Law Office of Richard A. Finnigan

2112 Black Lake Blvd. SW
Olympia, Washington 98512
Fax (360) 587-3852

Richard A. Finnigan
(360) 956-7001
rickfinn@localaccess.com

Candace Shofstall
Legal Assistant
(360) 753-7012
candaces@localaccess.com

January 30, 2013

VIA E-MAIL AND U.S. MAIL

Filing Center
Oregon Public Utility Commission
PO Box 2148
Salem, OR 97308-2148

Re: Docket UM 1481 - Reply Testimony on Behalf of the Oregon Telecommunications Association

Dear Sir/Madam:

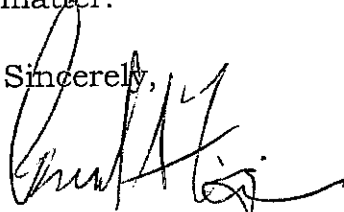
Enclosed are the original and five copies of the Reply Testimony of Chad Duval, the Reply Testimony of James Rennard, the Reply Testimony of Douglas Meredith, the Reply Testimony of Brant Wolf, the Reply Testimony of Craig Phillips, the Reply Testimony Rusti Lattin and accompanying Exhibits, the Reply Testimony of Don Lawrence, the Reply Testimony of Brandon Zupancic, the Reply Testimony James Smith, the Reply Testimony DeeDee Kluser and the Reply Testimony of John Hemphill, all on behalf of the Oregon Telecommunications Association.

Please note that there are confidential exhibits and the confidential page from Douglas Meredith's Reply Testimony enclosed in a separate envelopes.

The Certificate of Service is also enclosed.

Thank you for your attention to this matter.

Sincerely,



RICHARD A. FINNIGAN

RAF/cs
Enclosures

cc: Service List (via e-mail)

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CERTIFICATE OF SERVICE
UM 1481

3 I certify that I sent the attached Reply Testimony of Chad Duval, the Reply Testimony of James Rennard, the Reply Testimony of Douglas Meredith, the Reply Testimony of Brant Wolf, the Reply Testimony of Craig Phillips, the Reply Testimony Rusti Lattin and accompanying Exhibits, the Reply Testimony of Don Lawrence, the Reply Testimony of Brandon Zupancic, the Reply Testimony James Smith, the Reply Testimony DeeDee Kluser and the Reply Testimony of John Hemphill, all on behalf of the Oregon Telecommunications Association by electronic mail and U.S. mail to the following:
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6

7 FILING CENTER
PUBLIC UTILITY COMMISSION OF OREGON
8 PO BOX 2148
SALEM, OR 97308-2148
9 puc.filingcenter@state.or.us

10 I hereby certify that I served the attached Reply Testimony of Chad Duval, the Reply Testimony of James Rennard, the Reply Testimony of Douglas Meredith, the Reply Testimony of Brant Wolf, the Reply Testimony of Craig Phillips, the Reply Testimony Rusti Lattin and accompanying Exhibits, the Reply Testimony of Don Lawrence, the Reply Testimony of Brandon Zupancic, the Reply Testimony James Smith, the Reply Testimony DeeDee Kluser and the Reply Testimony of John Hemphill, all on behalf of the Oregon Telecommunications Association upon all parties of record in this proceeding by electronic mail, pursuant to OAR 860-013-0070, to the following parties or attorneys of parties:
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14
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16

CHARLES L. BEST
1631 NE BROADWAY #538
PORTLAND, OR 97232-1425
chuck@charleslbest.com

ANN SAGERSON
AT&T SERVICES, INC.
208 S. AKARD ST.
DALLAS, TX 75202-4206
ann.sagerson@att.com

17
18
19
20

DAVID COLLIER
AT&T SERVICES, INC.
645 E PLUMB LN, RM C142
PO BOX 11010
RENO, NV 89502
david.collier@att.com

SHARON L. MULLIN
AT&T SERVICES, INC.
DIRECTOR-EXTERNAL AFFAIRS
400 W 15TH ST, STE 930
AUSTIN, TX 78701
slmullin@att.com

21
22
23

ARTHUR BUTLER
ATER WYNNE LLP
601 UNION STREET, STE 1501
SEATTLE, WA 98101-3981
aab@aterwynne.com

JOEL PAISNER
ATER WYNNE LLP
601 UNION STREET, STE 1501
SEATTLE, WA 98101-3981
jrp@aterwynne.com

24
25
26

Law Office of
Richard A. Finnigan
2112 Black Lake Blvd. SW
Olympia, WA 98512
(360) 956-7001

WILLIAM E. HENDRICKS
CENTURYLINK, INC.
805 BROADWAY ST
VANCOUVER, WA 98660-3277
tre.hendricks@centurylink.com

ALAN GALLOWAY
DAVIS WRIGHT TREMAINE LLP
1300 SW FIFTH AVENUE, STE. 2400
PORTLAND, OR 97201
alangalloway@dwt.com

RICHARD B SEVERY
VERIZON
2775 MITCHELL DR, BLDG. 8-2
WALNUT CREEK CA 94598
richard.b.severy@verizon.com

G. CATRIONA MCCRACKEN
LEGAL COUNSEL/STAFF ATTY
CITIZENS' UTILITY BOARD OF OR
610 SW BROADWAY, SUITE 400
PORTLAND, OR 97205
catriona@oregoncub.org

CARLA BUTLER
QWEST CORPORATION
310 SW PARK AVE 11TH FL
PORTLAND OR 97205-3715
carla.butler@centurylink.com

ADAM HAAS
WSTC
10425 SW HAWTHORNE LN
PORTLAND, OR 97225
adamhaas@convergecomm.com

DOUG COOLEY
GOVERNMENT AFFAIRS MANAGER
COMCAST BUSINESS COMMUNICATIONS LLC
1710 SALEM INDUSTRIAL DRIVE NE
SALEM, OR 97303
doug_cooley@cable.comcast.com

MARSHA SPELLMAN
CONVERGE COMMUNICATIONS
10425 SW HAWTHORNE LN
PORTLAND, OR 97225
marsha@convergecomm.com

MARK TRINCHERO
DAVIS WRIGHT TREMAINE LLP
1300 SW FIFTH AVE STE 2300
PORTLAND, OR 97201-5682
marktrinchero@dwt.com

J JEFFERY OXLEY
INTEGRA TELECOM OF OREGON INC
6160 GOLDEN HILLS DR
GOLDEN VALLEY MN 55416-1020
jjoxley@integratelecom.com

BARBARA YOUNG
EMBARQ COMMUNICATIONS INC.
902 WASCO ST - ORHDRA0305
HOOD RIVER, OR 97031-3105
barbara.c.young@centurylink.com

RENEE WILLER, EXTERNAL AFFAIRS MANAGER
FRONTIER COMMUNICATIONS OF AMERICA
20575 NW VON NEUMANN DR
BEAVERTON, OR 97006-6982
renee.willer@ftr.com

JEFFRY H. SMITH
VICE PRESIDENT & DIVISION MANAGER
GVNW CONSULTING INC.
8050 SW WARM SPRINGS - STE 200
TUALATIN, OR 97062
jsmith@gvnw.com

CARSTEN KOLDSBAEK
CONSULTING MANAGER
GVNW INC.
8050 SW WARM SPRINGS - STE 200
TUALATIN, OR 97062
ckoldsbaek@gvnw.com

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DOUGLAS K. DENNEY
INTEGRA TELECOM OF OREGON INC.
6160 GOLDEN HILLS DR
GOLDEN VALLEY, MN 55416-1020
dkdenney@integratelecom.com

JASON W JONES
PUC STAFF--DEPARTMENT OF JUSTICE
BUSINESS ACTIVITIES SECTION
1162 COURT ST NE
SALEM OR 97301-4096
jason.w.jones@state.or.us

MICHAEL DEWEY
EXECUTIVE DIRECTOR
OREGON CABLE AND
TELECOMMUNICATIONS ASSN
1249 COMMERCIAL ST SE
SALEM, OR 97302
mdewey@oregoncable.com

CRAIG PHILLIPS
OREGON EXCHANGE CARRIER ASSN
800 C ST
VANCOUVER, WA 98660
cphillips@oeca.com

ROGER WHITE, PROGRAM MANAGER
PUBLIC UTILITY COMMISSION OF
OREGON
PO BOX 2148
SALEM, OR 97308
roger.white@state.or.us

KAY MARINOS
PUBLIC UTILITY COMMISSION OF
OREGON
PO BOX 2148
SALEM OR 97308-2148
kay.marinos@state.or.us

LISA F RACKNER
MCDOWELL RACKNER & GIBSON PC
419 SW 11TH AVE, STE 400
PORTLAND OR 97205
dockets@mcd-law.com

ADAM LOWNEY
MCDOWELL RACKNER & GIBSON PC
419 SW 11TH AVE, STE 400
PORTLAND OR 97205
adam@mcd-law.com

BRANT WOLF
OREGON TELECOMMUNICATIONS ASSN
777 13TH ST SE - STE 120
SALEM OR 97301-4038
bwolf@ota-telecom.org

FELZ, JOHN
REGULATORY OPERATIONS DIRECTOR
CENTURYLINK
5454 W 10TH STREET
OVERLAND PARK, KS 66211
john.felz@centurylink.com

RUDY M. REYES
ASST GENERAL COUNSEL
VERIZON
201 SPEAR STREET, 7TH FLOOR
SAN FRANCISCO, CA 94102
rudy.reyes@verizon.com

JIM RENNARD
CONSULTING MANAGER
GVNW CONSULTING, INC.
PO BOX 2330
TUALATIN, OR 97062
jrennard@gvnw.com

Law Office of
Richard A. Finnigan
2112 Black Lake Blvd. SW
Olympia, WA 98512
(360) 956-7001

KEVIN SAVILLE
GENERAL COUNSEL
FRONTIER COMMUNICATIONS
2378 WILSHIRE BLVD.
MOUND, MN 55364
kevin.saville@ftr.com

LYNDALL NIPPS
VICE PRESIDENT, REGULATORY-WESTERN REGION
TW TELECOM
9665 GRANITE RIDGE DRIVE, STE. 500
SAN DIEGO, CA 92123
lyndall.nipps@twtelecom.com

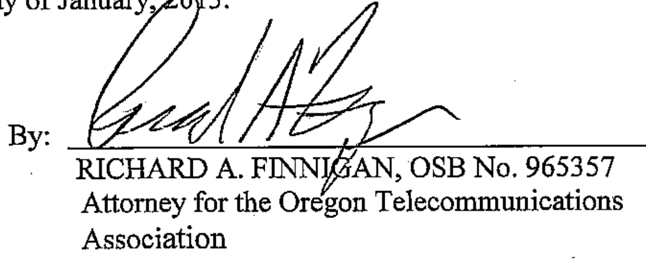
GORDON FEIGHNER, ENERGY ANALYST
CITIZENS' UTILITY BOARD OF OR
610 SW BROADWAY, SUITE 400
PORTLAND, OR 97205
gordon@oregoncub.org

RON L TRULLINGER
MANAGER - OREGON REGULATORY
CENTURYLINK
310 SW PARK AVE 11TH FL
PORTLAND OR 97205
ron.trullinger@centurylink.com

OPUC DOCKETS
CITIZENS' UTILITY BOARD OF OR
610 SW BROADWAY, SUITE 400
PORTLAND, OR 97205
dockets@oregoncub.org

TIM SPANNRING
OPERATIONS MANAGER
COMSPAN COMMUNICATIONS INC
278 NW GARDEN VALLEY BLVD
ROSEBURG OR 97470
tims@comspancomm.com

Dated at Olympia, WA this 30th day of January, 2013.



By: ______________________
RICHARD A. FINNIGAN, OSB No. 965357
Attorney for the Oregon Telecommunications Association

Law Office of
Richard A. Finnigan
2112 Black Lake Blvd. SW
Olympia, WA 98512
(360) 956-7001

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

RUSTI LATTIN

January 30, 2013

INTRODUCTION

Q. **Please state your name and give us your business address for the record.**

A. My name is Rusti Lattin. My business address is 349 1st Street, Richland, OR 97870.

Q. **By whom are you employed and in what capacity?**

A. I am employed by Eagle Telephone System, Inc. I am the Lead Telephone Service Coordinator.

Q. **What is the purpose of your testimony?**

A. I want to correct some mistakes that have been made in the direct testimony of Mr. Ankum.

Q. **At page 36 of Mr. Ankum's testimony he asserts that Eagle is receiving $57.00 per line in support. Is that accurate?**

A. No, to the extent Mr. Ankum implies the $57.00 has been received for many years. Prior to September of 2012, Eagle received $7.24 per line in support. In September of 2012 that amount increased to $42.00 per line, but not the $57.00 per line as stated by Mr. Ankum.

Q. **Does Eagle have a wireless operation?**

A. Yes. It goes under the name of Snake River PCS.

Q. **Is Mr. Ankum accurate at pages 37 and 38 of this testimony, where he implies that the wireless operation is taking lines away from the wireline operation?**

A. No. When our wireline operation loses a line it is due to either a death or somebody has moved out of the area. We did a study on the demographics of our service area and the average age of our service population is sixty-two years.

In our area, the geography is very rugged, which is an understatement. Reliable cellular service is difficult to maintain. We know that as a fact since we have invested a great deal of money in trying to make our wireless service as good as possible. While wireless service might be a

competitive service for wireline service in some urban areas, in our service area the customers view it as an additional service, not a replacement service.

Q. **Mr. Ankum talks about the wireless operation holding ETC status. Is he correct?**

A. Yes, he is correct on that. However, I do not think he understands the reason we have obtained ETC status. At the time that United States Cellular Corporation and RCC Minnesota were obtaining ETC status, Eagle actually testified in those dockets and pointed out to the Commission that if they granted ETC service to our wireless competitors, we, as a wireless operator, would need to also obtain ETC status. An excerpt from Patrick L. Lattin's testimony in Docket UM 1084 is attached. Exhibit OTA/501. The reason Snake River PCS obtained ETC status was that we had to be on the same competitive footing as the other wireless carriers. It was not to compete with the wireline operations.

Q. **At page 37 of his testimony, Mr. Ankum sets out figures for the amount of revenue that Eagle receives from its customers for local exchange switch services. Is he accurate?**

A. Yes and no. Those are the numbers that were on our Form O. However, when we reviewed the Form O we realized that an error was made in the reporting. We are correcting that report and the actual amounts received are significantly higher than those stated in Mr. Ankum's testimony.

Q. **Mr. Ankum asserts that Eagle has a cable operation as well. Is this correct?**

A. No. While we did have a cable operation, that has been terminated. In 2011 we had about fifty total customers for the cable operations. Because of the expense of that operation, we were not able to offer very much in the way of programming and customers continued to drop the service. It simply became financially infeasible to maintain the cable plant and serve a small number of customers. So, we terminated the service.

Q. Has Eagle undertaken any fiber to the home projects?

A. Yes. It is important to understand our geography. The Richland Exchange that we serve is very rugged in terrain. Most of the customers are located within two square miles in the buildable area of the town of Richland. This made it financially feasible to provide fiber to the home within the town of Richland. It was not economically feasible to provide fiber to the home to those people who live in the very outskirts of the exchange given the terrain that we have to deal with.

Q. Why did Eagle undertake a fiber to the home project?

A. Eagle Telephone's copper plant had been in use for more than twenty years and was due to be upgraded. After obtaining price quotes for both copper and fiber, it made fiscal sense to go with fiber and the use of fiber is encouraged by the RUS which supplied the loan for our project.

Q. Does that conclude your testimony?

A. Yes.

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

In the Matter of	)	
	)	
UNITED STATES CELLULAR CORPORATION	)	Docket No. UM 1084
	)	
	)	
Application for Designation as an Eligible Telecommunications Carrier, Pursuant to the Telecommunications Act of 1996	)	

DIRECT TESTIMONY OF

PATRICK L. LATTIN

ON BEHALF OF

OREGON TELECOMMUNICATIONS ASSOCIATION

OCTOBER 23, 2003

Q. Would designation of US Cellular as an ETC in the Richland exchange have an effect on any of your other operations?

A. Yes. We hold a PCS license under the name of Snake River PCS. Snake River PCS has not applied for ETC status. Snake River competes with US Cellular, as well as RCC Minnesota, for service in this area. We believe we do a very good job under the current competitive environment. I do not know the number of customers US Cellular has in this area, but I believe we serve more wireless customer than they do.

If US Cellular is granted ETC status, Snake River PCS will have no choice but to apply for ETC status for itself. If its competitor is receiving a new source of funding, then Snake River PCS will also have to have that same level of funding in order to maintain the competitive balance. This is wireless to wireless competition, not wireless to wireline competition. I would suspect the same would be true in other areas of the state of Oregon. That is, entities that compete with US Cellular will need to seek ETC status so they can have the same level of support for wireless to wireless competition.

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

CRAIG J. PHILLIPS

January 30, 2013

INTRODUCTION

Q. Please state your name and business address for the record.

A. My name is Craig J. Phillips. My address is 1104 Main Street, Suite 300, Vancouver, Washington 98660.

Q. What is your present position?

A. I am a Certified Public Accountant. I operate an accounting firm known as Craig J. Phillips, CPA. I also serve as the Administrator of the Washington Exchange Carrier Association (WECA) access pooling arrangement as approved by the Washington Utilities and Transportation Commission, and as the Administrator for the Oregon Exchange Carrier Association (OECA) access pooling arrangement as approved by the Oregon Public Utility Commission (OPUC).

Q. What is your experience in the telecommunications industry?

A. From January 1984 to April 1986 I was manager of the joint Oregon/Washington telecommunications industry audit group. This group consisted of employees of several of the large local exchange companies, whose duties were to review the projected revenue requirements and projected access minutes of OECA and WECA pool participants for consistency and reasonableness, propose adjustments if appropriate, and make recommendations to the OECA and WECA Boards. The approved revenue requirements and minutes were used as the basis for monthly settlements from the intrastate access pools.

Beginning in April 1986, I became Administrator for OECA, and as such became responsible for administering the intrastate access pools in Oregon. My staff and I administered the Oregon Carrier Access Fund (OCAF), the OECA Optional Pool and the OECA Billing & Collection and the OECA Special Access Pool. The Administrator is responsible for managing the pooling and distribution of intrastate access revenues, preparing the annual administrative budgets, monitoring pool results, preparing and filing access tariffs, preparing the corporate tax return and providing monthly and year-to-date reports to the OECA Board of Governors, various OECA committees and OPUC Staff. The Administrator also provides oversight for the OECA Rate Bureau, which provides an open forum for member companies and other interested parties to jointly discuss and consider proposals affecting rates and conditions for jointly provided Oregon intrastate telecommunications services. In addition, the OECA Administrator is responsible for oversight of the Oregon Data Distribution Center (DDC). The DDC receives intrastate, intraLATA originating access records from participating companies and produces and distributes intrastate, intraLATA terminating access records to participants. These records are used to bill terminating access to intraLATA carriers.

Beginning in May 1987, I became Administrator for WECA, and as such became responsible for administering the intrastate access pools in Washington. My staff and I administer the Washington USF Pool, the Washington Interim USF Pool and the Washington CCL Pool. The Administrator is responsible for managing the pooling and distribution of intrastate access revenues, preparing the annual administrative budgets, monitoring pool results, preparing and

filing access tariffs, preparing the corporate tax return and providing monthly and year-to-date reports to the WECA Board of Directors and various WECA committees. The Administrator also provides oversight for the WECA Rate Bureau, which provides an open forum for member companies and other interested parties to jointly discuss and consider proposals affecting rates and conditions for jointly provided Washington intrastate telecommunications services. In addition, the WECA Administrator is responsible for oversight of the Washington DDC. The DDC receives intrastate, intraLATA originating access records from participating companies and produces and distributes intrastate, intraLATA terminating access records to participants. These records are used to bill terminating access to intraLATA carriers.

Q. What is the purpose of your testimony?

A. I am testifying about the potential effects on originating access rates related to proposed reforms in the Oregon Universal service Fund or OUSF.

Q. Have you calculated what might happen if the proposals offered by Dr. Ankum and Mr. Price are successful in eliminating the OUSF.

A. Yes. Attached is confidential Exhibit OTA/601. This is an analysis of what would happen to the individual companies originating access rates. The reason I am saying originating access rates is that the intrastate terminating access rates have been capped at current levels by the FCC's USF/ICC Transformation Order.

Q. What is that effect on originating access rates?

A. The effect ranges from a potential originating access rate per minute of $0.067128 to a high of a $0.913463. Thirteen of the 27 OECA member companies would have originating rates in

excess of $0.20 per minute, and eighteen companies would have originating rates in excess of $0.17 per minute. This analysis assumes that local rates do not increase.

Q. **Have you done an analysis of what may happen to originating access rates under the current OUSF structure?**

A. Yes. Attached is Exhibit OTA/602. This is a confidential exhibit. This analysis assumes that local rates are not increased and that existing OUSF support is used to reduce the carrier common line portion of originating access rates. Absent the pooling of originating access revenues, eight companies would see increases in their individual company originating access rates. Five of those companies would have originating rates greater than $0.14 per minute, with the highest rate being $0.317410 per minute. This compares to the existing originating pool rate of $0.075145.

Q. Does that conclude your testimony?

A. Yes.

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY

TESTIMONY OF

BRANT WOLF

January 30, 2013

INTRODUCTION

Q. Please state your name and give us your business address for the record.

A. My name is Brant Wolf. My business address is 777 13th Street SE, Suite 120, Salem, Oregon 97301.

Q. By whom are you employed and in what capacity?

A. I am Executive Vice President of the Oregon Telecommunications Association.

Q. What is the purpose of your testimony?

A. In my testimony I am replying to certain policy positions undertaken by Verizon's witness and the witness for the Oregon Cable Telecommunications Association (OCTA). In addition I will respond to some specific factual assertions that have been made.

Q. In the testimony, Mr. Price and Mr. Ankum seem to be suggesting that only primary residential lines should be supported by the OUSF. Do you agree that is good public policy?

A. No. I think it is bad public policy and not in the public interest. Failure to support business lines in rural Oregon would be a major deterrent to economic development in rural Oregon.

The rates for business service would need to increase substantially if business lines are not supported. It should also be remembered that the lines ordered by healthcare providers and facilities are business lines. That means such a policy would hinder the provision of medical and health services in rural Oregon. As a result, that is a policy which could pose a danger to the health, safety and welfare of those people residing in rural Oregon. That is not appropriate public policy in my view.

Q. Should OUSF support be focused on the type of line provided?

A. No. It is OTA's position that the focus for OUSF support should be on the cost to provide the network in high cost areas of Oregon. As stated by other OUSF witnesses, the way the support should be calculated is to look at the actual cost the rural company has incurred in providing service. That information is provided to the Commission on Form O, Form I and other reports. Support should be based on a company-wide network cost basis, not based upon the number of lines it serves.

Q. There is a suggestion in Mr. Price's testimony that some companies may have unreasonably low rates. Verizon/100, Price/51. Do you agree?

A. No. I talked with each of the companies that were mentioned in the testimony. What Mr. Price fails to take in to account are the reasons for what he identifies as less than ten dollar rates. It is important to point out from the start that the rates identified by Mr. Price do not apply to all of the company's customers.

For example, for Monroe Telephone Company, that company has an established emergency line in place that allows 911 calls and incoming traffic but does not allow outgoing calls. The reason for coming up with this service is due to the high unemployment levels in the Monroe service area. This service gives a customer an alternative during difficult economic times.

For Clear Creek, the reason is completely different. That company has established a vacation disconnect service that allows a customer to go on an extended vacation and pay a reduced rate.

In the case of Monitor, the company has established an e-line service that allows only 911 calling if the customer subscribes to a "data only" line. Thus, the customer is paying for a data service and for a separate rate is able to call 911 for emergency purposes.

Canby and Mount Angel have an e-line service that allows the calling of 911 and the business office.

Pioneer has a vacation rate somewhat like Clear Creek

For Oregon Telephone Corporation, they have an exchange called Bates that has thirteen subscribers. Those subscribers have no calling without long distance charges except to each other. Oregon Telephone is currently looking at combining the Bates Exchange with another one of its exchanges which would substantially increase the calling area and the rates that those customers would pay. Oregon Telephone Corporation also has two customers on an e-line service where the only calling is for 911 and the to the business office.

Q. What is your impression of the rates charged for telephone service in Oregon?

A. For many companies, the rates are really quite high in my opinion. Attached as Exhibit OTA/701 is a table that sets out the local service rates. The Exhibit lists the residential rate, flat rate EAS, the subscriber line charge, 911 charge, the RSPF charge, the OUSF surcharge and produces a total rate. It does not include the ARC. Many companies have very substantial rates for residential service.

Q. Does that conclude your testimony?

A. Yes.

EXHIBIT OTA/701
Oregon Rural Company Local Service Rates[1]

Company	Residential Rate	EAS	Subscriber Line Charge	E911/RSPF	OUSF	Total Residential Rate
Asotin[2]	14.00		6.50	0.87	1.19	22.56
Beaver Creek	27.00	varies	6.50	0.87	2.30	36.67
Canby	12.80	12.20	6.50	0.87	2.13	34.50
Cascade - Corbett/Estacada	18.99	10.65	6.50	0.87	2.52	39.53
Cascade - All Others	18.99	7.00	6.50	0.87	2.21	35.57
Clear Creek	18.89	8.48	6.50	0.87	2.33	37.07
Colton	16.50	21.35	6.50	0.87	3.22	48.44
Eagle	11.60		6.50	0.87	0.99	19.96
Gervais	12.50	15.00	6.50	0.87	2.34	37.21
Helix - Base Area	13.80		6.50	0.87	1.17	22.34
Helix - Zone 1	15.80		6.50	0.87	1.34	24.51
Helix - Zone 2	17.80		6.50	0.87	1.51	26.68
Home	16.55		6.50	0.87	1.41	25.33
Molalla	14.95	13.00	6.50	0.87	2.38	37.70
Monitor	14.05	2.40	6.50	0.87	1.40	25.22
Monroe	11.69	11.89	6.50	0.87	2.00	32.95
Mt. Angel	9.00	9.00	6.50	0.87	1.53	26.90
Nehalem	13.00		6.50	0.87	1.11	21.48
North-State	12.45	12.45	6.50	0.87	2.12	34.39
Oregon Tel. Corp. - Bates[3]	8.95		6.50	0.87	0.76	17.08
Oregon Tel. Corp. - Harper/Juntura	14.35	14.35	6.50	0.87	2.44	38.51
Oregon Tel. Corp. - All Others	11.95	10.55	6.50	0.87	1.91	31.78
Oregon-Idaho - Jordan Valley, OR	11.65		6.50	0.87	0.99	20.01
Oregon-Idaho - Jordan Valley, OR-Zone A	13.65		6.50	0.87	1.16	22.18
Oregon-Idaho - Jordan Valley, OR-Zone B	18.65		6.50	0.87	1.59	27.61
Oregon-Idaho - Ridgeview, OR	18.65		6.50	0.87	1.59	27.61
Oregon-Idaho - Adrian, OR	18.65		6.50	0.87	1.59	27.61
People's	13.95	8.95	6.50	0.87	1.95	32.22
Pine[4]	12.00		6.50	0.87	1.02	20.39

Company	Residential Rate	EAS	Subscriber Line Charge	E911/RSPF	OUSF	Total Residential Rate
Pioneer Coop. - Triangle Lake/Deadwood	15.00	8.00	6.50	0.87	1.96	32.33
Pioneer Coop. - Bellfountain/Horton	15.00	7.00	6.50	0.87	1.87	31.24
Pioneer Coop. - South Beach	15.00	4.95	6.50	0.87	1.70	29.02
Pioneer Coop. - Chitwood/Philomath	15.00	3.95	6.50	0.87	1.61	27.93
Pioneer Coop. - All Others	15.00	2.95	6.50	0.87	1.53	26.85
RTI - Zone 1 (In Town)	15.00	12.20	6.50	0.87	2.31	36.88
RTI - Zone 2 (Out of Town)	18.00	12.20	6.50	0.87	2.57	40.14
Scio[5]	11.50	11.65	6.50	0.87	1.97	32.49
St. Paul[6]	10.50	11.85	6.50	0.87	1.90	31.62
Stayton	11.60	6.89	6.50	0.87	1.57	27.43
Trans-Cascades	14.80	9.32	6.50	0.87	2.05	33.54

[1] Rates do not include ARC charges.
[2] Scheduled to be in effect February 7, 2013.
[3] Work is underway to merge this exchange into the Prairie City Exchange and those rates would then apply.
[4] This rate will increase to $14.00 in 2013.
[5] EAS rates listed are for Salem. EAS rates for Albany are $13.00/month for residential service and $19.11/month for business service.
[6] EAS rates listed are for Newberg, Gervais and Salem. EAS for Newberg and Gervais only is $0.40 per month.

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

**REPLY
TESTIMONY
OF**

BRANDON ZUPANCIC

January 30, 2013

INTRODUCTION

Q. Please state your name and give us your business address for the record.

A. My name is Brandon Zupancic. My business address is 190 SE 2nd, Canby, Oregon 97013.

Q. By whom are you employed and in what capacity?

A. I am Vice President of Network Operations for Canby Telephone Association d/b/a Canby Telcom.

Q. Please describe Canby Telcom's operations?

A. Canby servers the area in and around Canby, Oregon. Canby's service area encompasses eighty-four square miles. Some of the area is relatively rural with farm lands and orchards. Other areas are more densely populated. According to data compiled by city-data.com, the population density of zip code 97013 (Canby) is 386 people per square mile, which is noted as "very low." Other areas of our exchange, such as the 97038 zip code, have a population density of 99 people per square mile.

Q. At page 33 of his testimony, Mr. Ankum states "As a result, rural carriers have an incentive to "gold plate" their network and RLEC customers often have access to advanced services that are, ironically, not available in urban areas." Do you agree with that statement?

A. No. I see no incentive for Canby or other rural carriers to gold plate their systems. As a member-owned association, we have a fiduciary obligation to our members to carefully and efficiently manage operating capital and expense. The Adjusted Gross Income for our serving area is approximately 15% below the state average, according to city-data.com (zip code 97038 AGI $41,860 versus statewide AGI $46,788), which means that our members typically have less

to spend on telecommunications services than customers in other parts of the state, including other urban areas of Clackamas County. That directly translates to Canby Telcom having to be far more frugal with our limited capital and expense resources than for-profit telecommunications entities in urban areas, including our primary cable competitor, which just received over $1 billion dollars of new equity investment and debt refinancing. Ninety-nine percent of Canby Telcom's capital investment over the past several years has been self-funded from operating revenue and cash on-hand.

I am also unaware of any telecommunications services that we provide that are not available in urban areas. There are examples of services that are available in urban areas that are not generally available in rural areas. As one example, Verizon constructed their high-speed FiOS "100% fiber-optic network" throughout the Beaverton area in order to offer broadband, voice, and data services. This means they can offer high capacity circuits for telecommunications such as SONET OC-768 or Gigabit circuits. Comcast also currently offers service up to 10 Gbps in the Portland metro area. Integra also offers services up to 10 Gbps in their metro areas. These offerings in the metro areas exceed the offerings of most every rural telco that I am aware of.

Q. **Please describe how Canby goes about determining how to build its network?**

A. First of all, as I said earlier, Canby is a cooperative which means that we are member owned. As such, Canby is obligated to make sound fiscal decisions regarding the use of our member's capital. I will provide you with a number of examples.

The following are specific examples of the fiscal due diligence we perform when determining how to serve each unique area, and whether to use copper or fiber or other alternatives.

The first example is an area in our service area that is served by twisted copper cable that was having some service affecting problems. The company evaluated the cost of replacing the existing copper with either fiber cable or new copper cable. In this case, it turned out that replacing the copper cable with fiber would have been higher in cost than replacing existing copper cable with new copper cable due to the extremely low address density combined with a lack of existing feeder fiber in close proximity. Based on that analysis, we went forward with copper cable as a replacement option. There was a second example very similar to this first example where we did the analysis and again given the extremely low address density and lack of existing feeder fiber in reasonable proximity, copper was the lower cost solution.

In yet another case, a wireless company requested a fiber backhaul. However, because of the remoteness of the location, even if the wireless carrier paid a substantial amount up front to aid in the construction, the cost was prohibitive to put in either fiber or copper. So in this location, we found where we could use microwave to backhaul traffic to a separate cell tower where we then had the reasonable capacity to backhaul the combined traffic on fiber.

In another case, we had a retail business customer who wanted a broadband connection to tie two business locations together. We again did a comparative analysis of the cost of placing fiber, copper cable, and fixed microwave. Due to the proximity of the two sites the most economical approach was the point-to-point microwave system.

Q. Do you have an example where fiber was the cost-effective choice?

A. Yes. We have had literally dozens of other areas where we needed to replace damaged copper cables, relocate existing facilities, or to serve new homes or businesses, and placement of fiber was a more economical solution.

In 2010 we were faced with a situation with a six hundred pair copper cable and a 400 pair copper cable feeding a large number of our subscribers that were old, badly deteriorated, and had water migration into the cable, audible cross-talk, and substantially degraded service due to electrical faults and defects. As a result, the existing cable needed replacement. Canby evaluated replacing the existing cable with either copper or fiber. It turned out in this case the cost to replace the existing cable with fiber was less than using copper. Given the advantage that fiber has with the capacity and lower maintenance costs and the elimination of the inherent service limitations and electrical interference associated with all copper cable, it was a far more cost effective solution to replace the six hundred pair copper cable with fiber. In fact, we were able to replace the 600 pair and 400 pair copper cables with a 556 fiber cable using multiple different existing fiber feeds to further reduce cost. In addition, we saved an enormous amount of cable splicing labor time by deploying fiber because we were able to reduce the number of physical splices. Unlike with copper cable, when we deploy fiber, we only need a single fiber to an address, and the Optical Network Terminal we install as the network interface is able to provide multiple phone lines or multiple services or services to multiple customers. With copper cable, we would have had to place multiple copper pairs for each address in order to provide multiple lines or multiple services to a single address, and the splicing labor is double for a

because it requires splicing pairs of cable for each subscriber, versus a single bi-directional fiber for fiber subscribers.

We also consider not only the initial capital construction cost, but also the ongoing maintenance of the plant. The annual maintenance cost is far lower for fiber plant than it is for copper plant, and fiber has none of the inherent sources of trouble that copper plant suffers from, such as electrical interference, crosstalk, shorts, electrical imbalance, ground faults, or distance limitations.

On a like for like basis, it is generally far less costly to place fiber-optic cable than copper cable. The following are actual 2012 materials costs that Canby experienced. Depending on the cable size, copper can cost anywhere from 1.4 times to 2.5 times as much as fiber. All costs are per foot.

copper BJF 6 pair (24 gauge) drop - $0.35
6 fiber drop - $0.20

copper BJF 25 pair (24 gauge) - $1.00
24 fiber $0.25
24 microfiber $0.25

copper BJF 50 pair (24 gauge) - $1.00
48 fiber - $0.30

copper BJF 100 pair (24 gauge) - $2.00
96 fiber - $0.60

copper BJF 200 pair (24 gauge) - $4.00
216 fiber $1.15

Where it makes sense to deploy fiber instead of copper cable, we do so. However, we do not put in fiber just for the sake of having fiber. In fact, we have specific areas where we do not plan to place fiber, either because the existing copper is sufficient to meet customer needs, and/or where the cost to replace damaged or worn copper with fiber would simply not make financial sense. We do not make decisions looking to "gold plate" our network.

Q. **Mr. Ankum argues that the presence of an unsubsidized competitor should mean that the company should not receive support from the OUSF and he included wireless as a possible "unsubsidized competitor." Mr. Price makes a similar argument about the presence of "unsubsidized competitors" including wireless companies. Do you believe the presence of a wireless carrier in your service area is the presence of an unsubsidized competitor?**

A. No I do not. I think these arguments are stretched for two reasons. First, wireless carriers do not have the same Carrier of Last Resort obligation that a rural local exchange carrier does. Wireless carriers can, and do, typically build their rural coverage areas in town centers and along highways, but often neglect to provide coverage to rural areas that have low population density or little arterial vehicle traffic. Second, to argue that a wireless carrier serving a rural area constitutes an “unsubsidized” competitor is erroneous. Wireless carriers do not have serving areas which are exclusively rural like the rural ILECs do. The wireless carriers subsidize construction of their highly geographically selective rural networks with revenue from adjacent urban areas. It is simply illogical to for a wireless company to claim that it can serve the rural area on a stand-a-lone basis without the revenues that it receives from its customers in the more urban areas and then qualify as an "unsubsidized competitor." The economics in rural areas are that there are just not enough customers in many cases to support a network without some federal

or state support, or both. The economics for rural wireless build-out only work if there is a public subsidy mechanism or if the wireless carrier cross-subsidizes from its urban markets to its rural ones. If it did not have the support from serving the more densely populated areas, such as Portland, it's highly unlikely that the wireless company could support a network that would serve Canby in an economical fashion. We have seen this time and again in Canby where the wireless carriers have either not covered our serving area at all, or provide only the most basic services in Canby and the surrounding rural areas long after providing more advanced services in Portland. The stark reality is that the wireless carriers rely on cross-market subsidization in order to offset the higher cost of construction in rural areas and the lower gross revenue per cell site in rural areas which have lower population densities.

I also find it ironic that Verizon Wireless would make an argument about removing our support when Verizon Wireless and other wireless carriers rely on our networks for their own operations.

Q. What do you mean that Verizon Wireless and other wireless carriers rely on Canby's network for their own operations?

A. What I mean is two fold. First, every wireless network requires wireline backhaul at some aggregation point. There is a limit to the bandwidth microwave radios can aggregate before requiring wireline transport to the wireless carrier's MTSO. A MTSO is a wireless company's switching facility. Wireless carriers purchase backhaul capacity from rural carriers in order to get traffic from a wireless carrier's cell site back to its switch. This backhaul capacity rides over the very network that is constructed to provide wireline voice service in the rural area. So, in

that sense, Verizon Wireless and other wireless carriers rely on the rural ILEC network to be there to allow them to provide wireless service.

The second means by which Verizon Wireless relies on the rural network is for the completion of traffic. We have a traffic exchange agreement with Verizon Wireless. That agreement is an indirect traffic exchange agreement. What that means is that Verizon Wireless does not have facilities directly into our switch. Rather, Verizon Wireless provides the "wireless" originated traffic through an existing wireline tandem and that traffic is delivered to Canby over the wireline network and Canby makes sure the call gets to the called party over Canby's network.

Q. Are there other distinctions between wireless service and wireline service provided by Canby?

A. Yes. Canby has the carrier of last resort obligation. A wireless company is free to choose or not choose to serve a customer. A wireless company is free to choose where to build its cell sites and what investment to make to have a given signal strength. If it is not economical to make the investment to improve signal capacity, the wireless carrier does not have to make the investment.

Q. Are there similar differences between the obligations of an ILEC and a wireline competitor?

A. Yes. Wireline competitors, including CLECs and cable TV companies, are free to build where they want to serve and can choose where they do not want to serve. Most cable companies provide service only where they provide cable television and do not extend phone service out to other areas. Indeed, many cable companies have provisions within their cable franchises that allow them the specific right not to build if certain tests are not met which would make the

building economically operational. Canby does not have that choice. Canby and other rural companies must provide service throughout its designated service areas. As one specific example, WaveDivision Holdings, LLC, the parent company of Wave Broadband, applied for a Federal BTOP grant to construct facilities to rural areas with very low population density along and near State Route 211 where Wave Broadband had previously chosen not to provide service. It is noteworthy that in this area, both Canby Telcom and Molalla Communications have a carrier of last resort obligation. Yet, Wave Broadband had chosen not to provide service in this high cost / low revenue area. It is also noteworthy that Wave Broadband resorted to applying for a Federal Grant to subsidize construction in this same area. Wave Broadband was not awarded their BTOP grant, and Wave Broadband has not constructed any facilities in this area. This demonstrates that in the absence of a carrier of last resort obligation and public subsidies, competitive providers and cable companies will not construct facilities to provide services in areas where the return on investment cannot justify construction or ongoing maintenance. If these areas had a reasonable return on investment, there would be no need for carrier of last resort obligations; there would always be a service provider willing to provide service.

Q. Does that conclude your testimony?

A. Yes.

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

JAMES A. SMITH

January 30, 2013

INTRODUCTION

Q. Please state your name and give us your business address for the record.

A. My name is James A. Smith. My business address is 200 Concord Street, Helix, Oregon 97835.

Q. By whom are you employed and in what capacity?

A. I am the President of Helix Telephone Company.

Q. Please describe the Helix Telephone Company's service area.

A. Helix serves two exchanges. The Helix Exchange and the Meacham Exchange. These exchanges are located in northeastern Oregon in Umatilla County. These exchanges are very rural in nature. The primary occupation is farming.

We serve approximately 217 access lines spread out over 176 square miles for an average density of 1.23 access lines per square mile. Many of the lines are found in the town of Helix. The rest are spread out throughout the service area.

Q. At page 33 of Mr. Ankum's testimony he states "As a result, rural carriers have an incentive to "gold plate" their network and RLEC customers often have access to advanced services that are, ironically, not available in urban areas." Do you agree with this statement?

A. No. When we look at a building project, we try to do it in the most cost effective means we can. Because we serve a rural area, we have a lot of plant invested on a per customer basis. However, that does not mean we are trying to put in plant that is not needed to provide service. We struggle to provide services that are comparable to those in urban areas.

Q. At page 35 of his testimony, Mr. Ankum's states that Helix receives an OUSF draw of $77.64 per line. Is that accurate?

A. At the present time it is not. Prior to September 1 of 2012 and for the past 10 years, Helix received OUSF support at $10.95 per line. That support went up as of October 1. In the spring of 2013, our support per line will reach the $77.64 number, but not until that time.

Q. Both Mr. Ankum and Mr. Price suggest that the presence of a wireless company in your service area constitutes an unsubsidized competitor and you should not receive OUSF support. Do you agree with this concept?

A. No. Wireless service cannot provide the level of service that we provide to our customers. Nor can it reach all of our customers. Although Verizon's wireless map seems to suggest that it serves all of our exchange, it does not. Verizon Wireless' service in our area is very spotty. Just because they have map that shows that they can provide service does not mean that they actually do provide service. Even if they did provide service, how can they reach all of the customers that Helix serves in our very rural area? I do not think they can.

Q. Does that conclude your testimony?

A. Yes.

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

DON LAWRENCE

January 30. 2013

INTRODUCTION

Q. Please state your name.

A. My name is Don Lawrence.

Q. Have you filed direct testimony in this matter?

A. Yes.

Q. What is the purpose of your reply testimony?

A. I am replying to certain positions advanced by the Oregon Cable Telecommunications Association and Verizon.

Q. At page 33 of Mr. Ankum's testimony he states "As a result, rural carriers have an incentive to "gold plate" their network and RLEC customers often have access to advanced services that are, ironically, not available in urban areas." Do you agree with this statement?

A. No. At Stayton, we evaluate each of the projects to provide the most cost effective means of providing service.

For example, we had experimented with wireless options to explore their economic feasibility. We used unlicensed 900 megahertz spectrum in two areas. We experienced significant interference issues. We also experienced excessive backhaul costs due to line-of- sight issues in one location. Those trials demonstrated to us that any sort of fixed wireless application would not work in the area that we serve, which is hilly and heavily treed.

Q. Does Stayton have an incentive to "gold plate?"

A. No. Stayton is a cooperative. If we attempted to gold plate our network using our members' dollars, we would quickly find that a new set of directors had been elected and the company's management had been replaced. We have to operate efficiently and use our members' dollars as efficiently as possible.

Q. At page 33 of his testimony, Mr. Ankum makes the following statement: "...RLEC customers often have access to advanced services that are, ironically, not available in urban areas." Do you agree with his characterization?

A. I am puzzled by his characterization. If he is referring to advanced telecommunications services, I am not aware of any services that are not available in urban areas that are available in rural areas. If he is referring to quality of service, then I think he is correct since rural carriers tend to be closer to their customers and offer a higher quality of service. If he is referring to broadband service, that is not an issue for this proceeding. However, again, I am not aware of the specifics that would support that statement since many urban customers have access to broadband speeds equal to or greater than that available in rural areas.

If I assume that his statement is correct, then I wonder why that is a bad thing. If rural companies are making investments to provide service to their customers, that should be a good thing. Since we are not "gold plating" our rural network, making the investment consistent with the overall goal of providing customers with quality service that meets their telecommunications needs should be what the Commission wants us to do.

Q. Both Mr. Price and Mr. Ankum appear to be recommending that if there is an unsubsidized competitor present, the ILEC should not receive support. Do you agree with that concept?

A. No I do not. First of all, the idea that you would look at a coverage map to determine if there is an unsubsidized competitor present is not appropriate. I happen to use Verizon Wireless. Although their coverage map shows that they cover the Stayton Exchange, they really do not cover it very well. I cannot use my wireless phone inside my own office in downtown Stayton. The truth is that Verizon coverage is very sporadic throughout the Stayton service area.

Beyond that, the issue should be focused on who has the carrier of last resort obligation and how is that obligation going to be met. It seems to me that the fundamental premise of universal service is to provide service to everyone. If a competitor can choose where it wants to serve, that does not satisfy the carrier of last resort obligation. That lack of commitment to ubiquitous service should not be leveraged to taking support away from the incumbent. There is no way that an incumbent can provide service to all customers and meet the carrier of last resort obligation if support is removed for the ILEC's most densely populated areas. The network is needed throughout the service area and it is the overall cost of that network that should be the issue.

Q. Does that conclude your testimony at this time?

A. Yes.

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

JOHN HEMPHILL

January 30, 2013

INTRODUCTION

Q. Please state your name.

A. My name is John Hemphill.

Q. Have you previously filed testimony in this matter?

A. Yes.

Q. What is the purpose of your reply testimony?

A. I am going to respond to certain allegations contained in the testimony of Mr. Price and Dr. Ankum.

Q. At page 33 of Dr. Ankum's testimony he states "As a result, rural carriers have an incentive to "gold plate" their network and RLEC customers often have access to advanced services that are, ironically, not available in urban areas." Do you agree with this statement?

A. The answer is no. We installed fiber because after looking into the issue, fiber was less expensive than copper. Even the RUS recognizes the situation. The current RUS loan design require special justification if copper is going to be used because it appears to the RUS, and to us that, a copper network in many cases will be more expensive than a fiber network.

It so happens that fiber has additional benefits over copper. One of those is a lower ongoing maintenance cost. Another is the versatility that it presents.

For example, Pine has designed and installed a video bridge, which it will operate for the local

school to enable connection and long distance learning for Pine/Eagle School District students from the remote schools and colleges. It means that subjects not taught locally can be taught in the school system in Halfway. This has been such a success for the school and the local school superintendant is so pleased, he has mentioned it to other school superintendents and two other rural school districts have approached Pine to help them provide distance learning. This service would not have been possible using a copper network in our location given the loop lengths and capacity issues.

To my mind this shows that a fiber network was not only the correct choice economically it was the correct service based choice as well.

Q. **Both Mr. Price and Dr. Ankum contend that the presence of an unsubsidized competitor in an ILEC service territory means that the ILEC should not receive support. Do you agree with that contention?**

A. No. First of all, I disagree with their concept of what is an unsubsidized competitor. Both Mr. Price and Dr. Ankum seem to include mobile wireless providers under that category. Even the FCC does not do that. In order to be an unsubsidized competitor as that term is defined by the FCC, a carrier must be a facilities-based provider of residential fixed voice and broadband service, either wireline or wireless. But if it is wireless service, it must be fixed wireless. A mobile wireless carrier does not meet this definition.

Q. **Are you advocating that the Commission adopt the FCC's definition of an unsubsidized competitor?**

A. No. I do not think the Commission should use the concept of an unsubsidized competitor

at all. The issue is the cost to serve a high cost area and which carrier has the carrier of last resort obligations.

In addition, I have trouble with the notion of an unsubsidized competitor. Pine serves only its areas in Eastern Oregon. These areas are relatively isolated and very rural. There is no competitor that would build a network to provide service in Pine's service areas on a stand-alone basis. The wireless carriers that are in the area are there primarily because they are providing coverage of the major arterials. They are there to provide service to their customers who are driving through Pine, not primarily to obtain customers in Pine, although that would be a side benefit. Those wireless networks are supported by the more densely populated areas such as the population of customers in Portland. If a wireless carrier were to consider building a stand-alone network to serve the rural areas with all the carrier of last resort obligations and quality of service required, I don't think it would because the economics are not there. There would have to be so many towers in our mountainous areas, and a huge amount of bandwidth capacity available just for voice service.

Q. Do you have any other concerns about the unsubsidized competitor concept?

A. The concept as advanced by OCTA and Verizon is that one could just use coverage maps or other maps that might show presence of competitors and then they would shift the burden to the ILEC to prove that there are not actual, real competitors present. That concept would lead to a vast amount of litigation and a great deal of expenditure of resources, but to what end? Actually, neither Mr. Price nor Dr. Ankum explains how his ideas would work from a practical standpoint, or how to actually implement them.

Further, I have a great deal of difficulty with the concept of the presence of wireless service meaning that there is an unsubsidized competitor present for the purposes of removing support. Verizon's coverage maps show that they cover a portion of Pine's Halfway service territory. However, Verizon's maps overstate its coverage. Further, if the idea is that the presence of a competitor means that fact alone is sufficient for universal service purposes and that presence is meant to satisfy universal service obligations, the concept will just not work. The heart of universal service is to provide rural, high cost areas with service comparable to that in urban areas. For the presence of a competitor to mean anything, the competitor must take on carrier of last report obligations and provide solid, reliable service.

And most importantly, wireless service is very unreliable in remote areas like ours. Just this last Christmas holiday, Verizon's service, even for the small area it covers, was completely out of service in the town of Halfway, in Pine's service territory and across the mountain in the town of Richland for two full days. To me that is not a service that meets universal service goals.

Q. **At page 34 of his testimony, Dr. Ankum makes the statement about Pine that reads as follows: "Moreover, because they [Pine] have enjoyed substantial financial support from the federal high-cost USF and OUSF mechanisms for years, they have been able to offer their services at prices that are often set well below the comparable urban surfaces' price levels." He then goes on to state that Pine is drawing OUSF support at the level of $95.03 per line. Is Dr. Ankum accurate?**

A. No. For the period of 2003 to September 2012, Pine received exactly zero in OUSF support. The statement by Dr. Ankum that we have received substantial OUSF support is completely

inaccurate. Beginning in October 2012, we did begin to draw from the OUSF. However the draw is a level of approximately seventy-five percent of the figure used by Dr. Ankum. Come this spring, approximately April, we will begin to draw, for the very first time, at the level described by Dr. Ankum. This level of support is the direct result of actual capital expenditures that Pine has made to provide service in rural Oregon, much of the money having been used to bring service to a completely unserved area, Three Rivers.

Q. Does that conclude your testimony?

A. Yes.

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

DEEDEE KLUSER

January 30, 2013

INTRODUCTION

Q. Please state your name and your business address.

A. My name is DeeDee Kluser. My address is One Telephone Drive, Mt. Vernon, OR 97865

Q. By whom are you employed and in what capacity?

A. I am the manager for both Oregon Telephone Corporation and North-State Telephone Company.

Q. What is the purpose of your reply testimony?

A. I am responding to Mr. Ankum's allegation that rural companies have an incentive to "gold plate."

Q. What is your concern with Mr. Ankum's testimony?

A. Mr. Ankum apparently does not understand what it takes to operate in rural parts of Oregon. Our incentive is to keep our costs as low as we can. However, we have much more plant per customer than companies serving urban populations due to our low population density.

Q. Do you have any examples of making choices in the construction of outside plant?

A. Recently, Oregon Telephone Corporation had a situation where we needed to replace copper plant that was inadequate. The capacity of the copper cable was too small due to growth. In addition, faults were occurring causing service quality problems. Our original proposal was to do a copper for copper replacement. When it came time to begin construction, we checked with several vendors before we put the project out to bid. The vendors provided us with preliminary bids that demonstrated that if we wanted copper it would probably cost more than fiber and that the overall costs would still mean that a fiber project would be little bit cheaper than a copper

based project. Since fiber generally has lower maintenance costs, we went with fiber. Our goal was to keep the construction costs as low as we could while meeting the service goals.

Q. Does that conclude your testimony?

A. Yes.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

JAMES RENNARD

January 30, 2013

Q. Please state your name and give your business address.

A. My name is James Rennard. My business address is 8050 SW Warm Springs St., Suite 200, PO Box 2330, Tualatin, OR 97062.

Q. Have you previously filed testimony in this proceeding?

A. Yes.

Q. In his direct testimony Dr. Ankum recommends that the Oregon Public Utility Commission should "...Implement caps on the supportable levels of capital, operating expense, and corporate overhead consistent with the approach taken by the FCC." OCTA/100, Ankum/5 and, "The Commission should adopt a similar approach of limiting the amounts of capital and operating expenses in the embedded cost studies used to determine OUSF support for rural carriers to discourage waste and inefficient spending." What is Dr. Ankum referring to?

A. He is referring to what is commonly referred to as the "quantile regression analysis" in FCC Order 11-161.

Q What is the "quantile regression analysis" in the FCC Order meant to accomplish?

A. Generally speaking, it creates a mathematical model using a specific type of regression analysis called "quantile regression analysis" (QRA) limiting the total costs that are includible in the federal high cost loop support algorithm.

Q. How does the model work?

A. I am not a mathematician so I cannot speak to the statistical underpinnings of QRA. However, generally speaking the model takes a set of selected input variables and develops a theoretical maximum level of allowable capital and allowable operating expenses that a company should "need" to meet its universal service obligations.

Q. Do you agree with Dr. Ankum's recommendation?

A. No. While I believe that there is universal agreement that "discourage(ing) waste and inefficient spending," OCTA/100 Ankum/27, is a desirable outcome, I do not believe that quantile regression analysis is the way to achieve this objective.

Q. Why not?

A. I believe there are many problems with the QRA approach. Perhaps the most significant problem is the underlying presumption that it is possible to create a mathematical model to generate appropriate company-specific limits ("benchmarks") for capital and operating expenses to be used in place of company-specific costs for purposes of high cost loop support computations. A specific company's cost drivers will be unique to the particular entity. The small rural carriers vary greatly from each other in their service area characteristics and operating conditions, whereas the much larger non-rural carriers are more homogenous with each other, statistically, due to their line counts, which are several orders of magnitude larger than the typical small rural carrier. While there will certainly be some general, and directionally correct, inferences you can draw from "similarly situated companies," it would be impossible to develop a model that can account for the hundreds of variables that drive the costs of building and operating a particular small rural company and arrive at an accurate assessment of the maximum necessary costs for that specific company.

The FCC record is rife with comments about the FCC's regression model. For example, please see NTCA's recent ex parte dated January 4, 2013. That ex parte and the internally referenced ex parte of October 18, 2012, are attached as Exhibit OTA/1301. The record before the FCC is

lengthy with specifics on the difficulties and problems of such a complex model including, but not necessarily limited to:

- Inaccuracies of data
- Inability to verify data
- Criticism of appropriateness of QRA methodology being applied for the purpose of setting company-specific limits for small rural companies (notably by the methodology's developer – Dr. Roger Keonker)

I include one example to highlight the level of concern about the serious risks that the regression analysis presents to rural exchange carriers. In a letter from Indiana Utility Regulatory Commissioner Larry S. Landis to FCC Commissioner Rosenworcel dated December 11, 2012, he notes that the current regression analysis may cause "severe financial hardship," "result in some carriers being...unable to provide service at all," and "irreparable harm in rural communities." Commissioner Landis is a highly respected member of the Indiana Commission and extremely knowledgeable on this subject. A copy of his letter is attached as Exhibit OTA/1302.

Q. Do you have any other concerns about Dr. Ankum's testimony?

A. Yes. Even if you believe that this approach of using the FCC's QRA is appropriate, what specifically does Dr. Ankum propose to do? Would he develop an Oregon-specific regression model to determine the appropriate level of allowable costs? With so many fewer companies in Oregon would this even be possible? If so, how reliable would such a model be?

Would he propose to apply the FCC QRA to the Oregon companies? Would the FCC model be transferable to a subset of Oregon companies?

Who would develop and maintain such a model? How would these costs be funded? Would this be an additional cost that customers would need to bear in support of the Oregon Universal Service Fund?

Q. Do you believe that the QRA caps or benchmarks will "discourage waste and inefficient spending?"

A. No. Dr. Ankum states that caps or benchmarks are an effective tool to "discourage waste and inefficient spending." In my experience, the primary effect they have had is to discourage any spending at all. While the FCC Order purports to create certainty, the fact of the matter is that companies are unable to forecast whether or how the regression model may or may not impact them in the future. This uncertainty paralyzes companies from moving forward with substantial capital projects even if they had access to capital.

Q. Do you believe that waste and inefficient spending is a concern?

A. As I noted earlier, I believe everyone would agree that "waste and inefficient spending" is a bad thing. At the same time, I do not believe that there is any kind of systemic problem with this issue in Oregon. The financial pressures on the rural telephone industry are not new and there has been a relentless focus on controlling costs and gaining efficiencies, particularly during the past several years. Seminar sessions dedicated to the topics of controlling costs and improving efficiency have been on state and national conference agendas for some time. Seminar sessions have explored this issue in a wide range of contexts including such things as mergers, consolidations, partnerships, and improving efficiency. Our client companies both in and out of Oregon have implemented changes to achieve greater efficiency and lower costs.

Q. What changes would you make to discourage waste and inefficient spending?

A. I do not believe there is a systemic problem with this issue. I believe that the OPUC's current oversight of the rural telephone companies provides ample opportunity to ensure that waste and inefficient spending is not an issue. I outlined in my opening testimony, currently there are multiple filings containing detailed information that the rural, rate-of-return companies make with the Commission. I believe that these reviews are sufficient to ensure that only appropriate costs are included in the development of companies' tariffed rates. For example, the current process sets specific limits on executive compensation and training and conference expenses. Companies are free to spend what they wish, but only a certain expense level is allowed for ratemaking purposes.

Q. How many Oregon companies are subject to the FCC regression caps or benchmarks?

A. As Dr. Ankum points out, there are two – Pine Telephone System, Inc. (Pine) and Scio Mutual Telephone Association (Scio). However, for 2013 and in the future, Scio will most likely not be subject to the FCC regression caps or benchmarks

Q. Does Dr. Ankum make any observations based on this data?

A. No. He merely cites that two companies exceed the FCC regression analysis limits. He goes on to state that: "For Pine, the FCC-capped cost per line is 29% lower than the actual uncapped cost, and for Scio this percentage measure is 6%." Dr. Ankum's footnote seems to indicate that he intended these figures to be 19% and 6%, respectively.

Q. What are your observations based on this data?

A. If exceeding the regression limitations is an indication of "waste and inefficient spending" it would seem to support a conclusion that this is not a significant issue as only two different companies exceed the computed limitations. However, what the facts actually show is that there

are reasons why the benchmarks are exceeded that have nothing to do with waste or inefficient spending.

Each of these particular companies has special circumstances. Pine operates in an extremely high cost to serve area as has been discussed in Mr. Hemphill's testimony. And, halfway through a large capital construction project by Pine to reach five hundred to six hundred homes and businesses without any telecommunications service, the FCC's USF/ICC Transformation Order was issued. This was before Pine could finish the second phase of the project which would have laid new lines to the largest remaining concentration of unserved establishments, but after having already completed the exchange central office, installing the switch, and laying the main fiber trunk to establish access for the service area. This would explain why Pine may exceed a formula-driven limitation of costs as determined by "similarly situated companies," which are not, in fact, actually similarly situated. This is why arbitrary models do not work.

Scio was subject to the regression limitation in 2012 due to the timing of retiring certain plant assets. Scio will not be subject to the regression limitation in 2013 and is not expected to be in future years either. In this case, the model was not able to pick up on an anomalous situation.

Q. How many Oregon companies are subject to the corporate operations limitation for ICLS?

A. As Dr. Ankum points out, there are three - Canby Telephone Association, COLTONTEL, and Pine.

Q. Does Dr. Ankum make any observations based on this data?

A. No. He simply states: "The Commission should adopt a similar approach of limiting the

amounts of corporate expense per line in the embedded cost studies used to determine OUSF support to discourage waste and inefficient spending."

Q. Would you care to make any observations based on this data?

A. Yes. I would reiterate my earlier comment that if exceeding the corporate operations limitation for ICLS is an indication of "waste and inefficient spending" it would seem to support a conclusion that this is not a significant issue as only three companies exceed the computed limitations. Also, as noted earlier, the companies all file considerable financial and operating information with the Commission that is subject to review during the ratemaking process. Furthermore, corporate operations expenses will vary from company to company depending upon the corporate structure under which the organization operates which could be a contributing factor to higher than average costs.

Q. Dr. Ankum recommends four enhancements to the reporting requirements under Order 12-065. Do you agree with these recommendations?

A. No. However, my comments relate only to the rural, rate-of-return local exchange carriers. As I stated in my earlier testimony, there is ample data already reported to the Commission providing them with multiple opportunities to review companies' information for appropriateness. I would vigorously oppose reporting broadband revenue for the reasons outlined elsewhere in the OTA testimony. The other revenues are already reported to the Commission in the Form I or the Form O. My concern with the final recommendation is that is does not include a proposed description of how the costs of the investments should be allocated among various services. Under the cost allocation rules in effect today, costs are already allocated between regulated and non-regulated services. From a theoretical standpoint, the incremental costs above those required to construct and operate a network capable of providing basic telephone services could serve as a basis for

allocation. Two obvious problems are that trying to identify this incremental difference could be very expensive and complex and it would require a change to the existing cost allocation rules. In addition, as others have pointed out, in today's environment, the cost of building a network that is capable of providing broadband is not any more expensive and may, in fact, be less expensive than construction a network that was designed for the one purpose of providing voice service. So, the incremental difference in cable and wire facilities may be zero. Further, if an allocation process is created, as Mr. Duval points out, it would also require that less than the full federal high cost support be used as an offset. And, finally, a new allocation method for the network cable and wire facilities should be not undertaken because these costs also reflect the carrier of last resort obligations that incumbent local exchange carriers bear.

Q. Do you have concerns about any of Dr. Ankum's other reporting requirement recommendations?

A. Yes, if Dr. Ankum means to say at Ankum/113 that the reporting requirements for the non-rural carriers adopted in Order 12-065 should apply across the board, I disagree. This Order was applicable only to the non-rural carriers and assessment of support was made on a "going-forward basis" which would be inappropriate for rural rate-of-return carriers. Dr Ankum notes this in his own testimony at Ankum/26.

Q. At page 34 of his testimony, Dr. Ankum begins a description of five companies that he describes as profiles of the five RLEC's that draw over fifty dollars per line per month from the OUSF. Do you agree with his statements?

A. If his statements are meant to imply that those companies have had that level of a draw from the OUSF for the past ten years, that is an incorrect inference. For example, Pine did not draw any

support from the OUSF until the fall of 2012. For the other companies, their support prior to 2012 was much lower than the amounts stated in Dr. Ankum's testimony.

Q Have the companies increased their level of investment made in serving rural Oregon?

A. In most cases, yes. Attached as Exhibit OTA/1303 is a confidential depiction of the difference in cable facilities that have been installed between 2002 and 2011. Please note that 2011 is the most recent year for which information is available.

As an aside, I do note that Dr. Ankum says that Monitor is providing cable television service. That is not correct. The company has not been providing cable television service for several years now.

Q. Does this conclude your testimony?

A. Yes.

NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION
The Voice of Rural Telecommunications
www.ntca.org

January 4, 2013

Ex Parte Notice

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

***Connect America Fund*, WC Docket No. 10-90; *A National Broadband Plan for Our Future*, GN Docket No. 09-51; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Lifeline and Link-Up*, WC Docket No. 03-109; *Universal Service Reform – Mobility Fund*, WT Docket No. 10-208**

Dear Ms. Dortch:

On Thursday, January 3, 2013, the undersigned, on behalf of the National Telecommunications Cooperative Association ("NTCA") spoke via telephone with Nicholas Degani, Wireline Legal Advisor to Commissioner Ajit Pai, to discuss certain matters in the above-referenced proceedings.

NTCA raised the need for the Federal Communications Commission (the "Commission") to take both near-term and longer-term steps to address statistical and data-related shortcomings with respect to the regression analysis-based caps on universal service fund ("USF") support. *See* Application for Review of NTCA, *et al.*, WC Docket No. 10-90 (filed May 25, 2012). Specifically, NTCA pressed for near-term resolution of certain concerns with respect to such caps consistent with prior presentations, *see, e.g.*, *Ex Parte* Letter from Michael R. Romano, Sr. Vice President – Policy, NTCA, to Marlene H. Dortch, Secretary, WC Docket No. 10-90, *et al.* (filed Oct. 18, 2012), and also raised the need for review, testing, and resolution of broader concerns with respect to the persistent lack of transparency, accuracy, and predictability within the capping mechanisms.

NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION
4121 Wilson Boulevard • Tenth Floor • Arlington, Virginia 22203
Phone/703-351-2000 • Fax/703-351-2001 • www.ntca.org

As a more general matter, NTCA continues to assert that the Commission's broadband policy objectives and the statutory mandate of universal service can only be achieved through: (1) clear and well-tested "business rules" that provide sufficient support and enable company managers to understand with a reasonable degree of certainty what investments and operations will be recoverable (or unrecoverable, as the case may be) through USF support prospectively; and (2) a careful data-driven process that takes true and thoughtful measure of – and then corrects concerns with respect to – those reforms just now being implemented (including, but not limited to, the caps) before racing forward with additional changes that exacerbate already-occurring consumer rate increases, deter broadband investment, and encourage cutbacks in service quality and customer service.

Pursuant to Section 1.1206 of the Commission's rules, a copy of this letter is being filed via ECFS. If you have any questions, please do not hesitate to contact the undersigned.

Sincerely,

/s/ Michael R. Romano
Michael R. Romano
Senior Vice President – Policy

cc: Nicholas Degani

NATIONAL TELECOMMUNICATIONS COOPERATIVE ASSOCIATION
The Voice of Rural Telecommunications
www.ntca.org

October 18, 2012

Ex Parte Notice

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

***Connect America Fund*, WC Docket No. 10-90; *A National Broadband Plan for Our Future*, GN Docket No. 09-51; *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135; *High-Cost Universal Service Support*, WC Docket No. 05-337; *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92; *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45; *Lifeline and Link-Up*, WC Docket No. 03-109; *Universal Service Reform – Mobility Fund*, WT Docket No. 10-208**

Dear Ms. Dortch:

On Wednesday, October 17, 2012, the undersigned, on behalf of the National Telecommunications Cooperative Association ("NTCA"), had telephone conversations with Michael Steffen, Legal Advisor to Chairman Julius Genachowski, and Julie Veach, Chief of the Wireline Competition Bureau; Priscilla Argeris, Legal Advisor to Commissioner Jessica Rosenworcel; Nicholas Degani, Legal Advisor to Commissioner Ajit Pai; and Rebekah Goodheart from the Wireline Competition Bureau. The subject matter discussed in those conversations related to regression analysis issues, and my presentation was consistent with the discussions described in the *Ex Parte* letter filed yesterday, October 17, 2012, by NTCA, the Organization for the Promotion and Advancement of Small Telecommunications Companies, the Western Telecommunications Alliance, and the National Exchange Carrier Association.

In particular, NTCA expressed support for the Federal Communications Commission (the "Commission") to: (1) extend the phase-in associated with the regression analysis caps pending further review of concerns raised by various pleadings in these proceedings; (2) maintain the current 2012 model cost limits but add together the CAPEX and OPEX values for 2013 support calculations pending consideration of a single regression model; (3) adopt as a default rule that the caps will be held constant, as calculated on a total study area basis as of the model base period, for a period of several years starting in 2014 subject to further review and testing of the caps as described below; (4) ensure that any near-term steps taken with respect to the model are carefully coordinated and subject to reasonable transitions in connection with needed broader review and testing of the model; and (5) conduct further testing and analysis over the next twelve months to identify potential alternatives for improving predictability specifically and the accuracy and transparency of the model generally.

Pursuant to Section 1.1206 of the Commission's rules, a copy of this letter is being filed via ECFS. If you have any questions, please do not hesitate to contact the undersigned.

Sincerely,

/s/ Michael R. Romano
Michael R. Romano
Senior Vice President – Policy

cc: Michael Steffen
Priscilla Delgado Argeris
Nicholas Degani
Julie Veach
Rebekah Goodheart

STATE of INDIANA

INDIANA UTILITY REGULATORY COMMISSION
101 W. WASHINGTON STREET, SUITE 1500E
INDIANAPOLIS, INDIANA 46204-3407

http://www.in.gov/iurc
Office: (317) 232-2701
Facsimile: (317) 232-6758

December 11, 2012

The Honorable Jessica Rosenworcel
Commissioner
Federal Communication Commission
445 12th Street, SW
Washington, DC 20554

Dear Commissioner Rosenworcel,

I read with great interest your statement that accompanied the Federal Communication Commission's Fifth Order on Reconsideration of the USF/ICC Transformation Order (the Order).[1] I appreciated your affirmative statements in support of the need to improve the regression analysis, which originated from the Transformation Order, to provide carriers with greater flexibility to meet new requirements for qualifying for federal Universal Service Funding (USF) support in the post-Transformation Order world. I particularly appreciated your recognition of the need to have a more predictable system that provides carriers with the increased confidence necessary to invest in broadband infrastructure. There is anecdotal evidence that the order has had a chilling effect on private LEC investment thus far.

I fear the current regression analysis and regulatory framework resulting from the USF/ICC Transformation Order unnecessarily places too many rural carriers on a trajectory toward severe financial hardship that will result in some carriers being unable to continue to provide telecommunication service to the extent their rural customers deserve and have come to expect, or worse still, being unable to provide service at all. Unfortunately, it is unknown whether the negative impacts from the recent federal regulatory changes will be limited to only those carriers for which a case can be made that they may have abused the receipt of USF funding and/or had previously received support in excess of what was necessary to offset the real and significant costs that face carriers providing telecommunication service in rural areas of the United States. Your comments add further weight to the gathering evidence that more work needs to be done to the regression analysis before it causes irreparable harm in rural communities that are struggling to recover from the global recession.

I look forward to increased collaboration between the FCC and states to formulate policies that provide reforms and improved efficiencies in federal USF but at the same time protect rural consumers' access to telecommunication service that is vital to economic development, health and public safety.

Respectfully Yours,

Larry S. Landis
Commissioner

[1] WC Docket No. 10-90 et al., Report and Order and Further Notice of Proposed Rulemaking, Released November 18, 2011. Fifth Order on Reconsideration, released November 16, 2012.

OTA/1400
Meredith/1

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

**REPLY
TESTIMONY
OF**

DOUGLAS DUNCAN MEREDITH

January 30, 2013

INTRODUCTION

Q: Please state your full name, place of employment and position.

A: My full name is Douglas Duncan Meredith. I am employed by John Staurulakis, Inc. ("JSI") as Director–Economics and Policy. JSI is a telecommunications consulting firm headquartered in Greenbelt, Maryland. My office is located at 547 Oakview Lane, Bountiful, Utah 84010. JSI has provided telecommunications consulting services to the telecommunications industry, including rural local exchange carriers since 1962.

Q: Please describe your professional experience and educational background.

A: As the Director of Economics and Policy at JSI, I assist clients with the development of policy pertaining to economics, pricing and regulatory affairs. I have been employed by JSI since 1995. Prior to my work at JSI, I was an independent research economist in the District of Columbia and a graduate student at the University of Maryland – College Park.

In my employment at JSI, I have participated in numerous proceedings for rural and non-rural telecommunications carriers. These activities include, but are not limited to, the creation of forward-looking economic cost studies, the development of policy related to the application of federal safeguards for rural local exchange carriers, the determination of Eligible Telecommunications Carriers pursuant to the Communications Act of 1934, as amended (the "Act"), and the sustainability and application of universal service policy for telecommunications carriers. In addition, while I do not perform cost studies for JSI

clients, I am involved in developing policy for and responding to changes in federal policy for our cost study work. Accordingly, I am aware of the various processes required for federal interstate cost studies and how JSI completes cost studies for incumbent local exchange carriers. Those processes include jurisdictional separations.

In addition to assisting telecommunications carrier clients, I have served as the economic advisor for the Telecommunications Regulatory Board of Puerto Rico since 1997. In this capacity, I provide economic and policy advice to the Board on all telecommunications issues that have either a financial or economic impact. I have participated in numerous Arbitration panels established by the Board to arbitrate interconnection issues under Section 252(b) of the Act.

I am participating or have participated in numerous national incumbent local exchange carrier and telecommunications groups, including those headed by the National Telecommunications Cooperative Association ("NTCA"), the Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"), the United States Telecom Association ("USTA"), and the Rural Policy Research Institute. My participation in these groups focuses on the development of policy recommendations for advancing universal service and telecommunications capabilities in rural communities and other policy matters.

I have testified or filed pre-filed regulatory testimony in various states including California, Maine, New Hampshire, New York, Michigan, Indiana, Wisconsin, North Dakota, South Dakota, South Carolina, Texas, Kentucky, Utah, Florida, Washington, Georgia and Tennessee. I have also participated in regulatory proceedings in many other states that did not require formal testimony, including Louisiana, Mississippi, North Carolina, Puerto Rico and Virginia. In addition to participation in state regulatory proceedings, I have participated in federal regulatory proceedings, including proceedings before the Federal Communications Commission (FCC), through filing of formal comments in various proceedings and submission of economic reports in an enforcement proceeding. This is my first appearance before the Oregon Public Utility Commission ("Commission" or "PUC").

I have a Master's degree in economics from the University of Maryland–College Park. While attending the University of Maryland–College Park, I was also a doctoral candidate in Economics. This means that I completed all coursework, comprehensive and field examinations for a Doctorate of Philosophy in Economics without completing my dissertation.

Q: **On whose behalf are you testifying?**

A: I am testifying on behalf of the members of the Oregon Telecommunications Association ("OTA") that are the smaller, rate of return regulated incumbent local exchange carriers ("ROR members").

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to provide my expert opinion on certain allegations and proposals contained in the testimonies of Dr. August H. Ankum on behalf of the Oregon Cable Telecommunications Association ("OCTA") and Mr. Don Price on behalf of Verizon ("VZ" or "Verizon").

Q: Please summarize your testimony.

A: I understand that the scope of this proceeding is limited to reexamining the Oregon Universal Service Fund ("OUSF") under the current statutory framework. Specifically, the Commission is examining three issues: (1) What changes should be made to the existing OUSF related to the calculation, collection and distribution of funds; (2) What changes should be made to the existing OUSF related to how funds are used; and, (3) What changes should be made to the existing OUSF related to transparency and accountability. My testimony responds principally to proposals promoted by OCTA and VZ regarding issues one and two.

OUSF PURPOSE

Q: What is the purpose of the OUSF?

A: For rural carriers offering telecommunications service in Oregon, the OUSF's purpose is "to ensure that that basic telephone service is available at reasonable and affordable rates." (Order 03-082, page 2) For this triennium, the Commission requires OTA members to "reduce their carrier common line charge" to the extent not reduced by

actions initiated by the Federal Communications Commission ("FCC") as part of its intercarrier compensation reform. In addition to reducing carrier common line rates that are charged to interexchange carriers, OTA ROR members "...may apply OUSF distributions for the purpose of keeping local service rates lower than they might otherwise be required to be in light of the rural ILECs' local service revenue requirement." (Order 12-309, Attachment 1, page 4) The OUSF received by OTA members is used to fulfill their obligations as carriers of last resort ("COLR") in the offering of basic telephone service.

Q: Do OTA ROR members receive the majority of annual OUSF disbursements?

A: No. OTA ROR members receive approximately ** CONFIDENTIAL ** percent of the total OUSF distributions. Confidential Exhibit OTA/1401. Notwithstanding this amount being less than ** CONFIDENTIAL ** of the total, this support is critical for OTA ROR members to operate as COLR carriers under the current rate of return regulatory regime.

Q: Are OTA ROR members treated differently in Oregon than for example the legacy Qwest portion of CenturyLink?

A: Generally yes. CenturyLink and Frontier have some areas of Oregon that are classified as rural, yet, the majority of their customers are in service areas identified as non-rural. Consequently, the OTA ROR members should not be grouped with non-rural carriers such as CenturyLink and Frontier for purposes of OUSF distributions. The creation of the OUSF has followed this pattern of establishing separate procedures with different calculations of support for the rural OTA members.

I also note that the current FCC reforms also allow for two paths: one for price-cap regulated carriers such as CenturyLink and Frontier and another for rate-of-return regulated carriers, such as the OTA ROR members. So the continued dual treatment of rural and non-rural carriers for OUSF policy is not inconsistent with FCC policy.

Q: OCTA witness Dr. Ankum suggests there is "no tangible benefit" to OUSF and that statewide telephone subscribership percentages suggest that the OUSF distributions should be reduced. (OCTA/100, Ankum/4:15 and 17:12-19) What is your response?

A: First, I disagree with Dr. Ankum's allegation there is no tangible benefit resulting from the OUSF. Since 2003, the OUSF reduced intrastate carrier common line rates and currently is reducing these rates as well as keeping the end-user rates OTA ROR members would need to charge under rate of return regulation reasonably comparable to urban rates. One tangible benefit from OUSF distributions is that interexchange carriers have seen a reduction in their intrastate access charges, and presumably, these carriers have passed these savings to their end-user long distance customers in the form of rate decreases. This is a tangible benefit not recognized by Dr. Ankum.

Furthermore, the residents and businesses located in the areas served by the OTA ROR members have a very tangible benefit of having reliable and affordable wireline telephone service. The existence of the OTA ROR members as COLRs in their service areas provides enormous tangible benefits to their communities. And, this benefit isn't limited to end-user customers of OTA ROR members. OTA ROR members provide

critical services to other carriers, like wireless providers. In this respect Dr. Ankum simply ignores or discounts the benefits that accrue to citizens that live in rural areas of the state.

I believe that Dr. Ankum's use of statewide telephone subscribership levels ignores the very basic cost recovery mechanism of OTA ROR members. The OTA ROR members serve less than 60,000 lines in the state. According to the recent Local Telephone Competition Report released this month, the state of Oregon had a 1,554,000 switched access lines, 985,000 of these were categorized as residential end-user switched access lines. (Local Telephone Competition Report, January 2013, FCC, Tables 9 and 10). OTA ROR members provide service to approximately six percent of the residential end-users of switched wireline service. The funds received by the OTA ROR members reduce or offset cost recovery of investments that have been made in the past to provide service to all OTA ROR customers in their service areas. Dr. Ankum appears to suggest that if you have telephone service today, there is no need to continue future OUSF distributions to the rural OTA members—or that the subscribership needle moves very little when accounting for OUSF. As this Commission is aware, telephone networks used to deliver end-user services require substantial investments that are recovered over a long timeframe. The deprecation expenses and return on investment accounted for each year is based on these long-term investments. To claim that since the investments have been made (sunk cost) and therefore should not be accounted in the current year is an incorrect

economic analysis that should be rejected when examining the benefits of OUSF for OTA ROR members. Investments made with current obligations and support based on these investments, and associated operational expenses, is direct tangible benefit that stems from OUSF distributions and other cost recovery mechanisms.

The rural areas served by OTA ROR members have access to an affordable telephone service. This availability of telephone service is a tangible benefit that exists due to a host of cost recovery mechanisms, including the OUSF distributions. The purpose and value of the OUSF for the customers of OTA ROR members should be reaffirmed by the Commission in this proceeding.

Q: **Does Verizon witness Mr. Price also suggest that the purpose of the OUSF has been met and that the program should be eliminated?**

A: Yes. Mr. Price argues that because there is intermodal competition, the OUSF should be eliminated, or at least substantially reduced. (Verizon/100, Price/3) I believe this argument suffers from the same failures as OCTA's claims I just described. Further, I believe that an elimination of the OUSF would have implications for rural carriers that are far beyond the scope of this proceeding, and that I discuss later in my testimony.

ISSUE #1

Q: Turning to the calculation of cost identified in Issue Number 1, how are the costs for OTA ROR members determined?

A: In 2003 the Commission adopted a stipulation that gave specific guidance on how OTA ROR member costs are to be determined. From 2003 to 2012, the OUSF has used this method. Cost is the first component of OUSF distributions, and these distributions are expressed as the following equation: OUSF = Cost – benchmark – certain federal offsets. The initial determination in 2003 was frozen until 2012.

Q: What is the cost basis for OTA ROR members?

A: The Commission adopted an embedded cost methodology to calculate the cost for OTA members. This was done as an interim until the FCC examined and then adopted forward-looking economic cost for rural carriers. I note that the FCC has not yet adopted forward-looking economic cost for rural carriers.

Q: Does Mr. Price argue that embedded cost is a discredited methodology and should be eliminated?

A: Yes. Mr. Price states that embedded cost has "long been discredited." (Verizon/100, Price/43-44). And he cites an Iowa case to support this claim. However, when reading *Kalona Cooperative Telephone Company v. Iowa Utilities Board* (No. 2-270 / 12-0119, October 31, 2012) I do not see where the Court of Appeals makes statements to support Verizon's claim. The Iowa Utilities Board asserted its final order "was not a rejection of all embedded cost studies." (Slip Op. page 9) Instead the Board rejected a poorly

performed embedded cost study. There is a world of difference in rejecting a specific embedded cost study and rejecting the entire embedded cost framework: neither the Board nor the Court rejected the framework. Verizon's claim is not supported by the case supplied as support for its position.

Q: What does the embedded cost base include?

A: The cost includes the total unseparated cost of common subscriber lines, the separated cost of switching and local transport used in the provision of local exchange telephone service, overhead costs associated with general support plant, customer operations, and corporate operations that are reasonably necessary in the provision of local exchange telephone service, a return on used and useful rate base of 11.1 percent, calculated state and federal income taxes, and allocated general taxes associated with the provision of local exchange telephone service. (Order 03-082, Attachment A, page 5 of 21)

Q: Is this embedded cost a total company cost framework?

A: No. Aside from common line costs, all costs are separated between the interstate and intrastate jurisdiction. While common line costs are unseparated, the Commission requires that certain interstate common line revenue-offsets reduce the common line costs—this means that even with common line costs the adopted methodology seeks to reflect intrastate costs. A total company cost framework would include all the cost in the provision of local exchange telephone service and would not allocate costs between the federal and state jurisdictions.

Q: One recommendation by OCTA is that the use of the loop for broadband service be accounted for, either through a cost allocation or with a revenue offset. (OCTA/100, Ankum/40 and 53) Do you agree that a broadband cost allocation is required for OUSF purposes?

A: No. There should be no broadband cost allocation for OUSF purposes. OTA ROR members offer wireline broadband Internet access service ("WBIAS") under their interstate tariff or on an interstate detariffed basis: in both instances this service remains under federal Title II of the Act. Most of the OTA ROR members use the National Exchange Carrier Association ("NECA") tariff for this service. The FCC has already allocated a portion of the common line costs to the interstate jurisdiction under its Part 36 rules. Once the FCC has made its jurisdictional separation, state commissions cannot modify it. (See *Crockett Telephone Company, et al. v. Federal Communications Commission*, 963 F2d 1564 (1992): The Court of Appeals for the District of Columbia states: "We should note that the Part 36 cost-based separations rules do affect state ratemaking authority to the extent such rules apply to the telephone companies within their jurisdiction. (Cites omitted) Although each state has great freedom to regulate intrastate rates, once the FCC has applied its jurisdictional separation, that part of the cost base deemed to be interstate is outside the jurisdictional reach of the state regulatory authority.") OTA witness Mr. Duval explains how the OUSF process takes this allocation into account.

Additionally, the WBIAS service offered by OTA ROR members (NECA's tariffed *a*DSL service) is generally purchased by third-party Internet Service Providers ("ISPs"). The ISP uses this *a*DSL service as an input to its retail service offering. Some OTA ROR members do have an affiliate that is the ISP or offer ISP service as a separate line of business. In either case, the effect is the same from an accounting and cost allocation perspective. The Commission would be incorrect if it were to use the retail price for broadband service as an offset to common line costs because the ISP has middle-mile costs, Internet port costs, router costs and overhead that it must cover with its retail rate. None of these costs are part of the embedded costs of OTA ROR members. Thus, the revenue received by the OTA ROR member from the ISP is not part of its interstate common line cost recovery. It would not be appropriate to offset the intrastate common line cost with revenues that don't have any relation to the underlying costs.

Q: Where are interstate common line costs recovered?

A: These costs are assigned to interstate switched access service and are recovered mostly through the federal subscriber line charge ("SLC") and the federal Interstate Common Line Support ("ICLS") program. For any OTA ROR member that is offering *a*DSL as a detariffed interstate service, the effect is the same. Both of these recovery mechanisms, SLC and ICLS, are already accounted for in the process developed by the Commission to determine OUSF disbursements. Thus, there is no need to consider other allocations of common line costs for ROR members of OTA.

Q: Do you propose the Commission reject the example and discussion related to Table 4 of Dr. Ankum's testimony?

A: Yes. The recommendation made by Dr. Ankum should be rejected. I have explained that the cost allocation used by the FCC for interstate services shows that interstate common line costs are accounted for through existing mechanisms. Further, the example in Table 4 of his testimony uses average revenue per unit ("ARPU") for broadband service that is not correct. For example, the revenue received for WBIAS is the NECA tariff rate that is far less than what is reported in Table 4. The current NECA tariff rate for WBIAS *a*DSL (6 Mbps download/1 Mbps upload, Band 3, Option B) service is $18.77 per month. Term discounts can be applied and the rate is lowered to $13.24 per month. These rates are in the middle of the rate bands. The WBIAS rates are interstate rates recovering the interstate WBIAS costs and these revenues should not be used to further offset intrastate costs. Thus, using these revenues to offset common line costs would be mixing cost-apples with revenue-oranges.

For the same reasons I also recommend the Commission reject Dr. Ankum's alternative proposal he identified as "second-best." (OCTA/100, Ankum/53) A revenue offset for WBIAS is not appropriate. The revenues from WBIAS are assigned to their underlying interstate costs—no further allocation is warranted.

Q: OCTA alleges that the OUSF is "growing because the mechanism is set to compensate rural LECs for the loss of lines to competitive forces." (OCTA/200, Ankum/20) Do you agree?

A: No. The cost used for the OTA ROR members has been a static number that was developed in 2003 based on costs reported to the Commission that are older than 2003. Further, the support, until 2012, was based on a per line amount. Thus, if lines declined, support declined. There is no support for the allegation and no proof is provided that demonstrates OCTA's claim. It should be rejected by the Commission.

Further, it should come as no surprise that costs over the past decade have been increasing. Technology developments have led to redeployment costs and in some cases a costly change in vendors because some vendors have gone out of business. Costs for the maintenance of legacy investments have not declined as can be demonstrated by the increase in labor costs. (See *Employment Cost Index—Historical Listing, September 1975 - September 2012*, Bureau of Labor Statistics, Table 4: Employment Cost Index for total compensation: civilian worker index September 2001 = 86.3, September 2012 = 117.5) There is no evidence in the record that OTA ROR members have seen reductions in the cost of providing service as a COLR.

Q: OCTA also recommends that the Commission cap the OUSF. What implication does this recommendation have for rate of return regulated carriers?

A: If the Commission were to cap the OUSF it would create a situation whereby rate of

return regulated carriers would likely be unable to earn their authorized intrastate rate of return. This is because the rate-of-return carriers are effectively under a residual ratemaking regime. In this regime, the carrier's costs are covered through various interstate and state services and the two last remaining services are OUSF and basic services.

The OTA ROR members have agreed to cap the fund on an interim basis under the 2012 Memorandum of Understanding stipulation. I observe that OTA ROR members have recognized the need to have a practical level for the OUSF surcharge and their history demonstrates a willingness to find practical solutions.

The consequence of not providing a viable avenue for rate-of-return regulated carriers to have an opportunity to earn their authorized rate of return is that investments will be depressed and service quality will likely decline. Recently, the FCC and the state of Virginia have discovered that left to its own devices under a price cap regime, Verizon failed to maintain critical infrastructure for 911 services and when a storm went through the area, 911 calls were not completed. (See *Impact of the June 2012 Drecho on Communications Networks and Services, Report and Recommendation,* FCC, Public Safety and Homeland Security Bureau, January 2013—"The effects of the storm revealed considerable flaws in system design, personnel management, policies, and procedures of the primary providers of the 9-1-1 networks in the affected region.

The storm also revealed that the major wireline providers serving the affected region had not fully implemented best practices and industry-developed solutions relating to backup power, 9-1-1 circuit diversity, and 9-1-1 trunk design – issues with a direct link to the loss of 9-1-1 service after the Derecho. Accordingly, the Bureau recommends that the Commission, while continuing to promote use of vital best practices, consider taking additional action to ensure the reliability of the communications infrastructure, especially with respect to 9-1-1 service." And, *Staff Report of Final Findings and Recommendations in the Matter of Investigating 911 Emergency Call Service Outages and Problems,* Division of Communications, Commonwealth of Virginia State Corporation Commission, Case No. PUC-2012-00042, January 17, 2013—"The 911 service outages after the June 29 Drecho put thousands of Virginia citizens at risk. Those outages were a direct result of Verizon's failure to perform the necessary maintenance on its central office facilities, and were compounded by its inability or failure to monitor and respond, both internally and externally, to the outages. As the generator maintenance logs, audits, and other Verizon interrogatory responses reveal, Verizon has allowed equipment and facilities at many of its offices to deteriorate.") On the other hand, rate-of-return regulation allows carriers to fulfill their obligations as COLR providers.

Q: Does the recommendation for eliminating support in unsubsidized competitor areas also pose problems for rate of return regulated carriers?

A: Yes. I do not recommend that the Commission adopt an unsubsidized competitor policy for rate-of-return carriers—especially the recommendation proposed by OCTA and

Verizon. OCTA/100, Ankum/70, Verizon/100, Price/34. The Commission has already established that the rural carrier study area is the geographic area for OUSF consideration. This, I believe, is consistent with rate-of-return regulation. OCTA and Verizon argue that any competition in a geographic area—be it wireline or wireless—should disqualify that geographic area from OUSF support. As has been noted by other OTA witnesses, this policy is an exaggerated version of the FCC's policy and goes beyond what the FCC has adopted for rate of return carriers. Further, it is important to note that even the less extreme FCC policy rests on the obligation placed on state commissions to pick up the pieces of this policy for rate-of-return regulated carriers.

A rural carrier's capacity to fulfill its COLR duties is placed in jeopardy by OCTA and Verizon's proposals because a carrier cannot meet these responsibilities with part of a network; and with portions of their basic telephone operations under rate-of-return regulation and the other portion not subject to the rate of return regime. Cost recovery for rate-of-return regulated carriers is based on a study area basis. A change of this basis has implications for rate-of-return regulation. If rate-of-return regulation is to be removed for all or any part of a rural carrier's study area, it would be prudent for the Commission to examine this regulatory reform in a separate proceeding where the benefits and consequences of such action can be thoroughly examined.

Q: OCTA recommends that OUSF distributions be reduced for rural carriers. (OCTA/100, Ankum/21) What is your response to this recommendation?

A: I disagree with OCTA's recommendation. Support for this recommendation supposedly comes from the FCC's Quantile Regression Analysis ("QRA"). The FCC's QRA is an econometric model that reduces the amount of High Cost Loop Support ("HCLS") for eligible carriers whose costs are above the ninetieth percentile of costs for HCLS capital expenditures and operating expenditures. At the time of writing this pre-filed rebuttal testimony, I understand the FCC has indicated that it will revise its QRA for a third time, so the support for this proposal is in flux.

The recommendation by OCTA is based on the premise that OUSF should borrow from the FCC's analysis and reduce support to increase the efficiency of rural carriers. The facts used by OCTA are misplaced and are not current. The results of QRA version 2.0 for 2013 distributions show that only one OTA ROR member is over the 90th percentile threshold for capital expenditures. (OCTA's view is for last year and only has two carriers affected for capital expenditures) This same carrier is the only OTA ROR member exceeding the threshold for operational expenditures. This means that all, save one, of the OTA ROR members are within the parameters established by the FCC for capital and operational expenditures. Rather than suggest the OTA ROR members are inefficient and need to have the OUSF support reduced, the FCC's QRA version 2.0 for 2013 suggests the opposite; to wit, the FCC found that only one exception to the fact that

all of the OTA ROR members are operating at efficient levels for capital and operational expenditures.

As I mentioned, the FCC's QRA version 3.0 is expected to revise yet again its model by combining the capital and operational expenditures. Based on my examination of what is being proposed, I have calculated the QRA 3.0 impact and one OTA ROR member will still be impacted.

The recommendation of OCTA should be rejected. The FCC's QRA examination shows that all but one of the OTA members are within the established parameters used to determine supposed "inefficiencies"—there is no support to suggest that these OTA members are inefficient. Thus, there is no need to develop what will probably be difficult standards to apply—there is no demonstrable need.

Q: OCTA also urges the Commission to reduce the authorized rate of return for OTA members. (OCTA/100, Ankum/29) Do you agree with this recommendation?

A: No. I believe this recommendation is premature. The FCC has suggested that it take a look at the prescribed rate of return in a Notice of Proposed Rulemaking and suggests that the interstate rate of return will decline from its 11.25 percent level. Until the FCC concludes its rulemaking, there is no federal support for reducing the authorized rate of return.

If the Commission wanted to examine the rate of return for OTA ROR members, this examination would require a specific investigation that would include the usual cost of capital examination—which is very difficult to perform at this time due to fluctuations in the equity markets—and the examination of a risk premium that would apply to rural carriers due to their increased risk in the current marketplace. See the attached illustrative discussion in Exhibit OTA/1402. Evidence of this risk is also seen in the very limited access rural carriers have to loans. Lenders such as CoBank, Rural Utilities Service ("RUS") and the Rural Telephone Finance Cooperative ("RTFC") specialize in lending to rural operations, including rural telephone companies.

These specialized lenders identify specific economic factors that are playing more of a role than in the past for determining their willingness to lend to entities such as the OTA ROR members. These factors—the impact of competition, loss of access lines, regulatory uncertainty and rural demographic trends—reduce the ability of rural carriers to qualify for debt associated with infrastructure projects.

CoBank recently stated "the ability to repay debt is the single most important factor to judge whether a loan is approved. The primary source of debt repayment is cash flow generated from operations. Industry uncertainty about the regulatory landscape has created additional risk and this additional risk translates into less available debt capital." This increased risk leads to debt to EBITDA (the capacity to pay) have declined, there are

shorter terms for loans, 12-15 years to 5-7 years, and higher pricing for the loans themselves.

CoBank filed comments to the FCC on October 20, 2011 stating the precarious situation rural lenders and borrowers are facing when financing forward-looking telecom networks: "CoBank urges the Commission to understand that unless there is a sufficient and sustainable cost recovery mechanism, no financing method (*e.g.*, loan, loan guarantee, revolving loans, or a one-time grant) will sustain a rural broadband network in the long term. The broadband network is a dynamic infrastructure, it is not static, and needs ongoing upgrades and maintenance."

There is no clear evidence that suggests the Commission's 11.1 percent would be reduced if the Commission were to investigate a change in the prescribed rate of return for OTA members. Thus, if the Commission wanted to pursue a separate investigation, I recommend it wait until the FCC's analysis is complete.

Q: Does this conclude your testimony?

A: Yes.

Identifying Rick Factors in Telecomm

Tuesday, July 31, 2012
8:30 a.m.

Speaker

DR. HAL B. HEATON is a professor of finance at Brigham Young University where he teaches advanced corporate finance and capital markets. He has also served on the finance faculty at the Harvard Business School and the University of Santa Clara. Dr. Heaton holds a Ph.D. in finance from Stanford University, a Masters degree in economics from Stanford University, an MBA from Brigham Young University, and a bachelors degree in mathematics/computer science also from BYU.

Following the completion of his MBA, Dr. Heaton was a consultant with the Boston Consulting Group where he dealt with strategic planning issues for major firms in the paper, farm equipment, lumber, oil, banking, and electronics industries. He currently serves as a consultant to a number of multinational organizations on issues in corporate finance, valuation, exposure management, capital markets and as an expert witness in hearings and court proceedings for cases involving business valuation.

An author of several articles, Dr. Heaton has research interest in valuation and related topics including optimal capital structure, cost of capital, mergers/acquisitions, and capital markets. He has authored articles dealing with business appraisal techniques, the impact of taxation on valuation and firm behavior, and capital market efficiency.

Moderators

ROBERT D. BUTTERBAUGH, CMI, is a Senior Manager in Ernst & Young's Philadelphia office and a leader of the firm's East Central Property Tax practice specializing in property tax consulting and credits and incentives. He has over 26 years of property tax and incentives experience in public accounting and industry where he has provided a range of real and personal property tax services including valuation, litigation support, expert testimony, research, planning and compliance. He has provided property tax administration or consulting services in thirty-eight states. Mr. Butterbaugh received his Bachelor's degree in Accounting from Indiana University and MBA in Finance from DePaul University. Prior to joining Ernst & Young, Bob managed the global grants and incentives and property tax practices for E.I. du Pont de Nemours and Company and was a Partner with another Big 4 accounting firm. Mr. Butterbaugh has been active in the Institute for Professionals in Taxation (IPT), having served as the President for the 2010-2011 term and currently serving on the Board of Governors and the

Professional Designation Committee - Property Tax. He has lectured on various property tax issues for the IPT, Appraisal Workshop for Ad Valorem Taxation of Communications, Energy and Transportation Properties, Broadband Tax Institute, Chicago Tax Club, IBC - Tax Minimization and Compliance for Electric and Gas Utilities and EXNET Utility Tax Conference.

MARK F. SEMERAD, C.M.I., is Senior Manager, Property Tax for Level 3 Communications, Inc. in Broomfield, Colorado. Prior to joining Level 3 in October, 2000, he was Director, Property Tax for ConAgra, Inc. in Omaha, Nebraska for over 16 years where his duties included tax incentive negotiation and lobbying as well as overall property tax management. Prior to joining ConAgra, he served as Attorney, Property Tax Division, Nebraska Department of Revenue. He holds a B. A. degree from Creighton University and a J. D. degree from the University of Nebraska.

Mr. Semerad is an inactive member of the Nebraska Bar Association and is an inactive Certified Public Accountant. He is a certified member of the Institute for Professionals in Taxation and has been a registered lobbyist in the Nebraska Legislature. Mr. Semerad has served as Chair, Board of Trustees, Nebraska Tax Research Council and President, Nebraska Tax Forum. He has spoken at the Institute for Professionals in Taxation annual conference and property tax symposium and before other local and regional groups. He was formerly a member of the IPT Board of Governors and served as Overall Chair of Property Tax Education. He is also an instructor of the IPT Intermediate Real Estate Tax Management course. He has previously served as chair of that committee.

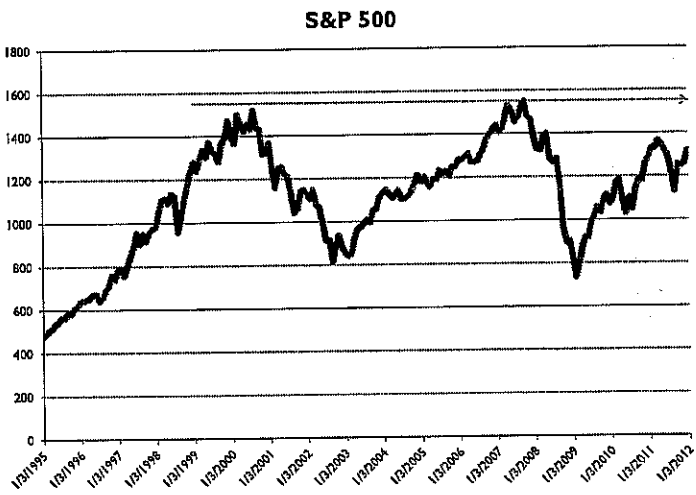
Telecom Cost of Capital Issues: January 1, 2012

Hal Heaton, PhD

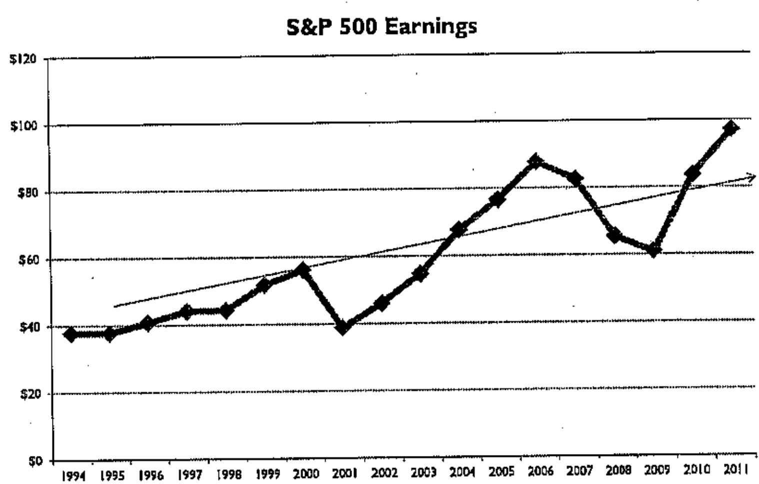
Issues in 2012

- In typical capitalization model, parameters must be long term
  - Must not reflect short term distortions
  - NOI/k requires that ***both*** NOI and k be long term
- Debt as percent of capital
  - Debt less available for landline telco with declining customer base
- Appropriate risk premiums
  - Historical average still biased low due to massive negative return in 2008
  - Market evidence suggests investors require higher risk premiums than historically
- CAPM estimates unacceptably low
- Dividend Growth Model better
- Decomposing the beta
- Liquidity is a critical issue
  - Adjustments to final value or discount rates essential
- Estimated Cost of Capital

The stock market is lower than 12 years ago…



But earnings have risen dramatically … discount rates must be higher!



Headlines are clear that obtaining credit is difficult ...

- Wall Street Journal: February 24, 2010

"**Lending Falls at Epic Pace**

U.S. banks posted last year their sharpest decline in lending since 1942, suggesting that the industry's continued slide is making it harder for the economy to recover. ... According to the FDIC, the number of U.S. banks at risk of failing hit a 16-year high at 702. More than 5% of all loans were at least three months past due, the highest level recorded in the 26 years the data have been collected. And the problems are expected to last through 2010. ... ...The struggling U.S. banking industry remains a problem for policy makers eager for banks to lend again."

Smaller, undiversified properties have greater difficulty obtaining debt

- "Company size and diversification often plays role. While we have no minimum size criterion for any given rating level, company size tends to be significantly correlated to rating levels. This is because larger companies often benefit from economies of scale and/or diversification, translating into a stronger competitive position. Small companies are, almost by definition, more concentrated in terms of product, number of customers, and geography. To the extent that markets and regional economies change, a broader scope of business affords protection."

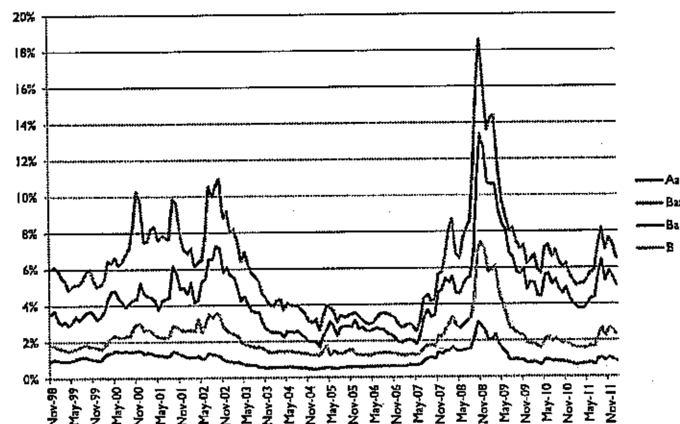
[Standard and Poor's, "Corporate Ratings Criteria" page 22.]

Ibbotson risk premium still biased by 2008 return

- Return on large stocks in 2008: -37.0%
- Return on long term Treasury bonds in 2008: +25.9%
- One year risk premium
  = Rm – Rf = -37.0% - 25.9% = -62.9%
- Historical average risk premium fell almost a full 1% as a result of one year's number

Risk spreads for debt elevated …

Debt Premiums over Treasuries



CAPM Data

	Share Price 12/31/2011	Shares Outstanding (millions)	Market Value of Equity ($millions)	Debt ($millions)	Percent Debt	Bloomberg Beta	Unlevered Beta*
Alaska Communications	$3.01	45.3	$136	$570	80.7%	0.74	0.21
Cincinnati Bell	$3.03	195.2	$591	$2,534	81.1%	1.13	0.31
Consolidated Communications	$19.05	29.9	$570	$885	60.8%	1.00	0.51
CenturyLink	$37.20	618.5	$23,009	$21,836	48.7%	0.78	0.49
Frontier Communications	$5.15	995.1	$5,125	$8,300	61.8%	0.98	0.49
Metro PCS	$8.68	362.5	$3,146	$4,744	60.1%	1.08	0.56
Sprint Nextel	$2.34	2996.0	$7,011	$20,274	74.3%	1.24	0.45
AT&T	$30.24	5926.5	$179,218	$64,753	26.5%	0.82	0.67
Verizon Communications	$40.12	2835.5	$113,761	$55,152	32.7%	0.79	0.61
Windstream	$11.74	586.3	$6,883	$9,150	57.1%	0.90	0.50

CAPM Estimate

- ***Required Return*** = $R_f + \beta(R_m - R_f)$
- **Morningstar/Ibbotson**
  - **Using 20% debt and relevering .5 unlevered beta**
  - **2.48% + .58 x 6.62% = 6.3%**
- **Treasury Rates absurdly low**
  - **Lower than inflation**
  - **Due to demand from foreign banks**
  - **...and foreigners terrified of European meltdown**
  - **...Foreign governments keeping currencies low for employment reasons**
- **6.3% equity rate is lower than the rate on long term telecom debt—impossible!**
- **As shown earlier, these results not supported by the market evidence.**

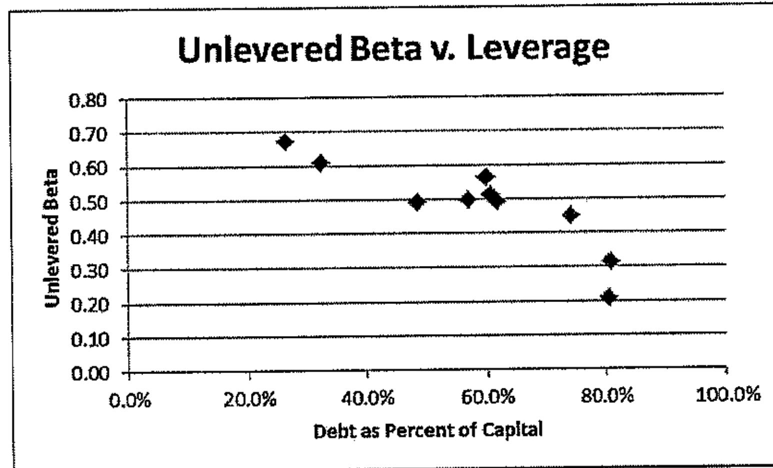
Dividend Growth Model

	Share Price 12/31/2011	Bloomberg 2012 Cash Distribution Forecast	Yield	Value Line Projected Growth	Bloomberg Projected Growth	Estimated Return
Alaska Communications	$3.01	$0.20	6.6%	NMF	9.0%	15.6%
Cincinnati Bell	$3.03	$0.00	0.0%	18.4%	3.0%	10.7%
Consolidated Communications	$19.05	$1.55	8.1%	10.8%	1.5%	14.3%
CenturyLink	$37.20	$2.90	7.8%	16.1%	-1.3%	15.2%
Frontier Communications	$5.15	$0.75	14.6%	21.4%	-5.9%	22.3%
Metro PCS	$8.68	$0.00	0.0%	15.3%	19.5%	17.4%
Sprint Nextel	$2.34	$0.00	0.0%	NMF	4.0%	4.0%
AT&T	$30.24	$1.77	5.9%	9.9%	4.9%	13.2%
Verizon Communications	$40.12	$2.05	5.1%	11.5%	8.8%	15.3%
Windstream	$11.74	$1.00	8.5%	17.8%	0.2%	17.5%
Average						14.6%

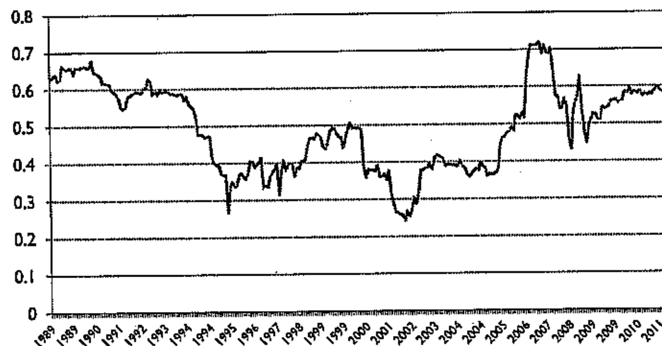
Deeper analysis of beta

- DGM model estimates better, but still not very reliable
  - Growth estimates exhibit wide range
  - Affected by extreme leverage of some telcos
- Beta estimates composed of two elements:
  - ***$\beta_i = \rho_{im} \times (\sigma_i / \sigma_m)$***
  - ***ρ_{im} = correlation with the market***
  - ***σ_i / σ_m = volatility relative to the market***

Leveraging Formula Assumes Debt Essentially Risk Free

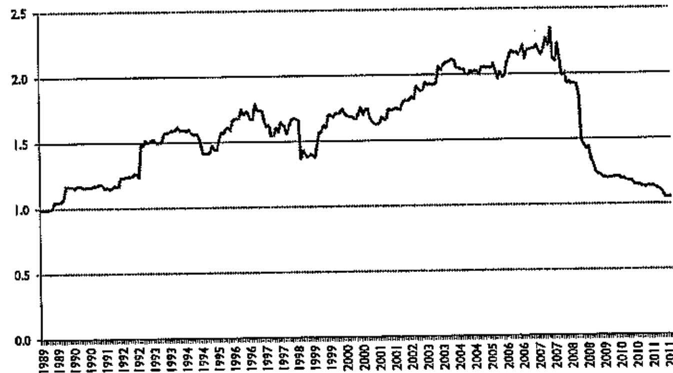


Example: AT&T rolling five year correlation to the S&P 500



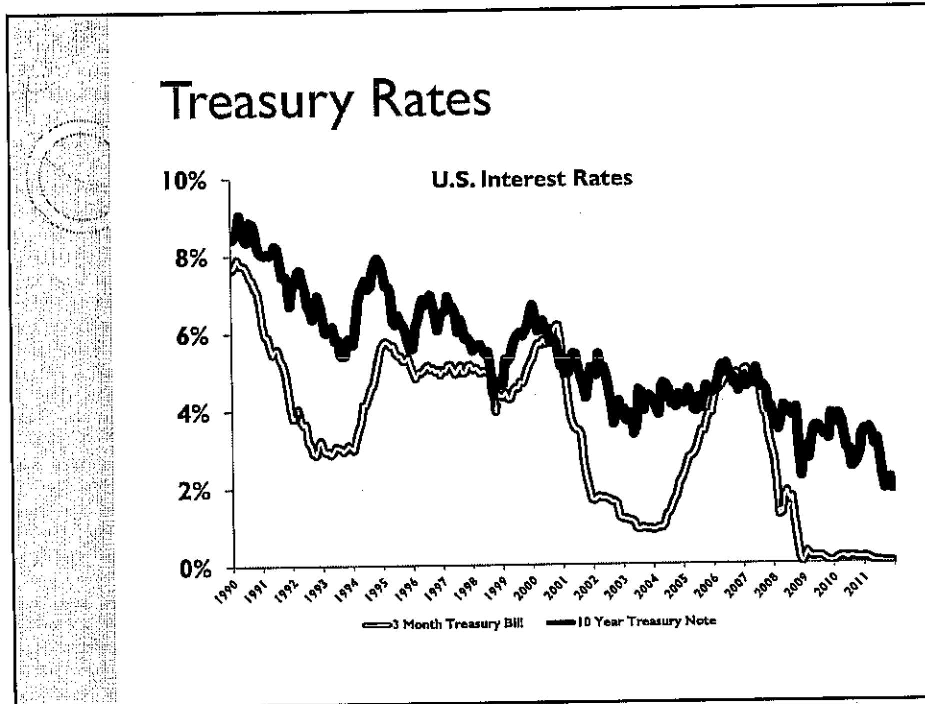
Example: AT&T rolling five year relative volatility to the S&P 500

AT&T Rolling Five Year Volatility Relative to the S&P 500



Discussion of beta

- Correlation fell during the merger mania of the 1990's
- ...But came back to normal levels
- Relative volatility rose as competition intensified but plunged with economic meltdown in late 2008
  - Why?



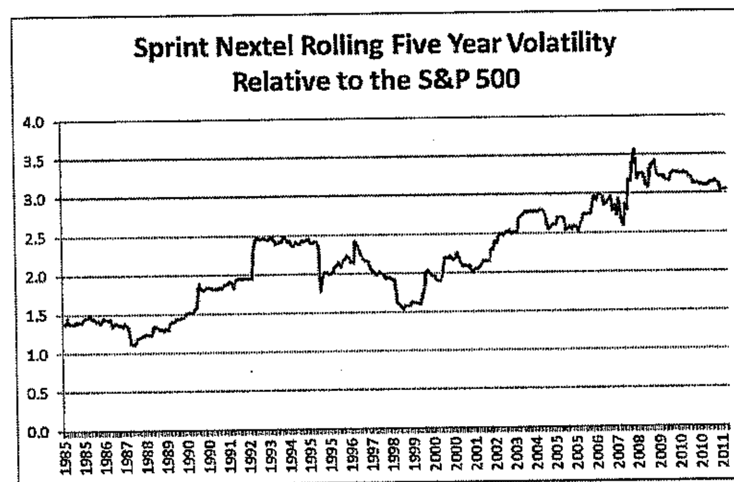
Example: Investors buying AT&T for yield

- "With tens of millions of people -- particularly retiring baby boomers -- looking for investment income and fed up with dismally low interest rates on bank accounts and bonds, brokerages and money managers believe there's a huge and growing audience for the dividend pitch." [Los Angeles Times February 26, 2012]
- "Dividends are winning new respect now that yields on U.S.Treasuries are near record lows. ...The focus on dividend-paying stocks could intensify, as investors look to Inflation protection. ...AT&T, for instance, has a dividend yield of more than 6% ..." [USA TODAY August 24, 2011]
- "THE first security I was ever aware of was a dividend-paying stock, the AT&T shares that my grandfather, a retired postman, owned when I was little. ... So when I heard recently that some advisers were using dividend-paying stocks to coax people who still hold their money in cash or low-yielding bonds back into the equity markets, my ears perked up. ...These stocks also offer at least some sort of hedge against inflation." [The New York Times June 4, 2011]

Example: AT&T Relative Volatility

- Investor's treating AT&T more like a bond
  - Inflation protection
  - Will end when Treasury rates rise
  - Long run, relative volatility will reflect risk of telecommunications industry
- Low relative volatility applies even less to current risk in telecoms
  - Declining demand as consumers shift to cellular = high risk for landlines
  - Other telecoms showing increasing volatility

Other telecoms show rising relative volatility ...



Beta estimate

- $\beta_i = \rho_{im} \times (\sigma_i/\sigma_m)$
  - Historically telecommunications have a correlation of about .6 with the S&P 500
  - Telecoms are historically about 2 to 3 times as volatile as the (diversified) S&P 500
  - ***β = .6 x 2.5 = 1.5***
  - ***Cost of Equity (for security)***
    - ***CAPM 2.48% + 1.5 x 6.62% = 12.4%***
    - ***DGM 14%***
    - ***Choose 13%***
  - ***WACC (for securities)***
    - ***.2 x 5.43% x (1-.39) + .8 x 13% = 11.0%***

Liquidity

- Liquidity refers to the ability to sell an investment easily, quickly, and at low cost
  - A ***liquidity discount*** refers to the lower value of an illiquid asset compared to a liquid asset of similar risk
  - A ***liquidity premium*** refers to the higher return that investors will require for an illiquid asset
- Liquidity became critical in January 2009
  - Ability to generate cash to meet obligations critical
  - Treasury bills were offering virtually zero interest
  - 30-day Treasury bills briefly offered ***negative*** interest

Liquidity: Illustration

- Build a pipeline/refinery/power plant …
  - Cost $800 million
- Hire managers, train a work force, market to obtain contracts and customer base
  - Cost $200 million
- If property generates $100 million per year and 10% is required rate
  - Value = $1000 = $100 / 10%
- May need intangibles such as patents, licenses, copyrights, intellectual property
  - Higher revenue/cash flow/value to compensate
- Problem: what is value for property taxes?

Liquidity Illustration (continued)

- Issue and sell stock (debt) claims on the property
  - Incur substantial costs to issue
  - Incur ongoing costs to stay listed
    - Exchange listing fees
    - Disclosure costs
    - Regulatory costs
    - Additional auditing costs
- Compare owning the property versus buying shares ….

Liquidity Illustration (continued)

- If you own the property you must
  - Have substantial knowledge of how to operate facility, market products or services
  - Worry about hiring, firing, training
  - Take care of all regulatory, licensing, disclosure, and other issues
- If you own the property you do not have limited liability
  - Environmental, accident, other litigation may lead to losing other assets
- Selling property takes time, expense, …

Liquidity Illustration (continued)

- If you buy the shares
  - You do not have to know anything about managing, operating, marketing, regulations ….
  - You can buy a few shares or a lot
    - Easy to diversify
- Shareholders have absolute limited liability
- You can turn your ownership into cash in seconds with the click of an icon
- Which you would rather own?

Liquidity Illustration (continued)

- If the shares sell for, say, $1.5 billion due to all the conveniences and advantages
  - The property is still only generating $100 million a year
  - Hence the discount rates extracted from stock and bond data must be lower than 10%
- In addition, shares can trade at higher values due to property which does not even exist on the assessment date!
  - Wynn Resorts example

Liquidity

- We are dealing with a **property** tax …
- Not what highly liquid claims on property will sell for
- If the data obtained and used comes from stocks and bonds …
- Which are so liquid they can be sold in seconds with the click of an icon …
- The estimated discount rates must be adjusted to make them useful to value illiquid property which is expensive to sell, takes months to sell, and carries substantial risk that securities don't

Using Securities Data

- Securities are very liquid
- Securities can be sold in small or large amounts
- Operating property requires dealing with management hassles
- Securities have absolute limited liability
- Securities represent ownership in companies than can expand, enter new businesses
- Securities capture value from assets that do not even exist on the lien date
- Securities capture all intangible values
- Not only do these facts affect extracted rates, it means measures of "market/book" do not mean there is no 'economic obsolescence'

Assessors recognize need for liquidity adjustments

- California State Board of Equalization, *Assessors' Handbook*, Section 502, Advanced Appraisal, p. 63.
  - "Most financial assets are liquid. Real estate and most business assets, however, are relatively illiquid, and real estate investors must be compensated for this reduced liquidity."
- California State Board of Equalization, *Assessors' Handbook*, Section 502, Advanced Appraisal, pp. 183-184.
  - "The argument based on lack of liquidity is a much stronger one. There is no question that financial assets are significantly more liquid than real estate assets. ... An adjustment for lack of liquidity can be made in two ways: (1) consider lack of liquidity as an added risk factor and add a premium for it to the cost of equity estimated by the CAPM; or (2) value the real estate asset using the CAPM/WACC without any liquidity adjustment, and then apply a liquidity discount to the estimated value."

Appraisal texts require adjustment:

- 13th Edition Appraisal of Real Estate
  - "If there are differences between a comparable property and the subject property that could affect the overall capitalization rate concluded, the appraiser must account for these differences."
- The word "must" is a very strong word

Size premium represents a minimum adjustment ...

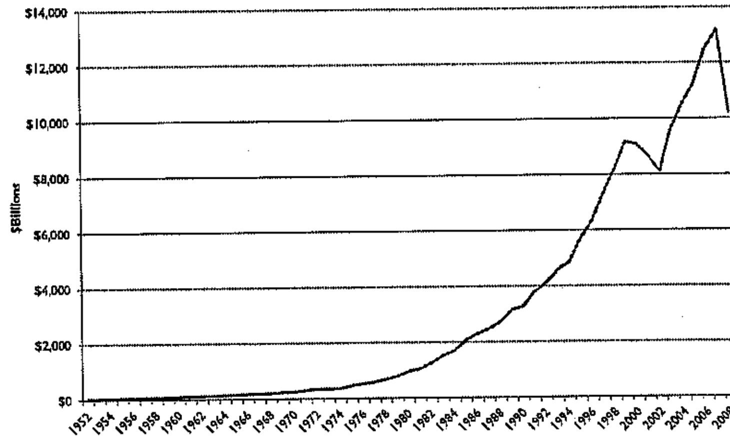
Size Premia (market capitalization in millions) [4]

Decile	Smallest Company		Largest Company	Size Premium (Return in Excess of CAPM)
Mid-Cap (3–5)	$1,621.096	–	$6,896.389	1.14%
Low-Cap (6–8)	422.999	–	1,620.860	1.88
Micro-Cap (9–10)	1.028	–	422.811	3.89
Breakdown of Deciles 1-10				
1-Largest	15,484.940	–	354,351.912	-0.38
2	6,927.557	–	15,408.314	0.78
3	3,596.535	–	6,896.389	0.94
4	2,366.464	–	3,577.774	1.17
5	1,621.096	–	2,362.532	1.74
6	1,090.652	–	1,620.860	1.75
7	683.059	–	1,090.515	1.77
8	422.999	–	682.750	2.51
9	206.802	–	422.811	2.80
10-Smallest	1.028		206.795	6.10

Datasource: Morningstar/Ibbotson Annual Yearbook 2012

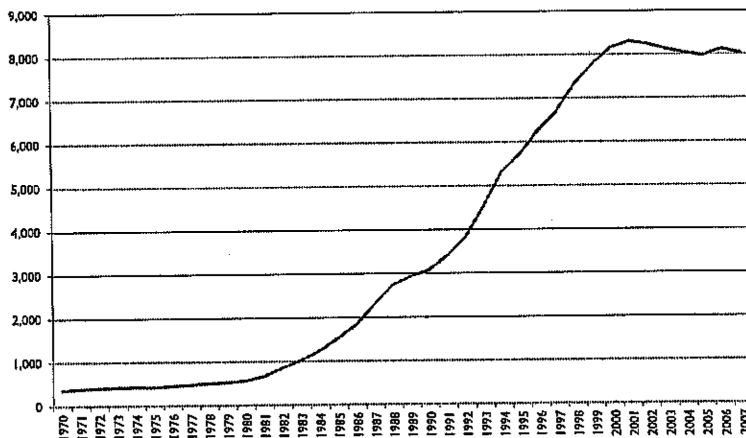
Why is liquidity becoming such a critical issue now?

U.S. Pension Fund Assets



Why is liquidity becoming such a critical issue now?

U.S. Mutual Funds



Damadoran Liquidity Adjustment

- Capital Asset Pricing Model (CAPM)
  - Required return
    = Risk Free Rate + Beta x Market Risk Premium
- Beta = $\beta_i = \rho_{i,m} \times (\sigma_i / \sigma_m)$
- Adjusted Beta = $\beta_i / \rho_{i,m}$
- Adjustment =
  - (Adjusted Beta – Beta) x Market Risk Premium

Damodaran liquidity adjustment

	Bloomberg Beta	R-squared	Damodaran Adjusted Beta	Difference in Equity Return	Percent Debt	Difference in WACC
Alaska Communications	0.74	0.114	1.20	3.03%	80.7%	0.58%
Cincinnati Bell	1.13	0.381	1.82	4.60%	81.0%	0.87%
Consolidated Communications	1.00	0.383	1.61	4.06%	60.8%	1.59%
CenturyLink	0.78	0.284	1.45	4.50%	49.1%	2.29%
Frontier Communications	0.98	0.443	1.47	3.25%	61.5%	1.25%
Metro PCS	1.08	0.222	2.30	8.04%	60.1%	3.20%
Sprint Nextel	1.24	0.220	2.64	9.28%	72.6%	2.55%
AT&T	0.82	0.482	1.18	2.39%	28.4%	1.71%
Verizon Communications	0.79	0.462	1.16	2.46%	32.7%	1.65%
Windstream	0.90	0.490	1.29	2.56%	51.7%	1.24%
Average	0.94		1.61	4.47%		1.69%

Summary

- Prevailing debt/equity ratios in early 2012 biased high
  - Must tie debt capacity to subject property
  - Comparable companies are large, diversified corporations
- CAPM approach does not produce credible results
  - Must adjust beta for unusual economic circumstances
  - Long run cash flows require long run risk measure
- CAPM approach still low even after adjustment
  - Treasury rate not realistic
  - Equity risk premium still biased low
- DGM expected growth estimates very wide
- Must adjust for differences between securities and illiquid property
  - Illiquidity/Size adjustment
  - Damodaran approach

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1481 (Phase II)

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

REPLY TESTIMONY OF

CHAD DUVAL

January 30, 2013

Q. Did you present Opening Testimony on behalf of the Oregon Telecommunications Association (OTA) in this proceeding?

A. Yes.

Q. What is the purpose of your reply testimony?

A. In this testimony, I will respond to various aspects of the direct testimonies of Commission Staff witness Roger White, Verizon witness Don Price, and Oregon Cable Telecommunications Association (OCTA) witness August H. Ankum, Ph.D. In addition, there are issues raised in these parties' direct testimonies that will be addressed by different witnesses representing the OTA member companies. When I use the term "OTA members" or "OTA member companies" I am referring to the smaller, rate-of-return members of OTA.

Q. How is this testimony organized?

A. It is organized by witness. I first address issues raised by OPUC Staff witness Roger White. Next I address issues raised by Verizon witness Don Price. Finally, I address issues raised by Oregon Cable Telecommunications Association witness August H. Ankum, Ph.D. In each question I quote the testimony that I am responding to or provide a summary in my own words, and reference the page and line number from each party's testimony. In some situations the issues raised by a witness are consistent with another witness' testimony, in which case I have not addressed the same issue multiple times.

Opening Testimony of Roger White on Behalf of the Staff of the Public Utility Commission of Oregon

Q. Are the OTA member companies opposed to OPUC Staff's proposal as outlined in the Opening Testimony of Roger White?

A. On the whole, the OTA member companies cannot support Staff's proposal, as it is based on several generalities that must be clarified and some inaccuracies that need to be corrected. However, there are components of Staff's proposal that may have merit and the OTA member companies believe that it could be used as a starting point to develop an appropriate mechanism to calculate support.

Q. What elements of Staff's proposal do the OTA member companies support as written?

A. OTA supports maintaining the methodology that is currently used to calculate support. This model was used in the development of the support established for the OTA member companies in Docket UM 1017, and OTA continues to support the use of this methodology in this proceeding. This methodology recognizes that rural carriers are rate-of-return regulated, and therefore should be provided the opportunity recover their expenses and to earn the authorized return on their investment. It also recognizes that actual costs above the benchmark, which are not recovered from federal support mechanisms, should be recovered from the OUSF, rather than from end user customers.

Q. Do you agree with Mr. White's conclusion that "the revenue requirement developed by each of the models would be reduced to reflect the sharing of cost among the services utilizing the network?"[1]

A. No, for a couple of reasons. The first reason is the fact that local loop electronics used in

[1] Opening Testimony of Roger White on Behalf of the Public Utility Commission of Oregon Staff, Staff/100, White/2, Lines 7-9.

the provision of broadband services are already allocated to broadband and assigned to the interstate jurisdiction for cost recovery under Part 36 – Jurisdictional Separations Procedures of the FCC Rules. An additional allocation of local loop electronics is not necessary or appropriate, as broadband costs are already excluded from the local loop. The second reason is that local loop cable and wire facilities utilized for broadband are supported by Federal High Cost Loop Support (HCLS), which is used as an offset to the local revenue requirement, calculated in the Oregon Universal Service Fund (OUSF) methodology, in determining the amount of OUSF that is necessary. If the OPUC were to allocate a portion of the local loop cable and wire facilities to broadband, it would also need to allocate a portion of the HCLS to broadband before determining the amount of OUSF necessary. It would be more appropriate and expedient to leave both the cost and the associated HCLS in the local loop.

Q. Even if an allocation of local loop costs to broadband were appropriate, is Staff's proposed "simple method of allocating joint network cost among broadband services and basic local service"[2] supported by the administrator of the FCC's access pools for rate-of-return regulated rural ILECs?

A. No. The National Exchange Carrier Association (NECA), as the administrator of the FCC's access pools, recently determined that a service based allocation of joint network costs between voice and broadband services is not appropriate for interstate cost recovery.[3] NECA determined that a service based allocation was not cost causative and that joint network cost allocations must be based on the actual use of the network, not on a theoretical or potential use of the network. In doing so, NECA also determined that an

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[2] Opening Testimony of Roger White on Behalf of the Public Utility Commission of Oregon Staff, Staff/100, White/16, Lines 4-5.

[3] See NECA Cost Reporting Guideline Paper: Separations Treatment of ADSL and SDSL Services.

allocation based on bandwidth is not appropriate. The use of a different allocation methodology in Oregon would result in a disconnect between state and federal cost recovery of the same costs.

Q. Do you agree with Mr. White that there are "other ways of arriving at the amount of support a company needs without allocating cost?"[4]

A. Yes, in some situations. However, in this case it would not be appropriate to include local loop related broadband revenues in the determination of OUSF support necessary, as Mr. White appears to conclude. As I previously indicated, the cost of the local loop associated with broadband is either already allocated to the interstate jurisdiction, in the case of electronics, or is included in the calculation of HCLS, in the case of cable and wire facilities.

There are two revenue streams associated with local loop facilities used in the provision of broadband services. The first revenue stream, associated with broadband local loop electronics, is Digital Subscriber Line (DSL) revenues collected from Internet Service Providers (ISPs) that provide retail Internet access. For most carriers, these DSL revenues are regulated by the FCC and for all carriers are necessary to recover the associated costs that are assigned to the interstate jurisdiction in the cost separations process. This interstate revenue stream cannot also be used to offset costs assigned to the local loop in the cost separations process. The second revenue stream is federal HCLS associated with broadband local loop cable and wire facilities. HCLS is already used to offset the local loop revenue requirement for OUSF purposes.

[4] Opening Testimony of Roger White on Behalf of the Public Utility Commission of Oregon Staff, Staff/100, White/20, Lines 16-22 and White/21, Lines 1-2.

Q. Do the OTA member companies believe that a new benchmark is necessary?

A. No. Staff's proposal states that "a new benchmark would be introduced to establish which areas would be classified as high cost."[5] Mr. White later states that, "Staff's proposal involves first establishing a target range for the surcharge rate and then determining a benchmark that will allow the surcharge to be in that range."[6] This approach would establish an artificial benchmark to meet a desired fund size and has nothing to do with establishing which areas are truly high-cost. The OTA member companies believe that the intent of the benchmark must be to determine a cost above which rural carriers will receive support. Staff's proposed approach does not ensure that rural carriers will receive the support necessary to recover their costs incurred in providing service in the highest cost areas of Oregon. The OPUC has previously established a $21 benchmark as the high cost threshold and the OTA member companies believe that this benchmark should be maintained.

This should not be taken to mean that the OTA member companies are seeking to increase the size of the fund. The rate-of-return members of OTA are willing to cap the size of the fund for the current triennium as established in the most recent Memorandum of Understanding. However, an increase in the benchmark is not necessary to accomplish this result.

[5] Opening Testimony of Roger White on Behalf of the Public Utility Commission of Oregon Staff, Staff/100, White/2, Lines 10-11.
[6] Opening Testimony of Roger White on Behalf of the Public Utility Commission of Oregon Staff, Staff/100, White/22, Lines 8-10.

Opening Testimony of Don Price on Behalf of Verizon

Q. Verizon witness Mr. Price states that "[t]he Commission can most efficiently ensure universal service in Oregon by harmonizing its efforts with those of the FCC."[7] Would a significant reduction in OUSF support for the OTA member companies be in harmony with the efforts of the FCC?

A. No. As I indicated in my response to Data Request Verizon-OTA 1-17, OUSF is first to be used to offset switched access costs, as the intrastate terminating Carrier Common Line (CCL) revenue requirement must be reduced to $0 before remaining OUSF support can be used to offset other costs. The amount of OUSF that is used to offset the CCL revenue requirement is considered a state access rebalancing fund by the FCC and is therefore included in the OTA member companies' Intercarrier Compensation Rate-of-Return Revenue Baseline established in the FCC's USF/ICC Transformation Order. The 2011 Rate-of-Return Revenue Baseline, less 5% each year, is the amount of revenue that OTA member companies will receive for the reduction of revenue from the provision of interstate switched access services and intrastate terminating switched access services pursuant to the USF/ICC Transformation Order.

To the extent that OUSF support is reduced or eliminated for the OTA member companies, federal Connect America Funding will need to increase to offset the reduction in OUSF to ensure that the Rate-of-Return Revenue Baseline is realized. This increase in Connect America Funding may not be available to the OTA member companies, as the FCC has established a cap on the amount of High Cost Support, which includes Connect

[7] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/5, Lines 4-5.

America Funding, that is available to rural rate-of-return carriers at $2 billion annually. I do not believe that such a result is in harmony with the efforts of the FCC and the Commission to ensure the continued availability of voice and broadband services to all customers.

Q. Mr. Price states that "access to 'basic telephone service' no longer depends on the availability of analog voice service over traditional copper networks" and supports this statement with statistics on cable television and wireless subscribership.[8] Does Verizon have ubiquitous wireless coverage throughout the rural areas served by the OTA member companies?

A. No. According to Exhibit Verizon/101 there are 38 wire centers in Oregon where Verizon has no wireless voice coverage, eight of which are served by OTA member companies. Neither Mr. Price's testimony, nor Exhibit Verizon/101, details Verizon's coverage area in the wire centers claimed to be served by Verizon. In response to Data Request CTL-VERIZON 2, and also Data Request OTA-VERIZON 1 of OTA's second set of data requests to Verizon, Mr. Price directed CenturyLink and OTA to review Verizon Wireless' online coverage area map. Unfortunately this map does not allow the viewer to determine whether a specific geographic area has Verizon coverage. Mr. Price later indicates that he compared the Verizon Wireless coverage map with a map of the Incumbent Local Exchange Carrier (ILEC) wire centers and determined that more than four-fifths of the ILEC wire centers are being served by at least one unsubsidized voice provider.[9] However, Mr. Price admitted in response to Data Request OTA-VERIZON 8

[8] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/7, Lines 7-16 and Price/8, Lines 1-5.
[9] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/34, Lines 22-25.

that "Verizon does not have information about the percentage of wireless coverage in individual wire centers."[10]

While it may be true that some, perhaps all, of these ILEC wire centers have some coverage by a voice provider (Verizon Wireless), it is highly unlikely that Verizon Wireless is able to provide wireline quality voice services to all customers in any of these wire centers, as pointed out by other OTA witnesses. Based on extensive experience living, traveling and working in their service areas, the OTA member companies have firsthand knowledge that Verizon does not have ubiquitous coverage throughout the wire centers claimed to be served by Verizon in Exhibit Verizon/101. If this is true, then Verizon Wireless would likely not meet the FCC's definition of an unsubsidized competitor (and Verizon Wireless does not meet that definition today because it is not a "fixed terrestrial" provider as required by the FCC). The Commission should not be misled to believe that all customers in these wire centers can replace their existing wireline phone with a wireless phone and receive service where they live and work, and therefore there is no need for OUSF support in these wire centers. As I discuss in more detail later in my testimony, absent the wireline network, wireless and broadband services may not be available in many areas of Oregon.

Q. Why is the ILEC study area important in determining competitive overlap?

A. The ILEC study area is important for at least two reasons. First, the study area is the geographic area in which the ILEC is obligated to provide service to customers upon reasonable request. This is the carrier's obligation as a COLR and a recipient of state and federal universal service funding. ILECs may not pick and choose, or make financial decisions, on which customers they will serve within their study area. Second, the study

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[10] See Exhibit OTA/1501

area typically comprises the ILEC's service area in a state and is a driving factor in designing and building the network. Carriers will design their network to serve all customers within the study area. As a result, the great majority of the network within the study area is necessary to serve each customer. If there is overlap of 90 percent of the customers, that does not mean that 90 percent of the cost of the network can be eliminated. If the Commission is to reduce support in study areas where there is only partial overlap by an unsubsidized competitor, then it must recognize that foregone costs, and support, will not directly correlate to the percentage of overlap.

Q. Mr. Price states that "cable telephony services are now available to 98 percent of household in Oregon that have access to cable TV service."[11] What percent of customers served by the OTA member companies have access to cable TV service?

A. While I do not have access to an exact percent, and it varies by company, I do not believe that cable telephony in rural areas is as readily available as Mr. Price would have the Commission believe. According to the FCC's latest report on competition in the cable television market nationwide,[12] only 48 percent of television households in counties with fewer than 85,000 households (rural areas) relied on cable service and 42 percent subscribed to direct broadcast satellite service.[13] If 48 percent of rural customers have access to cable television and 98 percent of these customers have access to cable telephony, then one could deduce that only 47 percent (48 percent access to cable television times 98 percent access to cable telephony) of rural customers nationwide have access to cable telephony. In addition, Mr. Price does not provide data specific to

[11] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/7, Lines 14-16.
[12] *In the Matter of Annual Assessment of the Status of Competition in MB Docket No. 07-269, the Market for the Delivery of Video Programming*, Fourteenth Report, FCC 12-81, Paragraph 348 (rel. July 20, 2012).
[13] Direct broadcast satellite providers do not generally provide telephony or viable broadband services.

Oregon. With such an incomplete record on this issue, it would be necessary to open another phase of this docket to even be able to consider this proposal.

Q. Mr. Price states that consumers no longer depend solely on the wireline network for voice services, and that they utilize a variety of networks including: traditional wireline, cable company, wireless, and broadband networks.[14] Do any of these alternate providers depend on the wireline network?

A. Yes. Many wireless and broadband providers are dependent on the wireline network for local transport to connect either their wireless towers or broadband customers to their own facilities. It is a misnomer that the wireless network is completely wireless throughout the entire call path. In most situations, originating wireless calls (including both voice and data) travel from the customer's handset to the wireless tower, where it then is routed over wireline local exchange carrier special access facilities to connect to the wireless carrier's transport network, much of which is also composed of special access facilities leased from wireline interexchange carriers. Absent the wireline local network, many wireless carriers would have no means of connecting their wireless towers, and therefore their end user customers, to their own transport and switching facilities for both voice and data services.

Many broadband providers also depend on the wireline network to connect to their end user customers. One of the primary means of connecting these broadband customers to the internet and Internet Protocol (IP) based voice services is ILEC provided Digital Subscriber Line (DSL) transport. The majority of the cost of providing DSL transport is not supported by either HCLS or OUSF, which I will discuss in greater detail later. The

[14] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/14, Lines 12-17.

local transport network is a multi-use network that may not be available for broadband use if the cost of providing voice services over this network is no longer sufficiently supported. Absent sufficient support for the wireline network, many wireless and broadband carriers may not be able to provide the competitive services that Mr. Price contends render the OUSF program "obsolete, unnecessary and should be eliminated, or at least substantially reduced."[15]

Q. **Mr. Price indicates that "[b]y controlling the size of federal support programs, the FCC also aimed to provide support 'that is sufficient but not excessive so as to not impose an excess burden on consumers and businesses who ultimately pay to support the Fund.' "[16] Did the FCC substantially reduce the amount of federal universal service funding available to rural carriers such as the OTA member companies?**

A. Yes and no. On the one hand, the FCC maintained federal High Cost Support at a level consistent with support historically provided to rural rate-of-return carriers. On the other hand, the FCC capped the fund at $2 billion, instituted some reductions in support based on certain limitations and built in an annual reduction in the Rate-of-Return Revenue Baseline. As a result, while there are some carriers that will see significant, negative impacts as a result of the FCC's actions, most carriers will continue to receive federal High Cost Support at approximately the same level as they have in the past. It should be noted that this is not true of ICC CAF support, which is subject to an annual 5 percent reduction in the Rate-of-Return Revenue Baseline, which is the starting point in the calculation of ICC CAF support. Of great concern is whether the development of such an Oregon specific system of additional tests and controls is even worth it. As OTA witness

[15] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/3, Lines 23-24.
[16] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/25, Lines 11-14.

Mr. Rennard point out, there does not appear to be any major issue of excessive spending by rural carriers in Oregon.

Q. Mr. Price states that "the FCC ruled that the CAF will not be used to provide funding support in areas where there is an unsubsidized competitor providing affordable voice and broadband service."[17] How big of an impact will the elimination of support for study areas overlapped by an unsubsidized competitor have?

A. While I cannot say for sure, there is some guidance in the Further Notice of Proposed Rulemaking in the FCC's USF/ICC Transformation Order. The FCC has indicated that they will eliminate support for study areas with 100 percent overlap and are considering reducing support in study areas where there is significant overlap, but they have not yet defined the level of overlap that will generate a reduction in support or how that reduction in support will be calculated. As a matter of fact, the FCC identified only 18 rate-of-return study areas serving approximately 55,000 lines nationwide with 99 percent or greater overlap, and 88 rate-of-return study areas serving approximately 639,000 lines with 80 percent or greater overlap, by an unsubsidized competitor.[18] There are approximately 1,100 rate-of-return study areas serving almost 4.5 million lines, as of the end of 2012, nationwide that receive some amount of High Cost Support.[19]

More importantly, to my knowledge, the FCC has yet to implement any reductions in support due to overlap by an unsubsidized competitor at any level. It is also unclear as to

[17] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/26, Lines 16-18.
[18] *FCC USF/ICC Transformation Order,* Paragraph 1065.
[19] http://www.universalservice.org/about/tools/fcc/filings/2012/q4.aspx. HC09 – Interstate Common Line Support Projected by State by Study Area – 4Q2012.xls. I utilized this report because nearly all rate-of-return carriers receive Interstate Common Line Support.

whether the FCC intended for overlap to be measured based on geography or customer locations, but it is clear that the overlap is based on the ILEC's study area and not on the competitor's service area. Before the Commission moves to even consider such a potentially drastic step, it seems prudent to observe how the unsubsidized competitor issue plays out on the federal level.

Q. **Mr. Price states that "there is no continuing need for the OUSF, given changes in consumer preferences, technology and markets."[20] Do you agree with Mr. Price's assessment?**

A. No. Despite shifts in some consumer preferences to alternate technologies, such as wireless, cable telephony and Internet based voice services, there are still a great deal of customers that subscribe to and depend on the wireline network for voice services. Many of these consumers reside in the most rural and high cost areas to serve in Oregon, which require OUSF support to ensure the availability of voice services for all consumers. After making this bold statement that there is no need for the OUSF, Mr. Price himself goes on to explain where and why OUSF support is necessary. There is clearly a continuing need for the OUSF.

Q. **Mr. Price appears to recommend that the Commission implement a competitive bidding process to award OUSF support.[21] Has the FCC implemented competitive bidding to award support in the study areas of rural rate-of-return carriers?**

A. No. The FCC has retained the embedded cost based calculation of support for rural rate-of-return carriers, with certain limitations on costs that may be included. It is unclear if

[20] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/33, Lines 8-9.

[21] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/44, Lines 17-22 and Price/45 Lines 1-2.

or when the FCC will implement competitive bidding to award support in the study areas of rural rate-of-return carriers.

Q. **Mr. Price also states that the Commission "could establish a methodology patterned after the new costing approach that the FCC is currently developing for use in the permanent Connect America Fund."[22] Has the FCC proposed that this new costing approach be used for rural rate-of-return carriers?**

A. No. The cost model referenced by Mr. Price is to be used in determining Connect America Fund Phase II for price cap carriers. The FCC states in the USF/ICC Transformation Order that the USF reforms adopted for rate-of-return companies are "consistent with the competitive bidding approach we adopt for the Mobility Fund Phase I and the framework we establish for support in price cap territories that combines a new forward-looking cost model and competitive bidding, we also lay the foundation for subsequent Commission action that will set rate-of-return companies on a path toward a more incentive-based form of regulation. These reforms, summarized below…"[23] However, despite this statement, the FCC did not adopt competitive bidding or cost models for rate-of-return carriers at this time. If the Commission is to follow a similar path as the FCC, as Mr. Price seems to favor, then it should continue to calculate rural rate-of-return OUSF based on the existing embedded cost based approach. If and when the FCC implements an alternative approach for rural rate-of-return carriers, then the Commission should carefully review it and open a separate proceeding so that interested parties can provide input at that point.

[22] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/45, Lines 3-5.
[23] *FCC USF/ICC Transformation Order*, Paragraph 195.

Q. Mr. Price indicates that "the FCC adopted a benchmark minimum rate to qualify for support that will be set at 'the national average of local rates plus [certain] state regulated fees.' The FCC also stated that this would serve as 'an intrastate rate minimum benchmark designed to avoid over-subsidizing carriers whose intrastate rates are not minimally reasonable.'"[24] At what level did the FCC establish this benchmark and what determines if a carrier has met the benchmark?

A. For July 1, 2012 through June 30, 2013 this benchmark is set at $10.00 per month. For July 1, 2013 through June 30, 2014 this benchmark is set at $14.00 per month. Each year thereafter, the benchmark will be set at the national average urban rate, established annually through a survey conducted by the FCC's Wireline Competition Bureau. The last time such a survey was undertaken in 2008, the national average urban rate was $15.62.

The benchmark is deemed to be met if a carrier's local end-user rates plus state regulated fees (specifically, state subscriber line charges, state universal service fund fees, and mandatory extended area service charges) exceed the levels outlined above.

Q. Do any of the OTA member companies have a flat-rate service that is priced below the $10.00 benchmark?

A. No. Exhibit Verizon/103 outlines the flat-rate service pricing for each of the OTA member companies. All of these companies have flat-rate basic local service rates that exceed $10.00 and all but four of these companies have rates that exceed both the $14.00 benchmark applicable for July 1, 2013 through July 1, 2014 and the last national average urban rate of $15.62, when mandatory extended area service is added to the flat-rat basic local service rate. Some of the companies do have usage sensitive local rates that are

[24] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/49, Lines 5-9.

below $10.00. However, the FCC requires that the average usage sensitive revenue be added to the monthly rate to determine if the benchmark has been met.[25] To the best of my knowledge, all of the OTA member companies currently exceed the FCC's benchmark for artificially low local rates and are fully eligible to receive federal High Cost Loop Support.

Q. **Mr. Price appears to propose rate benchmarks that range from the $24 benchmark in Texas up to $37.36, which is two standard deviations higher than the average rate for flat-rate local service in urban areas as determined by the FCC.[26] Are all of the rate benchmarks referenced by Mr. Price used in the determination of eligibility for universal service funding at the state or federal level?**

A. No. The two FCC benchmarks that Mr. Price references are not used in in the determination of eligibility for federal universal service funding. The $37.36 rate that he references is used as a safe harbor, rather than a benchmark, in determining if a rural carrier's rates are reasonably comparable to urban rates. OTA witness Mr. Meredith discusses this concept in more depth in his reply testimony. The $30.00 rate benchmark that Mr. Price references is the Residential Rate Ceiling established by the FCC, above which carriers may not assess an Access Recovery Charge (an intercarrier compensation cost recovery mechanism) on residential customers. Neither of these proposed benchmarks is directly related to eligibility for federal High Cost Support.

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[25] *In the Matter of Connect America Fund*, WC Docket No. 10-90, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Establishing Just and Reasonable Rates for Local Exchange Carriers*, WC Docket No. 07-135, *High-Cost Universal Service Support*, WC Docket No. 05-337, *Developing an Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Lifeline and Link-Up*, WC Docket No. 03-109, *Universal Service Reform – Mobility Fund*, WT Docket No. 10-208, Third Order on Reconsideration, FCC 12-52 (rel. May 14, 2012), Paragraph 22.

[26] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/50.

Q. What components are included in the calculation of the FCC's Residential Rate Ceiling?

A. The Residential Rate Ceiling includes: the flat rate for residential local service, mandatory extended area service charges, the federal subscriber line charge, the federal access recovery charge, the state subscriber line charge, state universal service fund contributions, state E911 charges, and state TRS charges.

Q. When Mr. Price compares the local rates of OTA member companies with the FCC's "safe harbor threshold" of $36.52 and the $30.00 Residential Rate Ceiling[27] is he making an apples-to-apples comparison?

A. No. The OTA member rates that he is referencing are only the flat-rate residential rates identified in the first column of Exhibit Verizon/103. Both the FCC's "safe harbor threshold" and the Residential Rate Ceiling include other components, such as: the federal subscriber line charge ($6.50 for residential lines), mandatory extended area service charges (ranges from $0.00 to $21.35 per line), state and federal Universal Service Fund surcharges, and potentially other rate elements and surcharges. If Mr. Price were to include these additional elements in the calculation of OTA member rates, he would find that the overall end-user contribution is substantially greater than he would have the Commission believe. This is supported by Exhibit OTA/701 of OTA witness Mr. Wolf's testimony.

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[27] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/52, Lines 8-12.

Q. **Mr. Price indicates that "ten companies have local residential rates, which combined with their current monthly OUSF support payments, are less than $20/month" and that "Pioneer could recover the $2.75 it receives in monthly OUSF support by increasing its $15.00 residential rate a reasonable amount without affecting the affordability of its service".[28] Do you agree with these statements?**

A. No. Mr. Price spends a great deal of time explaining why certain federal benchmark rates could be utilized in Oregon. Each of these federal benchmarks includes components beyond the flat-rate residential rate that Mr. Price references, as I outlined above. Pioneer Telephone Cooperative does have a flat-rate residential local service rate of $15.00, but it also assesses a residential subscriber line charge of $6.50, flat-rate extended area service charges that range from $2.95 to $8.00 depending on the exchange that a customer is in, a residential access recovery charge of up to $0.50 (which could increase by $0.50 per year until it reaches $3.00), an OUSF contribution surcharge that ranges from $1.53 to $1.69 depending on the exchange that a customer is in, Oregon E911 surcharge of $0.75, and Oregon TRS surcharge of $0.12. These are the rates and surcharges that are included in the FCC's Residential Rate Ceiling, which result in a range of rates from $27.35 to $32.33, depending on the exchange that a customer is in, for Pioneer.

However, as I've discussed previously, the Residential Rate Ceiling is not used by the FCC to determine eligibility for federal support; it is used to determine whether an access recovery charge must be assessed, and if so at what level. It is the Local Rate Floor that is used to determine whether carriers are eligible for federal support. Clearly, the FCC

[28] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/54, Lines 4-11.

would not agree that Pioneer's residential rates are too low to qualify for federal support, as they exceed the Local Rate Floor.

Q. Do you agree with Mr. Price's conclusion that the OUSF should not provide support for business lines?[29]

A. No. As I previously discussed, OUSF support should be based on the cost of making the network available to all customers throughout the study area as a result of the COLR obligation. A COLR has the same obligation to serve a business customer as it has to serve a residential customer. Therefore, the cost of providing service to business customers should also be included in the determination of support. The support of business lines is consistent with the FCC's approach for federal support and should continue in Oregon. As Mr. Wolf points out, Mr. Price's recommendation would also be poor public policy.

Direct Testimony of August H. Ankum, Ph.D. on Behalf of the Oregon Cable Telecommunications Association

Q. Oregon Cable Telecommunications Association (OCTA) witness August H. Ankum, Ph.D. (Mr. Ankum) states that "there is also no indication that spending over $40 million annually in subsidies going forward in Oregon will have any measurable impact on Oregon's telephone penetration rates."[30] Do you agree with his assessment?

A. No. Mr. Ankum seems to believe that the OUSF is a grant program that reimburses

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[29] Opening Testimony of Don Price on Behalf of Verizon, Verizon/100, Price/55, Lines 12-25.

[30] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/17, Lines 13-15.

carriers for their investment in the network and once the network is built the network will remain available forever. Unfortunately, neither of these assumptions is accurate. OUSF for rural carriers is based on the company's actual costs, which include: maintenance expense, depreciation expense, direct operating costs, corporate operations, and a return on rate base. These costs are incurred each year that the network is in operation, and if not recovered will result in the degradation of the network. The OUSF is not a grant program and absent annual funding to support the associated costs, the network will not remain available to customers. If the wireline network is no longer available, telephone penetration rates will drop.

Q. Mr. Ankum states that "[o]ne obvious adjustment" to the rural carrier cost studies "is to reduce the rate of return (cost of capital) assumption used in the embedded cost studies."[31] He then goes on to state that "[i]t is common knowledge that interest rates (and therefore, cost of capital) has gone down in recent years."[32] and "[r]ural ILECs have access to loans with particularly low interest rates."[33] What is your reaction to these statements?

A. Mr. Ankum is only telling part of the story. While interest rates have gone down in recent years, the cost of debt is only one component in the calculation of the cost of capital. The other components are the cost of equity and the debt and equity ratios of the company. The cost of equity for a rural carrier is difficult to determine, but, in large part, is driven by the amount of risk of investing in that carrier. The more risk there is the greater return that an investor will require to invest his or her funds. While interest rates

[31] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/29, Lines 15-16.
[32] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/30, Lines 1-2.
[33] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/30, Lines 2-3.

have been declining, the risk to rural carriers has increased significantly. One primary example of this increased risk is the potential impact of the FCC's USF/ICC Transformation Order. In response to Data Request Verizon-OTA 1-9, I listed more than fourteen potential risks faced by rural rate-of-return carriers as a result of the FCC's USF/ICC Transformation Order and associated Further Notice of Proposed Rulemaking. These are:

1. Quantile regression based limitations on capital expenditures and operating expenses, which may limit the amount of Federal Universal Service Funding that a carrier is eligible to receive.
2. Modifications of the FCC's limitation on corporate operations expense as it pertains to the calculation of High Cost Loop Support and Interstate Common Line Support, which will reduce the support receive by carriers that exceed the limitation.
3. Reductions in High Cost Loop Support for carriers with low local rates, with little or no initial notice that would allow carriers to raise local rates.
4. The retroactive elimination of qualification for Safety Net Additive support and the phase out of support for which qualification was already determined.
5. The elimination of Local Switching Support and the transition of the associated revenue requirement to the 2011 Rate-of-Return Revenue Baseline, which is subject to a 5% annual phase down. Essentially, Local Switching Support is being phased down by 5% annually regardless of a carrier's actual costs.
6. Limitation of monthly High Cost Support to $250 per line, regardless of the carrier's actual costs or operating circumstances.

7. Elimination of support for study areas with 100% overlap by an unsubsidized competitor, regardless of the fact that the network was built under legacy regulation that provided support based on actual costs incurred.

8. Significant, additional regulatory reporting requirements.

9. An unfunded mandate to provide 4 Mbps/1 Mbps broadband, and other public interest obligations, that may require carriers to incur additional costs in order to continue receiving High Cost Support.

10. Elimination of rate-of-return regulation for interstate switched access services and intrastate terminating switched access services, which are replaced by an incentive form of regulation that does not ensure the recovery of actual costs incurred. This includes a 5% annual reduction in revenues for these transitional services from a 2011 baseline.

11. Reduction in interstate switched access revenues and intrastate terminating switched access revenues as a result of a 9-year transition from the rates in effect as of December 29, 2011 to bill and keep.

12. The application of an Access Recovery Charge on many end user customers to help offset losses in switched access revenues, which may cause customer migration.

13. Additional dependence on Universal Service Funding in the form of the Connect America Fund, which is designed to help offset losses in switched access revenues. The overall size of the fund is capped, so there is no way of knowing that funding will be sufficient to ensure that rate-of-return carriers will recover their actual costs incurred.

14. Regulatory uncertainty as a result of the FNPRM:

a. The FCC has requested input on the process to represcribe the authorized rate-of-return. Any reduction in rate-of-return will result in reduced revenues and will make investment in rate-of-return carriers less attractive to potential investors.

b. The FCC has requested input on how to reduce support for carriers that have less than 100% overlap by an unsubsidized competitor.

c. The FCC has proposed applying quantile regression based limitations on capital expenditures and operating expenses in the calculation of Interstate Common Line Support, which would reduce support for some carriers.

d. The FCC has proposed a transition of intrastate originating switched access rates to bill and keep as well, and has questioned whether such reductions in revenue should be supported through the Connect America Fund.

e. The FCC has questioned whether certain end user charges and Connect America Fund Intercarrier Compensation support should continue and for how long.

All of the above reforms and proposed reforms present risk to rural, rate-of-return carriers in the form of reduced revenues, additional service obligations, and/or additional reporting requirements.

In addition, any reductions in OUSF support as a result of this proceeding will provide further risk to the rural carriers. Some of those risks potentially include: reduced revenues, customer churn as a result of increased local rates, additional switched access

arbitrage as a result of increased intrastate originating switched access rates, and possibly others.

It is also important to understand that OTA members have already experienced significant revenue reductions. Based on a review of the 2011 Form I for each rural, rate-of-return OTA member, the achieved rate-of-return on a collective basis was only 2.3 percent. Such returns do not make for an attractive investment for either lenders or capital investors.

This brings me to my second point, and that is the fact that traditional lenders to the rural ILEC community (including lenders such as the United States Department of Agriculture's Rural Utilities Service, CoBank and the Rural Telephone Finance Cooperative) have pulled back significantly in the past year, limiting rural ILEC access to additional debt. This is primarily the result of uncertainties and risks associated with the FCC's USF/ICC Transformation Order. Not only does this increase the risk associated with equity investment, it also increases rural ILEC dependence on equity investment. Two of the three factors in the calculation of cost of capital, the risk of equity investment and the reliance on equity investment, have increased while the cost of debt has decreased. This suggests that the rate of return may need to rise, rather than decline as Mr. Ankum suggests.

It should also be noted that making a change to the rate of return is not a simple process. While the FCC has initiated a rate of return represcription proceeding as Mr. Ankum indicates, there is no way of knowing what the outcome or timing of that proceeding will be. In fact, to my knowledge the FCC has not made any progress on rate of return

represcription beyond the mention of it in the USF/ICC Transformation Order. Such a proceeding will be time consuming, involve a wide variety of interested and affected parties, be very costly for all involved, and has no predetermined outcome; it may actually produce a higher authorized rate of return once the FCC completes the process required to modify the authorized rate of return. The Commission should not enter into such a proceeding lightly or with a predetermined outcome.

Q. Mr. Ankum states that "both the Synthesis Model and the embedded cost study assign 100% of the loop facility cost to basic voice service."[34] Is this statement correct as it pertains to the embedded cost studies prepared by the OTA member companies?

A. No. The embedded cost study that is used to determine both the state access and interstate access revenue requirements allocates 100 percent of the cost of broadband loop electronics to the special access revenue requirement and then assigns it to the interstate jurisdiction. These broadband costs that are assigned to interstate special access are recovered through a combination of DSL rates charged to Internet Service Providers (ISPs) and NECA (access pool) settlements. No broadband loop electronics are included in the cost of basic service and no cost recovery is generated from the OUSF.

Loop cable and wire facilities (either copper or fiber) used in the provision of broadband services are a bit more complex to explain, but generally come to the same conclusion as broadband loop electronics. In the embedded cost study, the costs of loop cable and wire facilities are first allocated to three categories based on the service being provided. The

[34] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/31, Lines 13-15.

first category is for local loops that are jointly used in the provision of local and long distance services and broadband when it is provided in connection with voice service on the same line. I will get back to this shortly, once I have explained the other two categories. The second category is for local loops that are used in the provision of state special access services, such as dedicated data connections where both points of connection are within the same state. These costs are assigned to state special access services and are recovered through special access rates assessed on carrier and end user customers. The third category is for local loops that are used in the provision of interstate special access services, such as dedicated data connections that cross state boundaries and data-only broadband services. These costs are assigned to interstate special access services and are recovered through special access rates assessed on carrier, ISP and end user customers and NECA settlements.

Now I will get back to the first category of loop cable and wire facility investment. This category is assigned 25 percent to the interstate jurisdiction and 75 percent to the state jurisdiction, by FCC Rule.[35] The 25 percent allocated to the interstate jurisdiction is assigned to the interstate CCL revenue requirement and is recovered through a combination of subscriber line charges assessed on end users and Interstate Common Line Support. The 75 percent that is assigned to the state jurisdiction is recovered through a variety of sources, including local service rates, federal High Cost Loop Support and OUSF.

[35] See 47 C.F.R. §36.154(c)

Q. Based on the realities of cost recovery for local loop costs that you discussed above, is it true that "the embedded cost studies (used by the rural carriers) overstate the actual cost of providing basic voice services because they assign 100% of network cost to voice services?"[36]

A. Absolutely not. As I have explained above, the costs associated with the provision of broadband services are either assigned to the interstate jurisdiction in the cost separations process or are primarily recovered through mechanisms other than the OUSF.

Q. Mr. Ankum states that "rural carriers have an incentive to 'gold plate' their network and RLEC customers often have access to advanced services that are, ironically, not available in urban areas."[37] Do you agree with Mr. Ankum's assessment?

A. No. I do not agree that there is an incentive to "gold plate" or that rural carriers have engaged in "gold plating." What the rural carriers have done is to utilize federal cost recovery mechanisms available to them to provide broadband services that are requested by, and provide significant benefit to, their customers. This cost recovery comes primarily from DSL rates, NECA settlements, and federal High Cost Loop Support.

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[36] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/33, Lines 6-8.

[37] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/33, Lines 16-17.

Q. Mr. Ankum suggests that there should be an apportionment of costs between basic (supported) services and non-basic (non-supported) services and recommends that this apportionment should be "based on the relative prices (or average revenue per unit) of basic voice telephony and broadband services adjust for take rates of broadband services."[38] Would Mr. Ankum's proposed apportionment appropriately recognize the cost of providing broadband services over the local loop?

A. No, for three reasons. First, the FCC specifically rejected the use of revenues as a factor in the allocation of costs between regulated and non-regulated activities when it established the cost allocation principles in Part 31 (now Parts 32 and 64) of its rules. In establishing these rules, the FCC first stated that "[w]e specifically stated that revenues should not be included as a factor in the general allocator because revenues do not reflect the amount of resources used by a company in providing service."[39] In the same Order, the FCC later stated that "[w]e will not accept the Centel argument that revenues be included as a factor in computing the general allocator. Centel has not provided any argument to controvert the NPRM's argument that revenues measure only the ability of an activity to bear costs, and not the amount of resources used by the activity."[40]

Second, if the Commission elects not to maintain consistency with the FCC's guidance in the development of its Part 69 rules, there are allocation issues that I have discussed

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[38] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/40, Lines 5-6.

[39] *In the Matter of Separation of costs of regulated telephone service from costs of nonregulated activities. Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to provide for nonregulated activities and to provide for transactions between telephone companies and their affiliates.* CC Docket 86-11,Report and Order, FCC 86-564 (Released February 6, 1987), Paragraph 122.

[40] *In the Matter of Separation of costs of regulated telephone service from costs of nonregulated activities. Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to provide for nonregulated activities and to provide for transactions between telephone companies and their affiliates.* CC Docket 86-11,Report and Order, FCC 86-564 (Released February 6, 1987), Paragraph 160.

previously. The vast majority of the cost of providing broadband over the local loop has already been allocated to other jurisdictions or rate elements that are not recovered through OUSF. Therefore, it would not be appropriate to include these costs in any apportionment to broadband a second time.

Finally, the average revenue per user that Mr. Ankum applies to both voice and broadband services are far from reality. As I discussed previously, the actual end user cost for voice service is much higher than the basic rate; it also includes items such as the federal subscriber line charge, the federal access recovery charge, extended area service charges, and state and federal surcharges. In all cases, this will be much higher than the $15.00 that Mr. Ankum uses in his example. It also appears that Mr. Ankum is using a retail rate of $35.00 for broadband services, which would not be appropriate to assign to the ILEC. Typically, the ILEC sells broadband on a wholesale basis to an ISP at a rate typically much lower than $35.00, likely in the range of $15.00 to $25.00 per month depending on the broadband speed offered and the wholesale pricing plan selected in the NECA tariff.[41]

Q. **Mr. Ankum references ARPUs for Pine and Eagle that are very low.[42] Are these numbers correct?**

A. No. It appears that incorrect information was provided in the Form O for both Pine and Eagle, as the resultant ARPU is lower than the basic rate for residential service for each company. It is my understanding that both companies are in the process of submitting a revised Form O to the Commission to correct this error.

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[41] See National Exchange Carrier Association F.C.C. Tariff No. 5, Section 17.4.9(H), DSL Access Services Wholesale Pricing Plan.
[42] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/44, Lines 1-3.

Q. Mr. Ankum proposes to adjust the benchmark for OUSF support to "average cost + two standard deviations above the average."[43] Is this consistent with what the FCC has done in determining eligibility for federal universal service funding for rural carriers?

A. No. The FCC has established a benchmark that is referred to as the Urban Rate Floor. As I previously discussed, this benchmark was set at $10.00 for the period from July 1, 2012 through June 30, 2013, $14.00 for the period from July 1, 2013 through June 30, 2014, and the nationwide average urban rate thereafter. There is no adjustment for standard deviation in the FCC's benchmark.

Q. Mr. Ankum proposes "that the federal CAF ICC and IS funding be included in the statutory formula for calculating OUSF support under its fourth component, the support from federal USF sources."[44] Do you agree that all CAF ICC support should be included in this calculation?

A. No. Intercarrier Compensation Connect America Funding (ICC CAF or CAF ICC) is associated with reductions in interstate and intrastate terminating switched access rates that are not loop related. These are rates associated with the cost of switching and interoffice transport, so the associated ICC CAF should not be included in the calculation of OUSF support, which is designed to recover loop related costs.

If anything, only a very small percentage of CAF ICC support should be included in the calculation of OUSF support, and that is the support associated with the intrastate terminating carrier common line (CCL) revenue requirement. Because the FCC's rate

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[43] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/45, Line 18.

[44] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/66, Lines 6-8.

transition and the associated ICC CAF deal with intrastate terminating rates, only the portion of the ICC CAF associated with intrastate terminating CCL could be considered for inclusion in the OUSF calculation. I will explain why including even this small amount is not appropriate.

The OUSF offset of the intrastate terminating CCL revenue requirement, which is referred to as an intrastate access rate rebalancing fund, is included in the calculation of a carrier's Rate-of-Return Revenue Baseline, which is the starting point in the calculation of ICC CAF support. The 2011 Revenue Baseline is then reduced by five percent each year going forward to establish the Annual Revenue Baseline, which is the starting point in determining how much ICC CAF that a carrier will receive in a given year. The Annual Revenue Baseline is reduced by intercarrier compensation revenues (including the OUSF offset of the terminating CCL revenue requirement) and end user access recovery charges, and whatever remains is the amount of ICC CAF that a carrier will receive. So, the OUSF support associated with the intrastate terminating CCL revenue requirement is included in the Annual Revenue Baseline and it is also used to offset the Annual Revenue Baseline. It nets to zero in this calculation.

Using the ICC CAF as a reduction to the OUSF that a company will receive is a circular reference. If the Commission reduces the OUSF by the ICC CAF, then the amount of ICC CAF that the company receives will increase because the Annual Revenue Baseline has already been established at a 5 percent reduction from the prior year, while the access rate rebalancing fund portion of the OUSF received to offset the Annual Revenue Baseline has been reduced. This will then increase the amount of ICC CAF that the

company receives to cover the Annual Revenue Baseline, which will once again reduce the amount of OUSF that the company receives if ICC CAF support is used to reduce the OUSF. Eventually all OUSF could be replaced with ICC CAF. I do not believe that this was the FCC's intent; otherwise they would not have included intrastate access rate rebalancing funds in the calculation of the Revenue Baseline. Regardless, ICC CAF is an access replacement mechanism and should not be used as an offset to the OUSF.

Q. **Mr. Ankum concludes that "OUSF Funding Should be Limited to Areas Without Unsubsidized Competitors."[45] Does Mr. Ankum raise any arguments not also included in the testimony of Verizon witness Don Price?**

A. Based on my reading of both Mr. Ankum's and Mr. Price's testimonies, I do not believe that there are significant differences in their testimony on these issues. Therefore, I have not addressed the same issues raised in Mr. Ankum's testimony that I have already addressed relative to Mr. Price's testimony. However, I will address a few other issues raised in Mr. Ankum's testimony.

Q. **Mr. Ankum proposes that the Commission adopt a carve-out that would eliminate OUSF support in areas where there is an unsubsidized competitor prior to the FCC's completion of a similar process, indicating that doing so "is consistent with the FCC's recent actions."[46] Do you agree with this approach?**

A. No. Mr. Ankum goes on to state that "there's nothing to suggest that the specific procedure the Oregon Commission would adopt to implement the carve outs would be inconsistent with the FCC's process, which is under development."[47] Mr. Ankum

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[45] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/70, Lines 3-4.

[46] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/77, Lines 19.

[47] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/77, Line 19 through Ankum/78, Lines 1-2.

appears to believe that there should be consistency between the FCC's actions and the Oregon Commission's actions. If this is true, the only way of ensuring consistency is to wait until the FCC acts, as the FCC is not likely to model its policy after that of the Oregon Commission. Mr. Ankum's suggested approach is akin to putting the cart before the horse.

Even if there are areas in Oregon where this is 100 percent overlap, it would be very risky to customers and carriers alike to move in this direction without first seeing how this will work, if at all, at the federal level. The risk of unintended consequences on the COLR objectives appears to be high and will be difficult, if not impossible, to reverse once implemented.

Q. **Mr. Ankum proposes a carve-out of OUSF support where there is an unsubsidized competitor based on the percentage of overlap of the ILEC study area and suggests that "[t]he resulting percentage could then be applied directly against the potential subsidy value calculated for the given high cost area to determine the total support carve-out that will be applied."[48] Do you agree with this approach?**

A. No. First it is not consistent with the methodology outlined by the FCC, which currently applies only where there is 100 percent overlap. In addition, it does not recognize the fact that there are fixed costs of building the local loop network. Each additional line added has an incremental cost, but also leverages off of the existing network that has already been built. Mr. Ankum's proposed approach does not recognize that regardless of how many customers are served by an unsubsidized competitor, there are both fixed

[48] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/82, Lines 12-14.

and incremental costs that remain to serve customers that are not covered by the unsubsidized competitor.

Q. **Mr. Ankum recommends that "the Commission limit universal service support to only primary residential lines, or at most, the Commission should clarify that "basic telephone service" includes only a singly/primary residential or single line business line."[49] Does Mr. Ankum raise any arguments not also included in the testimony of Verizon witness Don Price?**

A. Based on my reading of both Mr. Ankum's and Mr. Price's testimonies, I do not believe that there are significant differences in their testimony on these issues. Therefore, I have not addressed the same issues raised in Mr. Ankum's testimony that I have already addressed relative to Mr. Price's testimony. However, I would like to reiterate that it is vital that the OUSF be used to support the costs of the network in high-cost areas, which ensures that the network is available to all customers.

Q. **Mr. Ankum states that "subsidies are no friend to competition. In the case of the OUSF, the subsidy creates a competitive cost advantage for an ILEC over its competitors, even though they may be competing to provide basic telephone service to the very same customers in the very same "high cost" area."[50] Why does the OUSF support the ILEC and not the competitive provider?**

A. Because the ILEC has the obligation to serve all customers within its service territory as the COLR. The competitive provider does not have this obligation. COLRs must receive support to meet this obligation in high cost areas. It should also be noted that there are two CLECs that have been designated as eligible telecommunications carriers and receive

[49] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/93, Lines 12-15.
[50] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/95, Lines 20-21 and Ankum/96, Lines 1-3.

support from the OUSF. It is my understanding that those two companies have undertaken COLR obligations in the areas they serve. It can be inferred that the responsibilities of a COLR brings with them significant costs. Otherwise, one would expect there to be more CLEC eligible telecommunications carriers, with a commitment to meet the COLR obligations.

Q. Mr. Ankum states that "addition of this multi-line business puts further strain on OUSF."[51] Does the addition of lines truly add strain on the OUSF?

A. No. Under the existing Memorandum of Understanding, OUSF support is fixed. A per-line amount is recalculated twice annually using updated access line counts. But this is for porting of support purposes, not to change the amount of support that the incumbent LEC receives.

Q. Mr. Ankum states that "ILEC interstate end user access (SLC) charges are set at different levels for primary and non-primary residential lines."[52] Is this true for the rural ILECs?

A. No. The rural ILECs have a consistent subscriber line charge (SLC) for all residential and single line business lines, which is typically $6.50 per line.

Q. Does this conclude your reply testimony?

A. Yes.

[51] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/99, Lines 7-8.
[52] Opening Testimony of August H. Ankum on Behalf of the Oregon Cable Telecommunications Association, OCTA/100, Ankum/100, Lines 14-16.

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1481

In the Matter of

PUBLIC UTLITY COMMISION OF OREGON

Staff Investigation of the Oregon Universal Service Fund.

VERIZON'S OBJECTIONS AND RESPONSE TO OREGON TELECOMMUNICATIONS ASSOCIATION'S (OTA's) THIRD SET OF DATA REQUESTS TO VERIZON

MCI Communications Services, Inc. d/b/a Verizon Business Services LLC; MCImetro Access Transmission Services LLC d/b/a Verizon Access Transmission Services; TTI National, Inc.; Teleconnect Long Distance Services and Systems Co. d/b/a Telecom*USA; Verizon Select Services Inc.; Verizon Enterprise Solutions LLC; and Verizon Long Distance LLC (collectively, "Verizon") hereby object and respond to Oregon Telecommunications Association's ("OTA's") Third Set of Data Requests to Verizon

General Objections

1. Verizon objects to the Data Request and all definitions and instructions associated with the Data Request to the extent they purport to impose obligations that are different from, or go beyond, the obligations imposed under the applicable procedures and rules of the Public Utility Commission of Oregon.

2. Verizon objects to the Data Request to the extent it is addressed to and requests responses from "Cellco Partnership, d/b/a Verizon Wireless; RCC Minnesota, Inc.; Verizon

Wireless (VAW) LLC, d/b/a Verizon Wireless; and Verizon Wireless Telecom, Inc., d/b/a Verizon Wireless," and includes those entities in the definition of "Verizon." None of these named entities has intervened or is a party to this proceeding and, thus, it is improper to issue data requests to them.

3. Verizon objects to the Data Request and definition that seeks information about "each" of Verizon's parents, subsidiaries, affiliates and predecessors. Because there are more than 1,000 such entities, the request is overly broad and unduly burdensome.

4. To the extent Verizon responds to the Data Request, Verizon reserves the right to amend, replace, supersede, or supplement its response as may become appropriate in the future, but it undertakes no continuing or ongoing obligation to update its response.

Subject to and without waiving these objections, Verizon responds as follows:

Response

Data Request OTA-VERIZON 8. In Exhibit Verizon/101, there is a column labeled "Verizon Wireless Voice Coverage." In the column there is either a "Y" or an "N," presumably meaning yes or no. When Mr. Price inserts a "Y" is he indicating that Verizon Wireless covers one hundred percent of the wire center? If the answer to the preceding question is no for any wire center, please identify and provide the percentage coverage (separately) of each wire center listed on Exhibit Verizon/101 by geographic area of each wire center and, separately, the percentage coverage by population of each wire center.

Response: No. Verizon does not have information about the percentage of wireless coverage in individual wire centers.

Respondent: Don Price, Director – State Policy, Verizon