

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: October 11, 2005

REGULAR X CONSENT _____ EFFECTIVE DATE January 1, 2006

DATE: October 4, 2005

TO: Public Utility Commission

FROM: Roger White

THROUGH: Lee Sparling, Phil Nyegaard and Cynthia Van Landuyt

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

STAFF RECOMMENDATION:

Staff recommends that the Oregon Universal Service Fund (OUSF) end-user surcharge be increased from 6.00 percent to 7.12 percent and that the corresponding contribution rate be increased from 5.60 percent to 6.65 percent.¹ If approved, the new surcharge will be assessed on intrastate telecommunications services billed to retail end users beginning January 1, 2006.² The new contribution rate will be effective for contributions paid to the OUSF for the quarter beginning January 1, 2006, payable on May 28, 2006.

DISCUSSION:

A. Background Information:

ORS 759.425 directed the Public Utility Commission of Oregon to establish and implement a competitively neutral, nondiscriminatory fund to ensure that basic telephone service is available at an affordable rate; this fund is the OUSF, which commenced operation on September 1, 2000.

The OUSF collects money quarterly from all of the approximately four hundred certified telecommunications service providers (TSPs) based on their Oregon intrastate retail telecommunications revenues and distributes money monthly to the eligible

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.

² The OUSF Advisory Board approved this recommended surcharge and contribution rate increase on September 22, 2005.

telecommunications carriers (ETCs). Distributions are calculated using a wire center specific support per line multiplied times the number of basic service lines in the wire center. On a quarterly basis, the fund presently collects and disburses approximately thirteen million dollars.

The following table illustrates the rate changes that have taken place since inception of the fund as well as the proposed new rates:

Order Number	Surcharge Rate	Contribution Rate	Effective Date	Notes
Initial Rate	2.35%	2.30%	Sep 1, 2000	³
Order 00-760	3.24%	3.14%	Jan 1, 2001	
Order 01-752	3.00%	2.91%	Oct 1, 2001	
Order 01-1063	5.50%	5.21%	Feb 1, 2002	⁴
Order 03-594	6.50%	6.10%	Jan 1, 2004	⁵
Order 04-437	6.00%	5.60%	Oct 1, 2004	
Proposed Rate	7.12%	6.65%	Jan 1, 2006	⁶

B. The Reason for Increasing the Rates at this Time:

Over the first two quarters of 2005, the fund has disbursed over \$1.1 million per quarter more than it took in. At this present rate of net outflow, the fund will be below the lower allowable float limit⁷ by the third quarter of 2006.⁸ If this mismatch in inflows and

³ On June 16, 2000, the Commission issued Order No. 00-312 resolving issues raised in Phase IV of docket UM 731. In the July 10, 2000 public meeting, following the issuance of this Order, the Commission set the surcharge rate at 2.35 percent of total Oregon retail telecommunications sales.

⁴ As a result of the AT&T law suit, settled by the USA District Court on October 18, 2001, in favor of AT&T, the revenue assessment base for the OUSF was changed from total Oregon retail telecommunications revenues to Oregon intrastate retail telecommunications revenues. The revised rate nearly doubled due to the contribution base change.

⁵ In Order 03-085 in UM 1017, the Commission ordered the expansion of the OUSF to include the service area of the rural telephone companies. The annual impact of this expansion was estimated to be a \$9.38 million increase in the disbursements from the fund. The rate was increased to accommodate this new requirement.

⁶ The Federal Communications Commission USF contribution rate is currently set at 10.2 percent.

⁷ Order 99-197 established the float at approximately three months. Subsequently, the OUS Advisory Board proposed and the Commission adopted the extension of the float to three and one half months.

⁸ When the current rates were set on August 3, 2005, it was assumed that the OUSF would be able to maintain the required minimum cash surplus through the first quarter of 2006.

outflows were the only issue, the process of implementing a rate increase could be delayed for another quarter;⁹ however, this is not the case: there is a refund due to Verizon¹⁰ beginning this quarter, and there is an anticipated increase in the support per line for rural telecommunications carriers.¹¹

With or without the refund to Verizon and the projected increase in disbursements to the rural telecommunications carriers, a rate increase would be required. When the budget forecast was prepared for the current rates, it was assumed that the 6.0 percent decline in Oregon intrastate retail revenues that had previously been assumed for the prior forecast had dropped to 3.0 percent.¹² This turned out to not be the case. The 6.0 percent decline has continued into the present.

C. Updated OUSF Budget Forecast Assumptions and Rationale:

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

Baseline assumptions:

Retail Intrastate revenues	6.0 percent decline
Disbursements	2.3 percent decline
Minimum Fund Balance	3.5 months of expenditures
Time Horizon	Second Quarter of 2007

Forecast Overlays:

Verizon Refund	\$1.3 Million
Support Per Line Update	2.5 percent increase in disbursements

⁹ Because of the implementation lags, a rate increase approved at the beginning of the fourth quarter will not have an impact on the fund until the second quarter of the following year. Specific timelines for each step of the process were laid out in Order 99-197.

¹⁰ Staff reached an agreement with Verizon regarding revisions to Verizon's prior quarters' worksheets. The refund will consist of four quarterly payments of approximately \$325 thousand each, beginning the fourth quarter of 2005.

¹¹ In Order 03-085 in UM 1017, the Commission ordered that a study be conducted once every three years to update the support per line each rural telecommunication carrier receives. Verizon and Qwest were excluded from the updating process since their support was not calculated based on embedded cost. A preliminary study, consisting of a small sample of companies, indicates that average rates for the small companies could increase by 15 percent or more, which equates to a 2.5 percent overall increase. The last time these rates were reviewed was three years ago.

¹² At the time this assumption was made, the fund was \$9.7 million dollars over the required minimum balance of \$15.6 million. A rate reduction allowed this surplus to be brought down. At present the fund is \$6.4 million over the required minimum balance.

1. Retail Intrastate Revenues and Contributions

The baseline assumption for calculating contributions is that the 6.0 percent decline in Oregon intrastate retail telecommunication revenues over the past eight quarters will continue over the next eight quarters. Although there were some wide quarter-to-quarter swings for the first half of the year, the annualized drop was 6.2 percent; this is in line with the longer trend. With no rate changes, contributions move exactly like Oregon intrastate retail telecommunication revenues since they are derived by multiplying the surcharge rate times the Oregon intrastate retail telecommunications revenues.

2. Disbursements

The baseline assumption for calculating distributions is that the 2.3 percent decline in disbursements over the past eight quarters will continue over the next eight quarters. In the past few quarters, disbursements have dropped by 3.0 percent, but this rate of erosion is not expected to continue.

3. Minimum Fund Balance

Over the eight-quarter forecast horizon, which includes third and fourth quarter of this year, the average float cannot drop below 3.5 equivalent months.

4. Time Horizon

The forecast horizon is set at eight quarters, which includes the last two quarters of 2005 as well as a year and one half beyond. This horizon was set to keep the number of rate changes at one per year or less.

5. Verizon Refund Overlay

Beginning the fourth quarter of 2005, Verizon will receive a refund of approximately \$1.3 million in four quarterly payments of \$325,000. The refund is based on an agreement between staff and Verizon regarding revisions to Verizon's prior quarters' worksheets.

6. Rural Telecommunications Support Per Line Update Overlay

Every three years the wire center specific support per line is reviewed and updated for the rural telecommunication carriers¹³. This review will begin the fourth quarter of 2005 and the changes will start to impact disbursements in the third and fourth quarter of 2006. Based on a preliminary study, the overlay assumes that rates for the rural telecommunications carriers will increase by 15 percent or 2.5 percent for all companies. Disbursements are expected to grow by 0.85 percent in the third quarter of 2006 and an additional 1.64 percent in the fourth quarter of 2006.

¹³ See footnote 11.

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PROPOSED COMMISSION MOTION:

An order be prepared in docket UM 731, authorizing the OUSF surcharge to increase from 6.00 percent to 7.12 percent for intrastate retail telecommunications services billed beginning January 1, 2006, and authorizing the associated contribution rate to increase from 5.60 percent to 6.65 percent for the contributions remitted to the OUSF for the period beginning January 1, 2006, payable on May 28, 2006.