this section, we provide a brief overview of data collected from other states regarding their universal service funds. This data was collected from a survey conducted by the National Regulatory Research Institute (NRRI) in 2014, the most recent available at the time this report was compiled.[64]

Background

As discussed earlier in this report, the primary purpose of Universal Service is to ensure access to "robust, reliable communications services, including broadband connectivity, at affordable rates with 'reasonably comparable service' across the country."[65] State funds supplement Federal Universal Service Funds (FUSF) and are also used to provide targeted support for state-specific issues.

Forty-four states and the District of Columbia (hereafter referred to as 45 states) provide some type of state universal service support, in addition to federal universal service funding.[66] Of those 45 states, 39, including Nebraska, have a State Universal Service Fund (SUSF). Six states (Alabama, Florida, Massachusetts, New Jersey, Tennessee, and Virginia) have no SUSF. However, even though Florida has no fund, it does require its carriers to provide a specific program for low-income consumers, called Lifeline. Massachusetts also has no SUSF but has a separate state grant program for broadband support.

Of the states with SUSFs, most direct universal service fund money to specific programs. However, Texas collects its funding as a lump sum which is then distributed by its Commission based on need; Washington pays for its universal service through general funds and then directs it toward specific funds.

Types of contributors to the state funds also vary by state. Of the responding 50 states:

- All assess wireline (such as land-line phones) carriers;
- 32 assess long distance;
- 28 assess wireless providers; and
- 13 also assess Voice over Internet Protocol (VoIP) service providers.

Whereas federal universal service funding is a flat rate charged to providers quarterly, SUSF assessment differs based on the type of fund or program being supported. This allows states to tailor its universal service funds to fit an individual state's needs.

[64] National Regulatory Research Institute, *State Universal Service Funds 2014,* June 2015.
[65] National Regulatory Research Institute, *State Universal Service Funds 2014,* June 2015, p. iv.
[66] Hawaii did not reply to the NRRI survey so is not included in the data in this section.

Federal Universal Support

Federal universal service support is provided through four funds: (1) the Connect America Fund (formerly the High Cost Fund) which provides support for carriers providing broadband and voice connectivity in (primarily) rural areas; (2) the Lifeline Fund which provides discounted wireline and wireless services to low income customers; (3) the Schools and Libraries Fund (E-rate) which provides broadband access and other communications support for educational institutions; and (4) the Rural Health Care Fund, providing support to eligible health care providers for the telecommunications and broadband services required for providing telemedicine services in rural areas.

The FUSF is funded by a percentage of end user revenues for long distance, or interstate telecommunications services. Contributions are required from long distance, wireline, wireless, payphone, some private carriers, and interconnected VoIP[67] providers. Cable TV and broadband are not included. These charges are recouped by providers through a surcharge on customer bills, with the exception of Lifeline subscribers, who may not be charged.

The reduction in prices for long distance service, changes in calling patterns, and the shift to broadband-enabled products have reduced interstate revenue which has necessitated an increase in the contribution rate in order to maintain support at existing levels, without considering coverage for broadband deployment and availability. As a result, the FUSF contribution rate has increased from 6% in 2000 to 17.4% in 2015.

Overview of State Universal Service Funds

SUSFs supplement the support provided by the four areas included in the FUSF. One of the most important functions of SUSFs is that they provide a means for determining how best to support key telecommunications areas in each state, e.g., providing service in high cost areas, supporting disadvantaged and disabled customers, and deploying broadband. Additionally, states condition distribution on factors not considered in the federal program; for example, limiting funding to unserved and/or underserviced areas and creating funds to provide direct support for broadband.

The following table, Figure 3.1, shows the breakdown of states providing funding to the following common SUSF programs: High Cost Support; Intrastate Access Reform, Broadband Funding, Lifeline, Schools and Libraries Fund, Telecommunications Equipment Program, Telecommunications Relay Service, and miscellaneous other funding.

[67] Voice over Internet Protocol, i.e., phone service over the internet. https://www.voip-info.org/wiki/view/What+is+VOIP.

Figure 3.1. State Universal Service Funds

Type of Fund	Definition	States	Other Information
High Cost Support	Provides support to carriers serving rural or remote areas	WA, OR, ID, NV, AZ, WY, CO, SD, NE, KS, OK, TX, AR, LA, WI, IL, IN, GA, SC, NY, VT, ME	Most states limit support to carriers who are carriers of last resort (COLRs); GA, KS, SC, and WA include support for IAS in their HC programs.
Intrastate Access Reform (IAS)	Provides support to carriers to cover lost revenue from restructuring rates to bring intrastate access charges into alignment with interstate charges	AK, GA, MI, NM, SC	These five states have funds dedicated specifically to IAS
Broadband Funding	Funding specifically designated to support broadband deployment and adoption	CA, CO, DE, ME, NE, WV	CO established a broadband (BB) fund using money originally designated for HC support in areas that were subsequently deemed to be "competitive" and thus no longer requiring the HC subsidies. NE doubled the size of its BB program from 2012 to 2014 to 8.5 million. The BB program is a grant program that awards funds for capital construction and BB adoption. Grants are awarded according to the criteria in NUSF-77.[68]

[68] NUSF-77 sets forth seven eligibility requirements. Carriers must: (1) commit to offer the supported broadband service upon completion of the deployment to all households within the area defined by the application, for a minimum period of 5 years; (2) commit to offer a voice grade service to customers within the service area of the broadband deployment; (3) commit to offer access to emergency services; (4) commit to using broadband support only for the purposes intended and which have been approved by

Type of Fund	Definition	States	Other Information
Lifeline	Provides a bill credit to low income consumers	CA, DC, ID, KS, KY, MN, MO, NV, NM, NY, NE, OK, OR, SC, VT, WA, WI, WY	Total Lifeline expenditures have decreased as a result of changes at the federal level designed to limit fraud and abuse by eliminating duplication (i.e, ensuring applicants can only have one account)
Schools and Libraries (E-rate) Fund	Funds to support telecommunications and broadband services for schools and libraries	CA, ME, OK, RI, WI	
Telecommunications Equipment Program (TEP)	Funds assistive devices for the hearing, speech, and visually impaired	CA, GA, IL, IA, KS, KY, ME, MN, NH, OR, RI, SC, WA, WI, WY	This includes TTY devices, caption telephone equipment, and, in some states, tablets and other devices that enable the deaf and hard of hearing to communicate.
Telecommunications Relay Service (TRS)	Provides telephone accessibility to persons who are deaf, deaf-blind, hard of hearing, or speech disabled	TRS is required by Title IV of the Americans with Disabilities Act and to the extent possible, must be functionally equivalent to standard telephone service	A specially trained communications assistant facilitates the telephone conversation between a person who has hearing loss/speech disability and the person with whom they wish to speak

the Commission through the application process; (5) commit to offering the voice and broadband service at reasonably comparable rates for comparable services in urban areas; (6) commit to fulfilling reporting and audit requirements adopted by the Commission for oversight of the Nebraska Broadband Pilot program and (7) commit to abide by all applicable Commission rules, regulations and orders. NUSF-77, November 21, 2011, p. 9.

Type of Fund	Definition	States	Other Information
Other Funds	Other public welfare services such as public access payphones (AK, ME), hearing aids (GA), closed captioning (MN, SC), telehealth (NE, WI), news for the blind (RI, MN), E911 (VT)	AK, GA, MN, NE, RI, SC, VT, WI	

Source: Prepared by Audit Office using RNNI report data.

State Universal Service Contributors

While the Federal Universal Service Fund assesses providers based on a percentage of interstate and international revenues (a single assessment rate that is set quarterly), states assess revenue streams based on funding requirements, type of contributor, and the type of fund supported. The following tables (Figures 3.2–3.5) give SUSF information regarding types of contributors, types of revenues assessed, different contribution formulas, and types of benchmarks used. The majority of states responding to the survey use a benchmark rate in order to determine whether providers qualify for universal service support, i.e., providers must offer basic local service at or above the established benchmark rate in order to get funding.

Figure 3.2. Types of Contributors

Provider Type	Number of States*	Nebraska
Wireline (ILECs, CLECs)[69]	50	√
Wireless	28	√
Cable	17	√
Interconnected VoIP	13	√
IXCs (Intrastate Long Distance Carriers)	32	√
End-Users (direct contribution/not revenue based)	8	
Paging	12	√
Other	3	

*The 50 survey respondents consisted of 49 states (Hawaii did not respond) and the District of Columbia.

[69] Incumbent Local Exchange Carriers and Competitive Local Exchange Carriers, respectively.

Figure 3.3. Revenues Assessed

Revenues Assessed	Number of States	Includes Nebraska
Gross intrastate retail revenues	15	
Net intrastate retail revenues	12	√
Charge per access line/trunk	15	
Direct state funding	1 (Washington)	

Figure 3.4. Contribution Formulas

Contribution Formula	Number of States	Includes Nebraska
Single rate for all funds	21	√
Fund-specific rate	17	
Rate by provider type	4	

Figure 3.5. State Benchmarks

Benchmark	Number of States	Includes Nebraska
States with no USF, no benchmark	7	
States with state-developed benchmark	16	√
States using FCC benchmark	3	
States with no benchmark rate	24	

Source for Figures 3.2-3.5: Prepared by Audit Office using RNNI report data.

Please see the *Appendix* for a summary of survey responses.

APPENDIX: Overview of Other States' Revenue Sources

Thirty-seven universal service fund states have a single revenue source that funds universal service. Seven have multiple revenue sources. Of the single source revenue states, twelve use a per-line surcharge. Eleven assess total gross state retail revenues. Ten, including Nebraska, assess net intrastate retail revenues. Four states assess other sources or have a funding mechanism unique to their state.

Figure A.1. Revenue Source—States with a Single Source

State	State USF Funding	Revenues Assessed
CA	$377,000,000	Gross intrastate revenues
TX	$336,000,000	Gross intrastate revenues
OK	$82,389,959	Total gross state retail revenues
KS	$55,096,500	Net intrastate retail revenues (net of uncollectibles)
CO	$53,000,000	Total gross state retail revenues
NE	**$50,200,000**	**Net intrastate retail revenues**
LA	$45,300,000	Total gross state retail revenues
NY	$44,850,000	Net intrastate retail revenues
WI	$44,185,200	Total gross state retail revenues
AR	$39,000,000	Total gross state retail revenues
GA	$35,160,000	Total gross state retail revenues
PA	$31,321,636	Net intrastate retail revenues
NM	$24,800,000	Net intrastate retail revenues
IL	$22,381,001	Net intrastate retail revenues
NC	$16,670,356	Surcharge per line
WA	$14,000,000	State funding
ME	$13,263,324	Net intrastate retail revenues
MI	$12,000,000	Net intrastate retail revenues
UT	$11,100,000	Total gross state retail revenues
IN	$10,828,419	Net intrastate retail revenues
MD	$7,800,000	Per line surcharge
VT	$6,215,000	End user retail purchases
MN	$5,800,000	Per line monthly surcharge
OH	$2,954,598	Monthly $.02 per access line; assessment is technology neutral
MO	$2,650,316	Net intrastate retail revenues
WY	$2,136,364	Total gross state retail revenues
DE	$2,000,000	Total gross state retail revenues
RI	$1,785,084	End user revenues per line and/or trunk
CT	$1,745,172	Total gross state retail revenues
SD	$1,500,000	End user revenues per line and/or trunk
WV	$1,255,000	TRS per line
MT	$770,342	End user per line charge
MS	$725,000	Wireline end users assessed $.10 for each line EUCL line is applicable line
DC	$691,733	Total gross state retail revenues
KY	$540,000	Per line surcharge
ND	$360,000	Assessed per access line
NH	$96,000	Assessed per access line

Figure A.2. Revenue Source—States with Multiple Sources

State	State USF Funding	Revenues Assessed
SC	$45,300,000	Retail revenues; Relay is per access line; IAS - previous year allocation
OR	$44,600,000	Gross intrastate retail revenues; TEP and TRS are per line
AK	$29,234,574	Local: per access line/interconnecting trunk; Intrastate services annual gross and user revenues
ID	$3,231,500	Residential and business local exchange lines; intrastate LD minutes
NV	$2,339,252	Net intrastate retail revenues; monthly TDD surcharge per access line
IA	$1,282,319	Wireline: total gross state retail revenues Wireless: $.03 per month per assigned wireless number
AZ	$1,011,220	Local: per access line/interconnecting trunk; Intrastate toll: % toll revenue

Figure A.3. States Without a Universal Service Fund

State	Support USF type program?	Program Details
AL	No	
FL	Yes	Carriers are required to support Lifeline.
MA	Yes	MA has separate broadband program. 90 million has been allocated since its inception.
NJ	No	
TN	No	

Source for Figures A.1-A.3: Prepared by Audit Office using data from *State Universal Service Funds 2014,* National Regulatory Research Institute, June 2015.

Figure A.4. State Universal Service Funding by Program

State	High Cost Funding	Intrastate Access Reduction Support	Broadband	Lifeline	Schools and Libraries	Telecom Equipment	Telecom Relay Service	Other Funds
AK		$25,714,744		$2,008,087			$54,451	$1,457,292
AR	39,000,000							
AZ	$1,011,220							
CA	$92,000,000		$22,000,000	$150,000,000	$85,000,000	In TRS	$28,000,000	
CO	$50,000,000		$3,000,000				No data	
CT				No data			$1,745,172	
DC				$408,123			$283,611	
DE			$2,000,000				No data	
GA	$15,000,000	$18,600,000				$763,000	$1,400,000	$797,000
IA						$459,129	$823,190	
ID	$1,950,000			$1,142,500			$139,000	
IL	$18,984,631	In High Cost				$3,396,370	In TEP	
IN	$10,218,419							
KS	$48,000,000	$1,300,000		$3,900,000		$450,000	$928,500	$518,000
KY				$360,000		$90,000	$90,000	
LA	$45,300,000						$0	
MD							$7,800,000	
ME	$7,400,000	In High Cost	$1,248,324		$3,830,000	$185,000	$600,000	$50,000 payphone
MI		$12,000,000						
MN				$2,000,000		$1,400,000	$2,400,000	
MO				$1,150,316			$1,500,000	Disabled program
MS							$725,000	
MT							$770,342	
NC							$16,670,356	

State	High Cost Funding	Intrastate Access Reduction Support	Broadband	Lifeline	Schools and Libraries	Telecom Equipment	Telecom Relay Service	Other Funds
ND							$360,000	
NE	**$40,720,000**		**$8,050,000**	**$530,000**				**$900,000**
NH						$96,000	.06/line/month	
NM		$24,000,000		$800,000				
NV	$1,136,879						$1,202,373	TEP and TDD in TRS
NY	$1,150,000			$22,800,000			$5,600,000	$15,300,000
OH							$2,954,598	
OK	$37,000,000			$1,807,321	$36,445,707		$7,136,931	
OR	$40,000,000			$4,600,000			With TAP	
PA	$31,321,636							
RI					$1,200,000	$75,000	$470,084	$40,000
SC	$27,800,000	$13,200,000		$1,000,000		$600,000	$2,200,000	$500,000
SD							$1,500,000	
TX								
UT	$11,100,000			In High Cost				
VT			50% High Cost must be for broadband	$715,000			$500,000	$5,000,000
WA	$5,000,000	In High Cost		$4,000,000		$5,000,000	In TAP	
WI	$11,000		Stand alone grant program	$2,510,000	$36,809,200	$1,800,000	$2,055,000	$1,000,000
WV			$895,000				$360,000	BB funds end 12.31.14
WY	$2,080,000			$56,364			.04/line end user fee	

Source: Prepared by Audit Office using data from National Regulatory Research Institute, *State Universal Service Funds 2014,* June 2015.