BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1481

In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Investigation Into The Oregon Universal Service Fund	STAFF'S STRAW PROPOSAL

I. Universal Service Principles and Key Objectives

A. Federal Level Principles and Objectives

1. First Report and Order

47 U.S.C.Section 254 (b)[1] of the Telecommunications Act of 1996 sets forth six key principles that were intended to be the underpinnings of universal service. Those principles are: 1) quality service at an affordable rate; 2) all geographic regions having access to advanced services; 3) reasonably comparable service available in rural and high cost areas; 4) all providers of telecommunications making an equitable and non-discriminatory contribution to the preservation and advancement of universal service; 5) having the support mechanisms specific, predictable and sufficient; and, 6) ensuring that schools, health care and libraries have access to advanced telecommunications services.

Section 254(b) (3), quoted below, summarizes the key objective of Section 254(b), which was to have a network that was reasonably comparable from area to area at rates that are not substantially different. This passage also emphasizes that this network was to be one that was capable of handling not just voice services, but advanced services as well.

> Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are

[1] For ease of reference, future citations will provide the Section number and will omit the United States Code title number.

> available at rates that are reasonably comparable to rates charged for similar services in urban areas.[2]

Section 251(c)(3) and Section 251(c)(4) add other conditions that have a bearing on achieving universal service; these sections introduced the additional goal of introducing competition to the incumbent provider's franchise areas. These statutes require the existing franchise holder to sell components of their network to companies entering their markets as competitors.

2. Current Direction at the Federal Level

a) The FCC's Broadband Plan and Connect America Fund

In 2009, Congress in the American Recovery and Reinvestment Act directed the Commission to develop a National Broadband Plan to ensure that every American has "access to broadband capability."[3] Chapter 8 of the National Broadband Plan, which was released in March 16, 2010, laid the foundation for the Connect America Fund (CAF). A Notice of Proposed Rulemaking (NPRM) on the CAF[4] was released February 9, 2011.

Paragraph 10 of the NPRM on the CAF introduced four new principles that were identified as being rooted in Section 254 of the First Report and Order. These new principles stressed: 1) the need to modernize and refocus the federal USF to make affordable broadband available to all Americans; 2) the need to reduce waste and inefficiency; 3) the requirement to implement measures requiring accountability from companies receiving support, to ensure that public investments are used wisely to deliver the intended results; and 4) the need to transition the fund to market-driven and incentive-based policies that encourage technologies and services that maximize the value of these resources.

b) Federal-State Joint Board Recommendation

In their November 4, 2010, Recommended Decision the Joint Board stated their belief that it is appropriate for the Federal Universal Service Fund to support networks that provide broadband service, in addition to voice service. The Joint Board proposed that the FCC adopt an additional principle of universal service, pursuant to its authority under Section 254(b)(7). The Joint Board recommended that Commission should specifically find that universal service support should be directed where possible to networks that provide advanced services, as well as voice services. Such a principle they stated is consistent with Section 254(b) (3).

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[2] Section 254 (b)(3)

[3] American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009).

[4] FCC 11-13 Paragraph 10, pp 7-8.

B. State Level Principles and Objectives

1. Uses of the OUSF

ORS 759.425 states that the Universal Service Fund should be used "…to ensure basic telephone service is available at a reasonable and affordable rate" and that the objectives of the fund may be modified to conform to Section 254.

2. Benchmark

ORS 759.425 also states that there should be a cost benchmark used to calculate support. The amount of support is defined as the cost of providing service less the benchmark cost, less any explicit compensation received by the carrier from federal sources specifically targeted to the recovery of local loop costs. ORS 759.425 also goes on to state that the Commission at its discretion can modify the benchmark to reflect current conditions.

3. Commission Directed Rate Changes

ORS 759.425 (2)(a) states that the Public Utility Commission can establish the price a telecommunications utility may charge its customers for basic telephone service and that the Commission may adjust the price as necessary. It further states that the commission at its discretion can periodically review and change the services designated as basic telephone service.

4. Sources of Funds

ORS 759.425 and ORS 759.005 restrict the source of funds to a surcharge on intrastate retail telecommunications service revenues. The statutes explicitly exempt wireless customers from having to pay this fee; however, companies providing wireless services may at their discretion collect these fees from their customers and submit them to the Oregon Universal Service Fund (OUSF).

II. Staff's Interpretation of the Guidelines and Objectives

A. Vision of What the Network Should Be

Oregon consumers including competitive service providers in rural high cost areas should have access to networks capable of providing a full range of advanced telecommunications and information services. These networks should be reasonably comparable to those networks provided in urban areas and priced at rates that are comparable to those charged for similar networks in urban areas.

B. Use of the Oregon Universal Service Fund

The OUSF should be used solely to improve and maintain the Oregon infrastructure, which should result in a general lowering of operating expenses for the companies owning the networks. Lower expenses should result in lower prices paid by consumers and competitive service providers using the networks. The OUSF should be used strictly for the benefit of Oregon consumers.

C. Contributors to the Fund

All users of the network will be required to pay into the OUSF based on the intrastate services used, regardless of their status as an end-user, a competitive service provider, or wireless carrier. All intrastate revenues will be subject to a surcharge similar to the present process only without regard to whether or not the customer contributing to the fund is purchasing retail or wholesale services. Where this action results in an end-user paying the OUSF fee twice, the company providing the service to the end-user will be allowed to deduct the amount that they paid on the component parts used to make up the service from the amount that they owe to the OUSF, up to the amount that the company's customers are contributing to the fund.

D. Recipients of Money from the Fund

Money from the fund should go to the following two categories of companies: 1) the ILECs that have built out or are building out into previously unserved or underserved areas, and 2) the companies that are willing to provide the networks that meet the OUSF's objectives in areas where the ILEC is unwilling or unable to provide the networks in a timely manner.

E. Nature of Payments to the Companies

One of the principles of Section 254(b)(5) is that the support mechanisms should be specific, predictable and sufficient. With a system that makes periodic payments to a company, the money comes in as an uncertain--uncertain because the program can be changed or terminated--source of revenues to the company. When a company has to make financial decisions that have horizons of ten to twenty years, the uncertainty in the periodic payments becomes real risk. The funding is no longer completely predictable and possibly not sufficient. Another problem with periodic payments is that the payments are no longer for specific actions taken by the company; the one exception to this is where the company makes a rate reduction in exchange for receiving the payments. In general, periodic payments are not consistent with the goals of the fund and Section 254(b)(5).

F. Revenue Neutrality

The intent of the OUSF disbursements is to lower the costs of building and maintaining reasonably comparable networks in the High Cost Areas. By lowering the cost of building and maintaining the network in the High Cost Areas, the prices to customers in those areas should fall as part of the investment and expense is picked up by the OUSF and is no longer a part of the recipient company's revenue requirement. Because the rates will be reduced to reflect the lower cost of providing service, the benefit is shared by the company, the consumers, the carriers, and the competitive service providers. The Commission should ensure that the rates in these areas reflect the actual cost of providing service in these areas.

III. Staff's Proposal

A. Scope of Staff's Proposal

This proposal will be restricted to all of CenturyLink (Century, Embarq, and Qwest properties), all of Frontier (Verizon and Citizens' properties), and the CLEC companies that are or might be receiving money from the OUSF. The companies that are the subject of this proposal account for 93% of all monthly disbursements.

The non-rural companies, which account for the remaining 7%, were not included in this proposal for a number of reasons: their impact on the OUSF is minimal, their networks currently reflect the goal of staff's proposed use of the OUSF, and the issue of how to migrate their use of the OUSF from reducing access rates to an alternative use is a fundamentally different question then the one being addressed for the large companies. The remaining non-rural companies have built networks that are equal or in cases better than those found in the urban areas and at prices that appear to be at least comparable.

B. When Is An Area High Cost

For purposes of this proposal, a High Cost Area is defined geographically at the wire center level or higher and for Qwest and Verizon is an area that has been previously identified as high cost through the modeling process that took place. For the wire centers belonging to the previous Frontier, Century, and Embarq companies, which have the same level of support assigned to each wire center, the level of support will be adjusted to reflect the relative cost of each wire center. The relative cost will be based on the results of the FCC model that was used to establish the support levels for Qwest and Verizon. These adjustments will not impact the overall level of support the companies have been receiving.

C. Which Groups Should Be Allowed To Receive OUSF Monies

Money from the OUSF will be directed to the current existing ILECs and to CLECs that will be providing service to unserved and underserved areas where the ILEC does not intend to upgrade the service based on their five-year plan. CLECs that are presently receiving monthly support for the purchase of Unbundled Network Elements (UNEs) or building their own networks will see this monthly support phased out over a number of years.

D. Which Technologies Should Be Allowed

There should not be any constraints on the technology used other than its reliability. The objective of the OUSF proposal is to promote the building of a network that is reasonably comparable to those found in the higher density areas and is cost effective.

E. What Commitments Should A Company Have To Make

Since the focus of the fund will be on supporting projects and the ongoing maintenance of those projects in the unserved or underserved area, the primary requirement placed on the company receiving funds will be on developing a network that is compatible with the other networks existing in the area. There will be no carrier of last resort obligation.

F. How the OUSF Money Should Be Used

The money should be used to fund infrastructure investments and offset higher maintenance costs in the areas designated as High Cost Areas. These areas are the ones presently receiving support from the OUSF.

G. Method of the Payment to the Companies

For CenturyLink and Frontier money will accrue in separate OUSF accounts on a monthly basis using the present support levels. Money will be disbursed to the companies on a quarterly basis when they present the required documentation. This documentation will show the cost of the completed work on the infrastructure and the direct maintenance expenses.

CLECs operating in these two companies' areas will continue to receive support for the number of lines that they serve. The maximum line count for the CLECs will be set at the implementation date of staff's proposal for the CenturyLink and Frontier. The CLECs will not receive per line support for any additional lines above that maximum and will gradually see this support reduced. After the implementation date of staff's proposal, the CLECs will have to file the same forms required of CenturyLink and Frontier; plus, they will have to demonstrate that their network is not over-building an existing network that has already met the proposed OUSF objective.

H. Regulating the Amount of Money Spent on an Area

Each quarter the companies will submit an invoice to the OUSF that identifies the amount of infrastructure investment and the direct expenses incurred for maintenance. The maximum amount that can be spent on the High Cost Areas for any quarter is the current accrued amount, which is based on the monthly support each company is presently receiving.

I. Tracking What is Spent

1. The Proposed Budget for the High Cost Area

At the beginning of each year, except this year, the companies will submit a rolling five-year budget that specifies how much they are planning on spending on infrastructure. The companies will also submit a two-year expense budget that identifies direct, expenses that the company expects to incur in supporting those areas. By July 31, 2011, the companies will provide to staff a two-year plan (2011 and 2012) showing pending infrastructure investments and a two-year direct expense budget.

2. The Auditing Process

Each year the companies will provide the necessary records to the auditors so they can validate the disbursement requests made by the companies during the previous year. On completion of the audit, the findings will be presented to the board.

J. Rates in the High Cost Areas

The wholesale and retail rates in the High Cost Areas will be periodically reviewed and brought into line with each company's revenue requirement for the High Cost Areas. Investments and expenses derived from the fund will not be used in setting rates. The companies will be expected to maintain enough of their own investment in the areas to keep the rates calculated in this way at or above those in the low cost areas.

IV. Implementation –Time Lines

The following provides staff's timeline for implementing the proposal and the due dates:

1. **May 31, 2011**: Staff will provide a complete set of high cost wire centers made up of the present Qwest and Verizon wire centers presently receiving support and the most expense Century and Embarq wire centers, which are presently not differentiated from the other wire centers.
2. **July 31, 2011**: CenturyLink and Frontier will submit infrastructure construction budgets for the High Cost Areas for 2011 and 2012.
3. **July 31, 2011**: CenturyLink and Frontier will submit expense budgets for direct expenses incurred in the High Cost Areas for 2011 and 2012.
4. **October 31, 2011**: The companies will provide estimates by wire center or clusters of wire centers of the regulated and non-regulated revenues that have been facilitated by the last-mile and middle-mile networks in the High Cost Areas.
5. **January 31,2012:** CenturyLink and Frontier will submit infrastructure construction budgets for the High Cost Areas for 2012 to 2017 and actual expenditures on infrastructure for 2011.
6. **January 31,2012:** CenturyLink and Frontier will submit expense budgets for direct expenses incurred in the High Cost Areas for 2012 and actual expenses incurred in that area for 2011.
7. **October 31, 2012:** CenturyLink and Frontier will submit the first of two test requests for reimbursement from the OUSF to test the new staff proposed process and staff will review and modify the process as needed.
8. **December 31, 2012:** CenturyLink and Frontier will submit the second of two test requests for reimbursement from the OUSF to test the new staff proposed process and staff will review and modify the process as needed.
9. **January 1, 2013:** The staff proposed process will begin and CenturyLink and Frontier will cease getting monthly payments from the fund.
10. **April 30, 2013:** CenturyLink and Frontier file their first live quarterly request for support from the fund.
11. **January 31, 2014**: An annual audit is performed to verify the CenturyLink and Frontier filings.
12. **June 30, 2014:** Rate study is filed to set the rates for retail and wholesale rates in the High Cost Areas.

Summary of Proposed Changes

A. Required Use of the Money

Current	Staff Proposal
The Qwest and Verizon portion of Frontier NW and CenturyLink were required to lower selected business rates.	The companies will be required to use the money to pay for all or a portion of infrastructure investments and direct expenses in the areas identified as High Cost Areas.

B. Maximum Annual Support Calculation

Current	Staff Proposal
The maximum annual support was model based with reductions for federal support and a benchmark amount.	Actual incurred investments and expenses with an upper limit set at each of the company's' calculated support under the current system..

C. Revenue Neutral Requirement

Current	Staff Proposal
The support was required to be revenue neutral; that is the money the companies received was to offset rate reductions.	The payments will not be made on a revenue neutral basis, but the investments and expenses paid for by the fund will not be used to determine the retail and wholesale rates. The companies are expected to update the retail and wholesale rates in the High Cost Areas to reflect the company's portion of current net investment and expenses in the area.

D. Basis For Determining High Cost Areas

Current	Staff Proposal
Based on modeled costs less offsets and benchmark. Wire-centers that have adjusted model costs greater than zero receive support.	For what used to be the Qwest and Verizon wire centers, there will not be any changes from their present classification. For the wire centers that used to be Embarq and Century wire centers, the most expensive ones will be classified as high cost.

E. USF Support for CLECs

Current	Staff Proposal
An Eligible Telecommunications Company(ETC) can receive support for any wire center where it is designated. The support is based on what the ILEC is receiving for that area.	Support will be for building out into the unserved or under-serviced areas. Exceptions will be made where the ILEC serving the area has indicated that they do not plan on investing in the area or only plans minimal investments. The current CLEC support will be grandfathered to existing customers and will be eliminated gradually over five years.

F. Retail and Wholesale Rates in the High Cost Areas

Current	Staff Proposal
No specific rate changes were made that exclusively addresses the high cost areas.	Retail and wholesale rates in the High Cost Areas will be periodically adjusted to reflect the area specific revenue requirements and to make wholesale and retail prices consistent with each other.

G. Monitoring the Use of the OUSF

Current	Staff Proposal
Current monitor involves the level of disbursements to the recipient companies and a periodic review to verify that the rates have not been changed.	The companies will be required to submit a rolling five-year budget each year at the beginning of the year. This budget will show what they plan to invest in infrastructure in the High Cost Areas. Each quarter the companies will be reimbursed for their expenditures in High Cost Areas up to the maximum that they have accrued.

H. **Periodic Review of the OUSF**

Current	Staff Proposal
There is no requirement for a periodic review of the fund.	Every five years the fund will be completely reviewed.

I. **Accountability Requirements**

Current	Staff Proposal
There is no formal monitoring process directed at how the companies are using the money. The companies were ordered to reduce the rates of selected business services.	Each year an audit will be performed to verify that the companies have spent the funds as indicated in their request.

This concludes Staff's Straw Proposal.

Dated at Salem, Oregon, this 4th day of April 2011.

Roger White
Program Manager
Cost Analysis

CERTIFICATE OF SERVICE

UM 1481
(STRAW PROPOSAL)

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 4th day of April, 2011 at Salem, Oregon.

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