



Oregon

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January 30, 2013

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
Response Testimony.

/s/ Kay Barnes

Kay Barnes

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c: UM 1481Service List

**PUBLIC UTILITY COMMISSION
OF OREGON**

**UM 1481
Phase II**

STAFF RESPONSE TESTIMONY OF

Roger White

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

January 30, 2013

**PUBLIC UTILITY COMMISSION
OF
OREGON**

STAFF EXHIBIT 200

Response Testimony

January 30, 2013

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. There are four purposes to my testimony 1) propose an alternative to the way
10 the non-rural companies will use the OUSF going forward, 2) modify the way
11 support is calculated for the non-rural companies, 3) modify the way support is
12 calculated for the rural companies, and 4) introduce some additional
13 accountability and transparency processes.

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

15 A. My testimony is organized as follows:

| | | |
|----|--|----|
| 16 | INTRODUCTION | 2 |
| 17 | What changes should be made to the existing OUSF related to how | |
| 18 | the funds should be used? | 7 |
| 19 | What changes should be made to the existing OUSF related to the | |
| 20 | calculation, the collection, and the distribution of funds?..... | 11 |
| 21 | what changes should be made to the existing OUSF related to | |
| 22 | accountability and transparency? | 28 |

1 **INTRODUCTION**
2

3 **A. GUIDELINES FOR CHANGES**

4 **Q. WHAT GUIDELINES IS STAFF FOLLOWING IN ITS PROPOSAL?**

5 A. Staff is assuming that all proposals must be consistent with the current Oregon
6 statutes, in particular ORS 759.425. This statute establishes the requirement
7 for the OUSF, the goal of the OUSF, and the general guidelines for calculating
8 support.

9 **Q. ARE THERE OTHER GUIDELINES THAT STAFF IS FOLLOWING?**

10 A. Yes, there are other guidelines that staff is following as well. The following is a
11 brief list of other guidelines staff is following:

- 12 • The proposals should be limited to short-term changes that can be
13 implemented quickly, even though there might be better solutions.
- 14 • The proposals must be consistent with ORS 759.218.
- 15 • The proposals should encourage the deployment of broadband networks
16 wherever possible as required by ORS 759.016, but not subsidize it.

17 **Q. CAN YOU EXPLAIN WHAT YOU MEAN BY THE STATEMENT THAT**
18 **STAFF'S PROPOSAL SHOULD BE LIMITED TO SHORT-TERM**
19 **SOLUTIONS?**

20 A. Yes. The models presently used in the calculation of support for both the rural
21 and the non-rural companies need to be updated. In both cases, this is not a
22 simple process and could involve a year or more of works, assuming all of the
23 needed inputs were available.

1 **Q. CAN YOU EXPLAIN WHAT YOU MEAN BY STAFF’S “PROPOSAL MUST**
2 **BE CONSISTENT WITH ORS 759.218”?**

3 A. Yes. ORS 759.218 blocks a company from subsidizing its non-regulated
4 business with the regulated portion of its business. This would occur, for
5 example, if a company were allowed to use a network shared by both regulated
6 and non-regulated services without allocating a reasonable share of the
7 investment and expenses to the non-regulated business. This statute also
8 prevents the Public Utility Commission from requiring revenues from an activity
9 that is not regulated to be attributed to the regulated activities.

10 **Q. IS STAFF’S GUIDELINE THAT BROADBAND DEPLOYMENT BE**
11 **ENCOURAGED INCONSISTENT WITH THE STATED GOAL OF**
12 **ORS 759.425?**

13 A. No, this is not inconsistent with the stated goal of ORS 759.425. With the
14 exception of wireless service, this statute is silent on how basic local service
15 is provisioned. The stated goal of the OUSF found in ORS 759.425(1) is to
16 ensure basic telephone service is available at a reasonable and affordable
17 rate. If deploying broadband networks can achieve this goal while lowering
18 the amount of support required, then the deployment of broadband networks
19 should be encouraged.

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1 **B. TYPES OF NETWORKS SUPPORTED BY THE OUSF**

2 **Q. ARE THERE ANY STATUTES THAT PROVIDE GUIDANCE ON HOW THE**
3 **OREGON UNIVERSAL SERVICE FUND (OUSF) SHOULD BE USED?**

4 A. Yes. There are two Statutes that speak directly to the need for high quality
5 universal service. There is also a third statute that does not speak to universal
6 service, but speaks to a state telecommunication goal. This statute declares
7 that it is a goal of the state to promote access to broadband services for all
8 Oregonians. Statutes ORS 759.015 and ORS 759.425 directly address the
9 need for high quality telecommunications service; Statute ORS 759.016
10 addresses the desirability of deploying networks capable of broadband service.

11 **Q. ORS 759.425 STATES THAT THE OUSF SHOULD BE USED FOR BASIC**
12 **TELEPHONE SERVICE. DOES THAT PRECLUDE THAT SERVICE FROM**
13 **RIDING ON A NETWORK CAPABLE OF PROVIDING BROADBAND**
14 **SERVICES (BROADBAND NETWORK)?**

15 A. No. ORS 759.425 does not preclude the possibility of basic local service riding
16 on a broadband network. This statute does not require basic telephone service
17 to be an analog service provided over a traditional copper network. The statute
18 is silent on what hardware and software is used to provide basic local service.

19 **Q. IS THERE AN ADVANTAGE TO HAVING THE BASIC LOCAL SERVICE**
20 **PROVIDED ON A BROADBAND NETWORK?**

21 A. Yes. There can be an advantage to having basic local service carried on a
22 broadband network. If the cost of the network can be shared among different
23 services and if the cost of basic local service resulting from this sharing is less

1 than what it would be if it were the only service riding a voice grade network,
2 then there is an advantage to providing the service on a broadband network.

3 **Q. SHOULD THE OUSF FUND THE DEPLOYMENT OF NETWORKS THAT**
4 **ARE CAPABLE OF PROVIDING BROADBAND SERVICE?**

5 A. The purpose of the OUSF is to help fund the cost of basic local service. If the
6 deployment of broadband networks results in a lower cost of basic telephone
7 service and lower support amounts, the answer is yes. If the deployment
8 results in a higher cost of basic telephone service and a need for a higher level
9 of OUSF support, the answer is no.

10 **Q. DO YOU HAVE A GENERAL GUIDELINE FOR DETERMINING IF BASIC**
11 **LOCAL SERVICE SHOULD BE PROVIDED ON A BROADBAND**
12 **NETWORK?**

13 A. Yes. If basic local service is being provided by a broadband network, the cost
14 allocated to basic local service should not exceed the cost of providing the
15 service on a voice grade network.

16 **Q. WOULD YOU EXPECT THE COST ASSIGNED TO BASIC LOCAL SERVICE**
17 **TO BE LESS THAN THAT?**

18 A. Yes. A significant portion of the cost of a local loop is associated with items that
19 are common to both voice grade and broadband networks: cables, trenches,
20 poles, and ducts. On a shared network, these items would be allocated to the
21 services using the network. With one or more services being provided on the
22 network, the basic local service's portion of this cost should be reduced by 50
23 percent or more.

1 **C. GROUPING OF ILEC COMPANIES**

2 **Q. WHICH TYPES OF COMPANIES PRESENTLY RECEIVE SUPPORT**

3 **FROM THE OUSF?**

4 A. When the process for calculating support was set up, there were three different
5 types of companies: the rural companies, the non-rural companies, and the
6 CLECs. The non-rural companies have their support calculated based on a
7 forward-looking model, the rural companies have their support based a
8 separations model that allocates their book cost, and the CLECs get their
9 support based on the support that the ILEC is receiving for that wire center.

10 **Q. WHAT CHANGES HAVE TAKEN PLACE SINCE THAT TIME?**

11 A. The two non-rural companies at the time the fund was being set up, GTE and
12 US West, are no longer in existence. The GTE properties are now part of
13 Frontier and the US West properties are now part of CenturyLink.

14 **Q. HOW WILL STAFF BE IDENTIFYING THE COMPANIES IN ITS PROPOSED**
15 **CHANGES?**

16 A. The original GTE and US West properties will be labeled Frontier Northwest
17 and CenturyLink QC respectively or generically the non-rural companies. The
18 other holdings of CenturyLink and Frontier Communications (United,
19 CenturyTel, and Frontier) will be labeled rural companies and included in that
20 category.

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1 **WHAT CHANGES SHOULD BE MADE TO THE EXISTING OUSF RELATED TO**
2 **HOW THE FUNDS SHOULD BE USED?**
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4 **A. ALTERING HOW THE NON-RURAL COMPANIES USE THE MONEY**

5 **Q. HOW ARE THE NON-RURAL COMPANIES PRESENTLY USING THE**
6 **MONEY THEY RECEIVE FROM THE OUSF AND HOW WILL THIS CHANGE**
7 **GOING FORWARD?**

8 A. The two non-rural companies are still using the OUSF money as directed in
9 Order No. 00-312. In that order the companies were required to reduce their
10 revenues by the amount that they were going to receive from the OUSF. The
11 companies did this by lowering rates on a number of services. Neither
12 company has increased these rates since that time. Under Staff's proposal the
13 companies would no longer be bound to keep those rates fixed once the use of
14 the OUSF has been repurposed. Any rate changes would have to follow the
15 normal requirements each company faces for making rate changes.

16 **Q. UNDER STAFF'S PROPOSAL, HOW WOULD THE NON-RURAL**
17 **COMPANIES USE OF THE MONEY BE REPURPOSED?**

18 A. The non-rural companies would be required to use the money to maintain and
19 upgrade their public switched telephone networks in the high cost areas. The
20 money would be used for investment in interoffice facilities, switching, and local
21 loop.
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1 **B. ALTERING HOW THE RURAL COMPANIES USE THE MONEY**

2 **Q. HOW ARE THE RURAL COMPANIES PRESENTLY USING THE MONEY**

3 **THEY RECEIVE FROM THE OUSF?**

4 A. In the past the funds were used to reduce the intrastate carrier common line
5 charge and occasionally some other elements of the intrastate access charges.

6 The carrier common line charge recovers the portion of the local loop revenue
7 requirement that has been assigned to intrastate access rates. The funds were
8 also occasionally being used to reduce billing and collection and special
9 access rates. Starting this year, Order No.12-204 allows the rural companies to
10 use the support to fund any basic local service revenue shortfalls. A revenue
11 short fall occurs when the revenues received from a company's customers and
12 from federal support do not cover the basic local service revenue requirement.

13 **Q. HOW DOES STAFF'S PROPOSAL DIFFER FROM HOW THE COMPANIES**
14 **ARE PRESENTLY USING THE MONEY?**

15 A. Under Staff's proposal, the funds would only be used to offset the local service
16 revenue requirement and the portion of the carrier common line charge
17 revenue requirement that was not offset by ARC/CAF support.

18 **Q. WOULD YOU SUMMARIZE YOUR PROPOSAL FOR THE NON-RURAL AND**
19 **RURAL COMPANIES?**

20 A. The non-rural companies would be required to use their support for
21 maintenance and new investment in their high cost areas, while the rural
22 companies would be required to use the money to cover any basic local
23 service revenue short falls.

1 **Q. WHY ARE THE RURAL COMPANIES AND THE NON-RURAL**
2 **COMPANIES TREATED DIFFERENTLY UNDER STAFF'S PROPOSAL?**

3 A. Staff's would prefer that the companies use the OUSF to offset any revenue
4 short falls that they have for basic local service; this is how the rural companies
5 are presently using the money. At this time, this method would not be feasible
6 for the non-rural companies for two reasons: 1) the non-rural companies would
7 have difficulty determining the revenue requirement for their high cost areas; 2)
8 the rural companies are being compensated for what they did while the non-
9 rural companies will be compensated for what they will do going forward.

10 **Q. WHY WOULD THE NON-RURAL COMPANIES HAVE DIFFICULTY**
11 **DETERMINING THE REVENUE REQUIREMENT FOR THEIR HIGH COST**
12 **AREAS?**

13 A. Each of the rural companies is treated as a high cost area for purpose of
14 calculating support this allows separation studies to be done at the total
15 company level. For the non-rural companies, only a subset of wire centers is
16 identified as high cost. Any separation study addressing only the high cost
17 areas would have to be done below the total company level. The process of
18 carrying out such a study would most likely require the creation of another set
19 of books, a complicated and possibly costly process.

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1 **Q. HOW WOULD CENTURYTEL, UNITED, AND FRONTIER BE TREATED**
2 **UNDER YOUR PROPOSAL?**

3 A. All three of these business units currently have their support calculated on a
4 total company basis just like any other rural company. Staff proposes that they
5 be treated like rural companies going forward..

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7 **C. THE CLECS USE THE MONEY.**

8 **Q. HOW IS THE SUPPORT THE CLECS RECEIVES DETERMINED?**

9 A. The per line support that a CLEC receives is linked to the ILEC wire center that
10 originally serve its customers. Adjustments are made to the support the CLEC
11 receives varying with how the CLEC provides service. If the CLEC is providing
12 the service with its own facilities, it gets all of the support. If the CLEC is
13 providing the service with a UNE, it get a portion of the per line support
14 designated for that wire center. If the CLEC is re-selling the facility, it gets no
15 support.

16 **Q. HOW ARE THE CLECS USING THE MONEY THAT THEY RECEIVE FROM**
17 **THE OUSF FUND?**

18 A. At this time, the CLECs are not required to provide any specific information on
19 how they are using the money that they receive from the fund.

20 **Q. IS STAFF PROPOSING TO CHANGE HOW THE CLECS USE THE FUNDS**
21 **THAT THEY RECEIVE FROM THE OUSF?**

22 A. No. Staff is not proposing to change how the CLEC use the money that they
23 receive from the OUSF fund.

1 **WHAT CHANGES SHOULD BE MADE TO THE EXISTING OUSF RELATED TO**
2 **THE CALCULATION, THE COLLECTION, AND THE DISTRIBUTION OF**
3 **FUNDS?**
4

5 **A. CURRENT CALCULATION OF SUPPORT FOR NON-RURAL COMPANIES**

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7 **Q. HOW IS SUPPORT CALCULATED FOR THE NON-RURAL COMPANIES?**

8 A. Support for the non-rural companies was calculate in 1999 and has not been
9 updated since then. The support for the non-rural companies was calculated
10 through a three step process: 1) the FCC Cost Proxy model was used to
11 develop wire center specific costs per line; 2) the model results for both of the
12 non-rural companies was used to calculate the average cost, which became
13 the benchmark; and 3) the model generated costs per line was reduced by the
14 benchmark and the local service specific federal support that each company
15 received. The results coming out of the third step were the support per line
16 amounts.

17 **Q. WHAT IS THE SIGNIFICANCE OF THE AVERAGE COST USED FOR THE**
18 **BENCHMARK?**

19 A. The value of the benchmark was set in Order No. 00-312¹ and it was there
20 that it was characterized as an affordable price for basic local service. The
21 cost coming out of the model consisted not only of accounting costs it also
22 consisted of a return on investment, which gave it all of the components
23 necessary to be a price.

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26 **Q. IS THE BENCHMARK REALLY AN AFFORDABLE COST?**

¹ Docket UM 731 Phase IV, Order No. 00-312, Issue 4, Pp. 16-17.

1 **A.** Although it was reasonable to assume that \$21 was a price most people
2 could and would be willing to pay for phone service there were no studies
3 done to identify the \$21 as an affordable cost nor would it have made sense
4 to conduct such studies.

5 **Q. DO THE CURRENT RATES ALIGN WITH THE BENCHMARK?**

6 **A.** The average business rate is very close to the benchmark, but the average
7 residential rate is not close. Only one residential rate exceeds the
8 benchmark while 80percent of the rates are \$15 or less. The average
9 residential rate is 67percent of the benchmark.

10 **Q. IS THE COMMISSION REQUIRED TO KEEP PRICES FOR BASIC**
11 **TELEPHONE SERVICE CLOSE TO THE BENCHMARK?**

12 **A.** ORS 759.425(3)(c) requires the Commission to limit the difference between the
13 price a telecommunications utility with over 50,000 lines may charge for basic
14 telephone service and the benchmark. No specification was made regarding
15 what is an acceptable maximum difference between the price and the
16 benchmark. It is likely that this limit requirement is sensitive to whether the
17 price is greater than or less than the benchmark. Prices that exceeded the
18 benchmark would lead to a company getting excess support.

19 **Q. DOES ORS 759.425 SPECIFY THE USE OF THE BENCHMARK AND**
20 **REASONS FOR CHANGING IT?**

21 **A.** Yes. ORS 759.425(3) explicitly states how the benchmark will be used in the
22 process of calculating support per line. This section of ORS 759.425 also
23 allows the Commission to review and adjust the benchmark as necessary

1 for the following three situations: 1) changes in competition in the
2 telecommunications industry; 2) changes in federal universal service
3 support; and 3) other relevant factors as determined by the commission.

4 **Q. DOES ORS 759.425 REQUIRE THE BENCHMARK TO BE A PROXY FOR**
5 **AN AFFORDABLE COST?**

6 **A.** No. Although the stated goal of the OUSF is affordable basic local service,
7 there is no stated requirement in ORS 759.425 for the benchmark to be a
8 proxy for an affordable rate. As originally used, the benchmark can and was
9 viewed as an affordable rate for basic local telephone service. Staff will
10 continue to use the benchmark as a proxy for an affordable rate.

11 **Q. WHAT OTHER ITEMS ARE USED TO REDUCE THE AMOUNT OF**
12 **SUPPORT A COMPANY RECEIVES?**

13 **A.** ORS 759.425(3)(A) states that the cost of providing basic service should be
14 reduced by not only by a benchmark, but also by any explicit compensation
15 that the company receives from federal sources specifically targeted to
16 recover local loop costs.

17 **Q. WHY DO YOU THINK THESE OTHER ITEMS ARE REQUIRED BY**
18 **ORS 759.425?**

19 **A.** I have not found any historical documents that discuss the reasoning behind
20 this requirement, but it would make sense to assume that the intent was to
21 offset any basic local service revenue requirement a company had with
22 revenues that they explicitly received tied to the network. Doing this would
23 leave only the revenue requirement that was not covered by other sources of

1 revenues. The benchmark in this calculation represented the amount of
2 money the company was expected to get from its customers.

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4 **B. PROPOSED CALCULATION OF SUPPORT FOR NON-RURAL**
5 **COMPANIES**

6 **Q. DOES STAFF PROPOSE TO MAKE CHANGES IN HOW SUPPORT PER**
7 **LINE IS CALCULATED?**

8 **A.** Yes. Staff is proposing to make two changes in how the support per line is
9 calculated: 1) staffing is proposing to introduce a new benchmark that is not
10 tied to the average modeled cost of the two companies; and 2) staff is
11 proposing to introduce a second step in the process used to calculate support
12 per line that is tied to what the company is planning on spending the following
13 year.

14 **Q. IS THERE A REASON STAFF IS NOT PLANNING ON MAKING**
15 **CHANGES TO THE UNDERLYING FCC MODEL?**

16 **A.** Yes. To make significant changes to the FCC Cost Proxy model would
17 require a considerable amount of time and data, much of which is not
18 available. Trying to implement these changes would violate Staff's guideline
19 that the proposals should be limited to short-term changes that can be
20 implemented quickly.

21 **Q. WHAT CHANGES IS STAFF PROPOSING TO MAKE TO THE**
22 **BENCHMARK VALUE?**
23

1 A. Staff will be adopting the findings of Order No. 00-312 that \$21 represents
2 an affordable price for service in 1999. If \$21 was an affordable price of
3 basic local service in 1999, it makes sense to adjust that amount to reflect
4 the current buying power of \$21 in 2012. Using the CPI to estimate the
5 change in buying power between 1999 and 2012 and applying that change
6 to the \$21 gives a new benchmark of approximately \$30. Staff is proposing
7 the benchmark be increased to \$30 to reflect the current buying power of
8 \$21.

9 **Q. CAN YOU DESCRIBE THE SECOND CHANGE THAT STAFF WILL BE**
10 **PROPOSING?**

11 A. The second change that staff is proposing is the introduction of an annual
12 report that will be filed with Staff around mid-year. This report will show each
13 company's proposed investment in the high cost area for the following year.
14 The format of the report will be similar to the accountability report that each
15 company files annually with the Commission. That report shows each
16 company's investment by general category: switching, loop, and interoffice
17 facilities at the wire center level. The one difference in formatting between
18 the accountability report currently being filed and the new one Staff is
19 proposing is the inclusion of expenses; expenses will not be included as a
20 reporting category in the new form.

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1 **Q. WHY ARE YOU EXCLUDING EXPENSE?**

2 A. The reimbursable expenses should be those expenses that are greater than
3 the company's average expenses. At this time, both non-rural companies are
4 using variation of their average expense to assign expense to their high cost
5 wire centers. Staff has been informed by the companies that neither company
6 knows what its actual expenses are in the high cost areas, so there is no way of
7 determining their reimbursable expenses.

8 **Q. ARE YOU GOING TO SET A THRESHOLD LEVEL OF INVESTMENT THE**
9 **COMPANIES HAVE TO EXCEED BEFORE THEY CAN START RECEIVING**
10 **SUPPORT?**

11 A. Yes. Since neither company was getting subsidized in 2011 to invest in their
12 high cost areas, Staff will use the investment level for that year as the threshold
13 that each company needs to exceed before it starts receiving support for its
14 investment. This will in part assure that the companies are making prudent
15 investments since a portion of the investment is being paid for by them. Under
16 this structure, CenturyLink would have to invest \$11.2 million before it started
17 receiving support and Frontier Communications would have to invest \$7.2
18 million.

19 **Q. ASSUMING BOTH COMPANIES INVESTED AT A LEVEL WHERE THEY**
20 **RECEIVED THE FULL AMOUNT OF SUPPORT, HOW MUCH WOULD THEY**
21 **BE INVESTING?**

22 A. Using 2011 OUSF levels and assuming both companies invested at a level
23 where they received the full amount of support, CenturyLink would have

1 invested \$28.2 million and Frontier Communications would have invested
2 \$18.5 million. In both cases, this would be about 2.5 times what the companies
3 spent in 2011 in their high cost areas.

4 **Q. HOW WILL A NON-RURAL COMPANY'S SUPPORT BE DETERMINED?**

5 A. Each year the non-rural companies will submit their request for funds
6 identifying the amount that they plan to spend by category (switch, loop,
7 interoffice) at a wire center level. The company's support will then be the lesser
8 of the total model results and what they are planning on investing over the
9 threshold amount. The company's support will be determined at the total high
10 cost level. If the company overestimated what it was going to invest in the prior
11 years, its support for the upcoming period will be reduced by that amount that it
12 overestimated.

13 **Q. HOW WILL THIS SECOND CHANGE IMPACT THE SUPPORT PER LINE**
14 **VALUES?**

15 A. The modeled support per line in this process will remain fixed, but the
16 support per line that each wire center receives will vary from year to year
17 based on what the company is planning on spending in the high cost area. If
18 the company does not spend the money allotted to it in a given year, it will
19 lose that money. If a company only spends 80 percent of the modeled
20 support, each wire center specific support per line amount will be reduced
21 by 20 percent. This reduction will not impact the CLECs.

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1 **Q. HOW WILL THIS SECOND CHANGE IMPACT THE SURCHARGE RATE?**

2 **A.** The surcharge rate for a given year will be determined in the previous year
3 based on the model results and the actual support each company projects
4 that it will need in the upcoming year. If for a given year the non-rural
5 companies elect to invest less than what they could, the level of
6 disbursements would drop, and the surcharge rate would drop as well.

7 **Q. WILL THE SUPPORT GENERATED BY A WIRE CENTER HAVE TO BE**
8 **SPENT ON THAT WIRE CENTER?**

9 **A.** No. The high cost areas will be treated in aggregate.

10 **Q. WHEN WILL A COMPANY HAVE TO REPORT WHAT THEY ARE**
11 **SPENDING IN THE HIGH COST AREA?**

12 **A.** This report will be filed early in the third quarter of the year for the following
13 year. The companies will also file a variance report showing how what they
14 actually invested compared with what they filed a year earlier. The variance
15 report will be used to adjust the upcoming level of support.

16 **Q. WILL THE COMPANIES BE AUDITED ON HOW THEY USED THE**
17 **MONEY?**

18 **A.** Yes. The companies will be periodically audited to verify how they used the
19 money that they received. The companies will be expected to keep records
20 of their activities at a level of detail that it will allow the company's filing to
21 be easily audited.

22

1 **Q. WILL THE COMPANIES BE ABLE TO USE THE MONEY TO DEPLOY**
2 **BROAD BAND NETWORKS?**

3 A. The sole objective of the OUSF is to ensure that basic local service is available
4 at reasonable and affordable rates. ORS 759.425 does not restrict the type of
5 network used to provide basic local service. If the cost assigned to basic local
6 service can be reduced by sharing the cost of the network with other services
7 that require broadband networks, then allowing the OUSF to fund the
8 deployment of broadband networks is a desirable. Under these circumstances,
9 the OUSF is only funding that portion of cost associated with basic local
10 service.

11 **Q. WILL STAFF BE REVIEWING FOR PRUDENT INVESTMENTS?**

12 A. No. Staff will not be reviewing each company's filing to determine if their
13 investments are prudent. The decision makers for the companies, which have
14 full access to the information about their properties, are the best ones to decide
15 how to invest in the high cost areas. Each company will be required to invest
16 some of its money before it starts receiving support. Also, periodic audits will
17 provide some measure of control since they will identify specifically how the
18 money is being spent, but they will only reveal gross misuse of the funds.

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1 **C. CURRENT CALCULATION OF SUPPORT RURAL COMPANIES**

2 **Q. HOW IS SUPPORT DETERMINED FOR RURAL COMPANIES**

3 **CURRENTLY?**

4 **A.** The support for a rural company is based upon the results of the separation
5 model, which is specified in detail in the stipulation approved by
6 Order No. 03-082. This separation model first develops the cost of basic
7 local service by assigning expenses and return on investment to basic local
8 service through a series of separation rules. Some adjustments are made to
9 the expenses to reflect adjustments in training and executive compensation
10 expenses. Once this has been completed this cost of per line for basic local
11 service is reduced by subtracting the benchmark from the per-line cost and
12 then by subtracting any applicable federal support that the company
13 receives.

14 **Q. DO LINE COUNTS PLAY AN IMPORTANT ROLE IN THIS PROCESS?**

15 **A.** No. The line counts are used for administrative purposes. When the process
16 was first set up it was intended that the support a company would receive
17 should be based on how many lines the company served. If a company's
18 line count dropped, its support would drop. What is important is that the
19 types of lines that made up the count used to calculate the support-per-line
20 are the same types of lines that make up the count that is later multiplied by
21 the support-per-line to calculate the monthly support.

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1 **Q. IF SECOND LINES TO A HOME WERE REMOVED, WHAT WOULD BE THE**
2 **IMPACT ON THE AMOUNT OF SUPPORT A COMPANY RECEIVED?**

3 A. Without identify the revenue requirement associate with second line and
4 removing it, there would be no material impact on the support a company
5 receives. Throwing out second lines from the count, all other things equal
6 would cause the support per line to increase to exactly offset the reduced line
7 counts. To get a reduction in support from removing second lines would require
8 identifying the revenue requirement associated with them and removing it or
9 treating the second line as another service sharing the network and allocating a
10 portion of the cost to it.

11 **Q. DOES STAFF HAVE ANY ISSUES WITH THE MODEL?**

12 A. Yes. Staff has concerns with the way support is calculated for the rural
13 companies. Based on an OTA presentation, it appears that almost all of the
14 independent companies have broadband networks deployed to all of their
15 customers. Given the low speed requirements of basic local service, it is
16 safe to assume that these higher speed networks were deployed to provide
17 other services such as TV and Internet. The separation model, based on the
18 Form I, does not allocated enough investment and expenses to other
19 services using the same network such as TV and Internet.

20 **Q. WHAT MAKES YOU THINK THE MODEL DOES NOT ADEQUATELY**
21 **ADDRESS OTHER SERVICES?**

22 A. When Staff examined Category 1.3 (Subscriber Loop) in the Form-I and how it
23 changed over time for a sample of companies, for most of the companies in the

1 sample there were large increases in this category, which were probably due to
2 the deployment of broadband networks. Since the Form-I only contains
3 regulated investments and expenses the level of investment should reflect a
4 reasonable amount of sharing of investment with the non-regulated services.
5 This sharing is not apparent in the sample staff examined.

6 **Q. ARE THERE GUIDELINES THAT A COMPANY MUST FOLLOW WHEN**
7 **ALLOCATING INVESTMENT AND EXPENSES BETWEEN REGULATED**
8 **AND NON-REGULATED OPERATIONS?**

9 **A.** There are general guidelines, but there is no assurance that they would be
10 suitable for determining OUSF support. As part of the access filing each year
11 we have the companies submit separation studies that show how their
12 investments and expenses are divided up between regulated and non-
13 regulated operations. Each year, these studies show low percent allocations to
14 non-regulate operations even though their customers have access to a full
15 range of broadband services.

16 **Q. WHAT DO YOU MEAN THE GUIDELINES MIGHT NOT BE SUITABLE FOR**
17 **DETERMINING SUPPORT?**

18 **A.** Staff believes that the separation studies presented annually with the access
19 filings are consistent with the guidelines that the companies are required to
20 follow. These studies from year to year only show low percent allocations to
21 non-regulated operations. This low percentage allocated to non-regulated
22 operations, the ubiquitous deployment of broadband networks, and the rapid

1 growth of Category 1.3 regulated gross plant suggests the allocation process is
2 not doing a good job of determining the actual cost of basic local service.

3 **Q. FROM A COMPANY PERSPECTIVE, WHAT IS THE INTENT OF THE**
4 **OUSF?**

5 **A.** The intent of the OUSF is to allow affordable basic telephone services rates
6 in high cost areas. High cost areas are those where it would not be
7 profitable for a company with just a basic local service offering to operate
8 profitably due to high levels of per line investment and expenses. The intent
9 of the OUSF is to ensure that a high cost company is able to cover its
10 expenses and earn an adequate return on its basic local service investment.

11 **Q. WHAT IF THERE ARE OTHER SERVICES USING THE SAME**
12 **INVESTMENT THAT IS PROVIDING BASIC LOCAL SERVICE?**

13 **A.** If there are other services using the same network that is used to provide
14 basic local service, the cost that is allocated to basic local service should be
15 reduced to reflect those other services. This reduction in cost allocated to
16 basic local service should be done in a simple way without regard to
17 whether the company or one of its separate subsidiaries is providing the
18 broadband based service over the regulated network.

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1 **D. PROPOSED CALCULATION OF SUPPORT RURAL COMPANIES**

2 **Q. IS THE ALLOCATION OF COST TO NON-REGULATED SERVICES ONE OF**
3 **YOUR PROPOSED CHANGES?**

4 A. Yes. This is one of Staff's proposals. Staff will be proposing a reduction in the
5 cost allocated to basic local service, but this is strictly for the purposes of
6 calculating OUSF support. Staff is not proposing to alter how that cost is
7 allocated for any other purpose such as the calculation of access rates.

8 **Q. HOW WOULD YOU ALLOCATE THE COST AMONG THE SERVICES**
9 **USING THE NETWORK?**

10 A. Let me provide an example to illustrate how the allocation Staff is proposing
11 would be carried out. In this example, assume the company has 10,000 lines
12 all of which take voice service, 4,000 of them have voice and internet services,
13 and 2,000 take the triple play. Based on an equal allocation of cost to each
14 service, the voice only group would have 100percent of its cost allocated to
15 voice, the voice and internet group would have half of its cost allocated to
16 voice, and the triple play group would have a third of its cost allocated to voice.
17 The overall allocation to voice would be based on the share of total lines each
18 group represented. In this case voice or basic local service would be allocated
19 67percent of the cost.

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Cost Allocation Table

| | Group Percentage | Voice | Internet | TV | Voice Share of Cost | Weighted Sharing Percentage |
|---------|------------------|--------|----------|-------|---------------------|-----------------------------|
| Group 1 | 40% | 4,000 | None | None | 100% | 40% |
| Group 2 | 40% | 4,000 | 4,000 | None | 50% | 20% |
| Group 3 | 20% | 2,000 | 2,000 | 2,000 | 33% | 7% |
| Overall | 100% | 10,000 | 6,000 | 2,000 | | 67% |

Q. ASSUMING THE RESULTS FROM THE ABOVE EXAMPLE, HOW WOULD YOU INCORPORATE THIS IN THE MODELING PROCESS?

A. This adjustment would be incorporated just before the revenue requirement per line is reduced by the federal support the company receives and the benchmark. In this particular case the revenue requirement would be multiplied by 67percent and then the remaining amount would be reduced by the line specific federal support.

Q. HAVE YOU DONE ANY STUDIES TO DETERMINE THE IMPACT THIS CHANGE WOULD HAVE ON SUPPORT THE RURAL COMPANIES WOULD BE RECEIVING?

A. No. At this time I do not have access to the group percentages.

Q. HAVE DONE A STUDY TO DETERMINE WHAT IMPACT THIS CHANGE WOULD HAVE ON A TYPICAL COMPANY?

A. No. I have not done a study to determine the impact of this change on a typical company, but I have looked at what the impact of applying the 67percent against the per line revenue requirement would have on a typical company. In the two companies that I examine, there was a significant reduction in support.

1 **Q. WHAT OTHER CHANGES IS STAFF PROPOSING TO THE SUPPORT**
2 **CALCULATION PROCESS?**

3 A. In addition to the sharing proposal, Staff will be proposing the following: a new
4 benchmark; a review of model inputs and adjustments; a return to per line
5 support amounts and; an annual review of the support per line amounts, which
6 will allow the sharing factor to be updated.

7

8 **E. CURRENT AND PROPOSED CALCULATION FOR CLECS**

9 **Q. HOW IS THE AMOUNT OF SUPPORT DETERMINED FOR THE CLECS?**

10 A. Both CLEC companies are operating in non-rural company areas. The
11 support per line the CLEC receives is dependent on the location of its
12 customers. If a customer is located within the serving area boundaries of
13 wire center A, the CLEC can receive up to the amount of support the non-
14 rural company receives for that wire center. The CLEC would receive the full
15 amount of the support if it serves the company on its own facilities, a
16 fraction of the full amount if the facility is leased from the non-rural
17 company.

18 **Q. ARE YOU PROPOSING TO CHANGE HOW THIS SUPPORT IS**
19 **CALCULATED?**

20 A. No. Staff is not proposing to change how the support is calculated. The
21 support per line will be determined based on the model results as it is
22 currently done. The dollar amounts coming out modeling may change with a

1 new benchmark, but the sharing rules will not change. The support amounts
2 will also be independent of what the ILEC spends in the area.

3 **Q. WILL STAFF BE PROPOSING THAT THE CLECS HAVE TO FOLLOW**
4 **THE SAME PROCESS THE NON-RURAL COMPANIES HAVE TO**
5 **FOLLOW?**

6 **A.** No. Staff's proposal will not require the CLEC to identify projects that they
7 are working on to receive support.

1 **WHAT CHANGES SHOULD BE MADE TO THE EXISTING OUSF RELATED TO**
2 **ACCOUNTABILITY AND TRANSPARENCY?**
3
4

5 **A. NON-RURAL COMPANIES**

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

8 A. Staff's accountability proposal is tied to the process staff is proposing to use to
9 determine support for the non-rural companies. Around mid-year the non-rural
10 companies would submit a form showing what they are planning on investing in
11 the high cost areas by wire center. The company would also file a similar report
12 showing what it invested by wire center during the previous year. The
13 companies would also be required to maintain the records behind these reports
14 that would allow the filings to be audited.

15 **B. RURAL COMPANIES**

16 **Q. WHAT IS YOUR ACCOUNTABILITY AND TRANSPARENCY PROPOSAL**
17 **FOR THE RURAL COMPANIES?**

18 A. The rural companies would continue to file their Form-I reports so they could
19 be used as part of the mid-year update. The companies would also provide
20 their current take rates for voice, internet, and TV services on their
21 networks. These would be used to update the support per line calculations.
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1 **C. CLEC COMPANIES**

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3 **Q. DO THE CLECS CURRENTLY HAVE TO REPORT HOW THEY ARE**
4 **USING THE MONEY THEY RECEIVE FROM THE OUSF?**

5 A. No, Presently the two CLECs that are receiving support from the OUSF,
6 Comspan and Warm Springs, do not have to report how they are using the
7 money that they receive from the OUSF. This is different from their reporting
8 requirements at the federal level where they have to report annually how they
9 are using the money.

10 **Q. WHAT IS YOUR ACCOUNTABILITY AND TRANSPARENCY PROPOSAL**
11 **FOR THE CLEC COMPANIES?**

12 A. At the beginning of the second quarter of each year the CLECs will file a
13 report similar to the one that was required by federal fund recipients
14 showing how they used the support during the preceding year.

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

16 A. Yes.

17

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 30th day of January, 2013, at Salem, Oregon.

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**UM 1481
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