BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska Public Service Commission, on its own motion, to make adjustments to the universal service fund mechanism established in NUSF-26	**Application No. NUSF-50**
In the Matter of the Commission, on its own motion, seeking to determine the level of the fund necessary to carry out the Nebraska Telecommunications Universal Service Fund Act.	**Application No. NUSF-4**

NOTICE OF FILING THE DIRECT TESTIMONY OF PETER B. COPELAND

Comes Now Qwest Corporation and hereby notices and submits the direct testimony of Peter B. Copeland on this 29th day of September, 2006.

Qwest Corporation

By

Jill Vinjamuri Gettman #20763
Gettman & Mills LLP
10250 Regency Circle
Suite 200
Omaha, NE 68114
(402) 320-6000
(402) 391-6500 (fax)
jgettman@gettmanmills.com

Timothy J. Goodwin
QWEST SERVICES CORPORATION
1801 California, Ste. 1000
Denver, CO 80202
303-383-6612
303-296-3132 (fax)
tim.goodwin@qwest.com

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the Notice of Filing the Direct Testimony of Peter B. Copeland was sent via regular United States mail, on this 29th day of September, 2006, addressed as shown below, to the following:

Loel P. Brooks, Esq.
Brooks, Pansing & Brooks, PC, LLO
984 Wells Fargo Center
1248 "O" Street
Lincoln, NE 68508-1424

Paul M. Schudel
Woods & Aiken, LLP
301 South 13th Street
Suite 500
Lincoln, NE 68508

William Hendricks
901 Wasco Street
Hood River, OR 97031

Kevin Saville
Associate General Counsel
Frontier Communications
2378 Wilshire Blvd.
Mound, MN 55364

Mark Fahleson
Rembolt Ludtke, LLP
1201 Lincoln Mall
Suite 102
Lincoln, NE 68508

By: _____
Jill Gettman

1 **IDENTIFICATION OF WITNESS**

2

3 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

4 A. My name is Peter B. Copeland and my business address is 1801 California St.,
5 Denver, Colorado 80202. I am employed by Qwest Services Corporation ("Qwest")
6 as Director, Cost and Economic Analysis, in the Public Policy organization.

7

8 **Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.**

9 A. I have been employed by Qwest, U S WEST, and Bellcore for the past 25 years. My
10 experience with Qwest and Bellcore includes responsibility for the development of
11 wholesale and retail cost studies, models of the local exchange network, universal
12 service advocacy, jurisdictional separations, and rate development.

13

14 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

15 A. I have a Bachelor of Arts degree from Brown University in Urban Studies and a
16 Master of Public Administration from the University of Colorado.

17

18 **Q. WHAT ARE YOUR CURRENT JOB DUTIES?**

19 A. My current responsibilities include the development of universal service advocacy
20 and supervision and development of all wholesale and retail forward-looking cost
21 studies for Qwest. Additionally, my group provides economic analysis for regulatory
22 proceedings.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION OR OTHER STATE COMMISSIONS?

A. Yes. I have testified before the Nebraska Commission in several universal service proceedings. I have also testified in other states, including Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, New Mexico, North Dakota, Oregon, Utah, Washington, and Wyoming. I have also appeared as a panel member before the FCC concerning Universal Service costing.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to comment on proposed changes to the long term universal service fund mechanism originally established in NUSF26. These proposed changes include: modifications to the per-line backstop; changes in formulas concerning previous year over-earnings; depreciation changes to NUSF-7 support; increases to the urban benchmark; the imputation of certain of the federal universal service fund; reductions in the state earnings benchmark from 12 percent to 11.25 percent; phase down of the over-earnings redistribution (OER) by 25 percent per year; and imputation of a rural rate increase. Additionally, the Commission is also proposing to equalize funding for ported lines with funding for incumbent lines.

1 The changes proposed in the Order are all described at a high level. Further, the
2 Order neglects to discuss the single largest change to the NUSF fund, which is the
3 reduction of the long term fund size from $66.5M to $44.7M. My testimony is
4 focused on the major elements that cause the NUSF reductions for ETCs and the
5 negative impacts of the reductions on customers the state of Nebraska. My testimony
6 is organized in five sections covering (1) Model analysis, (2) additional fund size
7 issues, (3) porting, (4) implementation of rural benchmark, and (5) inclusion of
8 NUSF-7. Because much of the information supporting the proposed plan is either
9 unavailable or incompletely developed at this time, Qwest reserves its rights to
10 further develop these and potentially other issues in its reply testimony.
11 Before I begin the substantive points of my testimony, however, I would note an
12 initial concern. The Commission just entered what was supposed to be a final and
13 permanent NUSF distribution methodology in November 2004. Since that time, the
14 Commission has decided to reduce the funds available to support rural services by
15 reducing the surcharge, has decided to reduce funds available to support rural
16 wireline services by diverting some of the remaining funds to support wireless
17 infrastructure, has changed the method by which NUSF support is ported to
18 competitive providers and has proposed further changes, and now has undertaken to
19 change the method by which these drastically reduced funds will be distributed.
20 These changes disproportionately harm Qwest and its subscribers, but also render the
21 NUSF unpredictable. Predictability is a required characteristic of state universal
22 service funds. As the Commission continues to tinker with the distribution rules and

methodologies, the NUSF becomes less and less predictable, and it becomes harder and harder for carriers to make proper investment decisions regarding the maintenance and upgrading of their systems in rural Nebraska. Accordingly, Qwest believes the Commission should be very reluctant to implement any of the proposed changes to the distribution model.

MODEL ANALYSIS

Q. THE AUGUST 29 ORDER DESCRIBES A NUMBER OF UPDATES AND STEPS THAT DEVELOP THE NUSF FOR ETCS SERVING HIGH COST TERRITORY IN NEBRASKA. IS IT POSSIBLE TO FOLLOW THE STEPS IN THE ORDER WITH THE AID OF THE ORDER ATTACHMENTS AND REPLICATE THE CALCULATIONS OF EACH CARRIER's YEAR THREE NUSF?

A. No. The descriptions of changes in the Order and its Appendix A do not seem to be directly related to the Commission staff modified Distribution Model which calculates NUSF amounts for carriers in Nebraska. Some weeks after the Order was issued, the Commission provided an updated NUSF Distribution Model (Model) through its web site (for parties signing a non-disclosure agreement). The Model includes the calculations and inputs that set the year three high cost support for each company. Neither the original Model nor the updated Model matches the analytical framework and steps described in the Order, as discussed in more detail below. In fact, the differences between the descriptions of the ordered changes and their

implementation in the Model created difficulties in analyzing both the Order and the Model.

Q. DOES THE MODEL FOLLOW THE INPUT CHANGES AND STEPS DESCRIBED IN THE ORDER?

A. The steps are present in the model, though not implemented in a manner that makes them transparent to the user. The Model logic is very difficult to follow, since there are only vague column descriptions of the data calculations. Many of the critical calculations use multiple layers of nested logic, which requires time-intensive examination to step through the logic. The calculations could have been documented internally in the Model with comments, which would have greatly helped the understanding of the process followed in the Model. Additionally, the development of certain critical inputs is undocumented both in the Model and the Order. Regardless of the lack of documentation or justification, the Model defines the calculations for the NUSF funding. Therefore, my testimony focuses on key elements in the Model and their effect on Nebraska NUSF policy.

Q. WHAT IS THE MOST CRITICAL INPUT THAT LACKS ANY FORM OF DOCUMENTATION?

A. The most critical input is the overall high cost fund size. The fund size input of $44.7M is clearly the most significant value in the Model. The fund size is the basic determinant of both the post-transition NUSF funds available to each company and

1 the NUSF available in each transition year, yet it is never mentioned in the Order, nor
2 is there any documentation as to its derivation in the Order Attachments or in the
3 Model.
4
5 **Q. WHY IS THIS UNDOCUMENTED INPUT THE MOST CRITICAL INPUT IN**
6 **THE MODEL?**
7 A. This input arbitrarily sets the maximum size of the fund in the post-transition period.
8 The post-transition high cost support for each company's area is determined by two
9 things: 1) the fund size input to the model; and 2) the percentage of high cost
10 customers and area each company has relative to the others in the state as calculated
11 by the Staff regression model approved in NUSF-26. The second factor is unchanged
12 from NUSF-26. However, the size of the fund shown in the Model is 33 percent
13 lower than the $66.5M utilized in the Jan. 2005 version of the NUSF-26 Distribution
14 Model. The 33 percent reduction in the fund size lowers every carrier's post-
15 transition support by the same percentage.[1] This decreases Qwest's post-transition
16 NUSF from $14.4M to below $9.8M prior to porting.
17
18 **Q. DOES THE FUND SIZE DROP 33 PERCENT BECAUSE OF THE LOWER**
19 **NUSF SURCHARGE OF 5.75 PERCENT ON INTRASTATE REVENUE?**
20 A. No. The NUSF surcharge is dropping from 6.95 percent to 5.75 percent. That is only
21 a 17 percent reduction in the funding for the NUSF. The surcharge of 5.75 percent

[1] With the exception of NEBCOM whose allocation is now zero percent.

1 clearly allows for a larger fund size than $44.4M. If the fund size reduction were
2 proportional to the surcharge reduction, the adjusted fund size would be in excess of
3 $55M. A $55M fund would increase Qwest's post-transition NUSF to $12M. This
4 amount is still a large reduction from the NUSF-26 level of funding.
5
6 **Q. WHAT IS THE IMPACT OF THE $44.4M FUND ON QWEST'S**
7 **RESIDENTIAL CUSTOMERS?**
8 A. In 2006, Qwest estimates that $33.6M in support will be allocated to high cost
9 residential customers in its serving areas. Approximately $10M of this amount will
10 be ported to CETCs. After the three year transition period, it is proposed that Qwest
11 would receive $9.8M prior to porting. This proposed change is equivalent to $10.96
12 per month for each Qwest residential customer in Nebraska, not just the residential
13 customers in high cost areas. Another way to look at the potential loss in support is
14 that it would take a 60 percent increase in the local residential rate across Nebraska to
15 recover the loss in explicit support just from this proposal. Further increases would
16 be required to replace the subsidies lost under Docket NUSF-26.
17
18 **Q. WOULD A $44M FUND MEET THE SUFFICIENCY STANDARD?**
19 A. Qwest believes that the current fund size is insufficient and that further reductions are
20 unwarranted and certainly unjustified. Qwest measures sufficiency in terms of
21 replacing the implicit support removed from Qwest's access and business rates prior
22 to the adoption of the NUSF-26 Order. Qwest removed $39M of implicit support

1 from its rates in response to the Commission's orders in Docket C-1628 by reducing
2 switched access and business rates. This implicit support was replaced by explicit
3 support pursuant to the orders in C-1628 and the requirement of Neb. Rev. Stat. § 86-
4 323(7) that implicit support mechanisms "may be replaced" by NUSF support. When
5 NUSF-26 was implemented and Qwest's NUSF funding was reduced by
6 approximately $8M annually at the pre-porting level, Qwest was forced to increase
7 switched access rates in an attempt to partially replace the lost explicit support. In
8 this docket, the Commission proposes to further increase the gap between the implicit
9 support Qwest has foregone and the explicit support the Commission provides. As
10 such, the NUSF is not "sufficient" to "replace" the subsidies that have been removed.
11 If the Commission adopts this course, Qwest may need to increase switched access
12 rates again in the face of losing a substantial amount of support: the equivalent of
13 $10.96 per residential line per month.
14
15 **Q. HOW HAVE THE TRANSITION MECHANISMS CHANGED FROM NUSF-**
16 **26?**
17 A. There are two changes in the transition mechanisms: the per-line backstop and the
18 over earnings redistribution (OER). The first change involves moving the level of the
19 per-line backstop from $10 per line per month to $15 per line per month, which was
20 scheduled in NUSF-26 for the third year of transition. The second major transition
21 mechanism is the phase down of the over earnings redistribution (OER) by 25 percent
22 per year for the next three years. The OER phase-down produces the largest

1 proposed change to NUSF distributions, and adversely and disproportionately impacts
2 Qwest almost to the exclusion of other carriers.
3
4 **Q. WHAT IS THE IMPACT ON QWEST OF THE CHANGES TO THE OER?**
5 A. The OER phase down impact cannot be easily isolated from the change in the
6 earnings cap. However, Qwest's current pre-porting NUSF is estimated to be $33.6M
7 in 2006, and based on the proposed implementation of the OER phase down would
8 produce a 2007 pre-porting NUSF of $24.7M for Qwest. This is a reduction of
9 $8.9M.
10
11 **Q. ARE THE EFFECTS OF THE TRANSITION MECHANISMS AND**
12 **EARNINGS CAPS ON THE FINAL YEAR THREE NUSF PREDICTABLE**
13 **BASED ON THE DESCRIPTION IN THE ORDER OR IMPLEMENTATION**
14 **IN THE MODEL?**
15 A. No. Some peculiar results are appearing in the Model. For example, one assumes
16 with a change in the earnings cap and an imputation of Federal USF[2] that a number of
17 companies would drop from the distribution of NUSF. Approximately eight
18 companies no longer would receive distributions of NUSF in the Model. However,
19 when the 2005 earnings level and FUSF imputation are examined, at least one carrier
20 with earnings below the cap and no FUSF loses all NUSF support.[3]

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[2] It is not clear why ALLTEL's FUSF is set at zero within the Model, when they receive approximately $3.8M in non-rural federal high cost support.
[3] This carrier appears to lose support through a change in the regression results that now show zero high cost households and area in their serving area. This is the only carrier with such a change.

On the other hand, six carriers receive increases in NUSF support. While this result may be plausible due to current earnings levels further below the cap than previously existed, four of the six companies' earnings and FUSF data do not bear this out. One of the companies with increased NUSF now has earnings above the cap (Northeast), while three others either have earnings closer to the cap or the net of the FUSF imputation and earnings level should drive a lower level of NUSF (Cons Tele, Cooper, Neb Central). These counter-intuitive results need to be explained and/or corrected before the Model changes receive Commission approval.

ADDITIONAL FUND SIZE ISSUES

Q. WHAT IS THE ESTIMATED THE IMPACT IF THE COMMISSION ADOPTS THE PROPOSED CHANGE IN THE URBAN BENCHMARK TO $17.95 FROM $17.50?

A. At paragraph 10 of the Order, the Commission staff calculates that the fund size would increase approximately $2.4M due to this change.

Q. DOES THE ESTIMATE MAKE SENSE IN LIGHT OF THE MODEL'S OPERATION?

A. No, for two reasons. First, if the model calculated the support on an absolute basis (which it does not), the high benchmark would reduce the difference between the cost and the benchmark, thereby lowering support. Second, the model does calculate

1 difference between the cost and the rate benchmark, however it utilizes the result of
2 this difference to develop the proportion of the fund that should be allocated to the
3 high cost area where the cost is greater than the benchmark. The change in the
4 benchmark to $17.95 really means that areas with cost between the previous
5 benchmark of $17.50 and the proposed benchmark of $17.95 will no longer receive
6 support. The Model would continue to distribute whatever fund size is input.
7 Therefore, a benchmark change, in fact has no impact on the fund size, but does
8 change the distribution of the fund.
9
10 **Q. DOES THE PHASE DOWN OF THE OER RESULT IN FUNDING (AT 5.75**
11 **PERCENT SURCHARGE LEVEL) THAT EXCEEDS THE AMOUNT**
12 **DISBURSED TO HIGH COST NUSF RECIPIENTS IN THE PHASE DOWN**
13 **PERIOD AND BEYOND?**
14 A. Yes. As the OER is phased down (25 percent in year 3, 50 percent in year 4, etc.) a
15 growing amount of the OER dollars are not distributed to carriers with earnings
16 below the cap. This raises the question of where these funds are going to be used.
17 NUSF recipients, particularly those earning below established earnings caps or
18 benchmarks, have demonstrated a clear need for funding that is supported by rate
19 reductions and/or the NUSF-26 distribution model. For example, the model approved
20 in NUSF-26 demonstrated annual support above the benchmarks of greater than
21 $228M would be required to serve rural customers in Nebraska, but the then-existing
22 surcharge would only support a fund size $66.5M. Given the demonstrated need, the

1 Commission should explicitly consider the competing needs for use of the available
2 funds prior to implementing any phase down of OER.
3
4 **PORTING OF SUPPORT**
5
6 **Q. DOES THE ORDER CORRECT INEQUITIES THAT CURRENTLY OCCUR**
7 **BETWEEN SUPPORT FOR QWEST AND CETCS OPERATING IN QWEST**
8 **TERRITORY?**
9 A. At paragraph 18 of the Order, the previous NUSF-26 ruling that allows CETCs to
10 collect NUSF for all business lines and in-town residential lines (while Qwest
11 receives no NUSF for theses customers) appears to be removed. Qwest requests
12 clarification as to what support is phased down for CETCs, the phase down period to
13 reach equal per-line support with the ILEC, and which lines are subject to the phase
14 down. The Commission set forth a detailed and rational proposal for determining
15 porting in NUSF-50 Progression Order No. 2. The August 29 Order in this portion of
16 the proceeding does not indicate whether the Progression Order No. 2 methodology
17 would be used, or should be considered – or if a different method is being considered.
18 In either event, the Order does not provide sufficient detail to permit informed
19 comment at this time.
20

IMPLEMENTATION OF THE RURAL BENCHMARK

Q. HOW DOES THE IMPLEMENTATION OF THE RURAL BENCHMARK DIFFER FROM THE MODEL IMPLEMENTATION OF THE URBAN BENCHMARK?

A. The Order (at paragraph 14) specifies a different implementation of the rural benchmark than the urban benchmark. In the model, the urban benchmark is compared to the cost in each in-town and out-of-town area. In areas where the cost (based on the regression results) is higher than the urban benchmark, the total cost for the area in excess of the urban rate benchmark is calculated. Next, the sum of these excess costs for each company is determined. Finally, a percentage for each company as a portion of the state total high cost is calculated. The company by company percentage is used to distribute the total NUSF fund to each company. Thus, the Model uses the cost versus urban benchmark to develop an allocation process for dividing the fund among companies and high cost areas. The absolute calculation of the cost in excess of the fund is not utilized explicitly in deriving NUSF support. Companies receive far less funding than is calculated on an absolute basis.

On the other hand, the implementation of the rural benchmark is a dollar for dollar offset in the fund. Therefore, each company's funding is reduced by $2 per line for every line it has in the high cost out of town areas.

Q. DOES THIS SEEM TO BE A FAIR AND BALANCED METHOD OF IMPLEMENTING THE RURAL BENCHMARK?

A. No. Because the companies only receive NUSF for a portion of the cost above the urban benchmark, it seems like a disproportionate reduction when the $2 per-line is offset directly from the previously reduced NUSF receipts. If the rural benchmark was implemented as a change in the urban benchmark (changing the urban benchmark to $19.95 in the inputs) the fund size increases approximately $1.9M to $46.6M. This methodology is more consistent with the manner in which the support is calculated since it compares the $19.95 benchmark with the cost in each of the high cost out-of-town areas and creates company allocations based on that difference.

NUSF-7 AND THE CALCULATION OF NUSF-50 SUPPORT

Q. WHAT IS QWEST'S POSITION CONCERNING THE NUSF-26 METHODOLOGY THAT INCLUDES NUSF-7 AS PART OF THE HIGH COST SUPPORT?

A. NUSF-7 is an offset for capital expenditures[4] that Qwest is currently making in its network, which would not be possible in the absence of these funds. NUSF-7 grants require specified and pre-approved investments to be made, and promises reimbursement for those specified, directed investments. These reimbursements offset capital expenditures only after the expenditures are made. Therefore, it is

[4] Qwest supports the proposed NUSF-7 depreciated plant change.

1 inconsistent with the Commission's NUSF policies to reduce Qwest's on-going high
2 cost support from NUSF-26 because it receives the NUSF-7 funds. No policy
3 purpose is served by providing funds for specified capital expenditure reimbursement
4 in high cost areas and then reducing the general, on-going support for these same high
5 cost areas. No carrier has or would undertake the obligations associated with NUSF-
6 7 distributions at the cost of reduced NUSF-26 distributions. No NUSF-7 order
7 indicates that NUSF-26 support would or could be reduced as a result of NUSF-7
8 distributions. Thus, carriers have reasonably relied upon the fact that NUSF-7
9 distributions would not come at the cost of reduced NUSF-26 distributions in making
10 investments in their networks – both those that are supported by specified NUSF-7
11 funds and those that are supported in part by NUSF-26 funds. The Commission
12 would inappropriately undo the carriers' reliance and would undermine the beneficial
13 policy interests served by NUSF-7 distributions.
14
15 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**
16 A. Yes.
17