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BEFORE THE PUBLIC UTILITY COMMISSION**

OF OREGON

UM 731

In the Matter of)
) ORDER
The Investigation of Oregon Universal Service.)

DISPOSITION: SURCHARGE/CONTRIBUTION RATES DECREASED

At its public meeting on August 3, 2004, the Public Utility Commission of Oregon adopted Staff's recommendation that the Oregon Universal Service Fund (OUSF) surcharge rate should be decreased from 6.50 percent to 6.00 percent and the corresponding OUSF contribution rate be decreased from 6.10 percent to 5.60 percent. Staff's recommendation is attached as Appendix A, and incorporated by reference.

ORDER

IT IS HEREBY ORDERED AND AUTHORIZED that:

1. The OUSF surcharge rate is decreased from 6.50 percent to 6.00 percent for intrastate retail telecommunications services billed beginning October 1, 2004.
2. The associated OUSF contribution rate is decreased from 6.10 percent to 5.60 percent for contributions remitted to the OUSF, for the period beginning October 1, 2004, payable on February 28, 2005.
3. These changes to OUSF surcharge and contribution rates shall remain in effect until further notice.

Made, entered and effective _____.

BY THE COMMISSION:

Becky L. Beier
Commission Secretary

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: August 3, 2004**

REGULAR X CONSENT _____ EFFECTIVE DATE October 1, 2004

DATE: July 22, 2004

TO: Commissioners Lee Beyer, Ray Baum and John Savage

FROM: John Wright through Dave Booth, Cynthia Van Landuyt, Phil Nyegaard and Lee Sparling

SUBJECT: OREGON UNIVERSAL SERVICE FUND: (Docket UM 731) Decrease in the Oregon Universal Service Fund surcharge and contribution rates.

STAFF RECOMMENDATION:

Staff recommends the Oregon Universal Service Fund (OUSF) end user surcharge be lowered from 6.50 percent to 6.00 percent and the corresponding contribution rate be lowered from 6.10 percent to 5.60 percent.¹ If approved, the new surcharge will be assessed on intrastate telecommunications services billed to retail end users beginning October 1, 2004.² The new contribution rate will be effective for contributions paid to the OUSF for the quarter beginning October 1, 2004, payable on February 28, 2005.

DISCUSSION:

A. Background Information

ORS 759.425 directed the Commission to establish the OUSF to insure basic telephone service is available at reasonable and affordable rates in high cost areas. This statute also directed the Commission to establish a uniform surcharge on the sale of all retail telecommunications services

¹ The surcharge and contribution rates differ slightly because telecommunications service providers include OUSF surcharges received from end users as part of their contribution base. Therefore, the contribution rate must be slightly less than the surcharge rate to ensure a one-for-one relationship between surcharges collected from end users and contributions paid to the OUSF. This same methodology is used by the Federal Communications Commission for the federal USF.

² The OUSF Advisory Board approved this recommended surcharge and contribution rate decrease on June 30, 2004.

sold in Oregon in an amount sufficient to support the OUSF.³ The OUSF commenced operation on September 1, 2000. Since then, the Commission has changed rates four times as shown on the next page.

	<u>Surcharge Rate</u> <u>Effective Date</u>	<u>Contribution Rate</u>
Initial Rate	2.35	
	2.30	
	September 1, 2000	
Order 00-760	3.24	
	3.14	
	January 1, 2001	
Order 01-752	3.00	
	2.91	
	October 1, 2001	
Order 01-1063	5.50	
	5.21	
	February 1, 2002	
Order 03-594	6.50	
	6.10	
	January 1, 2004	

Staff is now recommending a fifth change: a decrease in the surcharge and contribution rates to 6.00 percent and 5.60 percent respectively, effective October 1, 2004.⁴ For comparative purposes, the federal universal service surcharge rate is 8.90 percent.⁵

B. OUSF Financial Performance

OUSF financial performance for the biennium July 2001 - June 2003 was as follows:

Contributions	\$101.1 million	
Interest & Late Fees		\$
<u>0.9 million</u>		

³ In response to a federal court order, the Commission changed the OUSF revenue base from "all" to "intrastate" retail telecommunication services sold in the state. *See* Order 01-1063.

⁴ From the time the Commission approves a new OUSF surcharge, there is a lag of about seven months before contributions are remitted to the OUSF Administrator. Notices of the increase must be mailed to all telecommunications service providers 45 days before the effective date so their billing systems can be modified. Contributions are not payable to the OUSF Administrator until February 28, 2005, two months after the end of the fourth quarter 2004.

⁵ The federal USF surcharge is assessed on retail **inter**state telecommunications services. In contrast, the OUSF surcharge is assessed on retail **intra**state telecommunications services.

Total Income		\$102.0 million
Disbursements	\$ 92.4 million	
Administrative Expenses		<u>\$ 0.3 million</u>
Total Expenses	\$ 92.7 million	
Operating Reserve	\$ 9.3 million ⁶	

During the eleven-month period July 2003 - May 2004, contributions to the OUSF have totaled approximately \$47.5 million with disbursements of \$46.5 million and a resulting operating reserve of approximately \$1 million.

C. Rationale for Decreasing the OUSF Surcharge and Contribution Rates

The current 6.50 percent OUSF surcharge was approved by the Commission on September 23, 2003 (*see* Order No. 03-594). At that time, the intrastate retail revenues reported by Oregon's telecommunications service providers had declined by 10.8 percent during the period mid-2002 through mid-2003 and 8.70 percent during the second quarter of 2003.⁷ In light of this decline, Staff prepared a budget forecast that assumed a 6.00 percent decline in contributions.⁸ Staff's forecast also assumed that competitive local exchange carriers (CLECs) would seek support of up to \$50,000 per month beginning in January 2004 and that rural ILECs would file revised cost studies seeking up to 10.00 percent additional support beginning in July 2004.

To date, these assumptions have not materialized. The annualized decline in intrastate retail telecommunications revenue slowed to approximately 3.50 percent in the first quarter of 2004. No rural ILECs have filed revised cost studies seeking increased OUSF support and the Commission has not granted eligible telecommunications carrier status to any CLECs. As a result, Staff recommends lowering these rates to reflect actual experience and provide some minimal rate relief to end users.⁹

⁶ This unusually high level of operating reserves allowed the OUSF to accumulate the funds required to begin making distributions to the rural ILECs in November 2003. *See* Commission Order No. 03-595 (Docket UM 1017) which, pursuant to the requirements of ORS 759.425, expanded the OUSF to include rural ILECs in addition to Qwest and Verizon.

⁷ Presumably this revenue decline was due to a combination of factors that included Oregon's floundering economy, the loss of ILEC customers to wireless carriers, and the conversion of dial-up Internet access to DSL and cable modem technologies.

⁸ A 6.00 percent annualized decline in retail intrastate revenues was used under the belief that revenue declines of 8.70 percent to 10.80 percent were unlikely to continue.

⁹ Decreasing the surcharge rate to 6.00 percent from 6.50 percent will save \$0.25 per month for an end user billed for \$50 of intrastate telecommunications services.

C. Updated OUSF Budget Forecast

Staff's current OUSF Budget Forecast features the following updated key assumptions:

Growth in revenue / contributions	3.00% decline
Disbursements to Qwest and Verizon	0.50% decline
Disbursements to rural ILECs	
5.00% increase in July 2005	
Disbursements to CLECs	
\$50,000 per month beginning July 2005	
Fund Balance	
monthly expenditures	Equivalent to 3.5

Growth in Intrastate Retail Revenue and Contributions

The assumed 3.00 percent annualized decline in intrastate retail telecommunications revenue is slightly less than the most recent quarterly decline of approximately 3.5 percent. This reflects Staff's belief that although intrastate retail revenue declines will continue, the rate of decline will stabilize at a level marginally below recent experience.

Disbursements to Qwest and Verizon

The assumed 0.50 percent annualized decline in disbursements to Qwest and Verizon is deliberately more conservative than recent experience. During the period March 2004 - June 2004, disbursements to Qwest and Verizon declined, on an annualized basis, by approximately 3.4 percent and 1.5 percent respectively. Staff prefers to assume that disbursements will decline at a rate less than actual experience in order to assure adequate fund cash flow.

Rural ILEC and CLEC Disbursements

The annualized rate of decline in rural ILEC disbursements was approximately 1.4 percent during the period March 2004 - June 2004. This decline causes Staff to believe that the rural ILECs will file updated cost studies by July 2005 in order to maintain their existing revenue base. For this reason, Staff's budget forecast includes a 5.00 percent increase in rural ILEC disbursements commencing July 2005. The assumption that disbursements to CLECs will total \$50,000 per month beginning in July 2005 is merely a placeholder.

Fund Balance

The Commission has required the OUSF to maintain a minimum cash surplus, equivalent to 3.0 times monthly expenditures, in order to preserve the fund's financial integrity.¹⁰ In actual practice, the OUSF maintains a minimum cash surplus equivalent to 3.5 times monthly expenditures, based on OUSF Advisory Board operating procedures. Based on the above updated assumptions, Staff

¹⁰ See Commission Order No. 99-197, issue 4, page 5

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believes the OUSF can maintain the required minimum cash surplus through approximately April 2006 if the surcharge and contribution rates are reduced to 6.00 percent and 5.60 percent respectively. Depending on the accuracy of the updated assumptions, this means the earliest the Commission will be required to entertain another possible rate adjustment, up or down, is approximately one year from now.

PROPOSED COMMISSION MOTION:

An order be prepared in Docket UM 731, authorizing the OUSF surcharge to decrease from 6.50 percent to 6.00 percent for intrastate retail telecommunications services billed beginning October 1, 2004; and authorizing the associated contribution rate to decrease from 6.00 percent to 5.60 percent for contributions remitted to the OUSF for the period beginning October 1, 2004, payable on February 28, 2005.

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