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January 30, 2013

VIA ELECTRONIC FILING AND U.S. MAIL

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

Re: UM 1481 – Staff Investigation of the Oregon Universal Service Fund

Enclosed for filing in the above-referenced docket are an original and five copies of the Reply Testimony of Don Price on Behalf of Verizon.

A copy of this filing has been served on all parties to this proceeding as indicated on the enclosed certificate of service.

Very truly yours,

Wendy McIndoo

Wendy McIndoo
Office Manager

cc: Service List
Enclosure

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

Docket No. UM 1481

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

REPLY TESTIMONY OF

DON PRICE

ON BEHALF OF VERIZON

January 30, 2013

Q. PLEASE STATE YOUR NAME.

A. My name is Don Price.

Q. DID YOU PREVIOUSLY SUBMIT OPENING TESTIMONY IN THIS PROCEEDING?

A. Yes, I submitted opening testimony on behalf of Verizon.

Q. WHAT ARE YOUR GENERAL OBSERVATIONS ABOUT THE OTHER PARTIES' OPENING TESTIMONIES?

A. As I explained in my Opening Testimony, the telecommunications marketplace in Oregon has changed radically since the OUSF was first established more than 12 years ago. The local exchange carriers acknowledge the escalation of competition, even in traditionally "high cost" areas.[1] The stunning growth of intermodal services, like wireless and VoIP, has overtaken notions of universal service that were rooted in the monopoly-wireline-provider world. The popularity of these alternatives to legacy voice services proves that they are helping fulfill the goal of the Oregon USF, which is to assure that consumers have access to basic voice telephone service at reasonable and affordable rates.

Regardless of where the parties' interests in this docket lie, the testimony reveals no dispute about the fundamental fact that the industry has changed. Recognition of this fact compels a re-assessment of the principles that should drive OUSF policy going forward — and it provides a basis for consensus around a few principles that should provide that guidance, both in the short term and in the longer view.

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[1] CTL/100 at 8 (CenturyLink has experienced declines in access lines in high cost areas, resulting in a 40 percent reduction in the amount of OUSF support the company received since 2001); FRONTIER/100 at 7-8 (Frontier has lost 57 percent of its subscriber access lines, and its high cost support payments have been reduced by 37 percent from 2000 to 2011); OTA/100 at 9, 11 (rural ILECs' "wireline access lines have declined precipitously over the last decade," and been replaced by competing wireless and VoIP services).

Q. WHAT ARE THE IMMEDIATE CONSIDERATIONS THAT SHOULD GUIDE THE COMMISSION'S THINKING WITH RESPECT TO THE OUSF?

A. There are two critical considerations for the short term. First, in no event should the Commission increase, or take any action that has the potential for increasing, the amount of the fund, which, at its current size of approximately $44 million (Staff/100 at 3), yields one the highest surcharges on telecommunications consumers in the country. It would be unreasonable and even unconscionable to increase this tax, which currently stands at 8.5%. Second, the Commission should reject any suggestion that the fund base should be expanded to require customers of new technologies, like VoIP, to contribute to it.

Q. OTA'S MR. DUVAL CONTENDS THAT "THERE IS NO NEED" TO IMPOSE "FURTHER LIMITATIONS" ON OUSF SUPPORT (OTA/100 at 15). DOES HIS ADVICE VIOLATE THE PRINCIPLE AGAINST GROWTH OF THE FUND?

A. Yes. In discussing the methodology used to determine a rural LEC's costs, Mr. Duval, on behalf of the Oregon Telecommunications Association ("OTA"), argues that there "is no need to institute additional review procedures or develop further limitations" on funding. In his view, carriers "must be given the latitude" to incur any costs they deem necessary (OTA/100 at 15), without any meaningful evaluation of whether these expenditures further universal service. OTA's approach would allow the OUSF to grow unchecked and undermine Staff's desire to improve accountability and transparency of the fund.

OTA's position is also inconsistent with the Federal Communications Commission's reforms of federal universal service programs. In its *USF/ICC Transformation Order*, the FCC found that rate-of-return regulation (which is one of the underpinnings of the existing OUSF support mechanism) and traditional USF funding mechanisms have conspired to provide support "regardless of the necessity or prudence of any given investment," and without imposing any practical limits on the type or extent of investments that are made.[2] The FCC found that long-standing funding mechanisms have provided "poor incentives for rate-of-return carriers to operate and invest efficiently," and can result in "excessive spending."[3] The FCC concluded that, because of these weaknesses in the regulatory regime, federal universal service programs were providing support to companies "with high costs due to imprudent investment decisions, unwarranted corporate overhead, or an inefficient operating structure." *USF/ICC Transformation Order* at ¶287. Thus, when it committed to reform its universal service policies for rate-of-return LECs, including rural LECs in Oregon, the FCC sought to "eliminate waste and inefficiency and improve incentives for rational investment and operation by rate-of-return LECs." *Id.* at ¶¶195, 207, Appendix O at ¶13.

This Commission should, likewise, seek to create similar incentives to curb inefficiency and rationalize the OUSF. Granting rural LECs "a blank check" to spend whatever amounts they consider fit, as Mr. Duval suggests, would be a move in the wrong direction, to the detriment of consumers who will have to pay ever-increasing surcharges. If carriers expect to recover whatever amounts they spend from a fund that is subsidized by all Oregon consumers, they will have little incentive to operate efficiently or to compete effectively. The Commission should, in the short term, stop the fund from increasing, and eventually reduce the size of the OUSF, rather than adopt any policies that would have the opposite effect.

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[2] *Connect America Fund, et al.,* Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17633 (2011) (*USF/ICC Transformation Order*) at ¶287.

[3] *In the Matter of Connect America Fund,* Notice of Proposed Rulemaking, FCC 11-13 (Feb. 9, 2011) at ¶21.

Q. DOES STAFF AGREE THAT REFORMS TO HOLD DOWN THE FUND ARE NECESSARY?

A. Yes. Mr. White agrees that the fund cannot continue in its current form, and a key Staff objective is to reduce the size of the OUSF. Staff/100 at 15. To this end, he recommends a number of reforms, including lowering the unduly burdensome end user surcharge and increasing the current benchmark, perhaps from $21 to $30 per month. Because OUSF support is determined by subtracting the benchmark from the cost of service calculated using one of the two cost models, increasing the benchmark will reduce the amount of support that is provided. In addition, Mr. White proposes to establish a "needs" test, under which carriers would have to report how they would use any OUSF distributions. Under Staff's proposal, a carrier's actual support would be calculated "as the smaller of the [cost] model results and what they report that they need." *Id.* at 13, 19, 21-22. These steps are intended to prevent growth of the fund and eventually reduce it.

Q. ARE THERE STEPS THE COMMISSION CAN TAKE NOW TOWARD THE EVENTUAL OBJECTIVE OF PHASING OUT FUNDING?

A. Yes. Verizon supports allowing carriers to raise their retail rates to more market-based levels, so that they can recover more of their revenues from their end users, in their retail rates. The Commission should encourage companies to adjust artificially low retail rates and consider limiting OUSF funding to carriers that do not so that other Oregonians are not forced to subsidize unreasonably low rates. But I recognize that it may be infeasible for funding recipients to otherwise adjust their business models overnight to accommodate the changes in the marketplace. So, for the longer term, the focus of the Commission and the parties should be on how best to achieve that transition, and over what time period — but there should be no doubt that the anachronistic, anti-competitive subsidy system must eventually be phased out.

Q. IS THERE REASON TO BELIEVE THAT ILECS HAVE ROOM TO INCREASE THEIR BASIC EXCHANGE RATES?

A. Yes. Staff conducted a survey of single line residential and business rates for each local exchange carrier and compared them to the current $21 benchmark. In 2000, the Commission considered the benchmark to be a "good surrogate for an affordable rate for basic local exchange service" (Order No. 00-312 at 21), although Mr. White suggests that the benchmark should be increased to account for inflation. The results of Staff's survey appear on the following page. Of the 40 residential rates shown, 39 are below $21.00. More than half of the business rates are below the benchmark, as well.

COMPARISION OF BASIC SERVICE RATES TO BENCHMARK

Company	Residential	Business	Residential	Business
Asotin	$12.75	$13.25	Below	Below
Beaver Creek	$27.00	$27.75	**Above**	**Above**
Canby	$12.80	$19.60	Below	Below
Cascade Utilities	$18.99	$34.47	Below	**Above**
CenturyTel	$12.48	$20.31	Below	Below
Citizens	$13.67	$24.32	Below	**Above**
Clear Creek	$18.89	$29.05	Below	**Above**
Colton	$16.50	$28.40	Below	**Above**
Eagle	$11.60	$16.95	Below	Below
Gervais	$17.95	$22.00	Below	**Above**
Helix	$14.80	$17.60	Below	Below
Home	$16.55	$25.55	Below	**Above**
Midvale	$14.35	$19.00	Below	Below
Molalla	$14.95	$19.95	Below	Below
Monitor	$14.05	$17.20	Below	Below
Monroe	11.69	$10.99	Below	Below
Mt. Angel	$9.00	$15.20	Below	Below
Nehalem	$13.00	$16.00	Below	Below
North State	$12.45	$17.40	Below	Below
Oregon - Bates	$8.95	$12.25	Below	Below
Oregon - All other	$11.95	$16.50	Below	Below
Oregon-Idaho zone 1	$11.65	$23.35	Below	**Above**
Oregon-Idaho zone 2	$13.65	$26.35	Below	**Above**
Oregon-Idaho zone 3	$18.65	$31.35	Below	**Above**
Peoples	$13.95	$17.95	Below	Below
Pine	$13.00	$17.00	Below	Below
Pioneer	$15.00	$16.00	Below	Below
Qwest (1)	$12.80	$26.00	Below	**Above**
Qwest (2)	$13.80	$28.50	Below	**Above**
Qwest (3)	$14.80	$30.50	Below	**Above**
Roome (in town)	$15.00	$20.00	Below	Below
Roome (out of town)	$18.00	$25.00	Below	**Above**
Scio	$11.50	$13.75	Below	Below
Sprint/United	$13.43	$24.00	Below	**Above**
St. Paul	$10.50	$10.50	Below	Below
Stayton	$11.60	$14.02	Below	Below
Trans-Cascades	$14.80	$29.95	Below	**Above**
Verizon (1)	$12.59	$22.00	Below	**Above**
Verizon (2)	$12.59	$27.00	Below	**Above**
Verizon (3)	$12.59	$31.20	Below	**Above**

Source: Staff Response to Data Request Verizon-Staff 2-9 a.

Q. DID ANY OF THE PARTIES PROVIDE EVIDENCE OF WHAT CONSTITUTES A REASONABLE AND AFFORDABLE RATE IN OREGON'S HIGH-COST AREAS?

A. No. In response to several data requests, Frontier, OTA and Staff all acknowledged that they had not conducted any studies or determined a standard for "affordable" rates, which is one of the criteria of the state USF program set forth in ORS 759.425(1). Mr. Duval appears to suggest that a national urban rate of $14 per month used by the FCC for different purposes might be an appropriate standard (OTA/100 at 9-10), but that misstates the purpose of that provision of the FCC's package of universal service reforms. The standard he refers to is not intended to represent a "reasonable and affordable rate" for basic telephone service. In the *USF/ICC Transformation Order,* the FCC ruled that it would be "inappropriate" and inequitable to provide federal high-cost support to subsidize the service offerings of any carriers that charge customers "local service rates that are significantly lower than the national urban average." "Doing so," the FCC said, would place "an undue burden on the Fund and consumers that pay into it." *USF/ICC Transformation Order* at ¶237. Accordingly, the FCC decided to limit high-cost support to carriers whose local end user rates plus state regulated fees do not meet an urban rate floor calculated by the FCC. Initially, the floor was set at $10, but will increase to $14 in July of this year, and will be adjusted further in subsequent years. *Id.* at ¶¶238-243. Under this policy, a rate-of-return carrier will have its federal support reduced, on a dollar-for-dollar basis, to the extent the carrier's rates do not meet the floor. Thus, the purpose of the floor is to avoid over-subsidizing carriers by limiting support to those LECs that maintain artificially low rates. The fact that rates below the floor are deemed unreasonable should not be construed as a finding by the FCC of what constitutes an "affordable" rate in rural areas. Accordingly, the Commission should not rely on that standard as a measure of "affordability" in this proceeding. Instead, as I testified previously, it would be more appropriate to rely on the FCC's explicit finding that $30 is a reasonable and affordable rate for local exchange service. *See* Verizon/100 at 49-50.

Q. WOULD IMPOSING NEW SURCHARGES ON VOIP SERVICES AND CUSTOMERS CONFLICT WITH THE NEED TO REFORM THE OUSF?

A. Yes. Again, Mr. Duval's recommendations on behalf of OTA go in exactly the wrong direction. He argues that all users of the wireline network, and particularly VoIP providers, should be required to contribute to the OUSF on the theory that "their service relies on the PSTN to, at the very least, terminate calls." OTA/100 at 15-16. Mr. White also suggests that revenues from VoIP services should be subject to the OUSF surcharge. His reasoning appears to be that, while different service providers use different technology to connect to the end-user, "the function being performed is connecting the end-user to the network." Staff/100 at 25-26. And Frontier's Mr. Lee states that, as a policy matter, all providers of voice communications service should contribute to the OUSF, although he acknowledges there are legal issues that must be closely reviewed. FRONTIER/100 at 14.

Indeed, the question of whether the Commission may impose new regulatory obligations on VoIP services raises a number of significant legal and jurisdictional issues. These matters are best left to briefs, but there is no difficulty in concluding that imposing new taxes on VoIP services is a bad idea from a policy and public interest perspective. None of the parties provide any detailed rationale for imposing this new obligation on VoIP providers and the customers of such services. Rather, they offer only cursory comments at best.

As Dr. Ankum and I have shown, providers of VoIP services are increasingly offering affordable, innovative solutions for consumers in Oregon. These new services and technological innovations, in turn, are spurring competition in the entire communications market, providing an impetus for holding down rates in the traditional wireline sector and promoting investment in broadband infrastructure. The rapid growth of VoIP and other intermodal services — without any subsidies from the OUSF -- has helped fulfill the state's universal service goals, which should reduce, not increase, the need for USF subsidies. It would be counterproductive to expand the program by including new groups of contributors. If anything, the Commission should be reducing the number of firms required to generate subsidy payments as the size of the OUSF shrinks.

There are no valid policy reasons for requiring consumers of new VoIP services to contribute to a high-cost support fund that predominantly benefits incumbent wireline local exchange carriers that VoIP customers have abandoned. Consumers that have chosen to use these advanced applications would be forced to pay higher, unwarranted charges in order to continue supporting the older technologies and services they left behind. Requiring VoIP services to contribute to the OUSF would result in higher prices and discourage other customers from migrating to these new innovative services, to the detriment of the State's economy and its consumers.

In his testimony, Mr. White opines that including revenues from VoIP providers will not greatly increase the revenue base. Staff/100 at 25. However, during discovery, Staff admitted that it has not performed any analysis or evaluation of how much additional revenue would be generated if VoIP services were required to contribute to the fund. Staff Response to Data Request Verizon-Staff 2-13 b. Thus, there is no factual basis for the Commission to find that the impact of such a significant shift in policy would be minimal.

Imposing new fees on VoIP services would deter investment and innovation, at a time when the deployment of an advanced telecommunications infrastructure is critical to supporting Oregon's economic growth. Increasing taxes will result in fewer competitive options and fewer benefits for consumers. For all these reasons, the

Commission should not hamper the continued growth of VoIP services by imposing new fees on the customers of those services.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in Docket UM 1481 on the following named person(s) on the date indicated below by email addressed to said person(s) at his or her last-known address(es) indicated below.

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