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

DIRECT TESTIMONY OF KEN PFISTER
ON BEHALF OF THE RURAL INDEPENDENT COMPANIES

I. INTRODUCTION - WITNESS BACKGROUND.

Q. PLEASE STATE YOUR NAME, EMPLOYER, BUSINESS ADDRESS AND TELEPHONE NUMBER.

A. My name is Ken Pfister. I am employed with Great Plains Communications. My business address is 1600 Great Plains Centre, P.O. Box 500, Blair, Nebraska 68008. My business telephone number is (402) 426-6413.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of the Nebraska Rural Independent Telephone Companies (to be referred to as the "Companies").[1] The Companies provide local exchange and exchange access services predominantly in the more rural parts of Nebraska.

Q. WHAT IS YOUR CURRENT POSITION?

A. I am Vice President-Strategic Policy at Great Plains Communications, which is a diversified telecommunications service company that provides service to approximately 30,000 access lines in this State.

Q. WHAT ARE YOUR DUTIES AND RESPONSIBILITIES AT GREAT PLAINS COMMUNICATIONS?

[1] The Companies are: Arlington Telephone Company, The Blair Telephone Company, Cambridge Telephone Company, Clarks Telecommunications Co., Consolidated Telco Inc., Consolidated Telecom, Inc., Consolidated Telephone Company, Eastern Nebraska Telephone Company, Great Plains Communications, Inc., Hartington Telecommunications Co., Inc., Hershey Cooperative Telephone Co., K & M Telephone Company, Inc., The Nebraska Central Telephone Company, Northeast Nebraska Telephone Company, Rock County Telephone Company, Stanton Telecom Inc., and Three River Telco.

A. I am responsible for directing and developing the Company's strategies on access charge and universal service funding issues, interconnection issues and regulatory support. I also support our regulatory finance operations including carrier access billing, filing of cost studies, universal service fund reporting and regulatory compliance. I also am a member of Great Plains' executive staff, which is responsible for establishing the Company's long-term strategic direction.

Q. WHAT WAS YOUR PROFESSIONAL EXPERIENCE PRIOR TO YOUR CURRENT POSITION?

A. I have worked in the telecommunications industry for 20 years. Prior to my current position, I served as President of TELEC Consulting Resources, Inc. now known as Consortia Consulting, a firm that assists local exchange telephone companies with regulatory analysis and representation, as well as evaluation of financial and operational decisions. Prior to that, I held various business relations and regulatory positions with AT&T, the most recent being Assistant Vice President of Regulatory Affairs for Ohio.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I have a Master's degree from Michigan State University and a Bachelor's degree from the University of Wisconsin-Madison, both in Journalism. I have also completed graduate programs including the Columbia University Graduate School of Business Marketing Management and the Kellogg School of Business Executive Development at Northwestern University.

Q. ARE YOU FAMILIAR WITH THIS COMMISSION'S ACTIONS AND THE FINAL ORDER ENTERED IN APPLICATION NUSF-26?

A. Yes, I was involved in all aspects of this Commission's Application NUSF-26, testifying before the Commission as well as being actively involved in preparation of comments and testimony presented in such docket. On several occasions I have read the Commission's November 3, 2004 Order establishing the Permanent NUSF and have a general familiarity with its contents.

Q. HAVE YOU BEEN INVOLVED IN APPLICATION NUSF-50 SINCE IT WAS COMMENCED BEFORE THE COMMISSION?

A. Again, yes I have. I participated in the preparation of the Companies' Comments on the Staff Proposal in this docket as set forth in Progression Order No. 1 dated July 18, 2006. Further, I have carefully reviewed the Order entered in this docket on August 29 in response to which this testimony is filed.

II. PURPOSE OF THIS TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to present the Companies' policy and legal concerns about the possible changes to the NUSF that the Commission proposes to make in NUSF-50. I

will also provide testimony about the impact that reductions in NUSF support would have to a rural company's ability to maintain its universal service obligations throughout its service area. In addition, drawing upon my extensive experience working on federal intercarrier compensation and universal service reform, I will testify on our concerns about the Commission making significant reductions in NUSF support at a time when major reforms to USF and intercarrier compensation in the interstate jurisdiction are being considered.

III. RATIONALE FOR REDUCTIONS IN PERMANENT NUSF SUPPORT

Q. THE STAFF PROPOSAL IN NUSF-50 SEEKS A $23.4 MILLION REDUCTION IN NUSF SUPPORT FOR THE 2007 FUND YEAR. IN YOUR OPINION, WHY IS THIS REDUCTION IN ANNUAL NUSF SUPPORT BEING PROPOSED?

A. Based on public positions expressed by Mr. Jeffrey Pursley, Director of the NUSF, it appears the primary reason that these reductions are being considered is because of the Commission's lowering of the NUSF surcharge last year.
At the time the Commission made the decision to lower the surcharge to 5.75% in its Order entered July 6, 2005 in Application No. NUSF-4, projections filed by Mr. Pursley indicated that at a 6.95 percent surcharge level, the fund balance was projected to be reduced to approximately $20 million by October, 2009, and was projected to reach a two-month reserve amount by July 2014. Mr. Pursley also notified the Commission that the outcome of pending FCC cases addressing intercarrier compensation and Voice over Internet Protocol issues could cause pressure on the amount of NUSF support needed by Nebraska ETCs.

The Commission stated that it made its decision to lower the surcharge based upon consumer impacts, universal service needs and other revenue sources that are available to Nebraska ETCs. In my view, it appears likely the Commission decided at that time that because the NUSF balance was not projected to decline below a two-month reserve for almost ten years, lowering the surcharge for a period of time would benefit consumers, while not adversely impacting universal service, because a sufficient balance would remain. Further, the Commission stated that it did have the ability to adjust the surcharge on an emergency basis.

More recently, at the hearing in Application NUSF-4 held on June 6, 2006, Mr. Pursley testified that the Fund balance would likely continue to rapidly decline. Mr. Pursley stated that broadband-based voice services are eroding the funding base for the NUSF and that this erosion will continue to accelerate. Mr. Pursley also indicated that the Fund balance could be as low as $12 million by January 2007, assuming payout commitments that have been made are disbursed. He said this balance would be less than a two-month reserve.

In fact, at the Commission's public meeting held on September 12, in accordance with the Commission's directive in its Order entered in Application NUSF-4 on June 27, 2006, Mr. Pursley provided verbal and written notice to the Commissioners that he projects that the Fund balance will decline to less than $15 million by January 31, 2007. Thus, it is my opinion that the Staff Proposal is an effort to match forecasted Fund receipts with Fund expenditures in a manner that will avert insolvency of the Fund at a not too distant point in time. I must add that neither the Companies nor I have access to NUSF forecasts; thus my

above testimony summarizes the information about the NUSF balance that has been publicly presented or contained in Commission orders.

IV. NO LEGAL OR POLICY RATIONALE SUPPORTS THE PROPOSAL TO REDUCE NUSF SUPPORT BY $23.4 MILLION FOR THE 2007 FUND YEAR.

Q. HAS THE NEBRASKA LEGISLATURE ADOPTED ANY CHANGES TO THE STATEMENT OF PURPOSE AND DECLARATION OF POLICY IN SECTIONS 86-317 AND 86-323 OF THE NEBRASKA TELECOMMUNICATIONS UNIVERSAL SERVICE FUND ACT ("NTUSF ACT")?

A. There have been no amendments to the NTUSF Act since the passage of LB 1105 in 2002, and that enactment merely revised the section numbers but made no substantive changes. The purpose of the NTUSF Act, as it was passed in 1997, continues to be that a state funding mechanism is maintained which supplements federal universal service support mechanisms and "ensures that all Nebraskans, without regard to their location, have comparable accessibility to telecommunications services at affordable prices." (§ 86-317)

Similarly, the policies set forth in § 86-323 remain intact and unchanged. Included among such policies is the requirement that "there should be specific, predictable, sufficient, and competitively neutral mechanisms to preserve and advance universal service." (§ 86-323(5))

Q. HAVE THERE BEEN ANY JUDICIAL INTERPRETATIONS OF THE NTUSF ACT THAT WOULD REQUIRE THE COMMISSION TO CHANGE THE NUSF PERMANENT SUPPORT MECHANISM IN ORDER TO REDUCE THE AMOUNT OF NUSF SUPPORT THAT IS DISTRIBUTED?

A. No. In fact, earlier today the Nebraska Supreme Court released its decision in the case of *Cannon, et al. v. Johanns, et al.*, 272 Neb. 346 (Sept. 29, 2006) in which the Court concluded that "we find no merit in any of appellants' claims that the NTUSFA violates the federal or Nebraska Constitution." Among the statements contained in this 25-page decision by the Court are the following:

> "The stated purpose of the NTUSFA 'is to authorize the [PSC] to establish a funding mechanism which supplements federal universal service support mechanisms and ensures that all Nebraskans . . . have comparable accessibility to telecommunications services at affordable prices.' § 86-317. In § 86-323, the Legislature stated that it is 'the policy of the state to preserve and advance universal service' based on eight principles. The principles generally provide that consumers in all areas of the state should have reasonably priced access to telecommunications services . . . *and that there should be 'specific, predictable, sufficient, and competitively neutral mechanisms to preserve and advance universal service.'* § 86-323(1) through (5). . . . (emphasis added) *Id.* at 368.
>
> We conclude that these provisions of the NTUSFA constitute reasonably adequate, sufficient, and definite standards for the guidance of the agency in the exercise of the power conferred upon it, and *to enable those affected to know and understand their rights and obligations*. (emphasis added) *Id.* at 369.

Based upon the foregoing statements, the Court acknowledged that the Legislature has provided specific guidance to the Commission that the NUSF should be "specific, predictable, and sufficient", so as to enable those affected by it to "know and understand their rights and obligations." Contrary to supporting any reduction in the NUSF support, these statements reaffirm the directives provided by the Legislature in the NTUSF Act.

Q. HAS THE COMMISSION CONDUCTED ANY DOCKETS THAT HAVE RESULTED IN ANY REVISIONS TO THE FINDINGS AND CONCLUSIONS MADE IN THE SERIES OF ORDERS IN APPLICATION NUSF-26 THAT CONFIRMED THE POLICIES AND PRINCIPLES THE COMMISSION WOULD FOLLOW IN ITS ADMINISTRATION OF THE NTUSF ACT, AND PARTICULARLY TO THE GOALS ADOPTED FOR THE PERMANENT NUSF SUPPORT MECHANISM IN PROGRESSION ORDER NO. 2?

A. No. This docket, NUSF-50, is the first action by the Commission to re-examine *any* aspect of its November 3, 2004 Order entered in NUSF-26. It is interesting to recall that in the Order Opening Docket and Seeking Comment dated December 6, 2005 which initiated NUSF-50, the Commission sought "comment on some limited adjustments to the permanent mechanism." (Para. 3) The adjustments to the permanent mechanism addressed in the December 6, 2005 Order were indeed of an administrative nature. Certainly no policy issues were addressed.

On January 18, 2006, the Commission entered Progression Order No. 1 in NUSF-50 which requested "comment on how the mechanism should be modified in light of the Commission's decision to reduce the NUSF surcharge from 6.95 percent to 5.75 percent of intrastate retail revenues on telecommunications services." It should be noted that Progression Order No. 1 did not initiate a re-examination of the purpose, policies or goals of the Fund. The focus of such Order was and is how to make modifications in NUSF support to match disbursements to receipts.

Q. BASED UPON THE FOREGOING FACTS, HAVE YOU IDENTIFIED ANY LEGAL OR POLICY JUSTIFICATION FOR REDUCTION OF NUSF SUPPORT PAYMENTS BY APPROXIMATELY $23 MILLION FOR THE 2007 FUND YEAR?

A. No, I have not. I believe that it is clear that the sole driver of the Staff Proposal is the current "out of balance" situation that appears to exist between Fund receipts and Fund disbursement that, if not corrected, would seem to indicate that the Fund ultimately would become insolvent. While I do not in any way seek to minimize the importance of this consideration, I believe that the most-critical focus for the Commission's consideration is the continuing duty of this Commission to administer the Fund in accordance with the directives of the Legislature in the NTUSF Act and the goals identified and approved by this Commission in NUSF-26. Prior to the advancement of the proposals contained in NUSF-50, I do believe the Commission's actions in implementing the permanent fund were entirely consistent with the NTUSF Act and the Commission's stated goals.

V. IN PROGRESSION ORDER NO. 1 ENTERED IN NUSF-50 ON JANUARY 18, 2006, THE COMMISSION ASKED WHETHER PROPOSED REDUCTIONS IN NUSF FUNDING WOULD BE CONSISTENT WITH THE PREDICTABILITY AND

SUFFICIENCY REQUIREMENTS OF THE NTUSF ACT, AND WHETHER PROPOSED ADJUSTMENTS TO THE LOCAL BENCHMARK AND ACCESS RATES WOULD VIOLATE THE COMMISSION'S OBLIGATION TO ENSURE THAT RATES ARE AFFORDABLE AND REASONABLY COMPARABLE ACROSS THE STATE. THE STAFF PROPOSAL, IF ADOPTED WITHOUT SIGNIFICANT MODIFICATIONS, WOULD APPEAR TO VIOLATE THESE STATUTORY REQUIREMENTS.

Q. IN YOUR OPINION, IS A REDUCTION IN THE TOTAL AMOUNT OF NUSF SUPPORT DISTRIBUTED OF ABOUT $23 MILLION TO $44.7 MILLION IN 2007 CONSISTENT WITH THE STATUTORY REQUIREMENTS THAT SUPPORT SHOULD BE "PREDICTABLE"?

A. No. I do not think that an approximately 34 percent one-year reduction in the total amount of support paid would be consistent with a requirement that support should be predictable. A reduction of total support of this magnitude would mean that, in total, Nebraska Eligible Telecommunications Carriers ("ETCs") would overall receive 34 percent less NUSF support in 2007 than in 2006, with no notice of such reductions if the Commission were to issue an order in this proceeding as expected in December 2006 to take effect in January 2007. This industry is not one in which capital expenditures are planned based on a term of weeks or months. Rather, the planning and implementation of capital expenditures occurs based on years, and for some improvements such as fiber projects, over many years as such projects evolve. I would add that making such investments in capital is not optional for ETCs such as Great Plains; it is required in order to meet our universal service obligations at both the state and federal levels.

For the Companies, and indeed for all facilities-based providers of local exchange service in this State, NUSF support is a material and indispensable element of total revenues that enables us to fulfill the universal service compact we have with the Commission, the Legislature and, most importantly, our customers. A reduction of the magnitude represented by the Proposal under consideration, particularly if such reduction is to occur on a "flash cut" basis, destroys a carrier's ability to plan and execute capital expenditure projects. For that matter, *any* unpredictability in NUSF support can cause a disruption in plans. Therefore, I am firmly of the opinion that a reduction of this magnitude cannot be considered to be consistent with the statutory requirement of "predictable" support.

Q. HOW WOULD THE LACK OF PREDICTABILITY OF NUSF SUPPORT AFFECT THE MANNER IN WHICH GREAT PLAINS COMMUNICATIONS PROVIDES SERVICE TO ITS CUSTOMERS?

A. A substantial amount of the NUSF support funding that Great Plains receives goes toward capital expenditures for replacements, upgrades and maintenance of our network. Consistent with my above comments, because network investments typically have depreciable asset lives of 14 years to 25 years, and since Great Plains has invested so extensively in our network over the years, in order to adequately budget for additional network investments over a period of years, a predictable amount of support is needed to ensure that the costs associated with network investments are recovered over the life of the investment. Without predictable support amounts, Great Plains will likely not be in a

position to commit to make additional investments that would depend upon the receipt of NUSF support, as Great Plains would not have any reasonable assurance that it would be able to recover the cost of such investments. A reduction in network investments would certainly affect the further deployment of facilities to provide advanced services such as broadband; however, it could also affect basic service quality, as the lack of predictability of NUSF support may reduce the amount of funds upon which Great Plains bases it capital budgets to the point that Great Plains may not be able to make sufficient investments to maintain current network service quality.

As I said, universal service support is not only critical to enabling Great Plains to undertake new network construction projects, it also is key to allowing us to provide network maintenance. For the Companies, which like Great Plains serve small towns and surrounding rural areas, the ability to maintain their networks is an ongoing challenge as we have to balance the needs of our customers – many of whom are located in very rural areas – with the limited resources that we receive from universal service and other cost recovery.

Q. CAN YOU GIVE EXAMPLES OF HOW THE LACK OF INVESTMENT MIGHT ADVERSELY AFFECT SERVICE QUALITY?

Yes, I will provide two such examples. First, Great Plains is in the process of upgrading its switching network throughout the state with Internet Protocol-based switches. This upgrade started in 2005 and is scheduled to be completed in 2011 under current plans. We are also upgrading our plant facilities by installing fiber in many exchanges throughout the state. These upgrades are necessary to provide the quality of service needed for advanced and basic services. If we do not have a predictable source of revenue from the NUSF, these switching and fiber upgrades might have to be eliminated or, at a minimum, scaled back and spread over more years.

For another example, consider that the local loop plant in one of Great Plains' exchanges is aging and in the process deteriorating to the point that it requires replacement. The loop is the "lifeline," if you will, to customers' residences or businesses over which all services are provided. About 40 percent of Great Plains' customers are located outside of incorporated municipalities. Many of our customer loops are many miles in length – some even as far as 60 miles from the central office. Obviously these loops are costly to maintain, and if replacement is required, that cost is very high compared to loops in town where customer locations are more dense. In fact, the permanent NUSF program structure specifically recognizes this correlation between density and loop costs in determining NUSF distribution for qualified areas.

If Great Plains' NUSF support were to be significantly reduced, the Company would be forced to further re-prioritize projects in order to focus our limited resources on projects that benefit the largest number of customers. Therefore, if some customer loops in the most-rural areas were experiencing problems, but revenues were not sufficient to allow for their replacement, it is likely that new construction would not be feasible. Obviously, as a carrier of last resort, we would do our utmost to maintain service to these customers, but there is no doubt in my mind that the service would not be at Great Plains' traditional standards of quality if we could not accommodate replacement of the facilities that were the source of service problems. The ultimate result of this, of course, is that the ability to upgrade the

network to meet the ever-increasing need for higher speed broadband service and more bandwidth would not be possible, or at a minimum, would be materially reduced. Given the Commission's commendable NUSF goal of furthering broadband penetration across the State and the availability of advanced services to all users wherever located in Nebraska, such an outcome is unacceptable.

Q. BEYOND REDUCTIONS IN NETWORK INVESTMENTS, ARE THERE OTHER NEGATIVE IMPACTS THAT THE LACK OF PREDICTABILITY IN NUSF SUPPORT WOULD HAVE ON GREAT PLAINS' PROVISION OF SERVICE TO CONSUMERS BEYOND A REDUCTION IN NETWORK INVESTMENT?

A. Yes. Depending on the severity of the reduction in NUSF support, cuts in operating expenses might also have to be made. This could impact service quality in a multitude of ways, including reductions in customer service personnel, technicians, operations and marketing – every aspect of the Company.

Q. IN YOUR OPINION, IS A REDUCTION IN THE TOTAL AMOUNT OF NUSF SUPPORT DISTRIBUTED OF APPROXIMATELY $23 MILLION TO $44.7 MILLION IN 2007 CONSISTENT WITH THE STATUTORY REQUIREMENT THAT SUPPORT SHOULD BE "SUFFICIENT "?

A. No, by any reasonable definition, a reduction of this magnitude cannot result in a Fund that can still be found to be sufficient as required by law. As Ms. Vanicek states in her testimony on behalf of the Companies, in establishing the permanent mechanism in NUSF-26 at an amount comparable to the transitional NUSF program, the Commission found the amount to be allocated to be sufficient. Black's Law Dictionary defines "sufficient" as "adequate, enough, as much as may be necessary, equal or fit for the end proposed, and that which may be necessary to accomplish an object." Consideration of this definition logically refers one's focus back to the purpose and policies of the NTUSF Act.

Q. IS AN NUSF REDUCTION OF THE MAGNITUDE PROPOSED COMPATIBLE WITH ENSURING THAT ALL NEBRASKANS, IRRESPECTIVE OF WHERE THEY LIVE, HAVE COMPARABLE ACCESSIBILITY TO TELECOMMUNICATIONS SERVICES AT AFFORDABLE PRICES?

A. I submit that the answer is clearly no. For the reasons that I stated above, capital expenditures and operating expenses required for "comparable accessibility," as required by state law, cannot be maintained in the face of a one-year cut of this magnitude. As such, to refer back to the definition of "sufficient," the end proposed and the object to be accomplished in accordance with the Legislature's directive will not be realized if the cuts under the proposal are approved. Thus, the Fund would become insufficient and non-compliant with the requirements of the NTUSF Act.

VI. THE COMMISSION SHOULD TAKE INTO CONSIDERATION THE IMPACT OF PENDING FEDERAL INTERCARRIER COMPENSATION AND UNIVERSAL SERVICE PROCEEDINGS ON POSSIBLE CHANGES IN THE ADMINISTRATION OF THE NUSF.

Q. HAVE YOU BEEN PERSONALLY INVOLVED IN PROCEEDINGS RELATED TO FEDERAL PROGRAMS THAT SUPPORT UNIVERSAL SERVICE?

A. Yes, I have been working in various capacities on intercarrier compensation and universal service reform at the federal level for several years. Most recently, I represented the Rural Alliance, an organization that is supported by several hundred rural LECs, in negotiations on the Missoula Plan, an intercarrier compensation reform proposal that was filed at the Federal Communications Commission ("FCC") by the National Association of Regulatory Utility Commissioners Task Force on Intercarrier Compensation in late July.

Q. WHAT IS THE STATUS OF THE MISSOULA PLAN?

A. The FCC has requested comments and reply comments on the Missoula Plan during the balance of this year.

Q. HOW MIGHT THE MISSOULA PLAN, IF ADOPTED, AFFECT THE NUSF?

A. The Plan provides for proposals to reduce intrastate access rates to the level of interstate rates, as well as a Restructure Mechanism designed to replace the revenues that are eliminated through reduced access charges. It also creates an "Early Adopter Fund" that would provide support for states that have previously reduced access rates through the establishment of an explicit state fund such as the NUSF. The amount of funding for this program has yet to be finalized, but the Plan states that this fund will be at least $200 million. However, I believe it is very likely that this amount would have to be significantly increased, given that it is small in comparison to the amount of state universal service funds that exist today.

If an "Early Adopter Fund" were ultimately to be implemented, there should be no question that Nebraska would qualify for support due to this Commission's aggressive efforts to replace high access rates with NUSF support. Since the NUSF was initially established to replace the amount of access reductions experienced by local exchange carriers, it would seem likely that a significant amount of the NUSF disbursements would receive support under this proposal. Therefore, I do not think it would be appropriate to make large cuts to the NUSF support when those funds that might be cut could very possibly be recovered through an "Early Adopter" federal support mechanism.

Q. IS THERE ANOTHER CURRENT FEDERAL PROCEEDING THAT COULD ALSO IMPACT THE NUSF?

A. Yes, the FCC has also issued a notice requesting comment on the merits of using reverse auctions to determine distribution of federal high-cost universal service support. The use of auctions to award universal service support to selected carriers has to potential to reduce or even eliminate federal USF that Nebraska telecommunications carriers currently receive.

Q. WHAT IS YOUR OVERALL RECOMMENDATION TO THE COMMISSION REGARDING IMPLEMENTATION OF MAJOR CHANGES TO THE NUSF IN LIGHT OF THESE FEDERAL PROCEEDINGS?

A. Given that these proceedings have the potential to significantly change federal and state cost recovery sources and very possibly could reduce total universal service support, I would urge the Commission to refrain from making changes to the permanent NUSF mechanism such as those proposed. Changes of the magnitude being considered in these FCC proceedings would require further changes in the permanent NUSF mechanism in order to maintain sufficient cost recovery and thus fulfill the statutory purposes and policies and the Commission-established NUSF goals that I discussed earlier.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.