



# Oregon

John A. Kitzhaber, MD. Governor

## Public Utility Commission

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December 10, 2012

### ***Via Electronic Filing***

OREGON PUBLIC UTILITY COMMISSION  
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**RE: Docket No. UM 1481 – In the Matter of PUBLIC UTILITY  
COMMISSION OF OREGON Staff investigation of the Oregon Universal  
Service Fund.**

Enclosed for electronic filing in the above-captioned docket is Staff  
Opening Testimony.

*/s/ Mark Brown*  
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c: UM 1481Service List

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**PUBLIC UTILITY COMMISSION  
OF OREGON**

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**UM 1481**

**STAFF OPENING TESTIMONY OF**

**ROGER WHITE**

**In the Matter of  
PUBLIC UTILITY COMMISSION OF OREGON  
Staff investigation of the Oregon Universal Service  
Fund.**

**December 10, 2012**

CASE: UM 1481 Phase II  
WITNESS: ROGER WHITE

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 100**

**Opening Testimony**

**December 10, 2012**

1 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**  
2 **ADDRESS.**

3 A. My name is Roger White. My business address is 550 Capitol Street NE Suite  
4 215, Salem, Oregon 97301-2551.

5 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**  
6 **EXPERIENCE.**

7 A. My Witness Qualification Statement is found in Exhibit Staff/101.

8 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

9 A. The purpose of my testimony is to discuss the background for Staff's  
10 proposal on each of the three issues identified in the judge's ruling and offer  
11 Staff's recommendations related to changes in the Oregon Universal Service  
12 Fund ("OUSF").

13 **Q. WHAT IS STAFF'S RECOMMENDATION CONCERNING THIS DOCKET?**

14 A. Staff's proposal consists of eight elements, which taken together will lower the  
15 surcharge rate, achieve the objectives of ORS 759.425, encourage the  
16 expansion of broadband service while maintaining focus on basic service and  
17 introduce new accountability measures that are not overly burdensome.  
18 Consistent with the purpose of this phase of this docket, these changes are  
19 intended to be short-term changes that can be implemented quickly.

20 **Q. WHAT ARE THE OBJECTIVES OF STAFF'S PROPOSAL?**

21 A. The objectives of Staff's proposal are: 1) to present changes that can be  
22 implemented quickly; 2) lower the surcharge rate; 3) redirect the use of the

1 funds from some of its current uses; and 4) promote accountability and  
2 transparency.

3 **Q. WHAT ARE THE ELEMENTS OF STAFF'S PROPOSAL?**

4 A. The following are the elements of Staff's proposal:

5 1. Staff's proposal would maintain the models currently being used to  
6 calculate the support for both the large and small companies.

7 2. The revenue requirement developed by each of the models would be  
8 reduced to reflect the sharing of cost among the services utilizing the  
9 network.

10 3. A new benchmark would be introduced to establish which areas would be  
11 classified as high cost.

12 4. The results of the models, the adjustments for sharing, and the new  
13 benchmark will produce values which will provide caps to how much  
14 OUSF support companies can receive.

15 5. During the second or third quarter of the year, all recipients of OUSF  
16 money would submit work papers for review demonstrating how much  
17 money they are planning on using and the proposed uses of the money.  
18 These work papers would be used to provide the second cap on how  
19 much OUSF support a company receives.

20 6. The use of the funds would be restricted to offsetting the cost of proposed  
21 network improvements, above average expenses, or previous network  
22 improvements in the high cost areas.

23

1           7. Based on each company's established need for funds, the modeled  
2           constraints, and the fund's balance, the Commission would determine  
3           annually the surcharge rate needed to fund the needs of the companies  
4           and maintain an adequate balance to administer the OUSF fund.

5           8. Reviews and audits would be performed to ensure that each company's  
6           proposal matched its actual expenditures.

7           **Q. WHAT WOULD BE THE IMPACT OF YOUR PROPOSAL ON THE SIZE**  
8           **OF THE FUND?**

9           A. The current annual disbursement is approximately \$44 million. Under Staff's  
10          proposal, using the same benchmark Staff used in Docket UM 1017 to set the  
11          support amounts, the annual disbursements would fall to approximately \$33  
12          million. The corresponding surcharge rate would be between 6 and 6.5  
13          percent. The current surcharge rate is 8.5%.

14          **Q. WHAT ARE THE ISSUES THAT YOU WILL BE ADDRESSING IN YOUR**  
15          **TESTIMONY?**

16          A. There are three issues, which were established in the ALJ's ruling dated  
17          August 29, 2012, that I will be addressing in my testimony:

18                 Issue 1: What changes should be made to the existing OUSF related to the  
19                 calculation, the collection, and the distribution of funds;

20                 Issue 2: What changes should be made to the existing OUSF related to  
21                 how the funds should be used, and;

22                 Issue 3: What changes should be made to the existing OUSF related to  
23                 accountability and transparency?

1       **Q.       HOW IS YOUR TESTIMONY ORGANIZED?**

2       A. My testimony is organized as follows:

3	ISSUE 1(A): An Overview Of The Current Calculation Of OUSF Support.....	5
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5	ISSUE 1(C): Current Support Calculations-- Rural Companies. ....	12
6	ISSUE 1(D): Staff Proposed Changes--Benchmark And Network Sharing. ....	15
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10	ISSUE 3: Accountability And Transparency.....	32

1 **ISSUE 1(A): An Overview Of The Current Calculation Of OUSF Support.**

2  
3 **Q. ARE THERE GUIDELINES FOR CALCULATING OUSF SUPPORT?**

4 A. Yes. The statutory guidelines are found in Oregon Revised Statute (“ORS”)  
5 759.425(3). These guidelines were established prior to 2000 and have not  
6 changed. At that time the guidelines were established, voice services  
7 accounted for almost all of the revenues derived from the facilities that were to  
8 be supported by the OUSF. Currently, the facilities carrying the voice services  
9 are also carrying other revenue producing services.

10 **Q. WHAT DOES ORS 759.425(3) STATE REGARDING THE CALCULATION**  
11 **OF SUPPORT?**

12 A. ORS 759.425(3) describes the process of calculating the support as follows:

13 The universal service fund shall provide explicit support to an eligible  
14 telecommunications carrier that is equal to the difference between the  
15 cost of providing basic telephone service and the benchmark, less any  
16 explicit compensation received by the carrier from federal sources  
17 specifically targeted to recovery of local loop costs and less any explicit  
18 support received by the carrier from a federal universal service  
19 program.  
20

21 **Q. ARE THE COST REFERRED TO IN ORS 759.425(3) THE SAME AS AN**  
22 **ACCOUNTING COST?**

23 A. No. This cost is not the same as the accounting cost one would find on an  
24 income statement. This cost is a proxy for the price or rate of the service. The  
25 cost includes not only the type of expenses one would normally expect to find  
26 on an income statement, it also includes the return on investment. This return  
27 covers both the return to bond holders and to shareholders. Going forward, this  
28 cost—sometimes called an economic cost—will be referred to as the “Rate.”



1 **Q. ORS 759.425(3) REQUIRES THE USE OF A BENCHMARK. WHY IS A**  
2 **BENCHMARK USED IN THESE CALCULATIONS?**

3 A. The benchmark divides the set of wire center and company Rates into two  
4 groups: the high cost group and all others. Employed this way, the benchmark  
5 can be viewed as an affordable rate for basic local exchange service.<sup>1</sup> High  
6 cost Rates are those that are above the affordable rate, all others are at or  
7 below the affordable rate. Another way of viewing the benchmark is as a device  
8 that separates areas into two groups - ones that are candidates for OUSF  
9 support and ones that are not candidates for OUSF support.

10 **Q. ONCE THE BENCHMARK HAS ESTABLISHED WHICH AREAS ARE**  
11 **HIGH COST, WHAT IS THE NEXT STEP IN DETERMINING IF THOSE**  
12 **AREAS SHOULD RECEIVE SUPPORT?**

13 A. Before a candidate high cost area can receive support, the theoretical support  
14 measured by the difference between the Rate and the benchmark must be  
15 adjusted downward. ORS 759.425(3) requires the support to be reduced by  
16 any federal money specifically targeted to recovery of local loop costs and also  
17 by any explicit support the company receives from a federal universal service  
18 program.

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<sup>1</sup> Docket UM731 Phase IV, Order No. 00-312, p 21, Issue 8, "Discussion and Resolution."

1 **Q. WHY DOES ORS 759.425(3) REQUIRE THAT THE THEORETICAL**  
2 **SUPPORT TO BE REDUCED BY ANY EXPLICIT FEDERAL SUPPORT**  
3 **THE COMPANY RECEIVES?**

4 A. Generally speaking, the purpose of the OUSF is to address revenue short-falls  
5 that arise from providing basic local service. To determine if there is a short-  
6 fall, all sources of relevant revenues must be considered. One of those  
7 revenue sources is the Federal Communications Commission (FCC), which  
8 provides companies in need high cost support explicitly directed to subsidizing  
9 last-mile services.

10 **Q. ORS 759.425(3) ONLY ADDRESSES FEDERAL SUPPORT. DOES THIS**  
11 **MEAN THAT NO OTHER REVENUES ARE TO BE CONSIDERED?**

12 A. No. At the time ORS 759.425(3) was created, the only two significant sources  
13 of revenue derived from the local loop network were customers paying for  
14 basic local exchange service and from federal support. Currently, there are a  
15 number of revenue streams generated by the last-mile network that could be  
16 considered when calculating the amount of support a company receives from  
17 the OUSF.

18 **Q. WOULD YOU PLEASE SUMMARIZE HOW OUSF SUPPORT IS**  
19 **CURRENTLY CALCULATED?**

20 A. The current support amounts are calculated in the following three step process:  
21 First, calculate a per-line Rate, which may be wire center specific or done at  
22 the company level. This will vary depending whether the company is classified  
23 as rural or non-rural. Second, calculate the theoretical support per line. This is

1 the difference between the Rate and the benchmark. For Rates less than or  
2 equal to the benchmark, the theoretical support is set at zero. For Rates  
3 greater than the benchmark, the theoretical support is set at the difference  
4 between the Rate and the benchmark. Third, calculate the adjusted support.  
5 This calculation is done by subtracting the support that the company is  
6 receiving from the FCC from the theoretical support per line. If the federal  
7 support is greater than the theoretical support, then the adjusted support is  
8 zero. If the federal support is less than the theoretical support, then the  
9 adjusted support is the difference between the theoretical support and the  
10 federal support.

11 **Q. IS THE CALCULATION PROCESS CURRENTLY USED CONSISTENT**  
12 **WITH ORS 759.425(3)?**

13 A. Yes, the three step process currently being used to calculate support is  
14 consistent with the requirements of ORS 759.425(3).

**ISSUE 1(B): Current Support Calculations-- Non-Rural Companies.****Q. FOR THE PURPOSE OF OUSF SUPPORT, WHICH COMPANIES ARE  
THE NON-RURAL COMPANIES?**

A. When support was first being developed there were two non-rural companies: GTE and US west. These companies later became Verizon and Qwest. At this time, the wire centers once owned by Verizon are now owned by Frontier and the wire centers once owned by Qwest are now owned by CenturyLink. Based upon the method that OUSF support is calculated, both Frontier and CenturyLink have subsidiaries that are classified as rural companies and subsidiaries that are classified as non-rural companies. For the sake of simplicity, whenever talking about specific non-rural companies, I will refer to them as Legacy Verizon and Legacy Qwest rather than their new business unit names.

**Q. PLEASE DESCRIBE HOW THE RATE WAS CALCULATED FOR THE  
NON-RURAL COMPANIES?**

A. The current wire center specific Rates are based on the 1999 FCC Cost Proxy model runs using Oregon specific adjustments. The FCC Cost Proxy model was a forward-looking cost model that assumed a higher cost digital network would replace the current analog network. The Rates that were calculated in 1999 are the same Rates that are used today.

1 **Q. IS THERE A REASON THE RATES HAVE NOT BEEN UPDATED SINCE**  
2 **THEN?**

3 A. The order adopting the methodology and Rates did not require periodic runs of  
4 the model to update the Rates. This was not an oversight on the part of the  
5 order. The FCC model was based on a number of input data sets that for all  
6 practical purposes could not be updated because the exact structure of the  
7 sets was unknown and the owner at the time was not willing to share that  
8 information.

9 **Q. HOW WAS THE BENCHMARK CALCULATED FOR THE NON-RURAL**  
10 **COMPANIES?**

11 A. The \$21 benchmark used in developing the wire center specific support per  
12 line was calculated taking a weighted average of the 1999 FCC model results  
13 for Legacy Verizon and US West model runs. The stated reason for using the  
14 composite output from the model was its relative stability and because it was  
15 viewed as a reasonable surrogate for an affordable rate for basic local  
16 exchange service.

17 **Q. HOW IS SUPPORT DETERMINED FOR THE NON-RURAL WIRE**  
18 **CENTERS?**

19 A. Support for the non-rural wire centers follows the three step process that I have  
20 described under Issue 1(A). For the non-rural companies, the wire center  
21 Rates are calculated by the FCC model as is the benchmark. The theoretical  
22 support was then reduced by the estimated federal support.

1 **Q. DO YOU HAVE ANY CONCERNS ABOUT THE WAY SUPPORT IS**  
2 **CALCULATED FOR THE NON-RURAL COMPANIES?**

3 A. Yes. I have concerns regarding the way support is calculated for the non-rural  
4 companies. The present method of calculating support is disconnected from  
5 the type of service being provided in the high cost areas.

6 **Q. IN WHAT WAY IS THE CALCULATION OF SUPPORT DISCONNECTED**  
7 **FROM THE TYPE OF SERVICE ACTUALLY BEING PROVIDED?**

8 A. The level of support was determined using a model that assumed a network  
9 capable of providing low speed digital services. Presently, there is no process  
10 in place to ensure that the present network is at least reasonably comparable  
11 to the modeled network that was at one time the more expensive than the  
12 actual one in place.

13 **Q. HOW MUCH MONEY ARE THE TWO NON-RURAL COMPANIES**  
14 **PRESENTLY RECEIVING FROM THE OUSF FUND?**

15 A. Annualizing the present draw from the fund, both companies combined are  
16 receiving approximately \$30 million per year.

17

1 **ISSUE 1(C): Current Support Calculations-- Rural Companies.**

2  
3 **Q. HOW MUCH MONEY ARE THE RURAL COMPANIES PRESENTLY**  
4 **RECEIVING FROM THE OUSF FUND?**

5 A. Annualizing the present draw from the OUSF fund, it is approximately \$9  
6 million per year.

7 **Q. HOW DOES THE PROCESS OF CALCULATING SUPPORT FOR THE**  
8 **RURAL COMPANIES DIFFER FROM THE PROCESS USED TO**  
9 **CALCULATED SUPPORT FOR THE NON-RURAL COMPANIES?**

10 A. The two processes for calculating support differ in three ways. First, the  
11 support for the rural companies is based upon actual costs rather than  
12 modeled costs. Second, the support for the rural companies is calculated at the  
13 company level rather than the wire center level Third, the support is calculated  
14 every three years rather than remaining fixed.

15 **Q. WHAT IS THE BASIS FOR DETERMINING A RURAL COMPANY'S**  
16 **SUPPORT PER LINE?**

17 A. The Rate for a rural company is based upon the results of the separation  
18 model, which is specified in detail in the stipulation approved by Order No. 03-  
19 082. The separation model is an integrated model that develops not only the  
20 Rate, it also calculates the theoretical support by subtracting the benchmark  
21 from the Rate, and then adjusts the theoretical support by subtracting any  
22 federal support that the company receives. The output of the model is the  
23 company specific support per line. Unlike the process used for the non-rural

1 companies, the support is calculated at the total company level with all wire  
2 centers getting the same per line support.

3 **Q. IS THE BENCHMARK USED FOR THE RURAL COMPANIES THE SAME**  
4 **AS THE ONE USED FOR THE NON-RURAL COMPANIES?**

5 A. Yes. The \$21 benchmark used in the separations model for the rural  
6 companies is the same benchmark that was used to calculate the support the  
7 non-rural companies. Order No. 03-082 established the link between the  
8 benchmark used by the non-rural companies and the benchmark used by the  
9 rural companies.

10 **Q. WAS A DIFFERENT BENCHMARK USED IN THE MOST RECENT**  
11 **SUPPORT CALCULATIONS?**

12 A. No. The \$21 benchmark was used in calculating the unadjusted support for the  
13 rural companies. The unadjusted support was later reduced in negotiations by  
14 introducing a second, unofficial \$30 benchmark. This benchmark was just a  
15 negotiation tool for lowering the support level. The \$30 value was arrived at by  
16 adjusting the \$21 benchmark for inflation.

17 **Q. WERE YOU PROPOSING TO CHANGE THE BENCHMARK WHEN YOU**  
18 **MADE THIS ADJUSTMENT?**

19 A. No. The adjustment to the benchmark for this particular study was done to  
20 reduce the amount of funds that were going to be disbursed to the rural  
21 companies. A change in the benchmark or payment threshold was the most  
22 reasonable way of doing this at that time.

23



1 **Q. DO YOU HAVE ANY CONCERNS WITH THE WAY SUPPORT IS**  
2 **CALCULATED FOR THE RURAL COMPANIES?**

3 A. Yes. I have concerns with the way support is calculated for the rural  
4 companies. With the possible exception of the rural companies owned by  
5 CenturyLink and Frontier, almost a hundred percent of the rural companies'  
6 customers are served by broadband networks. Voice service is just one of the  
7 services these networks are capable of providing and are providing. The  
8 separation model used to calculate support allocates almost all of the network  
9 cost and associated expenses to basic exchange service and does not offset  
10 these cost in any way. This is an over allocation of costs and is an issue if one  
11 is trying to develop an accurate estimate of the cost of providing basic  
12 telephone service.

13 **Q. IS THIS ISSUE WITH THE SEPARATIONS MODEL OREGON SPECIFIC?**

14 A. No. The issue is not Oregon specific. This issue was discussed in a February  
15 7, 2011, white paper<sup>2</sup> presented to the state member of the Federal-State joint  
16 board on Universal Service. The focus of the paper was on federal support, but  
17 the issues that are identified are very similar to those that we are encountering  
18 with the present Oregon model.

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<sup>2</sup> "Separations" by Peter Bluhm, Lorraine Kenyon, and Dr. Robert Loube, February 7, 2011.

1 **ISSUE 1(D): STAFF Proposed Changes--Benchmark And Network**  
2 **Sharing.**  
3

4 **Q. SHOULD THERE BE A RESTRICTION ON THE TYPES OF NETWORKS**  
5 **BEING SUPPORTED BY THE OUSF IN THE HIGH COST AREAS?**

6 A. No. There should not be a restriction on the type of network being deployed.

7 One of Staff's objectives is to lower the amount of OUSF support that is  
8 needed by the recipient companies to support basic local service. If that  
9 objective can be met by supporting the deployment of broadband networks  
10 capable of providing multiple services, then a broadband network should be  
11 preferred to a narrowband network that is only capable of voice service.

12 **Q. ARE BROADBAND NETWORKS MORE EXPENSIVE THAN VOICE GRADE**  
13 **NETWORKS?**

14 A. Yes. Typically, they are more expensive than voice grade networks because  
15 they require more high cost components than a basic voice grade network to  
16 provide the higher transmission speeds.

17 **Q. IF BROADBAND NETWORKS ARE MORE EXPENSIVE THAN BASIC**  
18 **VOICE GRADE NETWORKS, HOW CAN THE DEPLOYMENT OF A**  
19 **BROADBAND NETWORK LOWER THE AMOUNT OF OUSF SUPPORT**  
20 **NEEDED?**

21 A. Although the total cost of the loop may be higher, when it is shared among a  
22 number of services the cost attributable to basic local service, the actual cost of  
23 basic local service will drop if a reasonable method of allocating a portion of the  
24 cost is used.

1 **Q. CAN YOU GIVE AN EXAMPLE OF A REASONABLE METHOD OF**  
2 **ALLOCATING THE NETWORK COSTS BETWEEN BROADBAND**  
3 **SERVICES AND BASIC LOCAL SERVICE?**

4 **A.** A simple method of allocating joint network cost among broadband services  
5 and basic local service is to divide up the cost of the network equally among  
6 the services. If there were three services being offered, then basic local service  
7 would get one third of the cost.

8 **Q. WOULD YOU REDUCE THE COST BY FEDERAL SUPPORT BEFORE OR**  
9 **AFTER DOING THE ALLOCATION TO SERVICES?**

10 **A.** The reduction should be done after the costs have been assigned to the  
11 services. The federal support is intended to be used for basic local service, not  
12 the broadband services.

13 **Q. ARE THERE BETTER WAYS OF ASSIGNING COST THEN YOUR SIMPLE**  
14 **EXAMPLE?**

15 **A.** Yes. There are better ways of making the assignment of cost to the different  
16 services. There are two ways that have been discussed at the national level.  
17 First, the separations process could be enhanced. . Second, the so-called  
18 “total company financial view” could be employed. However, enhancing the  
19 separations process is outside of the scope this phase of the docket. The “total  
20 company financial view” would require comparing all of the related revenue  
21 streams with the cost to determine if there was a short fall that needed to be  
22 covered by the OUSF.

1 **Q. DOES STAFF PLAN TO PROPOSE A WAY OF ALLOCATING COST TO**  
2 **THE VARIOUS SERVICES THAT USE THE NETWORK WHEN**  
3 **CALCULATING SUPPORT FOR THE COMPANIES?**

4 A. Yes. Staff's proposal will address how to incorporate the method discussed  
5 above into the support calculation.

6 **Q. HAS THE BENCHMARK CHANGED SINCE IT WAS FIRST**  
7 **CALCULATED?**

8 A. No, as mention in the discussion of how the support for rural companies is  
9 calculated, it was noted that the benchmark has not changed since it was first  
10 developed in 1999. During the most recent update of support for the rural  
11 companies the \$21 benchmark was used to calculate the unadjusted support.  
12 During negotiations, Staff used a \$30 benchmark to reduce the Rates coming  
13 out of the separations model, but this did not involve a change in the  
14 benchmark. The \$21 benchmark value was set in Docket UM 731, Order No.  
15 00-312.<sup>3</sup> The same value was subsequently adopted Docket UM 1017, Order  
16 No. 03-082.<sup>4</sup>

17 **Q. ARE THERE ANY LEGAL RESTRICTIONS ON CHANGING THE**  
18 **BENCHMARK?**

19 A. No. There are no legal restrictions on changing the benchmark. To the  
20 contrary, Statute ORS 759.425(3) specifically allows the Commission to  
21 change the benchmark as conditions change. The statute allows the

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<sup>3</sup> Docket UM731 Phase IV, Order No. 00-312, Issue 4, Pp 16-17,

<sup>4</sup> Docket UM 1017, Order No. 03-082, Attachment A, p7.

1 Commission to adjust the benchmark for other relevant factors, which in this  
2 case is the change in price levels.

3 **Q. SHOULD THE BENCHMARK BE ONLY FOR BASIC TELEPHONE**  
4 **SERVICE?**

5 A. No. The stated purpose of the benchmark is to assist in the administration and  
6 distribution of universal service funds for basic telephone service. This does  
7 not require the benchmark to be related to basic service. A quick survey of  
8 basic local exchange rates demonstrates that the benchmark is in fact not the  
9 standard for affordable rates. The benchmark is just a mean to split the Rates  
10 into two groups.

11 **Q. HOW WOULD YOU SET THE BENCHMARK VALUE?**

12 A. I would set the benchmark rate based on a target range for the surcharge rate  
13 and the needs of the companies. As a tool, the benchmark is the easiest and  
14 most straight forward way to set the distribution level and subsequently the  
15 surcharge rate. This method of setting the benchmark rate and establishing the  
16 needs of the companies will be addressed in Staff's proposal.

17

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1 **ISSUE 1(E): Staff's Proposal for Calculating Support.**  
2

3 **Q. WHAT ARE THE OBJECTIVES OF STAFF'S PROPOSAL FOR**  
4 **CALCULATING SUPPORT?**

5 A. The Staff's proposal has three goals, which are to present changes that can be  
6 implemented quickly consistent with the parameters of this phase of the  
7 proceeding, lower the surcharge rate, and promote additional accountability  
8 and transparency.

9 **Q. DOES YOUR PROPOSAL CHANGE THE UNDERLYING MODELS USED**  
10 **TO CALCULATE SUPPORT?**

11 A. No. My current proposal is to leave the basic models used to calculate both  
12 the rural and the non-rural company support unchanged. In the case of the  
13 separations model, which is really an integrated model, I plan on leaving the  
14 separation portion of the model unchanged. This is the section that calculates  
15 the revenue requirement. The other sections make adjustments for federal  
16 support and the benchmark.

17 **Q. WHAT IS YOUR REASON FOR NOT CHANGING EITHER ONE OF THE**  
18 **MODELS USED TO DEVELOP THE RATE?**

19 A. Changing either one of the models would require a significant amount of time  
20 and the process of developing new models could potentially be burdensome for  
21 the companies. The objective of my proposal is to make some changes that  
22 can be implemented quickly without being overly burdensome for the  
23 companies.

1 **Q. DO YOU PLAN ON MAKING ANY CHANGES TO THE OUTPUTS OF THE**  
2 **MODELS?**

3 A. Yes. Staff is proposing on making two changes to the model output. The first  
4 change involves allocating the network cost to the services using the network  
5 based on Staff's simple method of allocation discussed in the Issue 1(D)  
6 section of Staff's testimony. The second change involves changing the value of  
7 the benchmark.

8 **Q. WHY DO YOU WANT TO ALLOCATE NETWORK COSTS TO THE OTHER**  
9 **SERVICES USING THE NETWORK?**

10 A. When there are multiple services sharing the same network, a portion of the  
11 costs need to be assigned to each of the services. Clearly, no one service  
12 should get the entire cost of the network. This allocation is done to get a  
13 reasonably estimate of the actual costs of each of the services. In particular,  
14 this allocation is done in order to calculate a reasonable estimate of the actual  
15 cost of basic local service.

16 **Q. ARE THERE OTHER WAYS OF ARRIVING AT THE AMOUNT OF**  
17 **SUPPORT A COMPANY NEEDS WITHOUT ALLOCATING COST?**

18 A. Yes. It is a common practice to look at all revenue streams when performing a  
19 financial evaluation of a project. In the case of this specific project where we  
20 are looking at the local loop, all revenues derived from the local loop would be  
21 used to determine if additional revenues were needed to make the project meet  
22 the minimum required return. The purpose of high cost support is to ensure

1 that the revenues derived from it cover expenses, return of capital, and return  
2 on capital.

3 **Q. ONCE A COST HAS BEEN ASSIGNED TO BASIC LOCAL SERVICE**  
4 **WHAT ARE THE NEXT STEPS IN THE PROCESS YOU ARE**  
5 **PROPOSING?**

6 A. The next steps are identical to the current ones. The cost is first reduced by any  
7 explicit federal support the company receives and then by the benchmark. If  
8 the remaining amount is greater than zero that is the support that the company  
9 receives.

10 **Q. WHY ARE YOU PROPOSING TO CHANGE THE BENCHMARK IN YOUR**  
11 **PROCESS?**

12 A. The original benchmark was set about twelve years ago as a proxy for  
13 affordable service. Since that time the buying power of \$21 has dropped with  
14 inflation. The benchmark also provides an easy way control the size of the  
15 fund, the amount of money flowing out of the fund, and the surcharge rate.

16 **Q. HOW DOES THE BENCHMARK CONTROL THE AMOUNT OF MONEY**  
17 **FLOWING OUT OF THE FUND?**

18 A. When a benchmark is introduced into the support calculation process it will in  
19 most cases reduce the support per line for any given company, which will in  
20 turn reduce the amount of support that the company is receiving. Once a  
21 benchmark has been introduced into the calculation process changing it up or  
22 down will decrease or increase the amount of money being disbursed; the level  
23 of support drops as the benchmark increases.



1 **Q. HOW DOES THE MONEY FLOWING OUT OF THE FUNDS IMPACT THE**  
2 **SURCHARGE RATE?**

3 A. The surcharge rate is set to balance the flow of funds into and out of the  
4 OUSF. If the flow of funds out of the OUSF drops then, everything else  
5 unchanged, the surcharge rate can be dropped as well.

6 **Q. IS IT YOUR INTENT TO USE A TARGET SURCHARGE RATE WHEN YOU**  
7 **SET THE BENCHMARK?**

8 A. Yes. Staff's proposal involves first establishing a target range for the surcharge  
9 rate and then determining a benchmark that will allow the surcharge to be in  
10 that range. Both the surcharge rate and the benchmark will be upper bounds.  
11 The second step to Staff's proposal will establish the actual disbursement  
12 amounts and the actual surcharge rate.

13 **Q. WHAT IS THE SECOND STEP IN STAFF'S PROPOSAL?**

14 A. The second step of Staff's proposal requires the companies to report how they  
15 will be using their OUSF distributions in the upcoming year. This reporting will  
16 be done in either the third or the fourth quarter of the preceding year to allow  
17 enough time to review the proposals.

18 **Q. WHAT IS THE THIRD STEP IN STAFF'S PROPOSAL?**

19 A. The third step in Staff's proposal consists of comparing each company's  
20 support as calculated by the modeling process with what each company needs  
21 for the upcoming year, based on the reports filed with Staff. Actual support for  
22 each company is calculated as the smaller of the model results and what they  
23 report that they need.

1 **Q. WHAT IS THE FOURTH STEP IN STAFF'S PROPOSAL?**

2 **A.** The fourth step in the process is to calculate a new surcharge rate based  
3 upon the support requirements established in step three of this process.  
4 This new surcharge rate will be effective for one year.

5 **Q. WHAT IS THE FIFTH AND LAST STEP IN STAFF'S PROPOSAL?**

6 **A.** The last step in Staff's proposal is the recalibration of the model based upon  
7 support per line amounts. These will be proportionally changed for each  
8 company depending on the percent reduction that occurs when the reported  
9 requirement is compared to the modeled requirement.

10 **Q. ARE THERE ANY OTHER CHANGES TO THE METHOD OF**  
11 **CALCULATING SUPPORT THAT STAFF IS PROPOSING?**

12 **A.** No.

13 **Q. YOU HAVE DISCUSSED THE TREATMENT OF RURAL AND NON-**  
14 **RURAL COMPANIES, BUT NOT COMPETITIVE LOCAL EXCHANGE**  
15 **CARRIERS ("CLEC"). HOW WOULD CLEC'S BE TREATED UNDER**  
16 **STAFF'S PROPOSAL?**

17 **A.** A CLECs would be treated similarly to the rural companies. Their support  
18 would be the minimum of the model based support value and the company's  
19 estimate of what it needs to cover its revenue requirement

20 **Q. WOULD THE MODEL BASED RESULT BE ADJUSTED TO REFLECT THE**  
21 **CLECS DEPLOYMENT OF BROADBAND SERVICES?**

22 **A.** Yes. Any adjustments to the model results would be CLEC specific.

23

1 **ISSUE 1(F): collection and disbursement of support.**  
2

3 **Q. DO YOU HAVE ANY CONCERNS ABOUT THE LINE COUNTS USED TO**  
4 **DETERMINE DISTRIBUTION AMOUNTS?**

5 A. Yes. One of my concerns has to do with the adoption of the Ethernet  
6 technology using VoIP (VoIP) or other advanced technologies to serve basic  
7 local service customers. At the present time, companies that utilize VoIP to  
8 deliver basic local service to their customers are not required to hold a  
9 certificate and subsequently are not required to pay into the OUSF. Similarly, it  
10 makes sense that a company that is using VoIP to deliver basic local service  
11 should not use those line counts to receive support if revenues from VoIP lines  
12 are exempt from the surcharge.

13 **Q. ARE YOU PROPOSING THAT ANY COMPANY USING VOIP TO**  
14 **PROVIDE LOCAL SERVICE SHOULD NOT INCLUDE VOIP LINES IN**  
15 **THOSE LINE COUNTS UPON WHICH THEIR SUPPORT IS BASED?**

16 A. No. From the standpoint that revenues derived from VoIP services are not  
17 subject to the OUSF, it makes sense that VoIP lines cannot be used to in the  
18 line count used to determine support. However, the revenues derived from  
19 VoIP services should be subject to the OUSF and the lines counts should  
20 include lines where VoIP is used to deliver basic local service.  
21  
22  
23

1 **Q. WHY ARE YOU PROPOSING TO INCLUDE REVENUES AND LINES**  
2 **WHEN VOIP IS USED TO DELIVER BASIC LOCAL SERVICE?**

3 A. The FCC has authorized states to include VoIP revenues in the base of  
4 revenues subject to state USF surcharges.

5 **Q. IS THERE ANY OTHER REASON WHY YOU WOULD NOT**  
6 **DIFFERENTIATE BETWEEN CONNECTIONS TO AN END-USER**  
7 **CUSTOMER SET UP BY VOIP AND ANY OF THE OTHER CURRENT**  
8 **MEANS OF CONNECTING TO AN END-USER?**

9 A. Yes. Although the technology used to connect to the end-user is different, the  
10 use of the technology is not different. In each case, the function being  
11 performed is connecting the end-user to the network. Although there are  
12 additional features that can be derived from one type of technology or another,  
13 the key feature in this case is setting up a voice path over the local loop so the  
14 end-user at a fixed location can speak with another end-user.

15 **Q. DO YOU THINK THAT INCLUSION OF REVENUES FROM VOIP**  
16 **PROVIDERS WILL SUBSTANTIALLY INCREASE THE SIZE OF THE**  
17 **REVENUE BASE?**

18 A. No. I do not think that inclusion of revenues from the VoIP providers that are  
19 presently not paying into the fund will greatly increase the revenue base. I do,  
20 however, believe that the inclusion of revenues from those companies will  
21 make the process fairer.

22

1 **Q. ARE YOU PROPOSING THAT REVENUES FROM VOIP ENABLED**  
2 **SERVICES SHOULD BE SUBJECT TO THE OUSF SURCHARGE.**

3 A. Yes.

4 **Q. ARE THERE ANY OTHER CHANGES THAT YOU WOULD MAKE**  
5 **REGARDING DISBURSEMENTS TO THE COMPANIES?**

6 A. Yes. Staff would like to eliminate the revenue neutral requirement. This  
7 requirement was implemented to prevent the companies from getting a windfall  
8 from the OUSF support. Both the rural companies and the non-rural companies  
9 were required to offset any money received from the OUSF by an equal  
10 amount of revenue reduction achieved by lowering prices.

11 **Q. WHY DO YOU WANT TO ELIMINATE THIS REQUIREMENT?**

12 A. The focus should be on improving the network and this is done by providing the  
13 companies with the additional money that they need to make these  
14 improvements. The goal of revenue neutrality is not network improvement, but  
15 rather price reduction. Because most of the rates are below the \$21  
16 benchmark, I do not think the emphasis should be on lowering basic local  
17 service rates. With enhanced networks will come enhanced revenue streams  
18 and these should reduce the amount of OUSF support that is required.

1 **ISSUE 2: Use of the Funds.**  
2

3 **Q. HOW WERE LEGACY VERIZON AND LEGACY QWEST DIRECTED TO**  
4 **USE THE MONEY THAT THEY RECEIVED FROM THE FUND?**

5 A. Order No. 00-312<sup>5</sup> directed Legacy Verizon and Legacy Qwest to file revenue  
6 neutral tariff filings; for each dollar of support that the companies received from  
7 the OUSF they were to reduce revenues by a dollar. Both Legacy Qwest and  
8 Legacy Verizon focused on reducing business services rates.

9 **Q. ARE THE TWO LEGACY COMPANIES STILL USING THE MONEY TO**  
10 **HOLD DOWN BUSINESS RATES?**

11 A. When Staff conducted a review of the rates about two years ago, both  
12 companies appear to be holding the rates at the agreed upon level.

13 **Q. ORDER NO. 11-192 DIRECTED THE TWO LEGACY COMPANIES TO**  
14 **FILE REPORTS SHOWING HOW MUCH THEY WERE INVESTING AND**  
15 **SPENDING IN THE HIGH COST AREA. HAVE YOU RECEIVED THESE**  
16 **REPORTS?**

17 A. Yes. I have received report for both 2010 and 2011.

18 **Q. WOULD YOU SUMMARIZE WHAT YOU HAVE CONCLUDED FROM**  
19 **THESE REPORTS?**

20 A. Yes. Based on this two-year sample, the amount of money being generated by  
21 the high cost areas significantly exceeds the investment and expenses in those  
22 areas.

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<sup>5</sup> Docket UM 731 Phase IV, Order No. 00-312, p. 28.

1 **Q. WOULD YOU CHANGE THE WAY THE NON-RURAL COMPANIES ARE**  
2 **USING THE OUSF MONEY?**

3 A. Yes. The intent of the OUSF money is to ensure the quality and affordability of  
4 basic local service in the high cost areas. Clearly a portion of the payment to  
5 those areas is to offset above average expenses. The remaining portion of the  
6 money that these companies receive should go making.

7 **Q. HAVE THERE BEEN ANY RECENT RULING DIRECTING THE NON-**  
8 **RURAL COMPANIES TO CHANGE HOW THEY USE THE SUPPORT?**

9 A. Yes, there was a ruling on how the non-rural companies should use the money  
10 that they receive from the OUSF. The following is a passage taken from Order  
11 No. 10-496 directing the non-rural companies to use the support for investment  
12 and expenses in the high cost areas:

13 First, we clarify that non-rural companies may only use OUSF  
14 distributions for investment in infrastructure or maintenance, such as  
15 new investment or investment associated with repairs and  
16 maintenance.

17 **Q. WAS THIS RULING OVERTURNED?**

18 A. Yes, the ruling was overturned because it was determined that there was not a  
19 sufficient record on which to base the decision.  
20  
21  
22

1 **Q. DOES STAFF AGREE WITH THE FINDINGS OF THE ORDER THAT WAS**  
2 **OVERTURNED?**

3 A. Yes. Staff believes that the OUSF distributions for the non-rural companies  
4 should be used to improve the infrastructure and the level of maintenance in  
5 the high cost areas. This was part of Staff's proposal.

6 **Q. YOU TESTIFIED EARLIER THAT LEGACY VERIZON AND LEGACY**  
7 **FRONTIER HAVE MAINTAINED THE RATES AT THE AGREED UPON**  
8 **LEVEL. WOULD YOU ALLOW THEM TO INCREASE RATES AS PART OF**  
9 **THIS TRANSITION?**

10 A. Yes. I believe that it is fair to allow the companies to change prices as part of  
11 this transition, with the exception of those that were set in subsequent rate  
12 case.

13 **Q. HOW ARE THE FUNDS CURRENTLY BEING USED BY THE RURAL**  
14 **COMPANIES?**

15 A. The funds are being used to reduce the intrastate carrier common line charge  
16 and some other elements of the intrastate access charges. The funds are also  
17 being used to reduce billing and collection and special access rates to a lesser  
18 degree. These reductions are done on a revenue neutral basis. Starting this  
19 year with the Order No. 12-204, the rural companies are also allowed to use  
20 the support to fund the basic local service revenue shortfall.

21

22



1 **Q. HAVE THERE BEEN ANY RECENT RULINGS ON HOW THE RURAL**  
2 **COMPANIES SHOULD USE THE SUPPORT?**

3 A. Yes, there was a ruling on how the rural companies should use the money that  
4 they receive from the OUSF. Order No. 11-472 found no issue with the  
5 companies using money from the OUSF to reduce the portion of the loop  
6 assigned to intrastate access rates: the Carrier Common Line Charge (CCLC)  
7 element of the intrastate access rates, which is an implicit subsidy of basic  
8 local service. The order also stated that it was inappropriate to use the OUSF  
9 money to reduce the remaining elements, which are wholesale service rates.<sup>6</sup>

10 **Q. HOW WERE THE RURAL COMPANIES DIRECTED TO USE THE MONEY**  
11 **THAT THEY RECEIVED FROM THE FUND?**

12 A. Order No. 03-082<sup>7</sup> directed the companies to use their OUSF distributions to  
13 reduce the intrastate access Carrier Common Line Charge (CCLC)<sup>8</sup> revenue  
14 requirement and if there was any money left after do that, they were to reduce  
15 the prices of other services or return the excess money.

16 **Q. HAVE THERE BEEN ANY CHANGES IN HOW THE RURAL COMPANIES**  
17 **CAN USE THE FUNDS?**

18 A. Yes. Order No. 12-204<sup>9</sup> expanded the scope of how they could use to the  
19 funds. Under this order the companies can use the money from the fund to  
20 cover any gap between their local service revenue requirement and the

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<sup>6</sup> Docket UM1017 (iii), Order No. 11-472, p. 10

<sup>7</sup> Docket UM 1017, Order No. 03-082, Pp. 28-29.

<sup>8</sup> A portion of the local loop revenue requirement has been allocated to intrastate access charges and is the CCLC elements of the intrastate rates.

<sup>9</sup> Docket UM 1017, Order No. 02-206, Attachment 1, p.4.

1 revenues that they receive from their customers and from the FCC. The  
2 primary use of the funds is still the reduction of the CCLC revenue requirement.  
3 Under the current stipulation, the support is not on a per line basis.

4 **Q. HOW WOULD YOU CHANGE THE CURRENT PROCESS FOR THE RURAL**  
5 **COMPANIES?**

6 A. I would make three changes to the current process: 1) determine support on  
7 an annual basis; 2) revert to the prior method of providing support on a per line  
8 basis and; 3) establish the level of required support in the third or fourth quarter  
9 of the prior year. This support would be the lesser of the model based support  
10 and what the company is reporting

**ISSUE 3: ACCOUNTABILITY AND TRANSPARENCY****Q. WHAT ACCOUNTABILITY AND TRANSPARENCY MEASURES ARE CURRENTLY IN PLACE?**

A. The Legacy Verizon and Legacy Qwest companies file an annual report showing their investments and expenses by high cost wire center. The rural companies have an annual access charge filing in which they show the amount of OUSF support being used to offset the CCLC revenue requirement and other access related revenue requirements. Starting this year, the rural companies were also required to file work papers showing how the remaining OUSF support was used.

**Q. DO YOU HAVE ANY ISSUES WITH THE ACCOUNTABILITY AND TRANSPARENCY MEASURES FOR LEGACY VERIZON AND LEGACY QWEST?**

A. Yes. The assignment of expense to the high cost areas is done on an allocation basis, which was inconsistent between companies. When Staff requested that each company provide documentation that would support the allocation neither company was able to do so. Staff was told that the companies do not track expenses at a level where they can directly assign them to the high cost areas.

**Q. HOW DO YOU PROPOSE TO TREAT EXPENSES GOING FORWARD?**

A. If expenses are going to be considered in determining the level of support needed by the companies, the companies will need to implement changes that

1 allow the expenses to be identified at a low enough level to associate them  
2 with the high cost wire centers or clusters of high cost wire centers. If the  
3 companies choose not to develop this information, then the level of expenses  
4 should be set at a Staff determined amount.

5 **Q. WHAT IS YOUR ACCOUNTABILITY AND TRANSPARENCY PROPOSAL**  
6 **FOR LEGACY VERIZON AND LEGACY QWEST?**

7 A. Once the issue with expense reporting has been resolved, the reports filed by  
8 the companies would be adequate for the accountability and transparency  
9 process. The process would consist of the following steps:

- 10 1) In the third or fourth quarter, each company would file its estimate of  
11 investment and expenses for the following year.
- 12 2) The level of support would be established based on whichever was smaller,  
13 the model based support or the need forecasted by the company.
- 14 3) The model based support per line amounts for each wire center would be  
15 adjusted to reflect the impact of projected expenditures.
- 16 4) After the books have closed for a given year, the expenditures will be  
17 audited to verify the company's estimates and make true-ups as necessary.

18 **Q. DO YOU HAVE ANY ISSUES WITH THE ACCOUNTABILITY AND**  
19 **TRANSPARENCY MEASURES FOR THE RURAL COMPANIES?**

20 A. Aside from the timing of the reports, the primary issue with accountability and  
21 transparency measures for the rural companies is the need to standardize the  
22 report format so it is consistent across all companies and includes the  
23 appropriate revenue requirements and appropriate offsetting revenues.

1 **Q. WHAT ISSUES DO YOU HAVE WITH THE TIMING OF THE REPORTS?**

2 A. Staff would like to see the reports developed in time to set the level of support.

3 In Staff's proposal, the modeled level of support and the amount of support  
4 needed by the company would establish the amount of support that company  
5 receives in the following year.

6 **Q. WHAT IS YOUR ACCOUNTABILITY AND TRANSPARENCY PROPOSAL**  
7 **FOR THE RURAL COMPANIES AND CLECS?**

8 A. My proposal for the rural companies would be very similar to the one used for  
9 the non-rural companies, with the one exception that it would be based upon  
10 their revenue requirement rather than their projected investments and  
11 expenses. The process for the rural companies would be as follows:

12 1) In the third or fourth quarter, each company would file work papers  
13 supporting its request for OUSF support based on its local service revenue  
14 requirement.

15 2) The level of support would be established based on whichever was smaller,  
16 the model based support or the request for OUSF support.

17 3) The model based support per line amounts will be adjusted to reflect the  
18 amount of support determined in step 2.

19 4) Periodic audits will be conducted to verify the financial information, the  
20 information used to establish offsets to the model costs, and line counts.

21 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

22 A. Yes.

23

CASE: UM 1481  
WITNESS: Roger White

**PUBLIC UTILITY COMMISSION  
OF  
OREGON**

**STAFF EXHIBIT 101**

**Witness Qualifications Statement**

**December 10, 2012**

### WITNESS QUALIFICATION STATEMENT

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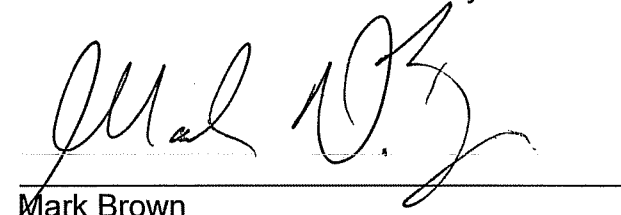
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Manager Cost Models and Methodology, GTE/Verizon-Irving, 1995-2001.  
Manger Process Cost, GTE, 1994-1995, GTE-Irving.  
Manager Research/Methods, GTE-Stamford, 1989-1994.  
Staff Manager Pricing Policy, GTE-Stamford, 1987-1989.  
Administrator Demand Analysis, GTE-MTO, 1982-1987.  
Administrator Pricing, GTE-Northwest, 1981-1982.  
Administrator Economic Research, GTE-Northwest, 1977-1981.  
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CERTIFICATE OF SERVICE

UM 1481

I certify that I have, this day, served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-001-0180, to the following parties or attorneys of parties.

Dated this 10th day of December, 2012 at Salem, Oregon

A handwritten signature in black ink, appearing to read 'Mark Brown', is written over a horizontal line.

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