ALJ/JSW/jac *

Mailed 334 pgs

NOV 4 1996

Decision 96-10-066 October 25, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643.	R.95-01-020 (Filed January 24, 1995)
Investigation on the Commission's Own Motion into Universal Service and to Comply with the Mandates of Assembly Bill 3643.	I.95-01-021 (Filed January 24, 1995)

(See Appendix F for List of Appearances.)

I N D E X

Subject	Page
OPINION	2
I. Summary	2
II. Procedural Background	6
III. Procedural Matters	11
A. Background	11
B. Discussion	13
IV. What Does Universal Service Mean in a Competitive Environment?	16
V. Basic Service	19
A. The Definition of Basic Service	19
1. Introduction	19
2. Positions of the Parties	21
3. Discussion	27
B. Review of The Basic Service Definition	32
1. Introduction	32
2. Positions of the Parties	32
3. Discussion	37
C. Promoting Access To And The Deployment of Advanced Technologies	39
1. Introduction	39
2. Positions of the Parties	40
3. Discussion	45
D. 95% Goal For Universal Service	50
1. Introduction	50
2. Positions of the Parties	50
3. Discussion	53
a. General	53
b. Unserved Territories	54
E. Redlining	58
1. Introduction	57
2. Positions of the Parties	59
3. Discussion	62
F. Bilingual Outreach	65
1. Introduction	65
2. Positions of the Parties	65
3. Discussion	66

I N D E X

Subject	Page
VI. Consumer Information	68
A. Introduction	68
B. Positions of the Parties	68
C. Discussion	70
VII. Benefits for Schools, Libraries, Health Care, and Community Based Organization	72
A. Introduction	72
B. Positions of the Parties	75
C. Discussion	80
VIII. Funding of High Cost Areas	92
A. Background	92
B. Should Business Customers Be Subsidized?	94
1. Introduction	94
2. Positions of the Parties	94
3. Discussion	95
C. The Small And Mid-Size LECs	96
1. Introduction	96
2. Positions of the Parties	96
3. Discussion	99
D. The Costing Standards To Be Applied	103
1. Introduction	103
2. Positions of the Parties	105
3. Discussion	107
E. The Competing Proxy Cost Models	108
1. Introduction	108
2. The Size of The Fund	109
a. Background	109
b. Discussion	110
3. The Two Proxy Models	111
a. The Cost Proxy Model	111
b. The Hatfield Proxy Model	113
c. Discussion	115
(1) Can The Model Estimate Costs for the Entire State on a CBG Basis?	115
(2) Does the Model Design Accurately Reflect Costs?	116
(3) Is the Model Open and Accessible to Changes in Inputs and Assumptions?	119

I N D E X

Subject	Page
(4) How Well Does the Model Comply With the Relevant Consensus Costing Principles?	120
(5) Can the Model Estimate the Cost of Basic Service and Subsequent Changes to this Definition	122
(6) Can The Inputs And Assumptions of The Model be Readily Verified?	122
d. Summary	124
F. Recommended Adjustments to the CPM	124
1. Introduction	124
2. How Many Lines Should be Subsidized?	125
a. Introduction	125
b. Positions of the Parties	125
c. Discussion	127
3. Drop Costs	130
a. Background	130
b. Discussion	130
4. Cable and Conduit Costs	131
a. Background	131
b. Discussion	133
5. Fiber Feeder Cut-off	135
a. Background	135
b. Discussion	137
6. Fill factors	138
a. Background	138
b. Discussion	140
7. Depreciation	140
a. Background	140
b. Discussion	142
8. Reordering of Switches	143
a. Background	143
b. Discussion	144
9. Outside Plant Factor	145
a. Background	145
b. Discussion	145
10. Switching Costs	146
a. Background	146
b. Discussion	147
11. Shared and Common Costs	148
a. Background	148
b. Discussion	152

I N D E X

Subject	Page
(1) The Loop	152
(2) Assignment of Costs	153
(3) Treatment of Shared Costs	156
(4) Treatment of Common Costs	156
(5) Imputation	157
12. Rearrangement Expenses And The Nonrecurring Burden	158
a. Background	158
b. Discussion	159
13. Directory Assistance	160
a. Background	160
b. Discussion	160
14. Repair and Maintenance Costs	161
G. Benchmark	161
1. Introduction	161
2. Positions of the Parties	162
3. Discussion	165
H. What Offsets Should There Be	168
1. Introduction	168
2. Positions of the Parties	169
3. Discussion	175
I. Funding Mechanism Issues	178
1. Introduction	178
2. What Type Of Funding Mechanism Should Be Adopted?	179
a. Positions of the Parties	179
b. Discussion	181
3. Who Should Be Obligated To Pay Into The Fund?	185
a. Introduction	185
b. Positions of the Parties	185
c. Discussion	189
4. The Surcharge For The CHCF-B	191
5. Combining the CHCF-A And CHCF-B	191
J. Carrier of Last Resort	193
1. Introduction	193
2. Positions of the Parties	194
3. Discussion	198
K. Recognition of The Explicit Subsidy	203
1. Introduction	203
2. Positions of the Parties	204
3. Discussion	207
L. Who Should Administer The Fund	209
1. Introduction	209
2. Positions of the Parties	210

3. Discussion 211
M. Review of The Fund Size 212
1. Introduction 212
2. Positions of the Parties 212
3. Discussion 213

IX. Universal Lifeline Telephone Service Program 217
A. Introduction 217
B. Position of the Parties 218
C. Discussion 225

X. Miscellaneous Issues 238

Findings of Fact 241

Conclusions of Law 261

ORDER 279

APPENDIX A
APPENDIX B
APPENDIX C
APPENDIX D
APPENDIX E
APPENDIX F

OPINION

I. Summary

This decision finalizes the universal service rules that we originally proposed in Decision (D.) 95-07-050. Many of the issues raised in those proposed rules did not require any evidentiary hearings, but instead were commented upon by a number of parties in written comments in accordance with Rule 14.1 of the Commission's Rules of Practice and Procedure. (Cal. Code Regs., Title 20, Sec. 14.1.) Other issues, such as the proxy cost model for estimating the costs of basic service, required evidentiary hearings. This decision addresses both the written comments and the evidence presented during the evidentiary hearings, as well as the comments that were filed in response to the issuance of the August 5, 1996 proposed decision.

Today's decision reaffirms the Commission's commitment to universal service by ensuring that residential basic telephone service be made available throughout California, and that the rates for such service remain affordable. Our decision adopts final rules pertaining to how universal service will be carried out in California as the local exchange telephone markets are opened to competing carriers. As we enter this competitive environment, yesterday's policies supporting universal service will no longer be sustainable.

The following are some of the key universal service rules and policies that we adopt:

- The term "basic service" for residential customers is defined to include those telephone service elements that consumers have come to expect. (See App. B, Rule 4.)

- All carriers providing local exchange residential service shall at a minimum, provide all the service elements included in the basic service definition.

- The definition of basic service may be revisited to evaluate whether service elements should be added or deleted from the definition.

- A Universal Service Working Group (USWG) will be formed to address ways in which access and deployment of advanced telecommunications technologies can be provided to all customer segments, and how education, health care, community, and government institutions can be positioned to take advantage of these technologies.

- All local exchange carriers (LECs) and competitive local carriers (CLCs) shall be responsible for pursuing the objective of achieving a 95% subscribership rate among all customer groups. They shall also be required to include in their annual reports information about their subscribership rates.

- All LECs and CLCs must provide a matrix of pricing information regarding basic service. Such a matrix will allow consumers to compare the rates charged by other carriers for the same type of service.

- The Commission should take proactive steps to educate the public about changes and issues in the telecommunications market.

- In accordance with state and federal directives, qualifying schools, libraries, municipal and county government owned and operated hospitals and health clinics, and qualifying community based organizations (CBOs) shall be entitled to discounted rates for certain services. Funding for these discounts will come from the California Teleconnect Fund surcharge of 0.41%.

- The five large and mid-size LECs shall be included in the proxy cost model calculation for determining universal service support. They, and other carriers of last resort (COLR), who serve high cost areas in these service territories, will be eligible for subsidy support through the newly created

California High Cost Fund-B (CHCF-B). The seventeen smaller LECs shall not be subject to the rules applicable to the CHCF-B fund. Instead, the seventeen smaller LECs shall continue to be eligible for universal service support under the existing California High Cost Fund. We shall refer to the existing fund as the CHCF-A.

- In order to avoid a windfall to the five large and mid-size LECs, any subsidy support received from the CHCF-B shall be reduced by the same amount through an equal percentage reduction for all services except for basic service rates. The five incumbent LECs may file applications to decide what rates should be rebalanced downwards to permanently offset the explicit subsidy support.

- The Cost Proxy Model (CPM) sponsored by Pacific Bell (Pacific) has been selected as the proxy model to estimate the cost of providing residential basic service to the five large and mid-size LECs. The CPM estimated the statewide subsidy needed for providing universal service at $1.7 billion, of which Pacific estimated that it would receive $1.3 billion in subsidy support. The CPM model, its inputs, and its results have been examined by the parties to this proceeding. As a result of these critiques, we have made adjustments to the model which total to $1.116 billion. As adjusted, we believe the adjusted CPM is consistent with the consensus costing principles (CCPs) adopted in the Open Access and Network Architecture Development (OANAD) proceeding.

- Using the adjusted CPM, a statewide average cost of $20.30 was derived. That statewide average cost serves as the cut-off point for determining which census block groups (CBGs) are high cost. CBGs whose costs exceed the statewide average cost of $20.30 shall be deemed high cost areas, and eligible for support from the CHCF-B.

- The benchmark for determining COLR support shall be the statewide average cost of

$20.30, or the carrier's flat rate plus EUCL, whichever is higher.

- The subsidy amounts which designated COLRs may expect to receive shall be offset with revenues that the LECs or CLCs receive from basic service, the end user common line charge (EUCL), the common carrier line charge (CCLC), and the interstate Universal Service Fund.

- The incumbent LEC, and any other designated COLR, shall be entitled to subsidy support for those high cost CBGs in accordance with the adopted rules.

- An all end user surcharge (AEUS), rather than a net trans account, will be used to collect the CHCF-B subsidy amount. The estimated surcharge is 2.87%.

- The CHCF-A and the CHCF-B may appear side by side as a single line item for purposes of collection on a customer's bill.

- The California Teleconnect Fund shall appear as a separate line item for purposes of collection on a customer's bill.

- The CHCF-B shall undergo a review in three years. The use of an auction mechanism in the future remains an option.

- The Universal Lifeline Telephone Service (ULTS) program is revised to allow CLCs to compete for ULTS customers, and to receive subsidy support for providing service to this customer group.

- In order to avoid situations where ULTS funds are being used to promote the name of a particular carrier, the marketing expenses associated with promoting the ULTS program shall no longer be recoverable from the ULTS fund in accordance with the schedule set forth in this decision. Instead, a ULTS Marketing Working Group will be formed to provide competitively neutral marketing for the program.

The above rules and policies are discussed in the sections which follow.

In addition to the CHCF-A, CHCF-B, and the California Teleconnect Fund, the other universal service programs include the Deaf and Disabled Telecommunications Program, and the ULTS program. As shown in Appendix E, these five universal service programs total to approximately $855 million on an annual basis.[1]

II. Procedural Background

In D.95-07-050, we described the backdrop leading up to the issuance of this rulemaking (OIR or R.95-01-020) and investigation (OII or I.95-01-021) into universal service. A brief recap of some of those events, and of events subsequent to the issuance of D.95-07-050 will be of aid to those who seek an understanding of the process for today's decision.

R.95-01-020 and I.95-01-021 were opened in January of 1995 to develop rules to further the goals of universal service in a competitive telecommunications environment. This proceeding was opened as part of this Commission's comprehensive review of how state regulatory policies need to respond to the opening of monopoly markets to competition. In addition, the enactment of Assembly Bill (AB) 3643 (Stats. 1994, Chapter 278), which became effective January 1, 1995, provided some guidance as to the type of issues the Commission should concern itself with.

AB 3643 called for the opening of a proceeding to examine the current and future definitions of universal service, and mandated that public hearings be held so as to encourage participation from broad and diverse interests from all areas of

1 The Deaf and Disabled Telecommunications Program is funded by the California Relay Service and Communications Devices Fund.

the state. AB 3643 also stated that the objectives of the proceeding were as follows:

> "(1) Define the goals of universal service given the new technologies and increasingly competitive markets, with emphasis on the role of basic service in education, health care, and in the workplace.
>
> "(2) Delineate the subsidy support needed to maintain universal service in the new competitive market.
>
> "(3) Design and recommend equitable and broad based subsidy support for universal service in freely competitive markets.
>
> "(4) Develop a process to periodically review and revise the definition of universal service to reflect new technology and markets.
>
> "(5) Address the issues of 'carrier of last resort' and 'franchise obligations.'" (Stats. 1994, Chap. 278, Sec. 2 (a).)

AB 3643 also went on to state that the recommendations developed in this proceeding shall be consistent with Public Utilities (PU) Code § 709,[2] and with the following principles:

> "(1) Essential telecommunications services should be provided at affordable prices to all Californians regardless of linguistic,

---

2 PU Code § 709 states as follows: "The Legislature hereby finds and declares that the policies for telecommunications in California are as follows: (a) To continue our universal service commitment by assuring the continued affordability and widespread availability of high-quality telecommunications service to all Californians. (b) To encourage the development and deployment of new technologies and the equitable provision of services in a way which efficiently meets consumer need and encourages the ubiquitous availability of a wide choice of state-of-the-art services. (c) To promote economic growth, job creation, and the substantial social benefits that will result from the rapid implementation of advanced information and communications technologies by adequate long-term investment in the necessary infrastructure."

cultural, ethnic, physical, geographic, or income considerations.

"(2) In order to avoid an 'information rich' and 'information poor' stratification, there must be an ongoing evaluation of which services are deemed essential and therefore a part of universal service.

"(3) Any subsidy that may be required to ensure that universal service remains a viable reality must have a clearly stated purpose and scope, include a broad based and competitively neutral funding mechanism, and be imposed in a manner that clearly identifies the source of the subsidy.

"(4) Public policy should provide incentives as needed to promote deployment of advanced telecommunications technology to all customer segments.

"(5) Consumers should be able to have access to all the information needed in order for them to make timely and informed choices about telecommunications products and services, and how to best use them.

"(6) Because of their economic and social impact, education, health care, community, and government institutions must be positioned to be early recipients of the benefits of the information age.

"(7) All parties involved in providing services utilizing evolving public networks should adhere to the same guidelines regarding mutual interconnectivity and interoperability, common carriage, reliability, privacy, and security." (Stats. 1994, Chap. 278, Sec. 2(b).)

The universal service OII/OIR solicited initial comments on how to meet the above objectives and principles. Responsive comments were filed in March 1995.

As a result of those initial comments, the Commission issued D.95-07-050. That decision described and set forth a proposed set of rules pertaining to universal service

responsibilities in a competitive environment. A set of the proposed rules are attached as Appendix A. Parties were allowed an opportunity to comment on the proposed universal service rules by filing opening and reply comments. Parties were also requested to identify in their opening comments whether any evidentiary hearings were needed to resolve any of the universal service issues.

In addition to the written comments, the Commission held a September 29, 1995 full panel hearing into the proposed universal service rules. A series of 13 public participation hearings (PPHs) were also held in September and October of 1995. The PPHs, which were co-hosted by the Commission and the State and Consumer Services Agency, were held in various parts of the state in both urban and rural areas. The purpose of the PPHs were to inform the public about universal service in a changing competitive environment, and to solicit their ideas and input. Numerous letters were also received by the Commission in connection with this proceeding.

In D.95-12-021, the Commission reviewed the list of issues for which parties requested evidentiary hearings. Of the three categories of issues that parties raised, the Commission decided that only the issues pertaining to the formulation of a proxy cost study for determining the cost of basic service throughout the state should be handled in the universal service proceeding. D.95-12-021 outlined the framework for structuring the design and development of a proxy cost model. Workshops were also set to facilitate the development of the proxy cost model, and to narrow the scope of the issues.

At the scheduled workshops, none of the parties could agree to the format of a single proxy cost model to develop the cost of providing basic telephone service within California. Nor was any agreement reached regarding the model structure, inputs, assumptions, and cost components at these workshops. Following the lack of agreement at the workshops, the assigned Administrative Law

Judge (ALJ) issued a ruling on February 21, 1996, setting forth the type of information that was to be included in the prepared testimony of the parties for the evidentiary hearings.

In ALJ rulings dated March 12, 1996, and April 3, 1996, delays in the schedule were granted to allow the parties additional time to prepare for hearings. Thirteen days of evidentiary hearings were then held in late April and May of 1996. The matter was submitted following the filing of opening and closing briefs, and the holding of oral argument before the assigned ALJ, and Commissioner Jessie J. Knight, Jr., the assigned Commissioner, on June 10, 1996.

The proposed decision of the assigned ALJ was mailed to the parties on August 5, 1996. Opening and reply comments to the proposed decision were filed on August 26, 1996, and September 3, 1996, respectively. An en banc oral argument was held on August 27, 1996.

During the time that parties were preparing for the universal service workshops, the Telecommunications Act of 1996 (Telco Act) underwent final revisions.[3] On February 8, 1996, President Clinton signed the Telco Act into law. The enactment of the Telco Act is intended to promote competition and reduce the regulation of telecommunications services. Among the provisions is the creation of a Federal-State Joint Board (Joint Board) to develop recommended changes to the procedures and regulations regarding universal service. The Joint Board's policies to preserve and advance universal service are to be based on the following principles: (1) quality services at just, reasonable, and affordable rates; (2) access to advanced telecommunications and information services to all regions; (3) access to

3 Telecommunications Act of 1996, Public Law No. 104-104, 110 Stat. 56.

telecommunications and information services to low income consumers, and those in rural, insular, and high cost areas; (4) equitable and nondiscriminatory contribution by all providers so as to preserve and advance universal service; (5) provide for federal and state mechanisms to preserve and advance universal service; (6) provide schools, health care providers, and libraries with access to advanced telecommunications services; and such other principles that are necessary and appropriate.

With respect to the state's authority to regulate universal service, the Telco Act states:

> "(b) State Regulatory Authority.--Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with Section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers." (Telco Act, Sec. 253(b).)

III. Procedural Matters

A. Background

GTE California Incorporated (GTEC) was the only party who submitted transcript corrections. Since no one has objected to GTEC's proposed corrections, those corrections will be adopted and made in the Commission's copy of the reporter's transcript.

Toward Utility Rate Normalization (TURN) requested during the hearings that the model sponsors provide handbooks describing how the two different models operate. The handbook for Pacific's CPM was marked and received into evidence without objection as Exhibit 116. The handbook for the model sponsored jointly by AT&T Communications of California, Inc. (AT&T) and MCI Telecommunications Corporation (MCI) was marked for identification as Exhibit 117, and was not distributed to the parties until the last day of hearing. Since none of the other parties had an

opportunity to review Exhibit 117, the assigned ALJ allowed parties the opportunity to object to the admission of Exhibit 117 in their opening briefs, and to respond to any such objections in their closing briefs.

GTEC objects to the admission of Exhibit 117 on the grounds that it did not have an opportunity to cross examine any witness about the exhibit, and that it is not relevant. GTEC also argues that Exhibit 117 refers to Version 2.2 of the Hatfield proxy model (HPM), and that no one other than the sponsors have been able to test that version. Citizens joins in the objection to the admission of Exhibit 117.

AT&T/MCI argue that GTEC's objection should be overruled. They argue that Exhibit 117 is relevant because the exhibit states that the HPM is being used to develop estimates of the economic costs of providing local telephone services, and that the HPM may be used to determine the subsidy requirements. Also, the exhibit identifies Version 2.2 of the HPM as simply an extension and refinement of the HPM model that the parties have been concerned with in this proceeding. AT&T/MCI also point out that the assigned ALJ requested that the document be produced.

In the evening of the last day of the evidentiary hearing, Exhibit 128 was marked for identification. Exhibit 128 is an exhibit sponsored by Pacific witness Richard Scholl in response to a question asked earlier that day by TURN's counsel. Scholl had testified earlier that he could not reconcile how the $3.39 figure in Exhibit 85 at page 11 was calculated. When Scholl resumed the stand that evening, Scholl explained how the $3.39 figure was derived, as shown in Exhibit 128. (26 R.T. 3543-3550, 3594-3596.) Parties were given the opportunity to object to the admission of Exhibit 128 in their opening briefs. Since no one filed any objection to the admission of Exhibit 128, that exhibit will be admitted into evidence.

After the opening briefs were filed, AT&T/MCI filed a June 6, 1996 motion to strike from Pacific's opening brief the references to an article by Dr. Alfred Kahn which was attached to Pacific's opening comments in this proceeding. AT&T/MCI contend that the Kahn article was never offered in evidence during the hearings, and that Pacific's attempt to introduce Kahn's article without the opportunity for cross examination is improper.

AT&T/MCI also seek to strike the references in Pacific's opening brief at pages 23, 42, and 44 about alleged conversations that took place between employees of Pacific, and employees of US West. AT&T/MCI argue that Pacific has offered no citation to the record that such conversations ever took place.

Pacific argues that Kahn's article is part of the record in this proceeding because his article was part of the comments which Pacific had filed in this proceeding. Also, the principles enunciated by Kahn were adopted by Dr. Richard Emmerson in his testimony, who was subject to cross examination. Furthermore, the citation to Kahn's article was simply to point out that Emmerson's position was carefully thought out.

In accordance with Article 19 of the Commission's Rules of Practice and Procedure, opening and reply comments to the proposed decision were filed by various interested parties. The California Department of Consumer Affairs (DCA) timely submitted its reply comments on September 3, 1996. However, DCA was informed by the Docket Office that its reply comments would not be filed because the type face used was too small. DCA then filed a motion dated September 4, 1996 to accept its reply comments in excess of the five-page limit. As reformatted in larger type, DCA's reply comments exceed the page limit by one page.

B. <u>Discussion</u>

The objection to the receipt of Exhibit 117 is overruled, and it will be received into evidence. The purpose of Exhibit 117, as well as Exhibit 116, are to provide interested persons with

background information as to how the two models are formulated and how they operate.

AT&T/MCI's motion to strike the references in Pacific's opening brief to Alfred Kahn's article is denied. Dr. Kahn's article was part of Pacific's September 1, 1995 comments that had been filed as part of this rulemaking proceeding. (See Rule 14.1.) In addition, the rebuttal testimony of Emmerson, Exhibit 75, contained two footnotes referring to the Kahn article in Pacific's September 1, 1995 comments.

With respect to AT&T/MCI's motion to strike the references in Pacific's opening brief to alleged conversations between US West and Pacific at pages 23, 42, and 44, we will grant the motion. As AT&T/MCI point out, there is no citation to the record that these alleged conversations ever took place. The sentences at pages 23, 42, and 44 of Pacific's opening brief which reference those alleged conversations shall be stricken.

As pointed out in DCA's motion, Rule 2 states that documents tendered for filing shall be in type "no smaller than 10 points." Rule 2 is mistaken in this regard. The intent behind Rule 2 was to have all pleadings adhere to a uniform size and format to avoid a situation where a party could circumvent page limit requirements by using a smaller size typeface. Rule 2 was intended to use a typeface in a size that is readily readable, i.e., in 12 point type, or 10 pica. Since Rule 2 is in error, DCA's motion to accept its reply comments in excess of the five-page limit shall be granted, and its reply comments shall be filed as of September 3, 1996.[4]

The comments to the August 5, 1996 proposed decision have been reviewed and considered. To the extent the comments reargued

4 The Docket Office shall continue to apply the 10 pica typeface or 12 point standard for all documents tendered for filing.

the earlier positions of the parties, or if the comments referred to new factual information, those comments have not been accorded any weight. As a result of the comments, both substantive and nonsubstantive revisions to the proposed decision were made by the assigned ALJ.

Three of the more significant changes in the revised proposed decision are: (1) using economic lives instead of Commission approved depreciation lives for the CPM; (2) fund a portion of the "gap" that exists between the cost benchmark of $20.30 and Pacific's flat rate plus other revenues; and (3) instead of funding the discounts for qualifying entities through the CHCF-B, a separate California Teleconnect Fund surcharge is adopted.

The revised proposed decision was filed and served on October 9, 1996. In accordance with the Assigned Commissioner ruling dated October 9, 1996, parties were given the opportunity to comment on the revised proposed decision. Opening and reply comments were to be filed on or before October 18, 1996, and October 22, 1996, respectively.

Both ICG Telecom Group, Inc. (ICG) and TURN filed separate motions seeking leave to late file their opening comments to the revised proposed decision. ICG requests that it be allowed to late file its opening comments because the delivery service that was hired to deliver the comments to the Docket Office arrived two minutes after the Docket Office had closed. TURN's motion recites that it was unable to file its opening comments on October 18, 1996 due to unforeseeable computer and printer problems. Both motions state that no parties would be harmed by the late filings since the parties to the proceeding were served with the opening comments on October 18, 1996.

Due to circumstances beyond the control of ICG and TURN, and because the parties were served with the opening comments on the due date, we will grant the motions of ICG and TURN, and permit

them to late file their opening comments to the revised proposed decision.

The comments to the revised proposed decision have been reviewed and considered. Appropriate changes have been made to this decision.

IV. What Does Universal Service Mean in a Competitive Environment?

As we noted in D.95-07-050 at page 7, and as the Legislature noted in subdivision (a) of Section 1 of AB 3643, universal service has over the years developed a twofold meaning with respect to telecommunications services. The first is that a certain minimum level of telecommunications services must be made available to virtually everywhere in the state. The second meaning of universal service is that the rate for such services remain affordable. By making affordable telephone service ubiquitous in California, all Californians can share in the social and business benefits of the telephone network.

As the marketplace for local telephone exchange service moves from a monopoly provider to multiple providers, the universal service program needs to be readjusted to meet the challenges of increasing competition. Two of the universal service programs that require attention are the Universal Lifeline Telephone Service (ULTS or Lifeline) program, and the subsidy mechanisms which keep rates affordable in high cost areas.

There are several adjustments that need to be made. The first adjustment has to do with the way in which the incumbent LEC is compensated for providing service to customers who qualify for a subsidy under the ULTS program. Prior to the opening of the local exchange to competition, the incumbent LEC was the only carrier who received the ULTS subsidy because it was the only carrier providing service to ULTS customers. As CLCs start to enter the markets of the incumbent LECs to serve residential customers, the ULTS subsidy needs to be made available to them as well.

The second adjustment that is needed concerns the mechanisms which have allowed the incumbent LECs to offer telephone service to all of their customers in high cost areas at affordable rates. Prior to the opening of the local exchange and toll markets to competition, the incumbent LECs were able to offset the increased cost of doing business in high cost areas by several mechanisms. They were able to have averaged rates throughout their service territory, which enabled the LECs to set a rate which reflected an average of the higher cost exchanges with the more profitable exchanges. The LECs were also able to price certain services above costs so as to subsidize basic local exchange service, which was generally priced below cost. Financial support for high cost areas is also available to the small and mid-size LECs through the California High Cost Fund (CHCF), and the interstate Universal Service Fund (USF).

With the introduction of competition, multiple carriers will be competing for the same customers. The implicit subsidies of averaged rates, and services priced above cost to support services priced below cost, will no longer be sustainable in a competitive market. Therefore, revisions to the mechanisms for the funding of high cost areas are needed so that the CLCs, and the incumbent LECs, can have access to universal service funds on a competitively neutral basis. To that end, as discussed later in this decision, we have created a new explicit subsidy support mechanism for high cost areas of the state. This fund shall be known as the CHCF-B. The purpose of this fund is to replace the implicit subsidies that are used to support universal service, with an explicit funding mechanism.

The proposed universal service rules also distinguishes residential customers from business customers. (D.95-07-050, pp. 34, 48.) The CHCF, which provides funding for the overall company costs of the small and mid-size LECs, does not distinguish between these two classes of customers. As we noted in D.95-12-021 at page

10, some of the commenting parties have suggested that subsidies in high cost areas include business customers as well. The issue of whether business customers in high cost areas should be subsidized is addressed later in this decision.

With respect to residential customers, and the introduction of competition into the local exchange, we need to ensure the continued availability of residential telephone service throughout the state. Residential customers have come to expect a certain minimum level of basic local exchange telephone service (basic service). Although there have been frequent references to the term "basic service" or "basic exchange service" in the past, it was not until the issuance of D.95-07-050 that all of the service elements which make up the definition of basic service appeared in one place.[5] Today's decision makes clear what service elements make up the basic service definition for residential customers. The cost of basic service also forms the basis for generating the estimate of the cost to serve and support high cost areas of the state.

Another issue that is raised by the concept of basic service, is what constitutes the minimum level of basic service. As new telecommunications technologies are developed, must the definition of basic service account for these new developments?

In the sections which follow, we address the basic service definition, the provisioning of basic service to high cost areas of the state, the ULTS program, and other related universal service issues raised in AB 3643 and the Telco Act.

5 In D.95-07-050 at page 15, we discussed that the "definition of universal service", as used in subdivision (a)(4) of Section 2 of AB 3643, means the same as our reference to basic service.

V. Basic Service

A. The Definition Of Basic Service

1. Introduction

In order to effectuate a policy of universal service throughout the state, the Commission first needs to develop a list of the service elements which make up residential basic service. If the basic service definition is too narrowly drawn, some service elements that may be essential for participation in society may only be enjoyed by those who can afford it. Or, certain urban areas of the state, may enjoy some essential service elements that customers in more rural areas may not have. In balancing what service elements should be included in the definition of basic service, the Commission must also be cognizant of the extra cost. If too broad of a definition is adopted, consumers may end up paying for service elements that they do not need or want.

In D.95-07-050, proposed rule 4 included the following elements in the basic service definition.

- Access to single party local exchange service;
- Access to interexchange carriers;
- Ability to place and receive calls;
- Touch tone dialing;
- Free access to emergency services, 911/E911;
- Lifeline rate for eligible customers;
- Customer choice of flat or measured rate service;
- Access to directory assistance;
- Access to a directory listing;
- Access to operator services;

- Voice grade connection to public switched telephone network;
- Access to information services and 800 services;
- One-time free blocking for information services and one-time billing adjustment for charges incurred inadvertently, mistakenly, or that were unauthorized;
- Access to telephone relay service as provided for in PU Code § 2881;
- Access to public policy pay telephones;
- Free access to customer service for information about ULTS, service activation, service termination, service repair, and bill inquiries.

Under our proposed rule, all 16 of the service elements which make up the definition of basic service would have to be

provided by all carriers in the state who provide residential service. (Proposed rule 4.A.)[6]

2. **Positions of the Parties**

Following the issuance of the proposed rules contained in D.95-07-050, interested parties were allowed an opportunity to comment. Generally speaking, the commenting parties were largely supportive of the 16 service elements proposed in the rule.

AT&T Wireless Services, Inc. (AT&T Wireless), formerly known as McCaw Cellular Communications, Inc.[7] commented that certain aspects of the proposed rules could unduly limit customer choice by creating mechanisms that disadvantage certain carriers and types of communications technologies. With regard to the definition of basic service, AT&T Wireless states that the service element of "customer choice of flat or measured service" results in a competitive disadvantage to carriers that may seek to provide forms of basic service using pricing mechanisms that are different than the traditional flat rate mechanism. AT&T Wireless believes that the unlimited flat rate calling option should only be mandatory where there is only one COLR in a geographic service area (GSA).

---

6 In proposed rule 4 of Appendix A of D.95-07-050, the service element for "access to directory assistance" mistakenly appeared twice.

7 AT&T Wireless filed its comments on behalf of its following affiliates, all of whom do business as AT&T Wireless Services: Alpine CA-3, L.P., Chico MSA Cellular, Inc., Fresno Cellular Telephone Company, Oxnard Cellular Telephone Company, McCaw Communications of Stockton, Inc., Redding Cellular Partnership, Sacramento Cellular Telephone Company, and Santa Barbara Cellular Systems Ltd.

The California/Nevada Community Action Association (Cal/Neva) favors expansion of the one-time free blocking and one-time billing adjustments for information services, to include unlimited free blocking and unlimited billing adjustments for unauthorized charges.

The DCA suggests that an additional service element be added to the definition of basic service. DCA proposes to add the following element, "access to a local telephone directory at no additional charge."

DCA also suggests that as more area code splits and area code overlays take place, that there will be an increase in the number of calls to directory assistance. DCA proposes that there be unlimited access to directory assistance at no additional charge, or that there be unlimited access to directory assistance at no additional charge for customers to adjoining areas that once were in the customer's own area code, or that there be a requirement that free telephone directories to all customers in areas where the split or overlay occurred be provided for both area codes.

The California Telecommunications Coalition (Coalition)[8] proposes the following modifications to some of the service elements which make up the proposed definition of basic service:

- free touch tone dialing;
- free access to directory assistance for the first five calls per month;
- a free directory listing for one name in a subscriber's household;

8 At the time this proceeding began, the Coalition was made up of the following: AT&T; California Association of Long Distance Telephone Companies; California Cable Television Association (CCTA); ICG Telecom Group, Inc., which was formally known as ICG Access Services, Inc. (ICG); MCI; MFS Intelenet, Inc.; Sprint Communications Co., L.P.; Teleport Communications Group (TCG); Time Warner AxS of California, L.P.; and TURN.

- a free white pages telephone directory and a free yellow pages telephone directory.

The Coalition is opposed to Pacific's recommendation that the service element which requires LECs and CLCs to offer flat rate service, be eliminated. The Coalition points out that residential customers have had the choice of flat rate service and measured rate service, and that flat rate service is the preferred option.

Citizens Utilities Company (Citizens)[9] commented that the policy statement in proposed rule 3.A.2. should be deleted. Citizens believes that the definition of basic service should be strictly limited to include only those services provided to residential customers which are so essential to basic network usage, that no customer should be denied access on the grounds of affordability. Citizens fears that this policy statement contains the implication that as technology advances, that there will be an automatic expansion of the definition of basic service. Citizens states that in order to foster a competitive market, it is important to limit and minimize the amount of subsidy required.

The Division of Ratepayer Advocates (DRA)[10] suggested that several minor changes and clarifications be made to the basic

9 Citizens' comments represent the consolidated position of Citizens' five separate telecommunications entities: Citizens Telecommunications Company of California Inc. (CTCC), an LEC; Citizens Telecommunications Company, d.b.a. Citizens Long Distance Company, an interexchange carrier (IEC); Electric Lightwave, Inc., a CLC; Citizens Telecommunications Company of Tuolumne, a small LEC, which purchased the operations and assets of Tuolumne Telephone Company (See D.95-07-037); and Citizens Telecommunications Company of the Golden State, a small LEC, which purchased the operations and assets of CP National. (See D.95-08-026).

10 Under the Commission's Vision 2000 reorganization plan, many of the functions of the DRA have been taken over by the Office of Ratepayer Advocates (ORA).

service definition. In DRA's reply comments, DRA stated that it also supports the recommended changes of the Coalition and UCAN to the basic service definition.

GTEC commented that it did not agree with the Coalition's suggestion to add the word "free" to elements 4, 6, 10, and 18 of proposed rule 4.B. GTEC stated that all those service elements are part of basic service, but they are not provided for free. GTEC contends that the cost of those service elements should be reflected in the price paid for the basic service package.

Intel Corporation (Intel) believes that services such as Integrated Services Digital Network (ISDN) should not be included in the basic service definition at this time. Intel points out that ISDN is becoming increasingly available, but at a slow rate and at high prices.

Pacific commented that it agreed with the definition of residential basic service, but recommends that the definition should not mandate the offering of both a flat rate and measured service. Pacific proposes that usage revenues and costs be excluded from the calculation of the fund because creative calling plans are likely to be introduced which will have the effect of eliminating distinctions between local and toll calls.

Public Advocates, Inc.'s (Public Advocates)[11] comments

11 Public Advocates represents the interests of the following groups: Southern Christian Leadership Conference, National Council of La Raza, Korean Youth and Community Center, Filipinos for Affirmative Action, Filipino Civil Rights Advocates, Association of Mexican-American Educators, California Association for Asian-Pacific Bilingual Education, California Association for Bilingual Education, California Rural Indian Health Board, Chicano Federation of San Diego County, Council for the Spanish Speaking, El Proyecto del Barrio, Escuela de La Raza Unida, Foundation Center for Phenomenological Research, Hermandad Mexicana Nacional, Korean Community Center of the East Bay, Lawyers' Committee for Civil

(Footnote continues on next page)

urge the Commission to include in the definition of basic service some access to advanced technology. Public Advocates' suggestions include the provisioning of lines with higher speed and more capacity so that transfer of voice, text, and images through the use of computers and telecommunication lines can be more easily accomplished. Another suggestion advanced by Public Advocates is to have CBOs act as the conduit by which the information superhighway is introduced to low income and immigrant communities. Under this proposal, qualified CBOs would receive a discounted rate of 50% for certain advanced telecommunications services. This issue is discussed later in this decision.

The Small LECs commented that they generally concur with the Commission's definition of basic service as set forth in the proposed rule, except for the requirement that companies offer measured rate local service.[12] The Small LECs state that many of them offer only flat rate service, and that the Commission should not require them to add a measured service offering as well. They contend that the addition of measured service will be more costly to provide than flat rate service because of the additional cost of measuring and billing the measured local usage.

The Smaller Independent LECs also generally agree with the proposed definition of basic service, but disagree that public

---

(Footnote continued from previous page)
Rights of the San Francisco Bay Area, Motivating Adolescents to Succeed, Mountain View Community Health Center, Multicultural Area Health Education Center, Spanish Speaking Citizen's Foundation, and Spanish Speaking Unity Council.

12 When this proceeding first began, the Small LECs were made up of the following entities: CP National, Evans Telephone Company, GTE West Coast Incorporated, Kerman Telephone Company, Pinnacles Telephone Company, the Siskiyou Telephone Company, Tuolumne Telephone Company, and The Volcano Telephone Company. As noted in footnote 9, the operations and assets of CP National, and Tuolumne Telephone Company were subsequently sold to two subsidiaries of Citizens. Our subsequent references to the Small LECs do not include these two subsidiaries of Citizens.

policy pay telephones should be included in the definition.[13] They contend that the definition of basic service should encompass the service components that should be provided in connection with each residential and business access line. They believe that the availability of public pay telephones is not relevant to the scope of basic service, and that public pay telephones should be addressed in the local exchange competition proceeding instead.

In footnote 8 to the Coalition's September 1, 1995 comments, TURN indicated its concern that the customers' local calling area should be at least as large as the current local calling area.

Utility Consumers' Action Network (UCAN) suggests certain clarifications to the proposed rule regarding the definition of basic service. UCAN suggests the following underlined portions be added to the rule:

- free and <u>unlimited access</u> to 911/E911;
- <u>free</u> touch tone dialing;
- Lifeline rate for <u>both monthly service as well as installation for</u> eligible customers;
- <u>free</u> access to directory assistance <u>for first five calls per month</u>;
- <u>free</u> access to 800 services <u>and 800 like services.</u>
- <u>free white pages telephone directory and free yellow pages telephone directory</u>;
- free access to customer service <u>in both English and non-English formats.</u>

13 The Smaller Independent LECs refer to the following entities: Calaveras Telephone Company, California-Oregon Telephone Co., Ducor Telephone Company, Foresthill Telephone Co., Happy Valley Telephone Company, Hornitos Telephone Company, The Ponderosa Telephone Co., Sierra Telephone Company, Inc., and Winterhaven Telephone Co.

3. **Discussion**

We believe that it is important to adopt a uniform definition of basic service so that all residential telephone customers, no matter where they live in California, or what their level of income is, can expect a certain minimum level of service. This is especially important in a mobile society where people may move across town, or from one part of the state to another. For the vast majority of telephone customers, they have come to expect and rely on the service elements that we listed in D.95-07-050.

We will adopt some of the suggested revisions to the service elements which make up basic service as suggested by the Coalition, DRA, and UCAN.[14] The suggested revisions are already incorporated as part of those particular service elements, and by adopting the suggested revisions, we are only clarifying what consumers, and our rules, regulations, and decisions, have come to expect.

Some of the revisions suggested by the Coalition and UCAN include the reference to the word "free" for certain services. GTEC points that each service element of basic service has an associated cost, and that the service elements which make up basic service are not free, since customers pay for basic service. Our use of the term in the universal service rules is intended to recognize that as part of the bundled basic service package offering, that "free" means there are no additional charges incurred by the customer when that service element is used by a customer.

14 The adopted rules are attached herein as Appendix B. Any differences between the adopted rules and the proposed rules, which are attached hereto as Appendix A for ease of reference, are highlighted in bold.

One of the suggestions of the Coalition, DCA, and UCAN, is to have a free white pages directory and free yellow pages directory. Telephone customers have become accustomed to receiving a free white pages directory and yellow pages directory every year. Free directories minimize the number of calls made to directory assistance, and promotes the wide distribution of yellow pages advertising. We shall add the free white pages directory to the definition of basic service.

As GTEC pointed out in its comments to the proposed decision, yellow pages directory advertising is not subject to the Commission's jurisdiction, except as provided for in subdivision (b) of Public Utilities Code § 728.2. Thus, we will not require carriers to provide free yellow pages directories as part of basic service. Although we cannot require the distribution of free yellow pages, as noted earlier, the continued free distribution of yellow pages is clearly in the best interests of the carriers, their advertisers, and the public.

In the September 5, 1996 proposed decision, and in the revised proposed decision, the assigned ALJ recommended that there be an allowance of five local directory assistance calls at no additional charge. We agree with the comments that there is a cost associated with answering these calls, and that this is an issue best left to the marketplace to decide. We will, however, require the incumbent LECs to continue to provide the same number of free

directory assistance calls that are provided for in their tariffs until otherwise ordered by the Commission.

As for UCAN's suggestion that there should be free access to customer service in both English and non-English formats, our discussion of bilingual services covers that issue.

We will adopt the suggestion by the Smaller Independent LECs that the proposed service element regarding access to public policy pay telephones, should be deleted. The focus of the basic service definition is to define the service elements that are to be provided to all residential households. Public policy pay telephones are not provided to households. Therefore, we will

delete access to public policy pay telephones from our definition of basic service.[15]

We do not adopt the suggestions by Pacific and AT&T Wireless that flat rate service be eliminated. At the PPHs, many consumers expressed satisfaction with having a choice of flat or measured rate service. Depending on their circumstances, some preferred measured rate service, while others preferred flat rate service. The flat and measured rate options preserve customer choice, and provide consumers with a method by which to comparison shop among carriers. We believe that if wireless providers desire to compete in the local exchange market, they should be required to offer basic service in the same type of pricing formats that are offered today by wireline carriers.

For the smaller LECs[16] in California, of which there are 17, we shall exempt them from the service element that they be required to offer customers the choice of flat or measured rate service, unless the smaller LEC currently offers that option. If, however, a new carrier decides to offer local exchange service in the service areas of these small companies, the new carrier will be required to provide all of the service elements listed in Rule 4 of Appendix B. Once competition arrives in these areas, the incumbent LECs that do not offer measured rate service will be forced by

15 Public policy pay telephones play a role in the universal service context because those types of phones are placed where the public safety or convenience requires it. (25 CPUC2d 281, 284, fn. 1.) Those type of telephones raise issues about the availability of such phones, where they should be placed, and who should have to place them there.

16 The term "smaller LECs" refers to all of the LECs included in the reference to Small LECs, the Smaller Independent LECs, Citizens Telecommunications Company of the Golden State, and Citizens Telecommunications Company of Tuolumne.

market considerations to decide whether such an option should be offered to their customers.

As for DCA's recommendations regarding unlimited directory assistance for those customers who may be subject to area code splits and overlays, we decline to adopt that suggestion. The evidence presented during the hearings clearly shows that there are costs associated with the LECs having to provide directory assistance. The number of directory assistance calls should be curtailed with our adoption of the requirement that customers be provided with a local telephone directory, and the notification process that is put into place before an area code split or overlay is adopted.

We also decline to adopt Cal/Neva's suggestion to have unlimited free blocking and unlimited billing adjustments for unauthorized information services calls. Such a change would invite an avalanche of billing adjustment complaints over whether calls were authorized or not. The end user should be responsible for deciding whether information services calls from their household should be blocked after this problem first occurs.

Citizens' recommendation to delete the policy statement in proposed rule 3.A.2. will not be adopted. Citizens' fear that the policy statement will result in the automatic expansion of the definition of basic service is unfounded. In order for the basic service definition to be expanded, the Commission will review the service in light of the criteria contained in Rule 4.C.3.

TURN raised the concern that with new entrants offering service, a customers' local calling area should be at least as large as the current local calling area. The Coalition, in footnote 13 of its reply comments, stated that CLCs who furnish residential service should be free to offer a flat rate service within a local calling area that differs from the local calling areas for the incumbent LECs. We believe that both of those

concerns are more properly addressed in the local competition proceeding rather than here.

Some of the comments made at the PPHs, and in letters to the Commission, suggested that Internet access, certain kinds of custom calling features, and advanced broadband services, such as ISDN, should be incorporated into the basic service definition. We first note that the basic service definition adopted today enables anyone who has the computer hardware and software to connect to an Internet provider. All that is needed from a telecommunications standpoint is a voice grade telephone line and touchtone dialing, both of which are included in the basic service definition. Although many have talked about access (or lack thereof) to the Internet and the information superhighway, we must point out that this Commission only has jurisdiction over the telephone companies whose wires connect the computer to the information provider.[17] To broaden the definition of universal service and basic service to include access to a computer, modem, software, and the information provider, is clearly outside this Commission's jurisdiction.

Broadening the definition of basic service to include broadband services, will also impose more costs on the incumbent LEC and the new carriers that want to enter the local exchange market. As some of the speakers mentioned at the PPHs, some customers may not want those services at all. In addition, the funding base would need to be increased as a result. We agree with

17 For example, in Public Advocates' survey of community based organizations, a survey question posed the need and demand for Internet service. 37.21% of the respondents had the service. 93.94% of the respondents who did not have the service, responded that they would use the service if it was affordable. The unaffordable portion may be the computer hardware, and the information provider's monthly fee, rather than the monthly cost of the telephone line. (See Public Advocates' Reply Comments, December 1, 1995, Survey attachment.)

Intel's comment that to include greater bandwidth services at this time would create a new entitlement, which presently does not exist, and increase the need for additional funding. Before mandating the inclusion of a broadband pipeline into every residential telephone customer's house, as well as other calling features, we need to keep in mind that a number of households still exist within California that are without the means to afford any telephone service at all. We therefore decline at this time to include any other service elements in the definition of basic service. The service elements which we have included in the definition of basic service are contained in Rule 4.B.

To ensure that all residential telephone customers are provided with the minimum level of service that we adopt today, Rule 4.A. in Appendix B provides that all carriers that provide local exchange residential service shall provide all the service elements of basic service. Such a rule does not prevent carriers from offering more service elements than what the basic service definition requires.

B. Review Of The Basic Service Definition

1. Introduction

AB 3643 states that one of the objectives of the universal service proceeding is to develop a periodic review process to revise the definition of universal service to reflect new technologies and markets. AB 3643 also provides that in order to avoid classes of information rich and information poor customers, there must be an ongoing evaluation of which services are deemed essential, and therefore a part of universal service. Consistent with those directives, the Commission in D.95-07-050 developed proposed rules for the review of the basic service definition.

2. Positions of the Parties

Citizens suggests that the proponent who desires to include an additional service element into the definition of basic

service must file an application, and meet the burden of demonstrating that the service is so fundamental to the use of the network, that as a matter of public policy, no end user should be denied access to that service .

In addition, Citizens does not agree with proposed rule 4.C.2.b., which states that one of the criteria to consider in evaluating whether a service should be added or deleted, is whether a substantial majority, 65%, of residential customers subscribe to the service. Citizens contends that subscribership only reflects the degree to which the service has been successfully marketed, and does not accurately reflect if the service is essential for access to the network.

The Coalition suggests that the three year review period should remain flexible in case an earlier review of the definition of basic service is needed. With respect to the criteria for reviewing the basic service definition, the Coalition recommends that each of the criteria should be considered, and each given the weight that seems appropriate. The Coalition states that the Commission should avoid locking itself into a situation where each criterion must be met.

DCA recommends that the Commission reconsider whether the criteria in proposed rule 4.C.2.d. should be included. DCA indicates that it is unclear to the exact meaning and intent of this criterion.

DRA recommends two clarifying changes to the rules regarding the review of the basic service definition. The first has to do with who can file the petition to review, and the second is to reconcile the petition to review with Rule 47 of the Commission's Rules of Practice and Procedure.

In DRA's reply comments, DRA expressed support for UCAN's recommendation that interested parties should have a right to petition to modify the basic service definition at any time.

As for the four criteria to consider in whether a service element should be added or deleted, DRA believes that the two most important criteria are: that the service is essential for participation in society; and that a substantial majority, 65%, of residential customers subscribe to the service. DRA suggests that the other two criteria should be deleted, or at a minimum, that the phrase "subscription rates" in proposed rule 4.C.2.d. be replaced with the phrase: "the number of subscribers."

DRA also commented that it opposes the recommendation of Roseville and the Smaller Independent LECs to eliminate proposed rule 4.C.3. DRA believes that this proposed rule ensures that the Commission has the necessary information to determine whether the criteria for including a new service element into the basic service definition has been met.

GTEC's comments agreed with the proposed rule for reviewing the basic service definition. GTEC believes that the proposed rule is more preferable than a pure trigger mechanism because of the planning, costing and pricing decisions associated with a change in the definition of basic service.

GTEC commented that the 65% subscription criterion should only be used as a trigger for determining whether or not a review of the basic service elements should occur. Once the review is initiated, GTEC agrees that the Commission needs to: review the quantitative and qualitative benefits of adding a service element; review whether the benefits outweigh the costs; and, determine if any intervention is necessary to assure continued subscriber growth and availability.

Intel suggests that a party who seeks to expand the basic service definition to include higher bandwidth services, must clearly and convincingly demonstrate that such an expansion will promote the proliferation of higher bandwidth services.

Intel also states that the funding mechanism for universal service be technology indifferent, so as to avoid

subjecting new telecommunications services from excessively bearing the burden of funding the universal service program.

Pacific suggests that proposed rule 4.C.3. should be revised to clarify that a service should be added or deleted from the basic service definition only if the Commission determines that all four criteria have been met. This would make clear that satisfying a single criteria is not sufficient to make a service essential, and therefore subject to inclusion in the basic service definition.

Public Advocates disagrees with the the 65% subscribership criterion in proposed rule 4.C.2.b. They argue that access is the key to remaining competitive in the new information age. If access does not become essential for participation until a 65% subscribership level is reached, those without access will be left behind, and a two tiered telecommunications system will develop in California. Public Advocates goes on to state that the 65% subscribership rate is not a relevant criterion to judge whether a service is essential, and may only serve to reinforce redlining patterns.

The Smaller Independent LECs generally concur in the proposed rule regarding the criteria to be considered in determining whether a particular service element should be included in the definition of basic service. They object, however, to the provision in proposed rule 4.C.3 which requires carriers to maintain data sufficient to determine whether the criteria for evaluating service elements have been met. They point out the following: that several of the criteria cannot be quantified; that it is unreasonable to require LECs and CLCs to provide data on a retroactive basis because it is uncertain as to which services may be the subject of a petition for review; that they will be forced to maintain large amounts of data of all kinds regarding various aspects of future services that may or may not actually be considered by the Commission; and that the proposed rule is

unnecessary in light of the Commission's broad authority to request information from carriers. Roseville also recommends that this proposed rule be eliminated on the same grounds.

UCAN comments that the Commission's proposed rule to periodically review the definition of basic service may be inadequate to effectively address the changing needs of universal service. The proposed rule fails to account for the possibility that a service may be designed that should be included in the basic service definition before there is a periodic review. In order to solve this possible lag problem, UCAN suggests that the review process contain a provision that allows interested parties the right to petition for a review of the basic service definition at any time, so long as the service in question meets some or all of the Commission's review requirements.

UCAN also states that the review criteria should be clarified, and that the Commission should be flexible as to the weight to be given to each factor. UCAN recommends that the review criteria be composed of the following:

"a. the service is essential for participation in society;

"b. the service will assist in the prevention of stratification due to the creation of information rich and information poor communities;

"c. a substantial majority, 65%, of residential customers subscribe to the service. Assess:

1) availability of the service;
2) the degree to which the service has been promoted by the carrier;
3) the level of customer education which has been provided for the service;
4) the communities which are presently being targeted for marketing and use of the service.

"d. the qualitative and quantitative benefits of adding the service outweigh the costs;

"e. availability of the service, or subscription rates would not increase without intervention."

The Universal Service Alliance (USA) proposes that the proposed rule for reviewing the definition of basic service be changed to a procedure whereby there is an ongoing evaluation of services by a committee consisting of community leaders, including representatives of low income, elderly, disabled, and rural consumers. This committee would meet as necessary to keep informed about new services, and to consider on at least an annual basis whether any services should be added to the definition of basic service. Subscription levels would be a consideration, but not necessarily a decisive factor. Other factors the committee could consider are the importance of service to consumers, the cost of providing the service, and whether other alternatives exist. This committee would then report its findings and recommendations to the Commission, which could conduct further proceedings as necessary.

3. **Discussion**

GTEC, UCAN and the Coalition have all commented on whether there should be an opportunity for an immediate review of the definition of basic service. Upon further reflection, we agree with UCAN and the Coalition that situations may arise where a service should be included in the definition of basic service without having to wait three years. As part of this immediate review procedure, the proponent for the inclusion of a new service element shall be permitted to make a showing that at least three of the four review criteria have been met. This alleviates the concern that a proposed service element may be so essential for participation in society, but has not yet reached a 65% subscribership rate in residential households. We will revise rule 4.C. to reflect these changes.

In order to ensure that frivolous and meritless petitions for review are kept to a minimum, we will use the summary denial

procedure contained in Rule 47(h) of the Commission's Rules of Practice and Procedure. Rule 47(h) will be used when it is clear that the basic service definition should not be expanded or reduced, or in cases where the Commission is not persuaded, based on the petition and the responses, that a service element should be included or deleted.

UCAN's suggestion to broaden the type of information to review as part of the 65% criteria will be adopted, as well as its suggestion that the quantitative and qualitative benefits of adding the service to the basic service definition outweigh the costs.

We decline to adopt as part of our review criteria UCAN's suggestion to include the statement that the service will assist in the prevention of stratification. The review criteria that we adopt today was designed with AB 3643 in mind. We have developed a review process to periodically review and revise the basic service definition to reflect new technology and markets. (AB 3643, Stats. 1994, Ch. 278, Sec. 2(a)(4).) This review process is consistent with PU Code § 709, and the principle enunciated in AB 3643 that "In order to avoid an 'information rich' and 'information poor' stratification, there must be an ongoing evaluation of which services are deemed essential and therefore a part of universal service." (Id., Sec. 2(b)(2).)

We have also considered and adopted most of the changes suggested by DRA.

The suggestion by the Smaller Independent LECs to eliminate proposed rule 4.C.3. should be adopted. We agree that this proposed rule would impose an undue burden on the LECs and CLCs to maintain data on every possible service offering being contemplated. Such a provision is also unnecessary given the Commission's broad authority to examine the books and records of these regulated companies.

We decline to adopt USA's suggestion that a review committee be formed to provide the Commission with ongoing

evaluations of what services should be considered for inclusion in the definition of basic service. It is our belief that this review committee procedure would just add an unnecessary layer of review and expense. Under the procedure which we adopt today, interested parties have the opportunity to participate in the Commission's review process for evaluating whether a new service element should be added to the definition of basic service.

The revised criteria for deciding whether a new service element should be included in the definition of basic service is set forth in Rule 4.D.3. of Appendix B. It is our intent to consider all of the listed criteria, as well as the associated policy considerations. However, as for the weight to give to each review criteria, we believe that this should be developed on a case by case basis. To state at the outset that all criteria should be weighted equally, or that one criteria is more important than another, ignores the possibility that a situation may arise where certain criteria and policy considerations outweigh other criteria and considerations. We believe these guidelines address the concerns of Citizens, GTEC, Intel, Pacific, and Public Advocates.

C. Promoting Access To And The Deployment Of Advanced Technologies

1. Introduction

In D.95-07-050 at pages 25 and 26, we solicited comment on the proposals of UCAN and USA to promote greater access to new technologies. We expressed concern in that decision that the activities contemplated by UCAN and USA involved other industries besides telecommunications, and that funding for such activities should not come solely from telecommunications carriers and their customers.

By soliciting additional information from the parties, we hoped to gather enough information to allow us to design an appropriate program that is consistent with PU Code § 709, and the following principles expressed in AB 3643:

> "(4) Public policy should provide incentive as needed to promote deployment of advanced

telecommunications technology to all customer segments."

* * *

"(6) Because of their economic and social impact, education, health care, community, and government institutions must be positioned to be early recipients of the benefits of the information age."

2. Positions of the Parties

Cal/Neva believes that with the dramatic growth of the information superhighway, access to this infrastructure will become a necessity. Unless efforts are made to ensure access to advanced technology, Cal/Neva fears that low income communities and others with special needs will be left behind. Cal/Neva proposes that the following steps be taken to ensure that everyone is provided with access to advanced telecommunication technology. First, there must be a prohibition against redlining. Second, a grant program to develop community based applications should be adopted. Third, there should be special rates for telecommunications services provided to schools and CBOS. And fourth, there must be a mechanism for incorporating enhanced services into basic services once they are used by a significant portion of the population.

Cal/Neva and Consumer Action have recommended that a working group made up of Commission employees, consumer groups, and CLCs and LECs be formed to address all aspects of universal service. They suggest that the working group be patterned after the customer owned pay telephone (COPT) enforcement subcommittee. (See 40 CPUC2d 704; 36 CPUC2d 446.)

Citizens is of the opinion that access to advanced technology for lower income customers, and to non-English speaking customers, is a social policy issue that is beyond the scope of universal service and of this Commission. Citizens believes that social policy is better addressed by the Legislature.

The Coalition asserts that the grant program and foundation approaches favored by UCAN and USA, and which were discussed in D.95-07-050, have significant problems. First, it is difficult for such programs to be competitively neutral because judgments have to be made as to which projects should be supported. Second, the proposals by UCAN and USA could result in the funding of activities of non-regulated entities. The Coalition contends that it would be inappropriate for telecommunications companies and their ratepayers to provide support for research, development, and market testing conducted by private businesses.

The Coalition, as well as TURN, favors the establishment of a universal service working group made up of telecommunications companies and users. Some funding to support the administrative aspects of this working group would be required. The working group would allow end users to influence the design and availability of telecommunications services and products by providing a forum for an exchange of ideas. The Coalition believes that only one working group should be formed, instead of establishing one working group in every local access and transport area (LATA) of the state. The single working group could then inform interested parties throughout the state, and solicit their input.

DCA believes that in order to avoid a division between information rich and information poor consumers, the Commission must employ other methods to promote access to, and to encourage the deployment of advanced technologies. DCA recommends that the Commission adopt policies which will make such services such as video dialtone, E-mail, and Internet access, available to schools, libraries, hospitals, government, and community centers.

DCA states that a grant type program should be only one of many incentives used to encourage the early deployment of advanced information technologies. DCA feels that the grant program could be funded through the current ULTS program if the current self certification process for applicants is converted into

an income verification process. By using an income verification process, federal Lifeline monies might then be available. DCA suggests that those monies be used to establish a program which would provide matching funding to public libraries, schools, and community organizations. DCA also suggests that other market incentives which do not include government or ratepayer funding be used as well.

DCA recognizes that private industry, local governments, community organizations, educational institutions, and various state agencies, must all work together to bring about a state of the art telecommunications network for California. DCA suggests that another program could be developed to coordinate activities by various state agencies regarding their information technology programs, and how those technologies and programs can benefit education, health care, community, and government institutions.

DRA suggests that the principle expressed in proposed rule 3.A.6. be revised to more closely reflect the wording regarding advanced telecommunications technology that is contained in AB 3643, and in the Commission's November 1993 report to the Governor entitled Enhancing California's Competitive Strength: A Strategy For Telecommunications Infrastructure (Infrastructure Report).

GTEC supports the concept of establishing a grant program for advanced technology, but favors a funding mechanism based on a state bond measure, or obtaining funds from an appropriation from the general fund. GTEC believes that because the information superhighway infrastructure is a convergence of technologies which include telecommunications, computers, cable, and information services, funding of such a program should not fall disproportionately on any segment of the telecommunications industry.

Pacific endorses the creation of working groups, and plans to participate in them when they are formed.

Public Advocates argues that access to advanced technology is the key to remaining competitive in the new information age. In order that certain communities are not left behind, Public Advocates recommends that CBOs, health clinics, educational organizations, schools, and libraries, be provided with access to enhanced telecommunications services.

The Smaller Independent LECs and Roseville commented that the proposed grant program in D.95-07-050 should be considered outside the scope of this proceeding. They recognize that a connection exists between access to advanced technology and universal service, but believe that the issues raised require careful thought and attention.

UCAN's goal of promoting access to telecommunications services and technologies, is to ensure that it is made available to, and meets the needs of, a majority of consumers. UCAN proposes that an alliance of interested parties be formed on a regional basis, such as one for each of the ten LATAs in California. The goal of the alliances would be to discuss and develop community based applications which utilize the telecommunications infrastructure. The more promising applications would then be chosen by all the different regions, and developed and tested for end user use, using privately raised monies. Such a program would assure that the market is responsive to all market segments.

UCAN estimates that funding for this alliance proposal will require approximately $2 million. This money would be used to administer the alliance, develop service ideas, choose the most feasible ideas, design the application(s), and then seek funding/services to deploy them in the community.

USA commented that the proposed rules do not contain anything to promote access to advanced telecommunications services, and do not contain any incentives to promote the deployment of advanced telecommunications technology to all customer segments. Nor do the proposed rules include any measures to position

education, health care, community and government institutions to be early recipients of the benefits of the information age.

USA believes that in order to effectuate the policies and principles set forth in AB 3643, a working group should be convened to address ways in which collaborative partnerships of telecommunications providers, local governments, and grassroots organizations can address telecommunications issues, develop solutions, and promote the deployment of advanced telecommunications technology to all customer segments. USA suggests that the working groups be made up of representatives from the following: LECs; CLCs; consumer organizations; other interested stakeholders involved in this proceeding; community leaders, particularly those who represent low income consumers, the elderly, people with disabilities, rural consumers, and local governments; and institutional leaders, such as health care, education, libraries, and local governments. USA believes that the operations of the working group will lead to the successful development of applications that benefit local communities, and which in turn, improve people's lives. In order to promote the deployment of advanced technologies, the working group could also establish regional technology centers where people could become familiarized with what these technologies can do.

USA also proposes that the Commission establish a separate working group to address the "universal design" of structures, products, and services, as it relates to universal service. USA states that telecommunications equipment and services are often designed for the normal human profile. USA suggests that members of this group consist of telecommunications providers, representatives of the disabled and elderly, and other interested parties. USA envisions that this working group would meet to discuss universal design to promote universal service, and to identify options for encouraging universal design in telecommunications equipment and products.

USA also requests that the Commission require as part of the universal service rules that all telecommunications providers in California have a written policy on universal design. USA states that such a policy, should at a minimum, commit the company to the following:

> "1. Creating products which are useful to the widest range of users (including customers with disabilities);
>
> "2. Paying conscious attention to the needs of customers with disabilities during the design process and building in flexibility that will make products easy for a wide range of people to use; and
>
> "3. Including a wide range of potential customers (including customers with disabilities) during market research and field trials." (USA Reply Comments, December 1, 1995.)

3. <u>Discussion</u>

We have considered, and adopted, DRA's suggestion to revise proposed rule 3.A.6. to make it consistent with AB 3643 and the Infrastructure Report.

The Cal/Neva, UCAN and USA proposals to create working groups and alliances have merit. However, their proposals envision that as a result of the meetings that these groups hold, new ideas for applications will be developed, and possibly funded through the working group itself. As we noted in D.95-07-050, part of the problem with developing incentives to promote the deployment of advanced technologies is that this Commission's jurisdiction is limited to public utilities. Many of the advanced services being developed and offered today require hardware, software, and other components, in addition to the information that is provided to the end user. The Commission can formulate incentives with respect to the telecommunication services that are utilized, but cannot order incentives or impose assessments on the other non-regulated

companies that are coming together to offer these services. The burden should not fall on telecommunications providers and their ratepayers to fund the design and research of potential new services and applications that are not directly related to telecommunications. To the extent that the proposals of Cal/Neva, UCAN and USA seek direct funding to develop new ideas and applications, we reject those proposals.

We recognize the importance of how advanced telecommunications technologies affect every Californian's life, and the state's economy. As the state agency in charge of regulating the telecommunications industry, we should take the initiative to ensure that the development and deployment of these technologies do not pass certain customer segments by. We believe that a single statewide working group to address universal service problems and issues should be formed under the auspices of this Commission.[18] This working group shall be known as the Universal Service Working Group (USWG). Although we will leave it to a workshop, and a subsequent decision, to work out the details of the USWG, the following are some of the criteria we will impose on the USWG. These criteria are also contained in Rule 7 of Appendix B.

1. The purpose of the USWG shall be to address ways in which access and deployment of advanced telecommunications technologies can be provided to all customer segments, and how education, health care, community, and government institutions can be positioned to take advantage of these technologies.

2. A Steering Committee shall oversee the organization and administration of the USWG. The USWG Steering Committee should

18 We reject the suggestion that there be one working group per LATA. LATAs do not necessarily represent a single community of interest. For example, LATA 1 stretches from Crescent City southward to Watsonville.

not function as a policy making body, nor should it seek to determine what the position of the USWG is with respect to any issue.

3. The USWG shall be open to the participation of any interested stakeholder. The objective of the USWG is to create a forum where interested stakeholders can freely exchange ideas about various issues and policies. The formation and organization of the USWG should promote the free exchange of ideas, and the views of all participants should be reflected in any USWG report.[19]

4. The USWG Steering Committee shall be composed of 24 members. There shall be eight representatives from the telecommunications industry, representing a spectrum of telecommunications carriers. There shall be two representatives each from the following kinds of concerns: education, health care, community, libraries, and local government; for a total of ten representatives. There shall be two representatives from the business sector, two representatives from this Commission, one representative from the disabled community, and one representative from another state agency.[20]

5. The USWG Steering Committee shall create a sub-group that will address the issue of unserved territories and may create other sub-groups as it deems necessary. The USWG Steering Committee shall consider whether regional sub-groups should be formed so as to increase participation by interested

19 In the Commission's electric restructuring proceeding, the working group concept has been very useful. We envision that the USWG will function in much the same way.

20 The representatives from the Commission should be the head of the Commission's CSD and the head of the Telecommunications Division, or their designees.

stakeholders, and to broaden the diversity of ideas.

6. The USWG will be initially funded at $250,000 per year for a period of two years from monies in the California Teleconnect Fund. These funds are intended to provide administrative support, and reimbursement for USWG's members' reasonable expenses relating to their participation on the USWG or the USWG Steering Committee.[21] Within 90 days of the formation of the USWG Steering Committee, the Steering Committee shall submit to the Commission for its approval via a Commission resolution or decision, an annual budget for the activities of the USWG.

7. The USWG Steering Committee shall prepare an annual report of a summary of the USWG meetings, their objectives, the issues raised, their accomplishments, and their recommendations. The report shall be submitted to the Commission, and forwarded by the Commission to the Legislature for their information.

8. Absent Commission action, the USWG shall terminate on December 31, 1998.

A workshop shall be organized and noticed in the Commission's Daily Calendar by the Commission's CSD. The workshop will be held no later than 90 days from the effective date of this decision. The workshop should determine who is interested in participating on the USWG, and its Steering Committee, the framework of how the USWG should run and operate from both an

21 In order to maximize efforts and input, and to minimize the expenses associated with the USWG, the Commission encourages the USWG members' employers to view their employee's participation as part of their job responsibilities and their respective companies' own expenses.

administrative and purpose point of view, and to develop recommendations as to other operational issues that the Commission needs to address. Once the workshop recommendations are received, the Commission shall decide who will serve on the USWG Steering Committee, and issue other directives regarding the USWG, as necessary.

We decline to adopt USA's recommendation that a working group be formed to address product design issues for telecommunications products and services. Although we believe that product design is an important strategy to enable the deaf and disabled population to improve their access to telecommunication products and services, this is an issue that affects the entire nation. As the attachment to USA's September 1, 1995 comments show, many of the nation's telephone manufacturers and companies are project supporters of efforts at the federal level to develop a national policy on this issue. Section 255 of the Telco Act also addresses the issue of making telecommunications equipment and services accessible and usable by disabled individuals. The FCC, in conjunction with the Architectural and Transportation Barriers Compliance Board, also plans to develop guidelines for accessibility of telecommunications equipment and customer premises equipment. These universal design issues and recommendations are more appropriately addressed at the federal level than by this Commission.

The suggestion by DCA to make services such as video dialtone, E-mail, and Internet access, available to certain institutions, and the suggestion that if additional federal monies are received as a result of the adoption of an income verification that they be used for matching funds for certain institutions, will be discussed later in this decision.

D. 95% Goal For Universal Service

1. Introduction

In D.94-09-065 at page 6, the Commission adopted a goal that 95% of the households in California have telephone service. That decision at page 7 also stated that "GTEC and Pacific must significantly improve their customer outreach and educational programs to achieve a 95% penetration rate for phone service among non-white and non-English speaking households." D.94-09-065 also required GTEC and Pacific to set targets, and to map out their marketing strategies to improve their universal service levels.

We proposed in D.95-07-050 that the same monitoring requirements that apply to GTEC and Pacific, should also apply to other providers of local exchange service, such as the CLCs, and the other incumbent LECs. (D.95-07-050, pp. 13-14, App. A, proposed Rule 3.B.3.) We also solicited comment on whether income should be the only criterion by which to measure subscribership.

The 95% subscribership goal raises several issues for Public Advocates. Public Advocates made a series of identical recommendations in both the local competition proceeding and in this proceeding regarding the 95% goal, bilingual services, and redlining. In D.95-12-056, a decision in the local competition proceeding, the Commission deferred the majority of Public Advocates' recommendations to this proceeding.

The 95% subscribership goal also raises the issue about telephone service in currently unserved areas of the state.

2. Positions of the Parties

Cal/Neva is opposed to using income as the only variable against which the 95% subscribership rate is measured. Instead, the variables to measure subscribership should include the following criteria: income, race, non-English speaking ability, and disabilities. Cal/Neva also suggests that subscribership rates be measured by census block groups (CBGs) so that subscribership rates

in rural communities and inner city neighborhoods can be determined.

The Coalition commented that income should not be the only variable against which subscribership is measured. Instead, the Coalition believes that the Commission should use all the variables to provide useful information about the extent of telephone subscribership, and about certain segments of society that may have relatively low subscribership rates.

Consumer Action believes that the 95% goal should be achieved for the following categories: for residential customers as a whole, for low income households, for the working poor, for seniors, for both urban and rural areas, and in minority communities.

DCA comments that there may be some merit in measuring subscribership rates using income levels, ethnicity, and the ability to speak and understand English. If subscribership rates are equal to or above the 95% subscribership rate for certain groups, DCA believes that further outreach efforts to those groups would not be necessary. To reach those groups whose subscribership rates are below the 95% goal, DCA suggests that marketing efforts be highly focused and targeted, and perhaps coordinated through community groups and ethnic organizations.

DRA points out that in D.94-09-065 at page 7, the Commission stated that GTEC and Pacific should increase their subscribership rates for all customer groups. However, in proposed Rule 3.B.3.a., the Commission's objective include only low income and non-English speaking households. DRA believes that all LECs and CLCs should be responsible for pursuing a 95% subscribership rate among all customer groups, including low income, disabled, non-white, and non-English speaking households.

DRA also recommends that income should not be the only criterion used to determine subscribership success.

DRA supports UCAN's recommendation, described below, that would improve customer outreach and educational programs.

Public Advocates believes that the Commission should continue to measure telephone subscribership rates by language status, race, and income, instead of measuring subscribership by a single income criterion. Public Advocates points out that one of the principles enunciated in AB 3643 is to provide essential telecommunications services at affordable prices to all Californians, regardless of linguistic, cultural, ethnic, physical, geographic or income considerations. In order to ensure that this principle is adhered to, language status, race, and income must all be considered.

Public Advocates also recommends that the following recommendations be adopted with respect to the 95% subscribership goal:

- Each carrier must be responsible for the Commission's goal of at least 95% telephone subscribership in poor, non-white, and non-English-speaking households.
- The Commission should annually assess the degree to which carriers have or have not met their universal-service goals in California's poor, non-white, and non-English-speaking communities, and should exercise their authority to ensure that their universal service goals are actively and effectively pursued.
- The Commission should analyze the service territory maps of all carriers to determine if there are areas suffering from an absence of competition. If such areas exist, the Commission should require carriers who serve territories bordering these redlined communities to expand their territories to encompass these underserved communities to increase competitive choice.

UCAN's comments express support for the 95% ubscribership goal, but points out that to achieve this goal, the

outreach efforts must be successful. UCAN suggests that the Commission improve customer outreach and educational programs for senior, disabled, and rural customers, in addition to low income, non-white, and non-English speaking households. UCAN also takes issue with the suggestion in D.95-07-050 that the 95% goal be based on income criteria only.

USA supports the proposed rule that requires all local service providers to meet the 95% subscribership goal for low income and non-English speaking households. USA also points out that there does not appear to be any California-specific data regarding telephone subscribership levels for the disabled, and that such data should be collected as well.

3. **Discussion**

a. **General**

We will adopt the suggestions by Consumer Action and DRA that the 95% subscribership rate in D.94-09-065 applies to all customer groups, and not just to low income and non-English speaking households. Rules 3.B.3. and 3.B.3.a. in Appendix B have been revised to reflect this.

In D.95-07-050 at page 14, we solicited input on the subject of whether the methodology for assessing whether the 95% subscribership goal should be modified to use income as the only measurement criterion. The methodology for assessing the 95% goal was first described in D.93-11-011.. The assessment criteria included the following:

> "(1) telephone penetration rates by income, ethnicity, and geography, and (2) knowledge of availability of lifeline service, including costs, services, and procedures for qualifying for and obtaining service." (D.93-11-011, pp. 47-48; See D.94-09-065, p. 277.)

Instead of measuring subscribership rates by income only, we will retain the existing measures stated in D.94-09-065 at page 277. These include measurement of telephone subscribership

rates by income, ethnicity, and geography.[22] These different measures will enable us to obtain information about what segments of the population are currently underserved. As the Coalition and DCA point out, that information can lead to more focused marketing efforts.[23]

The other suggestions by Public Advocates are discussed in the redlining and bilingual services sections which follow. UCAN's outreach and educational programs are discussed in the consumer information and ULTS sections of this decision.

b. **Unserved Territories**

Significant geographic areas of California have no local telephone service. The goal of a 95% subscribership rate for basic telephone service raises the issue of how to get service to these unserved territories. This was a topic of some concern during the PPHs.

Universal service policies have always had two focuses. The first is to improve the number of households who have telephones in areas that are currently served by a telephone service provider. The second is to ensure that telephone service is available over wide geographic areas. The continued geographic spread of telephone service will assist California's effort to achieve 95% subscribership. Expanding the geographic availability of telephone service will improve the public's health, safety, and

22 It may be appropriate to eliminate ethnicity as a measurement criterion at some point. As discussed later in the ULTS section, a single entity marketing ULTS can target the advertising to customer groups who do not have high telephone subscribership rates. Additionally, the income and geographic criteria provide much of the information that we need to determine where telephone subscribership remains low.

23 See the ULTS discussion as to who shall be required to submit these subscribership reports.

well being of those who live in or travel through these areas. In addition, the economic vitality of the area will be improved as a result.

Serving unserved territories must be addressed in the context of a comprehensive strategy for increasing subscribership. The fundamental problem is that unserved territories generally remain unserved because of the high costs of serving them. Many of these unserved territories would best be characterized as "extremely high cost" territories. Significant subsidies may be required to expand service to a relatively small number of households.

We note that several trends are working to increase the cost effectiveness of serving previously unserved territories. As population grows in these areas, so does the density of the households to be served. Generally speaking, greater density lowers the per household cost of serving the area. Furthermore the cost of telecommunications technologies and services continues to decline. This too makes serving previously unserved territories more economic. In addition, emerging technologies have the promise to significantly change the cost of serving certain areas. In particular satellite technologies and wireless technologies hold the promise of significantly increasing the economic feasibility of service in many currently unserved areas. While these trends may not make all areas of the state economic to serve on a stand alone basis, they may bring the cost of serving unserved areas within a range that is reasonable for society to subsidize service.

There are also existing programs that carriers can avail themselves of for those who desire to serve currently unserved territories. The existing CHCF-A is available to some carriers to serve high cost territories. The Rural Electrification Administration makes low interest loans available to small telecommunication companies serving rural areas. In addition, should authority be granted to a carrier to serve currently

unserved territory, the carrier may be authorized to draw a subsidy from the CHCF-B if the area is high cost.

We could conceivably adopt a rule which would provide all currently unserved areas of the state with telephone service. However, the cost of providing telephone service to all unserved areas of the state needs to be explored further. The rates to serve these areas might have to be set high, and other customers would still have to subsidize the service through the CHCF-B or a similar program. At some point the Commission must carefully weigh whether the cost justifies the service.

DRA has suggested that the existing CPC&N application procedure under Chapter 5, Article 1, of the PU code be used to determine whether new telephone service should be approved in unserved areas. That process allows the Commission to determine on a case by case basis whether it is reasonable and prudent to bring telephone service to those locations. In a recent Commission proceeding involving the Kennedy Meadows Exchange, we analyzed the following criteria: (1) what are the public benefits of the new exchange; (2) is the proposed new telephone exchange justified financially, and how will the cost of service be reflected in rates; and (3) are less costly telephone systems feasible. (D.95-11-025, pp. 6-17.)

Instead of adopting specific rules and policies regarding unserved territories, we will continue to encourage companies seeking to expand their service territories into otherwise unserved territory to do so by filing an application to expand service. We will look at each application on a case by case basis. We note that the current CPM model used to estimate costs for the served territories can also be used to generate cost estimates for unserved areas as well. The Commission's Telecommunications Division is directed to generate CPM cost estimates for any currently unserved CBGs that a potential carrier may wish to serve. This CPM based cost estimate could provide valuable information

about the relative cost of serving that area and would greatly aid the Commission in determining whether to authorize such expansion.

The CSD, in conjunction with the Telecommunications Division, shall review the unserved area issue and develop written recommendations for the Commission's consideration as to the steps we can take to expand the geographic availability of telephone service. Specifically, the CSD and the Telecommunications Division should employ the CPM, as well as other methods, to estimate the population and the number of households living in these areas, and the cost of serving currently unserved areas. The possibility of holding auctions for these unserved areas should be considered as well. The staff shall present these recommendations to the Commission within six months. Further, we direct the USWG to form a sub-group to address this issue and suggest possible policies or programs for the Commission to consider. We expect the staff to work with this sub-group to explore policy options for the Commission.

During the PPHs into universal service, the Commissioners were made aware of the need for emergency telephone communications in unserved territories. Commissioner Fessler subsequently expressed his concern that, at a minimum, there should be emergency telephone service on all designated state roads.

It is clear that the public health and safety of all citizens would be improved by such a program. However, we are unable to determine the cost of such a program, and whether the costs justifies such an undertaking. In addition, this Commission may not be the proper state agency to develop and/or implement such a policy. There are other state agencies that may be better able to address this issue. Therefore, we will direct the CSD and the Telecommunications Division to jointly contact the state and federal agencies who have the responsibility for providing emergency services on the roads and highways in rural parts of California, such as the California Highway Patrol, and the

California Department of Transportation, to form an interagency task-force to investigate the feasibility and policies of increasing access to emergency communications services along state roads and highways. The staff shall initiate this contact within 30 days from the issuance of this decision, and shall report back to the Commission about the status of the task-force within 6 months.

E. Redlining

1. Introduction

We noted in D.95-07-050 at page 26 that redlining "could be viewed as the practice of denying access to generally available advanced telecommunications services or adversely varying the terms of such access because of the conditions, characteristics or trends in particular communities." We suggested that an explicit prohibition against redlining be adopted, but invited comment on whether such language would be effective. We also invited comment on how to distinguish between redlining, and the economics of offering certain services.

Subsequent to the issuance of D.95-07-050, the Commission reiterated its position opposing any redlining, and adopted the following CLC regulation regarding redlining in D.95-12-056 at page 85, a decision in the local competition rulemaking and investigation proceeding (R.95-04-043 and I.95-04-044):

> "Redlining is prohibited and the Commission shall take strong action against any carrier engaging in redlining." (D.95-12-056, App. C, 4.F.(17).)

D.95-12-056 deferred to this proceeding Public Advocates' proposals regarding redlining.[24]

2. Positions of the Parties

Citizens commented that the redlining issue is related to the scope of a service provider's common carrier obligations. Citizens believes that redlining will not be a problem if the definition of basic service is narrowly limited to essential services only.

Californians For Advanced and Affordable Telecommunications (CAAT) commented that to minimize redlining, and to prevent discriminatory pricing, the Commission should require that the largest competitors, such as AT&T, MCI, Time Warner, and Sprint, be required to serve all customers within a LATA at a LATA wide price.[25]

The Coalition commented that it condemns the practice of redlining, and that the Commission must state that deliberate discrimination in the form of redlining will not be permitted. To help ensure that redlining does not occur, the Coalition states that all telecommunications carriers should be able to draw from the ULTS fund. In addition, the conditions for allowing new entrants to serve customers on a wide spread basis must be in place. The Coalition also suggests that the working group could

24 The Commission has already addressed Public Advocates' proposal that at the outset of local competition, all of the CLCs' service territory maps should be reviewed for redlining. The Commission declined to implement that suggestion, and we will not revisit that specific recommendation again. (D.95-12-056, p. 85.)

25 CAAT also recommends that the Commission require the largest competitors to provide local exchange services through their own facilities rather than simply serving as resellers. This issue would have been more appropriately addressed in our local competition proceeding, so we decline to address it in this proceeding.

discuss and assess how the development and deployment of telecommunications services is proceeding in their communities. Monitoring by the Commission of the LECs and CLCs performance with regard to the 95% subscribership goal would also aid in detecting whether redlining is occurring. In addition, the tracking of complaints that indicate redlining may have occurred is another detection device the Commission could use.

DCA suggests that the Commission should adopt strong policies against any form of discrimination on grounds other than price.

DRA commented that the Commission has reason to be concerned about the possibility of redlining. However, DRA believes that with the proposed definition of basic service, redlining is unlikely because basic service consumers will have a range of access options to choose from. These access options, in combination with an explicit prohibition, will deter redlining. DRA proposes that if redlining occurs, the Commission should withdraw the carrier's certificate of public convenience and necessity, and require the carrier to pay appropriate fines.

Pacific commented that redlining involves difficult evidentiary issues of intent and reasonableness. Pacific believes that an explicit prohibition could chill investment by creating a perception that in order to deploy new technology, one has to deploy it everywhere. Pacific also believes that an explicit prohibition would be costly for the Commission to administer and enforce effectively and fairly. Pacific contends that providing for the periodic review of the basic service definition, and adding new essential services over time will significantly reduce the potential for redlining problems.

Public Advocates pointed out that redlining may not just be confined to the practice of denying access to generally available advanced telecommunications services, but could occur with basic service as well. Public Advocates contends "that

redlining exists when there is an absence of competition in a given community, and a failure to target marketing and outreach efforts to minorities, non-English speaking, and low-income populations." (Public Advocates' Comments on D.95-07-050 and Proposed Rules, p. 25.) Public Advocates makes the following recommendations with respect to redlining:

- Each carrier must actively market its telephone services to poor, non-white, and non-English-speaking households and small businesses throughout each exchange or larger territory in which it operates.

- The Commission should annually assess the degree to which carriers have or have not met their universal-service goals in California's poor, non-white, and non-English-speaking communities, and should exercise their authority to ensure that their universal service goals are actively and effectively pursued.

- Each carrier must develop and submit one-year, two-year, and five-year business plans with detailed targets towards obtaining the Commission's goal among poor, non-white, and non-English-speaking households, and meeting the minimum specified criteria in D.94-09-065.

- Enhanced telecommunications services such as digital, broadband, and fiber or fiber-coax services must become part of basic service when such service is available to (even if not yet purchased by) 51% of the customers in the exchange, neighborhood, city, council, county, metropolitan area, or larger territory such as a LATA.

- Each carrier that is developing or building out new telecommunications technologies or services (hardware or software) must do so without discrimination in access on the basis of income, race or ethnicity, or geography.

- Enhanced telecommunications services must be available to qualified lifeline customers at

lifeline rates, i.e., no more than 50% of the regular price.

The Smaller Independent LECs, as well as Roseville, recognize the importance of redlining as an issue, but recommends that enforcement of redlining be left to the state and federal authorities. They point out that the Commission simply does not have the resources to determine whether discriminatory intentions form the basis for a carrier's service patterns.

3. **Discussion**

We do not believe that we need to include any other specific pronouncements in our universal service rules about redlining. The Commission in its local competition proceeding has already adopted an explicit prohibition against redlining. That regulation states: "Redlining is prohibited and the Commission shall take strong action against any carrier engaging in redlining." (D.95-12-056, Appendix C, 4.F.(17).) In the text of D.95-12-056, the Commission also stated in no uncertain terms that the Commission is "unalterably opposed to redlining and shall prohibit it," and will "take strong action against any carrier we find engaged in redlining." (D.95-12-056, p. 85.) In addition, public utilities are prohibited under PU Code § 453 from discriminating against any person or locality as to rates, charges, service, or facilities.

Public Advocates has made a series of recommendations to combat redlining. Public Advocates' recommendation that each carrier actively market its services to certain customer groups, and its recommendation that one year, two year, and five year business plans with detailed targets towards obtaining the 95% goal be disclosed, are based in part on what the Commission ordered of GTEC in D.94-09-065 and of Pacific in D.93-11-011 (51 CPUC2d 728). (See Public Advocates Comments On D.95-07-050, Sept. 1, 1995, pp. 22-23.)

However, the reporting requirement imposed on GTEC and Pacific concerned telephone subscribership rates, and awareness and ways of encouraging participation in the ULTS program.[26] We will not broaden the annual monitoring reports to include targeted marketing and outreach of all carriers' services to the poor, non-white, and non-English speaking households, and the development of business plans and targets, since that is not presently required of GTEC and Pacific. Public Advocates' call for targeted outreach by, and submission of marketing plans from, all carriers, simply goes beyond the requirements imposed on GTEC and Pacific in D.94-09-065 at page 277. We also believe that, in a competitive market, all carriers will need to actively market their available services to all customer segments because the total number of customers in California is limited.

We stated in D.95-07-050 that we were considering imposing on all other carriers of residential basic service some of the monitoring reporting requirements faced by GTEC and Pacific that are contained in D.94-09-065. (D.95-07-050, pp. 13-14, 73-74.) In the August 5, 1996 proposed decision, the recommendation was made that each carrier, except for GTEC and Pacific, be required to include in their annual reports the respective carrier's telephone subscribership rates by income, ethnicity, and

26 At the present time, GTEC and Pacific are required to file annual monitoring reports regarding the following: telephone subscription rates by income, ethnicity, and geography; customers' knowledge of the availability of the ULTS program; and one year, two year, and five year marketing plans designed to inform all eligible persons of the availability of the ULTS program, and how they may qualify and obtain such service. For Pacific, these reporting requirements end in 1999, and for GTEC, in 2000. (D.94-09-065, pp. 277-278; See D.95-07-050, pp. 13-14.) As we stated in D.95-07-050 at page 73, those requirements should continue to apply to GTEC and Pacific as long as they retain market power, or until the reporting requirements end.

geography, and their customer's knowledge of the availability of ULTS service, including costs, services, and procedures for qualifying for and obtaining that service. In the comments to the August 5, 1996 proposed decision, some of the parties commented that this type of information is proprietary, and that the carriers should be allowed to use non-carrier specific data as substitutes for income and ethnicity information.

Upon further reflection, we will not require the other carriers to include this type of information in their annual reports. It is our belief that the establishment of the ULTS Marketing Working Group, as discussed later in this decision, will be in a better position to assess how well the 95% subscribership goal is being met. If the Marketing Working Group detects that certain groups or communities do not have sufficiently high subscribership rates, the Marketing Working Group can target those groups or areas. Rule 3.B.3. has been revised to reflect this change.

We shall not impose on carriers other than GTEC and Pacific, the requirement that marketing plans be developed to inform all eligible persons of the availability of the ULTS program. (See D.94-09-065, p. 277.) As we discuss later in this decision, the marketing of the ULTS program in a competitive environment should be coordinated through the ULTS Marketing Working Group, rather than by multiple companies seeking to sign up the same customers.

As for Public Advocates' recommendations that enhanced telecommunications services must become part of basic service, and that those services should be made available to qualified ULTS customers at at 50% discount, our procedure for reviewing the service elements which make up the basic service definition will be followed instead of adopting Public Advocates' recommendations.

CAAT's recommendation that redlining can be minimized if the largest carriers are required to serve everyone at a LATA wide

price, will not be adopted either. Rather than set one uniform price, competition between competing carriers should be encouraged so that the market becomes more efficient and prices are driven downwards.

We will not follow the suggestion of Roseville and the Smaller Independent LECs that the enforcement of redlining issues should be left to the courts. Instead, utility redlining issues should be handled by the Commission since the Commission has the express power to prohibit discrimination as to rates, charges, service, and facilities. (PU Code § 453; See D.87739 (82 CPUC 422).) Should redlining take place in California by telecommunications providers subject to federal jurisdiction, the Commission will likely make its views known in that forum.

F. Bilingual Outreach

1. Introduction

In D.95-07-054, the Commission adopted the rule that a CLC making a sale in a language other than English is required to confirm with that customer in writing, in the same language in which the sale was made, the service(s) ordered. In D.95-12-056 the Commission expanded its bilingual information and outreach rules to require the CLCs to inform each new customer, in writing, and in the language in which the sale was made, information on the availability, terms and rates regarding the ULTS program and basic service. In addition, the CLC is to provide bills and notices, as well as access to bilingual customer service representatives, in the language in which prior sales were made. D.95-12-056 deferred to this proceeding the proposal of Public Advocates to provide bilingual service for customers to whom service was sold in English only, and its recommendations for bilingual marketing and outreach.

2. Positions of the Parties

Public Advocates' comments stated that to achieve universal service, people must have full access to, and a genuine

awareness of, information concerning rates and services. In order to do this, bilingual services must be provided.

Public Advocates recommends that the following bilingual service requirements be adopted:

- Every CLC should inform each new customer, and regularly inform existing customers, of the availability, terms, and statewide rates of lifeline telephone service and basic service. Public Advocates recommends that this information (and other information such as bills and notices) be provided to non-English-speaking customers in the common languages spoken within the exchange or larger territory, including Spanish, Cantonese, Mandarin, Tagalog, Vietnamese, and Korean.

- Each carrier must have bilingual customer service representatives available in the common languages of the exchange.

- Each carrier must conduct targeted marketing and outreach to non-English speaking populations.

3. **Discussion**

Public Advocates' first and second recommendations regarding bilingual services have already been adopted by the Commission in the rules regarding local exchange competition in D.95-12-056. (D.95-12-056, p. 80, App. C, 4.F.(16).) These underlying rules are the subject of a Petition to Modify D.95-07-054 and D.96-02-072. In D.96-08-027, the Commission ordered that a workshop be held to determine what operational and economic constraints carriers might face in complying with those rules. We defer resolution of Public Advocates' first and second recommendations to the local exchange competition proceeding, R.95-04-043 and I.95-04-044, and to the future disposition of the Petition to Modify D.95-07-054 and D.96-02-072.

With respect to the recommendation regarding targeted marketing and outreach to non-English speaking populations, and the

provisioning of bilingual services to customers to whom service was sold initially in English, we will not impose any further bilingual service requirements. As we noted in the 95% subscribership goal section discussed earlier, the targeted marketing and outreach idea was based on the requirement imposed on GTEC and Pacific that they encourage participation in the ULTS program. We will not bootstrap that requirement to make it mandatory that there be targeted marketing and outreach to non-English speaking persons for all of the carrier's services.

Customers whose first contact with a carrier was in English, should have no difficulty in accessing the bilingual customer service representatives of the carrier. Undoubtedly, given this state's diversity, there will be more than one non-English speaking customer per carrier. This diversity will necessitate that bilingual customer service representatives be on hand to serve these customers upon demand.

As we have previously expressed in prior decisions, we remain optimistic that carriers will recognize that tailoring products and services to particular market segments will be to the carriers' benefit.[27] We must keep in mind that the customer base, which was formerly served by a monopoly LEC, may now be served by competing carriers. In order to attract the business of this finite group of customers, all carriers can be expected to compete vigorously for all customers. The offering of bilingual services will be a natural consequence of competition.

27 Carriers who plan to target certain market segments based on language or ethnicity should be aware that the Commission will not countenance slamming of the customers in these markets.

VI. Consumer Information

A. Introduction

One of the principles enunciated in AB 3643 was that consumers should be able to have access to needed information in order to make timely and informed choices about telecommunications products and services, and how to best use them. To fulfill that principle, D.95-07-050 proposed the adoption of a matrix of certain information that all carriers of basic service be required to provide. The matrix proposed to include information about the cost of flat rate service, measured rate service, and ULTS.

B. Positions of the Parties

CAAT believes that the consumer information matrix proposed in D.95-07-050 needs to be expanded to meet the principle set forth in AB 3643. CAAT also recommends that a consumer education program, similar to the Telecommunications Education Trust, be created to inform and educate consumers about the changing telecommunications marketplace.

Consumer Action commented that the basic service matrix should be adopted. Consumer Action believes that other pricing packages may be developed in the future that the matrix needs to reflect. Consumer Action recommends that a workshop be held to consider the type of information that should be included in the matrix.

DRA endorses UCAN's and TURN's recommendations regarding the need for widely disseminated consumer information.

TURN commented that the proposed consumer information rules should be modified to provide the information suggested by UCAN. TURN recommends that the information about local service should be accompanied by a statement explaining the customer's local calling area, and that a toll free number be provided for customers inquiring about their local calling area. For measured service, carriers should provide their cost per minute, broken down

by initial and additional minute, as well as any rate differentials based on time of day.

With respect to toll service, TURN recommends that carriers provide information about their undiscounted toll rates in a matrix similar to what has been recommended for measured rate service. Due to the complexity of discount calling plans, and the difficulty in comparing such plans, TURN does not propose to include them in the matrix at this time.

TURN also states that the matrix should include information about the other significant charges that customers may be required to pay, such as charges for returned checks, late payments, changes to service, and reconnection after disconnection due to nonpayment.

UCAN commented that proposed rule 7 is limited as to the type of information that should be listed. UCAN recommends that the consumer information matrix include price information about per minute or sub-minute rates. In addition, because the local, toll, and long distance markets have been opened to competition, the matrix should include rate and service information for long distance and intraLATA toll calls. As new service offerings are made, UCAN favors expansion of the matrix to include rate and service information of these new services as well. UCAN also suggests that this rate and service information be set out before any discount, incentive, or packaged, pricing plan is included.

UCAN also disagrees with D.95-07-050 at page 73 that "other customer related information" should not be mandated at this time. UCAN believes that quality of service is a vital factor that consumers rely upon when shopping for a carrier. Thus, information about a carrier's complaint history should be disseminated to the public as well. UCAN believes that providing accurate complaint information about well known, as well as unknown carriers, will aid consumers in shopping for a carrier. UCAN also believes that this type of information is vital for the development of a competitive

market because consumers will be able to objectively determine which carriers have had fewer complaints.

During the San Diego PPH, it was suggested by a speaker that the Commission consider drafting a "customer bill of rights." The type of items that the speaker contemplated as being included had to do with fraudulent use of telephone calling cards and pricing or service options to detect that type of activity, a centralized clearinghouse to answer questions about the type of services a carrier has been authorized to offer, Commission review and approval of carrier notices so that consumers can rely on the information contained therein, and obtaining a property owner's permission before any utility related work is performed. Another speaker also expressed concern about the possible release of customer specific information. UCAN suggested in its December 1, 1995 reply comments that a set of consumer rights be developed. UCAN suggests that the rights cover the following categories: customer rate and service information, customer right to privacy, and the customer's right to redress.

C. **Discussion**

We have reviewed and considered the comments of the parties, and studied the matrix that was developed by UCAN in conjunction with TURN, and which was attached to UCAN's September 1, 1995 comments. We will adopt the matrix proposed by UCAN, with the exception of requiring carriers to have a toll free number to answer questions about a customer's local calling area, and whether a particular call is a toll or long distance call. We decline to adopt the latter suggestion at this time. Such a requirement could overburden the individual carriers with questions every time a customer considers making a telephone call to a different neighborhood or a different town or city. The consumer information rule in Rule 9 of Appendix B reflects the new matrix requirements. As competition develops for local calls, toll calls, and long distance calls, new pricing packages are going to

be introduced. This will present a problem for the customer information matrix because each carrier may offer a different type of program. CSD should conduct a workshop with interested parties to study ways in which these various pricing packages can be compared and included in the matrix.

As this Commission moves toward restructuring itself in light of the regulatory changes that have and are taking place, the complaint history idea of UCAN has some appeal. We will adopt on a trial basis UCAN's suggestion that the Commission annually compile a report that summarizes the complaint history for each certificated carrier. Such a report should also include any open Commission investigation pertaining to specific carriers. This information is already in our database for tracking proceedings before the Commission.

This annual report shall contain the following for each certificated carrier: the name, address, and telephone number of each certificated carrier; the dates when the carrier was certificated by this Commission to offer local exchange, intraLATA toll service, and interLATA service; the total number of complaint cases filed against each carrier during the past year; the total number of formal Commission investigations that were opened against each carrier during the past year; the total number of residential and business customers; and the number of open complaint cases and investigations as of the close of the reporting period. The Commission staff shall be responsible for preparing this annual report, and disseminating it to the public. Copies of the report shall also be provided to the Commission, and transmitted by the Commission to the Legislature for informational purposes. The first report should be available for dissemination on or about January 30, 1997, and cover the reporting period of July 1, 1995 to June 30, 1996. Subsequent annual reports should be available by August 1st of each year thereafter. The Commission will review the efficacy of these annual reports, and unless extended by Commission

order, this reporting requirement shall terminate after the annual report for the period July 1, 1998 to June 30, 1999 has been completed.

A consumer education program, as suggested by CAAT, is something the Commission needs to consider as well. As the Commission initiates steps to reform itself to meet the competitive environment of the future, consumer protection is likely to take on added importance in the Commission's mission and goals. With all of the regulatory and reorganization changes taking place, the Commission needs to consider taking proactive steps to inform the public about changes in the marketplace. We envision a public service media campaign, informational meetings before groups, and town hall meetings, where Commission staff can disseminate information about important consumer issues. To that end, we will direct the Commission's Executive Director to meet internally with the staff within 90 days to develop possible solutions to meet these challenges. The Executive Director, in concert with the appropriate Commission division(s), shall submit a plan of action to the Commission for approval. Such a plan should also include the fiscal impacts of implementing such a program.

VII. Benefits for Schools, Libraries, Health Care, and Community Based Organizations

A. Introduction

Two of the principles in AB 3643 express the intent that all customer segments, including certain kinds of institutions, benefit from the deployment of advanced telecommunications technology. Section 2.(b)(4) and 2.(b)(6) state as follows:

> "(4) Public policy should provide incentives as needed to promote deployment of advanced telecommunications technology to all customer segments.
>
> * * *

"(6) Because of their economic and social impact, education, health care, community, and government institutions must be positioned to be early recipients of the benefits of the information age." (AB 3643, Stats. 1994, Ch. 278, Sec. 2 (b).)

The Telco Act also provides that public or nonprofit health care providers serving rural areas, as well as elementary and secondary schools and libraries, should receive discounted rates. Section 254 (h)(1) of Section 101 of the Telco Act states as follows:

"(1) In general.

"(A) Health care providers for rural areas.--A telecommunications carrier shall, upon receiving a bona fide request, provide telecommunications services which are necessary for the provision of health care services in a State, including instruction relating to such services, to any public or nonprofit health care provider that serves persons who reside in rural areas in that State at rates that are reasonably comparable to rates charged for similar services in urban areas in that State. A telecommunications carrier providing service under this paragraph shall be entitled to have an amount equal to the difference, if any, between the rates for services provided to health care providers for rural areas in a State and the rates for similar services provided to other customers in comparable rural areas in that State treated as a service obligation as a part of its obligation to participate in the mechanisms to preserve and advance universal service.

"(B) Educational providers and libraries.--All telecommunications carriers serving a geographic area shall, upon a bona fide request for any of its services that are within the definition of universal service under subsection (c)(3), provide such services to elementary schools, secondary schools, and libraries for educational purposes at rates less than the amounts charged for similar services to other parties. The discount shall

> be an amount that the Commission, with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary to ensure affordable access to and use of such services by such entities. A telecommunications carrier providing service under this paragraph shall--
>
> '(i) have an amount equal to the amount of the discount treated as an offset to its obligation to contribute to the mechanisms to preserve and advance universal service, or
>
> '(ii) notwithstanding the provisions of subsection (e) of this section, receive reimbursement utilizing the support mechanisms to preserve and advance universal service.'"

In D.95-07-050 at page 14, we stated the following:

> "We believe that education, health care, community, and government institutions should be in a position to benefit from the information age. Absent suggestions to the contrary, we believe this objective can best be achieved by creating and fostering the development of a competitive market. Potential providers for this market must realize that making certain kinds of telecommunications services widely available to these institutions will increase demand, thereby encouraging the development of a market for these products and services.
>
> "Another way to position these kinds of institutions to benefit from the information age is to provide for special rates. However, providing special rates to certain classes of customers, to the exclusion of others for the same type of services, may be contrary to PU Code § 453, and its prohibition against discriminatory rates and charges."

Before the start of evidentiary hearings, and after the Telco Act was signed into law, the assigned ALJ issued a ruling on February 21, 1996 directing parties to provide testimony on the

Telco Act's requirement for funding of discounts for schools, libraries, and rural health care providers.

B. Positions of the Parties

AT&T/MCI take the position that the Telco Act left a lot of unanswered questions about how much of a discount should be subsidized. They recommend that the Commission wait to first see what the Federal Communications Commission (FCC) does with respect to this issue.

AT&T/MCI believe that only discounts below true economic cost or total service long run incremental cost (TSLRIC) are in need of subsidization.[28] They assert that there is no need to subsidize prices above TSLRIC because the carrier's costs will already have been recovered. If subsidy funding of discounted rates at above the TSLRIC is permitted, AT&T/MCI believe that these subsidies could pose a threat to competitive entry into these markets.

The California Cable Television Association (CCTA) agrees with AT&T/MCI that the Commission should wait until after the FCC has resolved the schools, libraries, and rural health care providers issue. CCTA contends that ordering discounts before the FCC has resolved the issue could allow the incumbent LECs to use the subsidized discounts to delay competition and lock up customers before new entrants have the opportunity to offer a competing service.

28 AT&T/MCI witness Cornell defined TSLRIC as the "forward-looking long run costs caused by supplying the total quantity of demand for the item whose costs are being estimated. The cost included in total service long run incremental costs can be both costs that vary with volume, and those that do not. Because they are long run costs, they include all categories of costs that are caused by the offering of the item in question. As forward-looking costs, they are calculated using the most efficient plant and equipment in the most efficient way."

Citizens commented that the need to provide advanced information age services to public and community institutions is a matter of social policy, which is best addressed by the Legislature, rather than this Commission. Therefore, Citizens believes that proposed rule 3.B.2 should be deleted because the Legislature has not adopted any social policy on this subject.

Due to the differences in the Telco Act regarding rural health care providers, and schools and libraries, DCA recommends that the Commission retain a distinction between the two types of subsidy funding.

With respect to discounted rates for schools and libraries, DCA is concerned that there is no direct evidence from any schools or libraries regarding what rates they believe are necessary to ensure affordable access. If the Commission decides to establish rates for schools and libraries without first seeking input from those entities, then DCA would support DRA's proposal for setting the discount rate. However, DCA advocates that additional steps should be taken to promote and foster broad deployment of advanced telecommunications and information services.

For rural health care providers, DCA contends that the use of the phrase, "reasonably comparable" rates, was intended to distinguish rate discounts for rural health care providers from the discounts for schools and libraries. DCA argues that a rate for a rural health care provider is reasonably comparable to the rate for services provided to urban health care providers if the rural health care providers' rate includes the additional costs, if any, incurred by the telecommunications provider to provide service to the rural area. Thus, DCA does not support DRA's proposal to provide rural health care providers with exactly the same subsidy as that which is provided to schools and libraries.

DCA also believes that the Commission should adopt policies that encourage the early deployment of a broadband telecommunications network for use by everyone. DCA recognizes

that the Telco Act does not discuss access to advanced services by CBOs, but agrees with Public Advocates that CBOs will play a major role in determining the extent to which society will be divided between "information haves and have nots."

DRA proposes that the Commission adopt the following discount mechanism for rural health care providers, schools, and libraries. The discounted rate would be set at the TSLRIC of a measured business line (1MB) for the lowest cost density zone in whichever proxy cost model the Commission adopts. The carrier would then be provided with a subsidy that reflects the difference between what carriers normally charge, and the rate limit established by the Commission. DRA proposes that the subsidy be funded through the CHCF-B fund.

DRA recognizes MCI's concern that the incumbent LECs might act in an anti-competitive manner if subsidies were distributed before the FCC adopted final rules. Instead of delaying the discounts as MCI has suggested, DRA recommends going forward with the adoption of DRA's proposal, and that the Commission monitor the program to detect any abuses. DRA proposes that after the FCC makes their determinations, the Commission can simply amend its discount methodology in an appropriate fashion.

GTEC points out in its brief that it has proposed a plan at the FCC which would provide funding sufficient to ensure that all schools and libraries in the country will be able to implement plans for advanced telecommunications programs.

Pacific's testimony noted that discounts for schools, libraries, and rural health care providers are mandated by the Telco Act, and that such discounts are to be funded by the federal universal service mechanism. Pacific points out that if this Commission develops a discount program which is in excess of the federal fund costs, then this Commission needs to approve a plan which provides for additional funding of the other groups. Pacific also believes that it should be permitted to receive funding for

providing voluntary discounts to schools, even though Pacific initiated its own discount program voluntarily. Pacific's witness, Rex Mitchell, recommended that the Commission should wait to see what the FCC does, before making any decisions regarding these issues.

Public Advocates argues that access to advanced technology is the key to remaining competitive in the new information age. In order that certain communities are not left behind, Public Advocates recommends that CBOs, health clinics, educational organizations, schools, and libraries, be provided with access to enhanced telecommunications services which offer broadband capacity. Public Advocates contends that these types of institutions play a pivotal role in providing information access to underserved communities. CBOs are especially important in Public Advocates' view because the schools and libraries in low income, minority, and limited English speaking communities do not have the access that they do in more affluent communities.

Public Advocates recommends that at a minimum, this broadband capacity should consist of a twisted pair that has two way digital capacity of 1.544 megabits per second (Mbps), or hybrid fiber/coax capacity. According to Public Advocates' witness, Thomas Hargadon, the cost for providing the equivalent of a T-1 line, which has a capacity of 1.544 Mbps, will soon be $35 to $50 per month. If 20,000 institutions are subsidized at this rate, the monthly rate is $1 million per month. In addition to access, Public Advocates proposes that these institutions receive technical assistance as well. Public Advocates contends that these discounts should be implemented now, instead of waiting until the FCC takes action.

In Public Advocates' opening brief dated May 29, 1996, it proposed the following definition of what a CBO is:

> "For purposes of obtaining access, a 'community-based organization' means any non-profit corporation or unincorporated

> association operating on a non-profit basis, whose primary commitment, as defined by its articles of incorporation, bylaws, or mission statement or as evidenced by demonstrated service, is to serve, directly or in an advocatory capacity, communities of individuals or groups, including, but not limited to low-income communities, minority communities, and limited English proficient communities. To obtain access, a community-based organization shall certify under penalty of perjury that it meets these requirements.
>
> "For purposes of receiving lifeline rates, a 'community based organization' means any non-profit corporation or unincorporated association operating on a non-profit basis, whose primary commitment, as defined by its articles of incorporation, bylaws, or mission statement or as evidenced by demonstrated service, is to serve, directly or in an advocatory capacity, low-income communities of individuals or groups, including but not limited to minority communities and limited English proficient communities. To qualify for lifeline rates, a community based organization shall certify that the populations it or its member individuals or groups primarily service, directly or in an advocatory capacity, are low-income individuals, as defined by the Public Utility Commission."

Public Advocates recognizes that the CBO definition specifically includes populations that it asserts have historically been underserved with respect to telecommunications. Public Advocates contends that the targeting of these communities is necessary because these communities are the least likely to have access to enhanced telecommunications services.

UCAN commented that CBOs should be positioned to benefit from advanced telecommunications technology. UCAN disagrees, however, with the discussion in D.95-07-050 that reliance on competition alone will make this a reality. UCAN is concerned that if the Commission relies solely on competition to ensure that these

institutions receive access, the needs of these organizations and the communities that they serve will not be met.

C. Discussion

Following the issuance of D.95-07-050, the Telco Act was signed into law. The Telco Act specifically mentions that rural health care providers can receive telecommunications services which are necessary for the provisioning of health care services at rates reasonably comparable to the rates charged for similar services in urban areas. The Telco Act also provides for discounted rates for schools and libraries for any services that are within the Telco Act's definition of universal service. The Telco Act omits any reference about discounts to CBOs. Since the Telco Act requires discounts to certain kinds of institutions, we decline to adopt Citizens' suggestion that rule 3.B.2 be deleted.

Although AB 3643 does not mandate discounts for schools, libraries, rural health care providers, and CBOs, that legislation made clear that these types of organizations are to be positioned to be early recipients of the benefits of the information age, and that incentives should be provided to promote the deployment of advanced telecommunications services to all customer segments.

The first question that we need to address is whether we should wait until the FCC addresses these issues. The advantage of waiting is that this Commission can review what the FCC has done, and then adopt state rules that are consistent with the FCC's rules.

We do not believe that we should wait until the FCC adopts its rules with respect to discounts to school and libraries. The Telco Act provides that a state may adopt regulations that are not inconsistent with the FCC's rules, and that the state can provide for additional definitions and standards that preserve and advance universal service. (Telco Act, § 254(f).) AB 3643 took effect on January 1, 1995, and called for the opening of a proceeding to address universal service issues by February 1, 1995.

If we were to wait until the FCC adopted its rules regarding discounts to schools and libraries, our rules on this subject could be delayed until May 1997, well beyond the time contemplated in AB 3643.

Before the discount programs can be established, we need to address the issues of who qualifies for the discount, what services qualify for the discount, and whether there should be a limit as to the number of lines or services that the institution is entitled to.

With respect to the discounts for schools, only public or nonprofit schools providing elementary or secondary education, i.e., grades K-12, and which do not have endowments of more than $50 million, may request the discounted rate.[29] For libraries, only those libraries which are eligible for participation in state-based plans for funds under Title III of the Library Services and Construction Act (20 USC §335c et seq.) shall be eligible for the discounted rate. This adopted criteria is consistent with the Telco Act's criteria. (See Telco Act, § 254(h)(4) and 254(h)(5).)

As for the type of services that qualifying schools and libraries can subscribe to at a discounted rate, it is instructive to refer to 254(h)(1)(B) of the Telco Act. That subsection provides that these kinds of institutions may receive "any of [the carriers'] services that are within the definition of universal service under subsection (c)(3)." Subsection 254(c)(3) provides as follows:

> "(3) Special services.--In addition to the services included in the definition of

29 It is our intent that the term "nonprofit schools" include schools run by a religious order that has been incorporated as a nonprofit Public Benefit Corporation (Corporations Code § 5110 et seq.) or as a nonprofit Religious Corporation (Corporations Code § 9110 et seq.).

> universal service under paragraph (1), the Commission may designate additional services for such support mechanisms for schools, libraries, and health care providers for the purpose of subsection (h)."

Subsection 254(c)(1) describes what universal service is, and the considerations that are to be taken into account in defining the services that are to be supported by the federal universal service support mechanism. This subsection recognizes that the definition of services may evolve as a result of advances in telecommunications and information technologies and services.

Subsection 254(c)(1) appears to contemplate a set of service elements which make up universal service, similar to what we have done with respect to the definition of basic service for residential customers. In addition to the service elements that are to be developed by the Joint Board and the FCC, the FCC under subsection 254(c)(3) can designate additional services that are to be supported by the funding mechanism.

Although the FCC has not yet adopted what list of services can be provided at a discount to schools and libraries, we believe that, at a minimum, it will include the service elements that make up a 1MB line. In recognition that there should be access to advanced telecommunications services, discounted rates for switched 56, ISDN, T-1, and DS-3, or their functional equivalents, are a strong possibility as well. (See Telco Act, § 254(b)(6).) We will therefore adopt a program of discounts for qualifying schools and libraries in Rule 8 of Appendix B. Qualifying schools and libraries shall be entitled to discounted rates for all 1MB, switched 56, ISDN, T-1, and DS-3 services, or their functional equivalents.[30] Once the FCC adopts its rules

30 Whether or not a service is the functional equivalent of the named service shall be determined when the tariff sheets are filed.

regarding which services should be discounted, we will review those rules for consistency with the rules we adopt today.

DRA's suggestion for calculating the rate for schools and libraries is not feasible given the residential focus of the proxy cost models. Instead, we will set the discount rate for schools and libraries at 50% for all 1 MBs, switched 56, ISDN, T-1, and DS-3 services, or their functional equivalents. Carriers who plan to offer these types of services shall file appropriate tariff sheets showing the discounted rates for schools and libraries for these services. Carriers who serve qualifying schools and libraries with these discounted services will receive a subsidy amount that represents the difference between the tariffed rate for businesses for such services, and the tariffed discount rate for schools and libraries; or if the schools and libraries can negotiate a better rate than the tariffed discount rate for these services with individual carriers, a discount of 50% off that negotiated rate shall apply.[31]

We believe that our discounted rate is appropriate and necessary to ensure that schools and libraries can afford access to these services. By providing for these discounts, the students, the community, and society as a whole benefit as well. As discussed later, the discounted rate also allows schools and libraries to be in a position that will make them early beneficiaries of advanced telecommunications and information services.

31 For example, if the tariffed rate for DS-3 service was $1000 per month, the tariffed discount rate for schools and libraries for that service would be $500. If the school or library is able to negotiate a lower monthly rate of say $400, the carrier would be entitled to a $200 subsidy. The school or library would end up paying the carrier $200 for the DS-3 service.

With respect to health care providers, the Telco Act provides that only those which serve persons in rural areas can obtain a rate that is reasonably comparable to rates charged for similar services in urban areas of the state. (Telco Act, § 254(h)(1)(A).)

We agree with DCA that the Telco Act intended to create a different rate discount for rural health care providers than the rate discount for schools and libraries. No one, however, submitted any evidence in this proceeding about what a reasonably comparable rate should be for a rural health care provider. Nor is there any evidence to suggest that health care providers in rural areas are currently charged different rates than their urban counterparts. We believe that the issue of reasonably comparable rates for rural health care providers should be deferred until the Joint Board and the FCC have had an opportunity to address this issue.

We will, however, establish a discounted rate for municipal and county government owned and operated hospitals and health clinics. Such a program is consistent with AB 3643's principle that health care and government institutions be positioned to be early recipients of the benefits of the information age. These qualifying hospitals and health clinics shall be entitled to a 20% discount off of the tariffed rate for switched 56, ISDN, T-1, and DS-3 services, or their functional equivalents. Carriers who plan to offer these discounted services to municipal and county government owned and operated hospitals and clinics shall file appropriate tariff sheets showing the discounted rate for these kinds of entities. Carriers who provide such services will receive a subsidy amount that represents the difference between the tariffed rate for businesses for such services, and the tariffed discount rate for municipal and county government owned and operated hospitals and clinics. As is the case for schools and libraries, if the parties can negotiate a

lower rate than the tariffed discount rate, a discount of 20% off that negotiated rate shall apply.

Turning now to the CBOs, we find merit in Public Advocates' suggestion that discounts be given to qualifying CBOs. CBOs, especially in low income and non-English speaking communities, oftentimes serve as a meeting place for people in those communities, and the CBOs oftentimes act as advocates on behalf of those communities on issues of interest. By providing access to CBOs, we can position communities to take advantage of the benefits of the information age, and promote access to the technology and information infrastructure throughout the state.

Since there is no specific provision in the Telco Act that mandates discounts to CBOs, we will develop the following rules. In order to qualify for the CBO discount, a CBO must provide proof at the time of application that it is a tax exempt organization.[32] This CBO must also certify that it offers health care, job training, job placement, or educational instruction. This latter requirement ensures that the discounted telecommunications services are being used to directly or indirectly benefit the public at large, and that the discount is not being used simply to reduce the CBO's telecommunications expenses. This definition of a qualifying CBO also imposes a limit on the number of CBOs which can take advantage of this program, which in turn, minimizes overall funding costs.

The discounted services that shall be made available to qualifying CBOs shall consist of switched 56, ISDN, T-1 service, or their functional equivalents. The qualifying CBO shall be limited to a total of: two switched 56 lines or their functional

32 A "tax exempt organization" shall refer to an organization described in Section 501(c)(3) or 501(d) of the Internal Revenue Code, Title 26 of the United States Code.

equivalents; or two ISDN lines or their functional equivalents; or one switched 56 line or its functional equivalent and one ISDN line or its functional equivalent; or one T-1 or its functional equivalent; at the discounted rate.

The discount for qualified CBOs shall be 25% off the tariff price for switched 56, ISDN and T-1 services, or their functional equivalents, offered to businesses. Carriers offering switched 56, ISDN, and T-1 services, or their functional equivalents, shall file tariffs reflecting that qualifying CBOs shall be entitled to this discounted rate. CBOs are free to negotiate better terms with the carriers. If the CBOs can negotiate a lower rate than the tariffed discount rate for such a service, then a discount of 25% off that negotiated rate shall apply.

Funding of these discount programs for qualifying schools and libraries, municipal and county government owned and operated hospitals and health clinics, and qualifying CBOs shall be through the California Teleconnect Fund. We will initially fund this program at $50 million per year. $5 million of the $50 million shall be for the qualifying CBOs, $5 million for municipal and county government owned and operated hospitals and health clinics, and the remaining $40 million will be set aside for qualifying schools and libraries. If the monies for the CBO and hospital and health clinic discount programs are not exhausted during the year, that money shall be available to fund the discounts for schools and libraries in the subsequent year.

First year funding for the schools and libraries portion of the California Teleconnect Fund has been set at $40 million. We believe that this fund is sufficiently sized to connect all qualifying schools and libraries to the nation's telecommunications infrastructure. This estimate is based upon DRA's estimate that California has approximately 1000 libraries, and approximately 7800 public schools and 4100 private schools. A $40 million annual

program would provide $258.40 per month in subsidy for each of the estimated 12,900 institutions. The SB 600 Task Force estimated that connection of a 56 kilobit circuit and a frame relay connection plus ongoing costs to serve each public school would cost approximately $8 million a year.[33] The California Teleconnect Fund will provide significant discounts when matched by school and library resources. It will also enable these institutions, and the population they serve, to benefit from the advanced telecommunications services that are available.

First year funding for the CBO portion of the California Teleconnect Fund is set at $5 million. If we assume that the CBO can be connected for approximately $1000 per year per line, and that each CBO has two such lines, the California Teleconnect Fund could provide discounts to over 10,000 qualifying CBOs.

Initial funding for municipal and county government owned and operated hospitals and health clinics is set at $5 million. Even if we assume that it costs $10,000 to connect such entities, the size of the fund will enable 2,500 of them to be connected. Rather than to wait to see what the FCC does with respect to rural health care providers, we believe that this discount program should begin as soon as possible so that these kinds of qualifying hospitals and health clinics can reap the full benefits of advanced telecommunications.

The California Teleconnect Fund shall be funded in the same manner and upon the same billing base as the CHCF-B, as discussed later in this decision. We will require that this California Teleconnect Fund surcharge be given separate line item treatment so that the funding for these discount programs is made

33 See California SB 600 Task Force Telecommunications Infrastructure For K-12 Schools and Public Libraries, December 1995, p. 52.

explicit. This is a change from the August 5, 1996 proposed decision wherein it was recommended that the discount program be funded through the CHCF-B. We believe that the discount programs which bring connectivity to selected types of qualifying entities, should be separate from a fund which is targeted at making telecommunications services in high cost areas available and affordable.

The surcharge that we adopt today for the California Teleconnect Fund is based on an initial funding level of $50.25 million. We estimate the initial surcharge level for this fund to be 0.41%. This surcharge shall be adjusted annually by the Commission to ensure that the proper funding level is maintained.

The California Teleconnect Fund surcharge shall become effective with the billing cycles that begin on February 1, 1997. Beginning with the billing cycles that begin on February 1, 1997, carriers shall mail bill inserts notifying customers of the California Teleconnect Fund surcharge. This bill insert notice may be combined with the CHCF-B bill insert notice.

The Telecommunications Division staff shall monitor the size of the California Teleconnect Fund over the course of the coming year, and annually thereafter. The staff shall notify us when half of the monies allocated for these discount programs has been appropriated, when 3/4 of the allocated monies have been appropriated, and when all of the allocated monies have been spent. The staff shall also keep us informed as to whether adjustments to the funding levels might be needed. No additional monies beyond what has been allocated for these programs is authorized at this time.

It is our intent that the above-described discount programs be used for the direct benefit of the qualifying entities and the population that they serve. To that end, the Telecommunications Division shall conduct a workshop within 60 days to discuss what type of reports qualifying entities may have to

submit. This workshop may be held in conjunction with the workshop described in the next paragraph. Furthermore, none of these discounted services may be resold to, or shared with, any other non-qualifying entity or person.

In order for the carriers to claim reimbursement from the California Teleconnect Fund, the carriers will be required to file a monthly report with the Telecommunications Division in a format to be prescribed. Among the items the report shall contain are the number of qualifying institutions or organizations in each of the discount programs, and the amount the carrier is seeking reimbursement for. The Telecommunications Division staff shall conduct a workshop within 60 days to develop a uniform reporting format.

As we noted earlier in this decision, the information superhighway is made up of many different interests and industries. In our capacity, we can provide the onramp to this highway at a discount. However, to make this highway accessible to all, and to ensure the success of this discount program, the telecommunications industry, computer and software manufacturers, and the information providers, must all take the lead and provide schools, libraries, hospitals, clinics, and CBOs, with the necessary equipment and services at no cost or at substantially reduced prices.

The California Teleconnect Fund is an important strategy in fostering the development of a state of the art telecommunications infrastructure for California. In the Infrastructure Report to the Governor, the Commission outlined three principles upon which the infrastructure strategy was based. The first was innovation in the delivery and use of advanced telecommunications. The second was to promote diversity in the range of choices among services and providers. The third was to ensure affordable, widespread access to California's public networks and the resources tied to those networks. The California Teleconnect Fund embodies all three of these principles.

First, by providing qualifying schools, libraries, hospitals, health clinics, and CBOs with discounts, we will foster innovation in the use of advanced telecommunications services. By making these advanced services more affordable to these kinds of institutions and organizations, we will see the development of new uses for these technologies by both the users and the providers of such services. Furthermore, as carriers strive to meet the demands of these institutions and organizations, new and innovative services are likely to be developed.

Second, the establishment of a competitively neutral fund permits any telecommunications carrier serving an eligible institution or organization to draw from the fund. The fund enables a qualifying institution or organization in a competitive market to seek out the carrier that best fits its individual needs. Telecommunications carriers will also target these markets because of the additional buying power the California Teleconnect Fund engenders. These competing carriers will increase the availability of choices, and spur the deployment of additional network infrastructure to other customers.

Third, the discounts provided for by the California Teleconnect Fund will assist in ensuring affordable, widespread access to the telecommunications networks, and the resources tied to those networks. Thousands of California school children, who may not have access to such services at home, will have access to today's advanced telecommunications and information age technologies at their schools as a direct result of the fund. Just as the library provides materials to thousands of Californians, the California Teleconnect Fund will enable libraries to provide the public with access to these networks and resources as well. CBOs will also find it less costly to connect to the information superhighway, and provide their constituencies with access.

The California Teleconnect Fund also reduces the dichotomy between the information rich and the information poor.

The funding of telecommunications discounts to qualifying schools and libraries has the potential to provide all school children and library customers with access to the information superhighway. By providing qualifying CBOs with discounts for high speed data connections, these CBOs can better serve their constituencies, and provide the communities they serve with increased access to the telecommunications network, thereby decreasing the stratification between information rich and information poor communities. The provisioning of discounts to qualifying hospitals and health clinics will also bring the benefits of advanced telecommunications to the very facilities that often are called upon to provide health care services to those who can least afford it.

The California Teleconnect Fund will also serve to promote the development of a more advanced telecommunications infrastructure that will bring benefits to all Californians. This will be accomplished in three ways.

First, the funding of discounts for schools and libraries will increase the demand for these services, which in turn will fuel investment in infrastructure by the telecommunications carriers. For example, many schools tend to be located in residential areas. The increased demand for advanced telecommunications by these schools will attract additional infrastructure investment into these communities making the availability of advanced telecommunications to residences more likely.

Second, qualifying schools, libraries, health care providers and CBOs are likely to develop many useful applications for these technologies. These applications will foster greater demand for these telecommunications technologies, which in turn will lead to greater investment.

Third, the enhanced availability of advanced telecommunications will lead to the development of a consumer base for advanced telecommunications services. By making these services

widely available, consumers will be better educated and trained in the use of information technologies, and will be positioned to reap the benefits of the information age. The California Teleconnect Fund will bring the benefits of advanced telecommunications to more Californians quicker, and lead to the fulfillment of California's vision of an advanced telecommunications infrastructure that benefits all.

To ensure that our rules are consistent with, and do not burden the FCC's rules, the Commission's Telecommunications Division shall review and compare the FCC's adopted rules with the rules we adopt today. If there are any inconsistencies between the two sets of rules, or with the federal and state funding mechanisms, the staff shall bring these problems to our attention. The issue of health care providers serving rural areas will be taken up after the FCC has addressed this issue.

VIII. Funding of High Cost Areas

A. Background

In D.95-07-050 at pages 7 and 8, we discussed the mechanics of how high cost areas of the state have been funded in the past. We noted that in an era of competition, the incumbent LECs can no longer rely on internal subsidies between high cost and low cost exchanges, and price differences between services, to help fund the cost of providing universal service in high cost areas. Instead of a single monopoly provider responsible for providing universal service, there may soon be competing providers. As we noted in D.95-07-050:

> "The funding mechanisms need to be redesigned to allow new market entrants access to universal service funds if they provide basic service to low income customers or to high cost areas. In addition, the mechanisms need to be changed to reflect the downward pressures on costs that competition should bring." (D.95-07-050, p. 34.)

We laid the foundation for developing how to fund high cost areas in D.95-07-050 and D.95-12-021. The process for funding high cost areas of the state involves several steps, all of which have been the subject of much debate and controversy. The first step, which we have described earlier in this decision, is to decide on which service elements make up residential basic service. Those service elements form the basis of the costing information that is developed in the second step.

The second step is to determine approximately how much it costs to provide basic service to the entire state. This step involves the use of a proxy cost model to develop statewide costs. Two proxy models have been presented to the Commission for consideration, the CPM sponsored by Pacific, and the HPM sponsored by AT&T and MCI.

The third step is to determine what the cut-off point, or benchmark, should be for deciding whether an area is high cost or low cost. The areas in which the proxy cost of providing service are at or exceed the benchmark would be deemed to be high cost areas and eligible for subsidy funding, and those proxy cost estimates which are below the benchmark would be considered low cost areas and not eligible for subsidy support.

The fourth step is then to determine whether any other sources of revenues which the carrier receives should be considered as offsets to the subsidy calculation. The fifth step is then to decide on the type of funding mechanism to be used. The sixth step is to decide whether any specific services or entities should be excluded from having to pay into the fund. The seventh step is to derive the surcharge amount. The final step is to determine what rates should be reduced in light of implicit subsidies being made explicit. In addition, there are some ancillary issues which need to be addressed, as well as other administrative details to consider, such as setting up the fund, and deciding who should administer the fund.

The sections below describe the steps that we have taken to ensure the continued availability of basic service in all areas of the state.

B. Should Business Customers Be Subsidized?

1. Introduction

Some of the comments to the proposed rules in D.95-07-050 recommended that business customers in high cost areas should be included in the subsidy mechanism. In response to those comments, the assigned ALJ issued a ruling on February 21, 1996 directing the parties to include in their prepared testimony the additional costs associated with subsidizing business customers in high cost areas. Despite this request, none of the proponents of the proxy models included business customers in their modeling of costs.

2. Positions of the Parties

The Smaller Independent LECs object to the Commission's proposal to exclude business customers from the benefits of the universal service funding mechanism. They argue that failing to include businesses in the subsidy for high cost areas will have an adverse impact on the rural economies of the state. They argue that business customers will depart rural areas because of the higher cost of service.

The Smaller Independent LECs also argue that PU Code § 739.3 was designed to reduce the disparities between high and low cost areas, and that the statute's goal applies to business customers as well as residential customers.

Roseville also opposes the Commission's proposal to exclude business customers for many of the reasons articulated by the Smaller Independent LECs. In addition, Roseville contends that if there is no subsidy for the cost of business access lines, the Commission will need to adjust business rates to cost. In such a case, Roseville believes that the Commission needs to have hearings and to notice customers in connection with these rate increases.

Pacific's comments in response to D.95-07-050 disagree with the position of Roseville and the Smaller Independent LECs that business customers should be eligible for a subsidy. Although Pacific recognizes their concerns, Pacific states that including business customers in high cost areas would increase funding requirements beyond the point of what a fund can bear.

For the evidentiary hearing, Pacific stated that because statewide averaged prices are currently mandated for business lines, business lines in high cost areas are being implicitly subsidized. Pacific proposed that until the Commission geographically deaverages prices for business lines, there should be subsidy funding for those areas where the costs exceed the mandated averaged price. However, according to Pacific's prepared testimony, it did not include any of the business service loop data in its model so that it could determine the required subsidy for business loops in high cost areas.

3. **Discussion**

Although we requested parties to provide information on the cost of providing businesses in high cost areas with service, no one presented any estimates of this cost during this proceeding. Due to this lack of information, and for the additional reasons we state below, the CHCF-B fund should not include the costs associated with serving business customers in high cost areas.[34]

Pacific suggested in its comments to D.95-07-050 that if businesses in high cost areas were included in the CHCF-B funding mechanism, the fund size would become too large. We agree with Pacific that in deciding whether basic service for business customers located in high cost areas should be subsidized or not,

34 We also refrain at this time from listing all the service elements that make up basic service for a business customer.

the Commission must weigh the cost of such a subsidy, and the burden on ratepayers.

Generally speaking, business customers tend to be more attractive to carriers than residential customers because businesses tend to make more toll and long distance calls. This attractiveness should lead multiple carriers to compete for business customers before similar competition reaches residential customers, resulting in lower prices for business customers. (See D.94-09-065, p. 49.)

We decline to include in the CHCF-B fund the costs of providing telephone service to business customers in high cost areas.

C. The Small And Mid-Size LECs

1. Introduction

In D.95-07-050 at page 35, the Commission analyzed PU Code § 709.5, and stated that: "Unless PU Code § 709.5 is amended to exempt the smaller LECs from local exchange competition, it is our belief that our redesign of universal service must apply statewide." It was from that point of view that we stated in D.95-12-021 that the proxy cost study should be developed for all of California. We also allowed the smaller and mid-size LECs to propose alternative proxy cost models in the event the other models do not adequately reflect their costs.

There are currently seventeen smaller LECs, three mid-size LECs, and two large LECs, in California.[35]

2. Positions of the Parties

AT&T/MCI note in footnote 4 of their opening brief that reform of the existing universal service funding mechanisms does

35 One of the three mid-size LECs, Contel of California, Inc. (Contel), will soon have its operations merged with GTEC. (See D.96-04-053.)

not necessitate the immediate elimination of the existing CHCF for the smaller LECs. AT&T/MCI believe that a fund which addresses the need for subsidies for the large and mid-size LECs is sufficient to create a more competitive telecommunications market.

Citizens' position represents the views of all its subsidiaries. Of the two proxy models presented in this proceeding, Citizens recommends that the CPM be adopted. However, Citizens recommends that the CPM incorporate more company specific data for the mid-size and smaller LECs.

In Pacific's comments to D.95-07-050, it stated that the smaller LECs should be handled separately from the large and mid-size LECs because the smaller LECs will not be immediately faced with competition. Including the smaller LECs may require an inordinate amount of Commission resources, which is not justified given the small number of lines that they operate. Pacific asserts that the existing CHCF should be left in place to handle the smaller LECs until they actually face competition and the new CHCF-B fund has undergone actual use.

The Small LECs recommend that the Commission should not adopt the HPM or the CPM for the smaller LECs. The Small LECs contend that neither of the models produced information that closely reflect the actual costs that the smaller LECs encounter on a daily basis. Unlike the large and mid-size LECs, the smaller LECs remain under rate of return regulation. General rate cases (GRCs) for all seventeen of the smaller LECs are currently pending before the Commission. The GRCs will determine the actual costs incurred by each of the smaller LECs, as well as determining the extent of interstate access and universal service revenues received by the company. The GRCs will also determine the companies' intrastate access and toll revenues, and decide how the remaining portion of the actual determined operating costs will be met.

In addition to the type of regulation that the smaller LECs are regulated under, the Small LECs point out nine other

distinctions between the large and mid-size LECs, and the smaller LECs: (1) smaller LECs receive interstate USF monies under rules that do not provide funding for Pacific; (2) the smaller LECs receive support in the form of interstate dial equipment minutes (DEM) weighting; (3) the smaller LECs have been classified as rural telecommunications carriers by the Telco Act, and are subject to different policies on universal service funding and competition; (4) the smaller LECs have accounting records to show their actual costs on a geographically specific basis, whereas the large LECs do not have such records; (5) the smaller LECs already have geographic specific local rates; (6) the smaller LECs do not have extensive toll networks like the larger LECs; (7) the smaller LECs will not be competing with the CLCs on the same scale as GTEC and Pacific; (8) given the size and budgets of the smaller LECs, the complexity and cost of dealing with proxy models cannot be justified; and (9) the proxy models do not produce accurate information on the actual costs of the smaller LECs.

The Small LECs recommend that with respect to the smaller LECs, the Commission should conclude their pending rates cases that are currently under way. The Commission should make a determination in those proceedings whether there is any need for intrastate universal service funding for the smaller LECs.

The Smaller Independent LECs' comments to D.95-07-050 stated that contrary to the Commission's conclusion that the redesign of universal service should apply to all service areas within the state, the Legislature in PU Code § 709.5(a) only expressed an intent that local service competition was a goal.

The Smaller Independent LECs recommend that the current CHCF be left intact for addressing the high cost element of universal service issues in their territories. They state that except for the one time recovery of IRD impacts in 1995, the draws from the CHCF have not been significant, and that the smaller LECs do not anticipate that draws from the CHCF in 1996 and thereafter,

under the current rules, will be significant. They also contend that it will take some time before competition actually occurs in the smaller, rural exchanges.

The Smaller Independent LECs state that the proposed high cost voucher program may be appropriate for the larger LECs, who will need a new source of revenue to replace the internal subsidies that flow between high cost and low cost exchanges. However, the smaller LECs should be exempted from the use of a proxy model. Instead, their universal service funding requirements should be determined by reference to the actual cost data developed in their GRCs.

Roseville takes the position that the universal service funding requirements of the smaller and mid-size LECs should be determined from their actual costs rather than from a model estimate. The use of a proxy model to estimate the amount of subsidies for the smaller and mid-size LECs should not be used until the adopted model's accuracy has been validated through the experience of GTEC and Pacific.

Roseville makes four arguments as to why the proxy model should not be used. First, Roseville contends that the errors in estimates for Roseville's costs will be magnified enormously by the CPM. Second, both models utilize only data derived from the large LECs. Third, there is no evidence that the two models reasonably estimate the costs of the smaller and mid-size LECs.[36] Instead, there is substantial evidence which suggests that the models do not reasonably estimate these costs. And fourth, the models are unnecessary when the actual costs are available.

36 The Smaller Independent LECs cite these three reasons as well in support of their argument that they should be exempted from the proxy cost modeling process.

3. **Discussion**

When we originally proposed our universal service rules in D.95-07-050, we felt that all carriers should be subject to the same universal service rules. In light of the Telco Act, and for the other reasons discussed below, we have reconsidered that position.

PU Code § 709.5(a) states as follows:

> "It is the intent of the Legislature that all telecommunications markets subject to commission jurisdiction be opened to competition not later than January 1, 1997. The commission shall take steps to ensure that competition in telecommunications markets is fair and that the state's universal service policy is observed."

Subdivision (c) of PU Code § 709.5 provides that the Commission shall expedite its universal service proceeding so "that whatever additional rules and regulations that may be necessary to achieve fair local exchange competition shall be in place no later than January 1, 1997."

The Legislature clearly intended that the local exchange market be opened to competition, and that the rules and regulations regarding universal service be in place by January 1, 1997. The broader issue raised by this code section is whether different universal service funds can be adopted for different size carriers. In light of the Telco Act, we believe that such an approach is permissible.

The Telco Act recognizes that certain LECs should be treated differently. The Telco Act specifically exempts certain rural telephone companies[37] from resale, number portability, dialing parity, and interconnection obligations. These obligations

37 A rural telephone company is defined in Section 3(a)(2)(47) of the Telco Act.

will not apply to rural telephone companies until such companies have received a bona fide request from another carrier for interconnection, services, or network elements, and the state commission determines that such request is not unduly economically burdensome, is technically feasible, and is consistent with Section 254 of the Telco Act. (Telco Act, § 251(f).)

As the Commission noted in D.89-10-031 (33 CPUC2d 43, 91.), the smaller LECs will face much lower levels of competition than GTEC and Pacific. Local exchange competition may take a longer time to reach the service territories of the smaller LECs. The Telco Act appears to account for this as it exempts rural telephone companies from interconnection obligations.[38]

Another reason why the smaller LECs should be treated differently is that the smaller LECs are currently regulated under rate of return regulation. The two large LECs, and the three mid-size LECs, are, or have requested to be, regulated under an incentive based ratemaking framework. Under rate of return regulation, the Commission examines the revenues and expenses of the company. Due to the smaller LECs' size, it is relatively easy to determine what their actual costs of service are. We agree with the arguments of the smaller LECs that there is no need for a proxy model to estimate these costs.

Another compelling reason as to why we should maintain two separate universal service funds is because the federal funding mechanisms for rural telephone companies may change in the future. These funding mechanisms are currently being studied by the Joint Board. Currently, the smaller LECs receive most, if not all, of

38 In the recent FCC interconnection order, the FCC determined that Congress intended that Section 251(f)(2) of Section 101 of the Telco Act only apply to companies, who at the holding company level, have fewer than two percent of subscriber lines nationwide. (FCC Order 96-325, par. 1264, p. 605.)

their universal service funding needs through these mechanisms. At present, very little support is provided to the carriers through the CHCF-A. The Commission should wait to see what the FCC does with the federal funding mechanisms before deciding whether the smaller LECs should be treated like the large and mid-size LECs.

For the above reasons, we will include GTEC, Pacific, CTCC, Contel, and Roseville in the CHCF-B fund for determining universal service subsidy support in their high cost areas.

As for the seventeen smaller LECs, we shall exclude them from the CHCF-B for the purpose of estimating their costs of service.[39] Instead, we shall continue to allow them to draw from the CHCF-A fund under our existing procedures. Once the FCC decides what federal universal service funding mechanisms should be in place, we shall revisit the smaller LECs and the CHCF-A.[40]

If a bona fide request to enter a smaller LEC's service territory is received, the Commission will make a determination in accordance with § 251(f) of the Telco Act. We are currently undecided as to what type of mechanism we should use to determine the high cost area subsidy support in such a situation. We are contemplating two possible options. The first is to compute the costs of providing universal service in the GSAs that the competitor wants to enter using the smaller LEC's actual data. The other option is to conduct an auction to determine the level of

39 As shown in Appendix C, an adjustment to the CPM has been made to remove the 17 smaller LECs.

40 In their comments to the PD, the Smaller Independent LECs recommended that the PD be modified to expressly provide for continued 100% funding of the CHCF-A beyond 1997. We decline to do so. As D.94-09-065 noted at page 259, "CHCF funding beyond the completion of the GRCs will be dependent on the ability of reasonably set rates to allow [small and mid-size] LECs the opportunity to earn their authorized returns."

cost support needed. Since it is unlikely that a bona fide request to enter the small LECs' service area will be filed soon, we will decide how this situation should be handled at a later time.

D. The Costing Standards To Be Applied

1. Introduction

In shaping the development of the proxy cost models for use in the universal service proceeding, we have attempted to achieve some consistency with the TSLRIC studies being developed in the OANAD proceeding. In D.95-07-050, we proposed that the subsidy should be based on the TSLRIC of providing basic service to residential customers. (D.95-07-063, App. B, proposed Rule 6.A.3; See D.95-12-021, p. 6.) We originally suggested that the costing methodologies for the two proceedings be performed jointly in the OANAD proceeding. (D.95-07-050, p. 54.) However, this joint arrangement proved impractical and in D.95-12-021, the Commission decided that an independent, proxy-based cost model should be developed in the universal service proceeding. It was left to the workshops to determine if a TSLRIC methodology was appropriate for the proxy models. (D.95-12-021, p. 6.)

In D.95-12-016, a decision in the OANAD proceeding, the Commission adopted a set of costing principles which the parties in that proceeding had agreed to. These costing principles are based on TSLRIC, and have been referred to as the "consensus costing principles" or CCPs. The principles relevant to universal service are as follows:

Principle No. 1: Long run implies a period long enough that all costs are avoidable.

Principle No. 2: Cost causation is a key concept in incremental costing.

Principle No. 3: The increment being studied shall be the entire quantity of the service provided, not some small increase in demand.

Principle No. 4: Any function necessary to produce a service must have an associated cost.

Principle No. 5: Common costs, if any, are not part of a TSLRIC study, except for a TSLRIC study of the firm as a whole.

Principle No. 6: Technology used in a long run incremental cost study shall be the least-cost, most efficient technology that is currently available for purchase.

Principle No. 7: Costs shall be forward looking.

This section will address the costing principles discussed during the universal service proceeding. We will focus on whether the least-cost technology and forward looking principles imply that new technologies, such as the use of a hybrid fiber coaxial cable (HFC) network, should be incorporated into the cost analysis.

2. Positions of the Parties

AT&T/MCI believe that the CCPs contain a number of fundamental concepts which govern how basic service costs should be determined. In accordance with that belief, AT&T/MCI evaluated the proxy cost models in terms of their consistency with the CCPs. AT&T/MCI argue that adherence to these principles means that: (1) shared and common costs should not be included as part of the cost of universal service; and (2) the cost savings of HFC should be reflected in universal service cost studies.

AT&T/MCI contend that the cost model Pacific is sponsoring should reflect the cost savings of HFC technology for providing basic service. AT&T/MCI's witness Lee Selwyn notes that in Pacific's Section 214 application that it filed at the FCC for video dialtone service, Pacific asserted that the HFC technology would reduce forward looking costs by 36%. In a quote from Pacific's testimony in support of its Section 214 application, Selwyn notes that Pacific stated that a HFC architecture leads to lower costs because: (1) it is a more efficient network design; (2) that such an architecture will generate substantial operational cost savings; and (3) it is a multiple use network. Pacific's Section 214 testimony also asserts that: "The cost of a 'telephony only' HFC network would result in a capital cost saving of 36% per subscriber line over conventional outside plant." (Ex. 7, p. 74.) Selwyn argues that if the testimony provided by Pacific in support of its Section 214 application is to be believed, then the HFC architecture represents the least cost form of new network construction, and Pacific's CPM should incorporate the HFC architecture in order to correctly model forward looking incremental costs.

The Coalition commented that the use of unreliable TSLRIC studies could result in the substantial inflation of the subsidy requirement. The Coalition stated in its December 1, 1995 reply comments at page 12 that the Commission should "incorporate a check

of the LECs' TSLRIC estimates using independent estimates of TSLRIC that rely on publicly available data and assumptions, rather than proprietary LEC data and assumptions."

Contel stated in its comments that the proposed mechanism for determining high cost support requirements must include the TSLRIC of basic service, as well as a reasonable level of contribution to the joint and common costs of the firm.

GTEC supports the use of forward looking TSLRIC costs in the proxy cost models, but states that the model must be adjusted to account for overhead costs, which are not captured by a TSLRIC estimate. Failure to include a reasonable level of contribution would inadequately compensate a COLR.

GTEC argues that neither the AT&T/MCI model nor the Pacific model come close to producing costs that reflect TSLRIC. GTEC asserts that both models failed to compare the total costs of providing all services, including basic service, which is what a true TSLRIC study should have done. Instead, GTEC contends that the two models are a "hodge-podge" of cost concepts that estimate the replacement cost of today's network, using only those technologies and engineering practices which are appropriate on a going forward basis.

Pacific recognizes that the goal of the Commission is to rely upon the TSLRIC cost studies in OANAD to help estimate the cost of basic service. Pacific has also evaluated the cost models in terms of the CCPs. Contrary to the position taken by AT&T/MCI, Pacific believes that the cost of basic service should include some shared and common costs, in addition to the TSLRIC.

Pacific also argues that HFC technology is not appropriate as part of a forward looking cost study. Pacific asserts that the HFC technology deployment is just beginning and will not be the primary serving technology for many years to come. Pacific also claims that its estimates of the HFC cost savings were projections based on a long-term view. Instead of a HFC network,

Pacific contends that the existing network should be the basis for any universal service cost study because that is the network that is actually being deployed and used.

In Roseville's comments to the proposed rules in D.95-07-050, it was opposed to the use of TSLRIC to estimate the cost of providing universal service. Roseville argues that TSLRIC fails to account for administrative costs, which are a legitimate part of providing universal service. Roseville recommends that in order to accurately determine costs, the Commission must include fully allocated costs.

3. **Discussion**

We believe that, for the most part, we should follow the TSLRIC CCPs as the cost standard for the development of a proxy model. By this we mean that costs should be long run in nature, the least cost technology that is being deployed today should be used, costs should be forward looking, and the costs should incorporate all the costs caused by providing basic residential service. Although the HPM and the CPM sponsors assert that their respective models adhere to the CCPs, the cost estimates of the two models vary dramatically.

As we noted in D.95-12-021 at page 7, we did not anticipate that the proxy cost model adopted in this proceeding would be a pure TSLRIC model. For example, a pure TSLRIC model would not include shared and common expenses. GTEC has also pointed out that TSLRIC studies look at the total quantity of a service. By focusing on geographically deaveraged costs, the universal service proxy cost models look at isolated segments of demand rather than at the entire quantity of demand. The emphasis on identifying the costs of specific areas makes the total service view difficult to realize.

We do not believe that the forward looking and least cost technology principles mean that the purported cost savings of a HFC network should be incorporated into an estimate of basic

residential service at this time. Notwithstanding Pacific's prior claims that HFC is the least cost network for providing basic telephone service, we believe that more substantive experience with HFC is needed before we estimate the cost of providing universal service based on an unproven technology.

We do not agree, however, with Pacific's view that a new technology must be deployed universally before it is incorporated into a universal service cost study. Instead, if it can be shown that such an architecture provides service to a significant number of residential customers, and that such architecture represents the least cost technology for providing basic residential service, then it should be incorporated into the cost model.

E. The Competing Proxy Cost Models

1. Introduction

In D.95-07-050 at page 50, we proposed that the costs for all the GSAs be developed by way of proxy cost studies. In D.95-12-021, we left open the possibility that there might be competing proxy cost models. During the scheduled workshops, various models were discussed, but no agreement as to a particular model was reached. Since no agreement could be reached, evidentiary hearings were scheduled to address all the proxy cost model issues. (See ALJ Ruling, February 21, 1996.)

Parties sponsored two proxy models for the Commission's consideration. AT&T/MCI sponsored the HPM. The HPM is based in part on the Benchmark Cost Model (BCM).[41] Pacific sponsored the statewide CPM.[42]

41 The BCM was developed for use at the FCC. The joint sponsors of the BCM are US West, NYNEX, Sprint, and MCI.

42 During the workshops in March 1996, Pacific had proposed using the CPM for its service territory only, rather than a statewide model. The statewide CPM was made available in April 1996, and is the CPM that is being sponsored in this proceeding.

2. The Size Of The Fund

a. Background

In deciding which proxy model to choose, the parties have also taken positions on the size of the fund.

AT&T/MCI witness Cornell testified that in deciding the size of the fund, the Commission should not err on the high side. She stated that if the Commission were to err on the high side, the long term consequences are much more likely to be irreversible than if the fund is set too low. The recipients could then use the monies for anticompetitive behavior that the market cannot necessarily correct. (14 RT 1421-1422, 1424.)

AT&T/MCI witness Selwyn testified that if the fund is oversized, that would be contrary to the goal of encouraging the development of competition. As Selwyn stated:

> "I think that as we move toward reliance upon competitive marketplace forces, to replace the forces of regulation, you're going to have to be very careful in making sure that competition has an opportunity to develop and to provide the discipline in the market that regulation was formerly responsible for bringing up." (15 RT 1619-1620.)

But if the fund is undersized, Selwyn believes that the recipients are still in a position to viably furnish the service, and to take any needed corrective measures, such as focusing on efficiency.

Citizens contends that the Telco Act directs that the universal service fund must be structured to assure quality

services at just, reasonable, and affordable rates. The support mechanisms must also be specific, predictable, and sufficient. Citizens believes that the Commission should adopt a funding mechanism which will provide sufficient funds to assure that quality services are available to all potential users at just, reasonable, and affordable rates.

DCA believes that the Commission's CHCF-B fund should be narrowly defined, and specifically targeted.

GTEC contends that the market will be distorted if the fund is either too large or too small. GTEC believes that the Commission should establish a fund of the correct size. According to GTEC, that size is one which funds the difference between the local rate ceiling and a proxy measure of the market rate.

ICG cautions that in determining the size of the universal service fund, the Commission must be careful not to oversize the fund. ICG argues that if the fund is oversized, the incumbent LECs will use the monies to subsidize the cost of competitive services. This will create a barrier to market entry, and the incumbent LECs will retain their market dominance.

Pacific agrees that there are risks to both oversizing and undersizing the fund. Pacific contends, however, that undersizing the fund runs the risk of disrupting telephone service to the high cost areas of the state, and that it will discourage facilities based competition in high cost areas. Contrary to what the AT&T/MCI witnesses believe will happen if the fund is oversized, Pacific argues that it must still abide by the competitive safeguards that are still in place. Pacific asserts that with these safeguards, anticompetitive conduct cannot occur.

b. <u>Discussion</u>

In deciding which proxy model to adopt, and what estimate of universal service the Commission should adopt, we must be vigilant that the fund is neither oversized nor undersized. If it is oversized, the subsidy provided to carriers will exceed the

actual cost of subsidizing residential basic service in high cost areas. This will allow recipients of such funds to cross subsidize other services, and to engage in other anticompetitive behavior. Oversizing the fund will deter new carriers from entering all markets because of the recipients' ability to subsidize the prices of certain services. The danger in undersizing the fund is that the ability of carriers to serve high cost areas may be impaired.

Our approach to deciding which model to adopt, and the results produced by the model, has been guided by this cautious attitude. Recognizing the disparity between the results produced by the competing models, and the respective interests of the model proponents, and other interested parties, we have crafted a fund which some may think is oversized, while others may think is undersized, but one which we think is appropriate in light of all the evidence. The CHCF-B that we adopt is appropriately sized to encourage competition in all markets, while at the same time preserving and promoting universal service throughout the state.

3. <u>The Two Proxy Models</u>

a. <u>The Cost Proxy Model</u>

The CPM was developed by Pacific, and its consultant, INDETEC. The CPM can estimate residential service costs on a number of geographical bases, including the CBG and wire center. Pacific presented two versions of the CPM during the workshops in this proceeding. The proprietary version relies on precise information about Pacific's customers, while the statewide version relies on more general, commercially available data about subscriber location to estimate costs for the entire state.

One of the primary innovations of the CPM is its use of a grid cell pattern to locate customers. These grid cells identify customer locations within 1/100th of a degree of longitude and latitude, roughly 1/4 mile. The quantity of facilities are estimated by measuring the distance between the center of the grid cell and the central office. These grid cells are also used to

determine the density of a given household. The density of the household is used to identify the distribution plant to be used. The CPM uses the overall density of the wire center to identify the feeder plant to be used.

The cost inputs, engineering and financial assumptions of the CPM are based on Pacific's practices. Some of this underlying cost data, specifically the switch and pair gain investments, are proprietary due to agreements with vendors. Pacific used operating expenses and per unit capital costs from its OANAD cost studies. The allocation of shared and common costs was performed by using a specially modified version of Pacific's Profitability Index (PI) model. The operating expenses for the areas served by other LECs were estimated using the relationship between Pacific's per line operating expenses and the other LECs' operating expenses.

Pacific contends that the CPM is the best available model for estimating the cost of providing residential service. Pacific asserts that the CPM's geographic division of the state is more reliable than the HPM. Pacific also argues that the CPM has been designed by experienced network engineers. In addition, Pacific contends that the CPM produces TSLRIC estimates that are consistent with the OANAD proceeding. Finally, Pacific argues that the Commission should adopt the CPM because it can be adapted to suit the Commission's needs.

Citizens, DRA, and GTEC support the use of the CPM with certain adjustments and modifications. Citizens supports the use of the CPM because the model is consistent with the data being formulated by Citizens and the other LECs for the OANAD cost studies. The CPM also uses verifiable input data, and uses economic lives for depreciation rather than prescribed lives. Citizens also points out that the CPM's use of grid cells more accurately estimates costs in rural areas. Citizens also states that the CPM is more readily adaptable than the HPM. Citizens

suggests that more company specific data be used for the smaller LECs' territories.

DRA believes that the Commission should use the CPM because: (1) it is easier to use than the HPM, and most of the inputs and assumptions can be changed in the CPM; (2) the CPM's inputs and assumptions are more easily verified than the HPM; and (3) the CPM relies more on California-specific numbers than the HPM. As discussed later in this decision, DRA recommends several specific modifications to the inputs and assumptions of the CPM regarding utilization factors, fiber/copper feeder cut-off, calculation of drop costs, costs for cable and conduit placement, and depreciation rates.

GTEC supports the use of the CPM with modifications because it believes that the CPM's estimates are closer to actual cost estimates than the HPM. The CPM also reflects the least cost means of serving customers today. In addition, GTEC contends that the CPM is flexible because it can use company-specific data or general data. The model can also process information on a grid cell, census block, or wire center level. GTEC recommends a series of modifications to the CPM. These include the following: (1) classifying wire centers based on the number of lines served; (2) an external process for developing non-company specific unit cost inputs and standards; and (3) a new copper/fiber feeder cut-off of 12,000 feet. GTEC also suggests investigating some further modifications such as using carrier records to determine business line and additional residential line counts.

b. <u>The Hatfield Proxy Model</u>

The HPM is based on the BCM. The HPM uses the BCM to estimate the capital cost of providing the residential local loop. The HPM departs from the BCM by: (1) adding the cost of certain critical network components, such as the drop and terminal; (2) calculating maintenance expenses using plant specific factors; (3) replacing the switching module with a new one; and

(4) explicitly accounting for billing and collection, and white page listing costs. In addition, the HPM modifies some of the user-changeable inputs such as the distribution fill factors.

The HPM relies on a variety of sources for its extensions to the BCM. For additional network components, the HPM relies on selected portions of particular incremental cost studies from other jurisdictions. For plant specific expense factors, the HPM relies on historic relationships between LEC investment and maintenance expense. Generally, the HPM uses historical California LEC cost relationships. However, for switch repair and maintenance cost, the HPM uses historical relationships from New England Telephone Company (NET). For switching costs, the HPM relies on published information and industry expert opinions.

AT&T/MCI contend that the HPM is competitively neutral. AT&T/MCI point out that the HPM bases its cost assumptions on a number of sources rather than the historical experience of any single incumbent LEC. It is also consistent with TSLRIC costing principles because it reflects the costs an efficient, cost-minimizing competitor would incur. AT&T/MCI also argue that the HPM has been approved in other jurisdictions, such as in the state of Washington. They also contend that the HPM is adaptable.

c. Discussion

It would have made our task much easier if the two models produced similar results. Unfortunately, the outcomes of the models are quite extreme. As a result, we have to analyze both models, and decide which model is better suited for developing the cost of providing basic service throughout the state.

To evaluate the two models, we examined a number of criteria. These criteria are based on our discussion of proxy models in D.95-12-021 and the criteria applied by DRA. (Ex. 109, p. 3-2.) These criteria are: (1) the ability to estimate costs for the entire state on a CBG level; (2) the degree to which the design of the model can accurately reflect costs; (3) the openness and accessibility of the model to changes in assumptions and inputs; (4) the ability to model costs based on today's placement of technology; (5) the ability to model the proposed definition of basic service and subsequent changes to this definition; and (6) the verifiability of inputs and assumptions. In evaluating the models, more emphasis has been placed on the model design and the ability to change the inputs and assumptions rather than the inputs themselves.

(1) **Can The Model Estimate Costs for the Entire State on a CBG Basis?**

The purpose of choosing the CBG as the GSA for determining the subsidy is to reduce the cost averaging that would occur if a larger GSA was used. The Commission first proposed CBGs as the basis for determining the costs to serve an area in D.95-07-050.[43] This designation was subsequently reaffirmed in D.95-12-021.

43 D.95-07-050 also proposed that a COLR be required to serve on a CBG basis.

Both models can produce costs for the entire state, but only the CPM can generate cost data for the entire state on a CBG basis. The HPM does not generate output on a CBG basis, but instead output is generated by density zones. The CPM is also capable of generating cost on a wire center basis, or some other grouping. The BCM apparently has this capability, but the designers of the HPM appear to have eliminated this capability from their model. (See 18 R.T. 1987-1988.)

(2) Does the Model Design Accurately Reflect Costs?

During this proceeding, parties, especially GTEC and the Small LECs, have identified design flaws in both models.

GTEC has identified a number of design flaws with the BCM which have not been addressed by the HPM. Many of these structural flaws have been recognized by the joint sponsors of the BCM, who, at the close of hearings, were attempting to correct them. It is unclear whether the joint sponsors will be successful in their ongoing attempts to improve the BCM. It is also unclear whether the sponsors of the HPM will embrace the revised BCM. The primary problems as identified by GTEC are the following: (1) the BCM assumes that the population is uniformly distributed within the CBGs; (2) the BCM assumes that the cost of placing facilities is linearly related to the cost of materials; and (3) the BCM assumes that the CBGs are square, and that the feeder plant reaches the border of the CBGs and that the distribution plant covers the interior. Each of these items are discussed below.

The BCM assumes that the population in CBGs is evenly distributed throughout the CBG. This assumption is not accurate for rural areas where the population tends to be clustered around roads and the towns. Consequently, the BCM would tend to overestimate the cost of serving less dense remote areas, all else being equal. The joint sponsors of the BCM have recognized this

deficiency with the BCM, and, at the time hearings concluded, were modifying the model to correlate the population with the road pattern in these less dense areas. The CPM's grid cell design avoids this problem by identifying the location of population in a more precise manner.

The BCM assumes that structure costs vary in direct proportion to the costs of those facilities. This means that a discount on material costs, for example, copper cable, will lead to a corresponding drop in the supporting structure costs, such as trenching costs. This also means that the model incorrectly assumes that the costs of placing facilities will vary with the size of cable. For example, the BCM assumes that a cable one quarter the size of the standard cable, will cost roughly one quarter as much as the standard cable, and will require a trench one quarter as deep. The joint sponsors of the BCM have recognized this problem as well, and are working to correct it.

The HPM attempts to rectify this problem by incorporating the installation factor for facilities in these two lowest population density zones. This installation factor adjustment represents somewhat of an ad hoc solution. It fails to address this deficiency in the more densely populated areas. The CPM avoids this problem by separately identifying costs for facilities placement from their cable costs, and separating per foot and per pair cable costs.

The BCM's process of taking irregularly shaped CBGs, assuming that they are square, and placing feeder and distribution plant accordingly, also raises a number of concerns. In rural areas where CBGs can be quite large, the BCM assumes that copper distribution plant can serve the entire interior. It is unclear whether the BCM allows for sufficient electronics in the distribution plant to ensure that these households could actually receive telephone service from the network as modelled. This deficiency has been recognized by the developers of the BCM.

(Ex. 62, Att. A, Item 10.) By relying on a regularly shaped grid, the CPM avoids creating this artificial geography and its attendant difficulties.

GTEC points out that the CPM also contains some design flaws. First, the CPM assigns central offices according to the density of the wire center, rather than according to the number of lines served by the central office. This type of categorization in turn drives the switching costs, and the application of unit costs to feeder plant. According to GTEC, classification of lines by density, instead of by wire center size, fails to take into account the economies of scale by wire center size. In contrast, the HPM uses actual central office line counts to size switches. GTEC has proposed this change to the CPM, which the designers of the CPM have accommodated. The CPM model that the Commission's Telecommunications Division has been using for this proceeding includes this change.[44]

Another weakness of the CPM is that it gathers inputs from a series of tables. Much of the modeling of the network has already been performed at a lower level to generate the data to populate these tables. This design is not necessarily problematic, but caution must be exercised to ensure that the inputs from the tables are consistent with the base data which generated the tables. The BCM appears to be a more self contained model, but some pre-processing of data is also necessary.

One of the primary advantages of the BCM is that it allows for the sharing of feeder cable between CBGs on the same feeder route belonging to the same wire center. According to AT&T/MCI's witness Mercer, this produces an accurate depiction of the distribution network associated with each wire center. The BCM

44 The Telecommunications Division staff responsible for reviewing the CPM was formerly organized within the Commission's Advisory and Compliance Division (CACD).

allows for the gradual tapering of feeder plant as it extends from the central office. This allows CBGs more distant from a central office to share in some of the economies of scale they receive by being served by a large central office.

The CPM does not contain an explicit method for accounting for the sharing of feeder cable by households served from the same wire center. The tapering effect is simulated by averaging segments of distribution plant used to serve sample loops. The CPM attempts to account for this through averaging. It is unclear, however, whether this process is sufficient. Consequently, the CPM may tend to exaggerate the cost of feeder plant in less dense areas served by large central offices.

Although both models have their flaws as far as reflecting costs, the CPM's shortcomings appear to be more easily resolved than those of the HPM and BCM.

(3) Is the Model Open and Accessible to Changes in Inputs and Assumptions?

AT&T/MCI assert that the HPM is an open and flexible model. While the HPM's extensions of the BCM are open and flexible, the underlying inputs and assumptions in the BCM model are not. By contrast, Pacific has offered to turn the universal service edition of the CPM over to the Commission after it runs any mandated revisions the Commission might require.

Certain critical assumptions and inputs to the BCM cannot be changed by the user because: (1) they are locked; and (2) changes are restricted by copyright. Pacific points out that many of the assumptions of the HPM and BCM are not user changeable. The fiber/copper cut-off, the cable multipliers and

the mix of aerial, buried and underground plant are all fixed. However, in the CPM, all similar assumptions are user changeable.[45] As Pacific points out, the BCM is a proprietary model which can be modified by the joint sponsors, but not necessarily by the Commission or even the HPM's sponsors in California.

(4) How Well Does the Model Comply With the Relevant Consensus Costing Principles?

The sponsors of the models spent a great deal of time evaluating the models to determine how well the models conformed to the CCPs.

AT&T/MCI argue that the HPM is consistent with the CCPs. They maintain that the HPM reflects efficient technology under a long run planning horizon for the entire demand of residential basic service. AT&T/MCI contend that by separately identifying certain structural costs, the HPM is able to separate the costs caused by providing basic service from other loop based services. AT&T/MCI also claims that the HPM appropriately includes overheads and excludes common costs. In contrast, AT&T/MCI argue that the CPM violates CCP 4 because it: (1) uses historical expenses from 1994; and (2) incorporates shared and common costs.

Pacific argues that its implementation of the CPM is consistent with the CCPs. The CPM is a scorched node model which assumes the current LEC switch topography. Pacific contends that the CPM uses forward-looking assumptions, and includes the entire demand for service.

45 MCI/AT&T's witness Selwyn asserts that the fiber/copper crossover point in unchangeable in the CPM. However, GTEC and DRA did not encounter this, and were able to make this change in the CPM.

Pacific argues that the HPM should not be used because it violates certain TSLRIC principles. According to Pacific, the HPM fails to acknowledge the existing topology of the network by misassigning wire centers. In addition, the HPM does not account for all costs caused by basic service, and understates costs to such an extent that it fails to identify associated costs. In addition, Pacific argues that the HPM is not forward looking because it estimates operating expenses based on the relationship between embedded investments and expenses.

Both the CPM and HPM are designed to model the costs of providing basic residential service using today's placement of technology. Neither model is well suited to account for new technologies, such as a HFC network or wireless technologies. Neither of those two technologies are currently being used to offer basic residential service on a wide scale in California, however. Both the HPM and CPM use a scorched node approach whereby the current topology of central offices is assumed. The models are provisioned with facilities as they would be deployed today.

Both models rely on historical LEC data to predict forward looking maintenance and repair costs. For some repair and maintenance expenses, the HPM applies a factor derived from the historical relationship between plant investment and repair expenses to the forward looking investment estimates generated by the BCM. For other operating expenses, such as network operations, the HPM adds a fixed per line expense based on historical data. In this respect the HPM differs from the BCM which uses an investment/expense factor for all operating expenses.

The CPM uses Pacific Bell's 1994 per line maintenance and repair expenses, adding a fixed amount per loop. Some adjustments are made to reflect the forward looking model assumptions; for example, maintenance of analog switches is excluded. As with other operating expenses, the CPM estimates

repair and maintenance for other companies by adjusting the per line ratio between Pacific's operating expenses and other operating expenses.

Both the CPM and the HPM make efforts to produce forward looking costs. However, the selection of the models was not determined by the forward looking nature of the models.

(5) Can the Model Estimate the Cost of Basic Service and Subsequent Changes to this Definition?

Both models can estimate the cost of providing voice grade residential service. However, it is unclear whether the HPM fully accounts for two elements of the definition of basic service: the directory assistance allowance and access to billing information. The HPM's estimates of directory assistance allowance costs do not appear realistic given the labor required to answer each directory assistance call. Also, the HPM makes little allowance for the cost of billing inquiries. The HPM could probably be modified to account for these services by adding a greater fixed amount for directory assistance and billing inquiries.

(6) Can The Inputs And Assumptions of The Model be Readily Verified?

The HPM and CPM each present unique difficulties for verifying inputs and assumptions. There are three classes of difficulties with the HPM: (1) it relies on assumptions in the BCM which AT&T/MCI cannot alter or explain; (2) it relies on unnamed experts; and (3) it relies on selected portions of cost studies from other jurisdictions. The designers of the HPM did not participate in developing the BCM, and were not familiar with how the BCM inputs were derived. Consequently, the designers of the HPM could not validate the data contained in the BCM or respond to questions about how the BCM worked. This difficulty is compounded

by the fact that the BCM's inputs are not readily comparable to other data sources. For example, GTEC claims that the BCM's structure factor is in such a form that a company cannot compare these costs to its own experience.

The HPM extensions to the BCM frequently relied on unidentified experts rather than any concrete source. For example, in response to a DRA data request, Hatfield Associates indicated that they relied on informal conversations with a person from a major switch manufacturer to identify switching costs. In addition to switching cost adjustments, several types of network costs, such as the network interface device, digital loop carrier equipment capacity and switch installation, were based on informal, undocumented conversations.

During the proceeding, DRA illustrated that the origins of many of the HPM's inputs were unclear. The HPM had to add certain critical network components which were not included in the BCM. For example, the HPM uses drop costs from a NET study, yet AT&T/MCI's witness could not explain how those costs were derived. Pacific also questioned whether the NET study is a TSLRIC study as defined by the Commission's CCPs.

In contrast, the CPM depends largely on Pacific's own data. However, Pacific's reliance on pre-existing models in implementing the CPM complicates the verification of Pacific's data. For example, the A.& B costs in the CPM are derived from Pacific's PLAN COSTDEC model. Switching costs are derived by the Switching Cost Information System (SCIS) model, and shared and common costs are allocated using a specially modified version of the PI model. Each of these models are highly complex on their own.

We find that the CPM's reliance on Pacific's own data and underlying models is a defect; however, with effort, the data underlying the CPM can be identified. This is not true of the HPM, since the HPM's dependence on unidentifiable sources presents greater problems.

d. Summary

Using the criteria above to evaluate the two models, we conclude that the CPM is a more appropriate model for estimating the cost of providing basic service in California. The CPM can model costs for the entire state on either a CBG or wire center basis. The CPM's grid cell design is more conducive to an accurate representation of costs than the HPM's design. In addition, the CPM is more open and accessible to changes in assumptions and inputs. Also, the assumptions and inputs in the CPM are more easily verified than in the HPM. For those reasons, we will adopt the CPM as the proxy model to develop the cost of providing basic service to all residential customers in California.

F. Recommended Adjustments to the CPM

1. Introduction

We have adopted Pacific's CPM in order to calculate the cost of providing basic service on a CBG level. With Pacific's original inputs and assumptions, the annual statewide subsidy amount totals $1.7 billion, of which it is estimated that $1.3 billion would go to Pacific initially.

Several parties recommended adjustments to the Pacific's CPM. The parties recommend that adjustments be made in order to change inputs which the parties believe lead to an overstated subsidy. For the most part, these changes affected the inputs, and not the structure, of Pacific's model. In some cases, a slight change to the model structure itself was recommended. The changes covered the number of lines to be subsidized, drop costs, cable and conduit costs, the fiber feeder cut-off, fill factors, depreciation rates, reordering of switches, the outside plant factor, switching costs, shared and common costs, rearrangement expenses and the nonrecurring burden, directory assistance, and repair and maintenance costs.

We have adopted overall adjustments which total to $1.116 billion. This section details all of the recommended changes. Appendix C summarizes these adjustments.[46] In describing the impact of the changes to the model, the effect of each change is described in isolation.

2. **How Many Lines Should be Subsidized?**

a. **Introduction**

The statewide CPM, as sponsored by Pacific, includes the cost of second lines in its subsidy calculation. As testified to by several of the witnesses, the subscribership rate for second lines for Pacific's customers is approximately 17%. The issue in this section is to decide how many lines in high cost areas should be subsidized by the fund.

b. **Positions of the Parties**

AT&T/MCI, and all the other members of the Coalition argue that only the primary line to a household should be subsidized.[47] According to the Coalition, additional access lines do not satisfy the definition of universal service under federal or state law.

Citizens agrees with AT&T/MCI witness Cornell that only the primary residential line, i.e., one line per household, should be included in the cost of universal service.

---

46 The numbers shown in Appendices C, D, and E vary from what was originally proposed in the August 5, 1996 proposed decision because of changes made in light of the comments to the proposed decision, and because of the issuance of D.96-08-021.

47 AT&T/MCI witness Cornell considers a household to be a situation where a person or persons live separately from others, even though they might reside in the same dwelling. Cornell's definition is virtually identical to Pacific witness Mitchell definition that a household is an unrelated, separate group or individual living separately, even if living in the same dwelling.

DRA takes the position that all residential lines in high cost areas should be subsidized. DRA believes that all of the lines should be subsidized because there is no rate difference between the first line and any subsequent lines. Second lines also increase the utilization of the network. In addition, by subsidizing all lines in high cost areas, it encourages facilities based competition because carriers would be competing for the first line, as well as subsequent lines. DRA also agrees with Pacific's argument that primary lines are more costly when they are separated from the total cost of access lines.

DRA agrees with GTEC that if a distinction needs to be made between first and second lines, that it would place carriers in the difficult position of making judgments as to what constitutes a household, and it would create a need for exchange of information among the various carriers. Such an exchange process would be difficult, and involve the exchange of proprietary customer information.

GTEC recommends that there be subsidy support for both primary and secondary residence lines because there is no tariff distinction at present between first and subsequent residence lines. GTEC points out that supporting secondary lines would permit access to information services on the secondary line, such as an Internet provider, without interfering with the use of the primary line. If additional lines are not supported, GTEC contends that it will be necessary for prices to rise to market levels for second lines.

GTEC contends that if only one line per household is to be subsidized, then there must be a definition of a household that can be reasonably applied so that the COLR is not in a position of having to determine whether the customer constitutes a separate household or not. GTEC believes that the support of a single line will cause administrative difficulties, and that

customers will construe the definition in a way that serves their own interest so that many second lines will end up being supported.

Pacific witness Mitchell testified that the subsidy should be made available for one basic service line per residence, and that the pricing of additional lines should be based on the market. According to Mitchell, this keeps the subsidy fund reasonably scoped, and assists with the transition from regulatory pricing to economic pricing. If the Commission restricts the price of additional lines, then it must provide a vehicle to recover the full cost of those additional lines.

TURN takes the position that the fund should only provide support for the first subscription for telephone service. TURN argues that the first connection is far more essential than additional subscriptions. The first subscription enables a household to receive calls, complete local calls, and provides access to toll service. Additional subscriptions are a separate and distinct service, and generally provide the household with additional convenience.

TURN contends that limiting high cost area support to the primary line only would not create any undue administrative burden. A customer in a high cost area would merely need to certify that it only has one primary line serving that household. TURN points out that the LECs are already doing this for customers who are on the ULTS rate. The self certification process described in General Order (GO) 153 for the ULTS program could be easily modified to apply to this fund.

c. <u>Discussion</u>

We agree with Pacific witness Mitchell's statement in his prepared opening testimony that: "The question of how many basic service lines should be subsidized per residence is a separate issue from the accurate and complete accounting of cost." (Ex. 46, p. 11.) Mitchell testified that the incremental cost of the second line is implicit in the CPM. If the number of lines to

individual premises were expanded or contracted, the model would reflect the costs of those expansions or contractions. Here, we are concerned about the number of lines that should be subsidized in each high cost area.

The Telco Act refers to universal service as an evolving level of telecommunications services. In defining the services to be funded by the federal universal service support mechanisms, one consideration is whether the telecommunications service is essential to education, public health, or public safety. (Telco Act, § 254(c)(1)(A).) The California Legislature in AB 3643 declared that universal service requires that telephone service be affordable and ubiquitously available. One of the principles of AB 3643 is that essential telecommunications services be provided at affordable prices. (Stats. 1994, Ch. 278, Sec. 1.(a), Sec. 2.(b)(1).) In determining how many lines should be subsidized in high cost areas of the state, we need to consider whether the number of lines we choose to subsidize is sufficient to provide essential telephone service.

In order to keep the fund size at a reasonable level, we believe that only the primary line, i.e., the first line, to a household should be subsidized. Subsidizing only one residential line per household in high cost areas allows that household to have essential telephone service. Subsidy of additional lines is not justified because the primary line already provides the essential connection. Subsidizing only one line per household also keeps telephone rates affordable for those who live in high cost areas, as well as for everyone who is obligated to support the fund. The arguments of DRA and GTEC that all residential lines in high cost areas should be supported would only serve to increase the size of the fund.

We will adopt an adjustment to our estimate of the CPM that the staff has developed to recognize that only one line per household in a high cost area shall be subsidized. That

adjustment of $128 million is shown on Appendix C. This adjustment is based on the CPM's assumption that approximately 17% of households in California have second lines.[48] This reduces our estimate of the number of subsidized lines to about 4.03 million lines.

As for the possible administrative problems of having a COLR determine whether a customer has only one primary line, we believe that TURN's suggestion to use a self certification procedure has merit. As Pacific witness Mitchell acknowledged, there would only be a limited burden on the carrier if customers in high cost areas had to self certify that they only have one primary line per household. The problem that TURN addressed will become a concern as competition in high cost areas grow. That is, telephone service to a residence may be provided over the traditional copper pair owned by the incumbent LEC, or a telephone signal may come over the coaxial cable that presently serves to connect cable television. With two or more sources of connection, it is possible that a household in a high cost area may attempt to subscribe to two subsidized primary lines. That is, a customer may subscribe with the LEC to obtain the first subsidized line, and then attempt to subscribe with a CLC to obtain another subsidized line that is provided over the coaxial cable. TURN's suggestion that all subscribers requesting residential basic service in high cost areas be required to certify that they are not presently receiving residential basic service through any other telephone company will

48 Some of the commenting parties contend that the 17% figure is too high of a number for each LEC. We would just note that the CPM assumes as part of the modeling process that there is at least one phone in each household, and that 17% of the households have second lines uniformly in all areas of the state regardless of the company. Thus, when the CPM is run, the extra 17% is included in the run result. Our adjustment resolves this problem.

be adopted. The certification should also provide that the customer will notify the company if circumstances change. A workshop will be convened by the CSD, in conjunction with the Telecommunications Division, to discuss ways in which the self certification process in GO 153 can be adapted for use with this fund.

3. Drop Costs

a. Background

The CPM currently assumes one buried drop per residence. The drop is the connection between the subscriber network interface on a customer's premises to the company's distribution plant.

DRA believes that the cost of placing the drop is overstated. DRA recommends that the CPM's buried drop cost be reduced by half so that the cost of placing the drop is spread over two copper pairs rather than to a single pair. Pacific's standard engineering practice is to use two copper pairs in drops in buried plant to each residential subscriber.

GTEC is unclear as to the purpose of DRA's proposed modification. Although DRA proposes to support all residential lines, GTEC asserts that DRA appears to be assuming that the CPM accounts for only one drop per household. GTEC asserts that DRA's proposed modification goes against industry standards which require placement of two pairs to each residential unit.

Pacific's reply brief did not address DRA's recommended adjustment.

b. Discussion

In the August 5, 1996 proposed decision, an adjustment of $39.7 million was made to the CPM. That adjustment was based on the belief that the cost of the drop plant should be spread evenly over two pairs.

In GTEC's comments to the proposed decision, GTEC argued that the adjustment should be eliminated because the cable

for buried drops is manufactured to carry two pairs, and that any attempt to separate the costs associated with a second pair is impractical. GTEC also asserts that the second pair is often used in the event the first pair is defective. In addition, it is not clear that there is any significant incremental cost.

We agree with GTEC's argument that drop wire is produced in a fashion that the installation of two pairs would be expected. The CPM's original drop assumption is also consistent with our policy that there should be spare capacity in the distribution plant. Upon further reflection, we shall eliminate the $39.7 million adjustment from the CPM.

4. Cable and Conduit Costs

a. Background

In the CPM, Pacific accounts for cable, conduit, pole, and pair gain costs in a table called A & B costs. "A" costs are fixed costs per foot, and are required regardless of the size of cable or number of pairs or size of cable being installed. "B" costs vary by the number of pairs or size of cable being placed. The A & B costs were derived from Pacific's PLAN COSTDEC model. The PLAN model is Pacific's loop planning program.

AT&T/MCI recommends that the Commission not accept Pacific's A & B costs. AT&T/MCI witness Selwyn testified that the CPM's terrain modifying factors appear to have been developed and applied inconsistently in the PLAN COSTDEC program. The modifying factors are multiplied against the structure costs, and the costs of copper and fiber cables from the PLAN COSTDEC program. According to Pacific's CPM documentation, the modifying factors represent Pacific's estimate of how the cost of installed outside plant can be affected by topographic considerations and urban congestion. AT&T/MCI contend that the evidence strongly suggests that the PLAN COSTDEC data represents average field conditions, rather than lower cost normal field conditions. When the modifying factors are applied to average field conditions, rather than lower

cost normal field conditions, the CPM is in effect double counting or overstating the effects of terrain and other sources of difficulty. Selwyn also points out that the regression analyses that were used originally to develop the A & B costs no longer exist, so the cost values that were used are unsupported.

Selwyn testified that Pacific recently announced it had developed new A & B cost values. Workpapers for the revised costs of copper cabling, and conduit sized for four or more ducts, were supplied. However, the remaining revisions to the A & B costs were not supplied and reviewed by the time hearings had concluded.

The revised copper cable cost for buried 26 gauge copper cable was reduced from $1.60 to $0.17 per foot. Selwyn testified that the substitution of the revised A & B costs for copper cable alone reduces the CPM's estimate of the statewide annual subsidy requirement by $45 million.

As for the revised A & B cost for conduit, Selwyn contends that this revised cost underestimates conduit investment for distances less than 1973 feet, and overestimates conduit investment that are longer than 1973 feet. Since the average conduit length produced by the CPM is 8730 feet, if the revised conduit A & B factors are used, the CPM will overstate the conduit costs.

DRA recommends using Pacific's revised A & B costs for cable. DRA estimates the annual statewide impact at about $50.5 million.

GTEC points out that the CPM inputs rely on extensive tables of unit cost factors, such as cable and conduit costs, which have been developed outside the CPM. This is of concern to GTEC because the actual modeling of the unit costs is external to the CPM, and raises an issue about their applicability to other LECs. When GTEC witness White reviewed the cable and conduit cost inputs in the CPM, he found them to be inconsistent with his experience. GTEC believes that the CPM does not have any internal controls

which assure that the assumptions used in developing these different unit cost inputs are consistent with each other, with the size of the wire center being evaluated, or with a specific network design for that wire center. GTEC also asserts that in addition to the unit costs, other key assumptions used in the model, such as the ratio of feeder to distribution, and the mix of cable by density zone, are based on averages or practices specific to Pacific.

GTEC proposes that a simple, consistent, and observable process be used to develop the unit cost estimates used in the CPM. GTEC has developed a spreadsheet which accepts some of the basic cost elements such as cable material costs and placement costs. These cost elements are based on GTEC's recent contract with Lucent Technologies (Lucent). This process also accepts assumptions for the rules that govern how these basic elements are combined, such as cable sizing, the branching and spacing of cable routes, and utilization rates. By modeling the wire center network using this information, this process would create a consistent set of unit cost values which would be used to populate the unit cost tables in the CPM.

Pacific agrees that the Commission should use the A & B costs for copper cable.

b. <u>Discussion</u>

We address three issues in this section. The first is the A & B cable cost. The other two issues relate to the conduit and cable costs generated by the CPM.

The CPM, as sponsored by Pacific, contains cable sizes based on averages from Pacific's installed plant. Separate samples of feeder and distribution plant were taken to identify what sizes of cable typically serve distinct categories of density. Feeder plant was sized based on the COSTDEC database, while distribution plant was sized based on OANAD loop samples.

GTEC's proposed method would base cable sizes on its external modeling process. GTEC's method sizes feeder plant according to the number of access lines served by a central office. Distribution plant would be sized in accordance with the number of lines in the distribution area.

The modification to the A & B cable cost is supported by Pacific's revised cost of copper cable to $0.17. Since this revised cost was not included in the CPM runs that Pacific sponsored during the hearings, this change needs to be reflected in the CPM. We will adopt the revised cable cost. This adjustment to the CPM results in a $48 million annual adjustment.

The modification to the conduit costs is less clear. The source for Pacific's conduit costs is the PLAN COSTDEC program. AT&T/MCI witness Selwyn points out that the regression that Pacific used to develop the conduit costs in the CPM was in error because it simplified the regression by failing to include a function that reflects cost incurred on a per trench foot basis. We believe that this manipulation of the regression tends to inflate conduit costs.

The August 5, 1996 proposed decision recommended the adoption of GTEC's proposed conduit costs. However, since GTEC's proposed conduit costs were based on a vendor contract that has expired, we will not adopt these costs. Instead, we will use Pacific's sample of conduit placement costs following the method implemented in the OANAD cost studies and taking into account GTEC's concern about ensuring that conduit and feeder cable capacity are aligned. Adoption of this conduit adjustment results in an annual adjustment of $40 million.

In the August 5, 1996 proposed decision, an adjustment of $46.06 million was made to the feeder and distribution cable sizes. The adjustment utilized GTEC's proposed feeder cable size and used an adjusted distribution cable size. Pacific points out in its comments to the proposed decision, that in the recent OANAD decision, D.96-08-021, the Commission accepted

Pacific's cable sizes. If the adjustment of $46.06 million is adopted, Pacific asserts that utilization will decrease, and that the fill factors should be reduced as a result.

To maintain consistency with the OANAD proceeding, and because of the concern we expressed in the August 5, 1996, proposed decision concerning GTEC's cable sizes, we will use Pacific's original cable sizes. Hence, no adjustment for cable sizes is shown on attached Appendix C.

5. Fiber Feeder Cut-off

a. Background

The material used for feeder plant depends on the length of the feeder route. The CPM assumes that if the feeder length is longer than 9000 feet, fiber is used. If the feeder length is shorter than 9000 feet, copper is used. Pair gain technology is used in conjunction with fiber feeder at the serving area interface. It is the cost of the pair gain device itself, rather than the type of cable, which drives the economics of feeder technology.

AT&T/MCI contend that the 9000 feet cut-off point is not a reasonable assumption. They point out that the CPM should take all significant factors, such as capacity requirements, into account that impact the choice of copper cable versus fiber. The CPM's assumption of 9000 feet generates loop investment costs that do not consider whether or not that distance is the economically efficient cut-off point for primary residential service. AT&T/MCI argue that in the last seven years, Pacific has made a number of revisions to its guidelines governing the planning and provisioning of feeder facilities to support advanced digital and broadband services. According to AT&T/MCI, this has led to a significant overbuilding of feeder facilities in relation to those facilities that are actually required to meet the demand for residential

access lines and other plain old telephone service (POTS) services.[49] This is evidenced by excessively low feeder plant utilization factors. AT&T/MCI also point out that Pacific's Crossover Study fails to provide any support for the use of a 9000 feet cut-off.

DRA recommends that the fiber feeder length assumption in the CPM be changed to reflect that fiber only be considered for feeder plant which exceeds 12,000 feet. When DRA investigated this issue, it was determined that Pacific's documents in support of the 9000 feet cut-off was for loop broadband planning. DRA asserts that the cost of basic service should not be used to subsidize the development of broadband services. GTEC uses fiber when the feeder length is beyond 12,000 feet. The BCM also considers the use of fiber when the total feeder length exceeds 12,000 feet.

GTEC recommends that the CPM be modified to assume that pair gain devices be placed no farther than 12,000 total feet from the end user. GTEC states that the 12,000 feet cut-off point is consistent with its engineering practices.

Pacific argues that the drop in electronics prices make it economical to place fiber for all feeder routes which exceed 9000 feet. According to Pacific, the 9000 feet cut-off makes economic sense for even narrow band telephony. Pacific also points out that GTEC's recommendation is based on 12,000 feet of the total loop length, whereas DRA's recommendation is 12,000 feet of feeder length. Pacific's copper distribution runs tend to be 2800 to 3200 feet in length. If GTEC's distribution runs are the same, GTEC's feeder length would be about 9000 feet. Pacific also contends that if the cut-off is increased to 12,000 feet, an

49 POTS is a frequently used industry acronym which refers to an analog voice grade dial tone access line.

increase in costs will be needed to reflect the costs of maintaining more copper in the feeder.

b. Discussion

The testimony of AT&T/MCI witness Selwyn is compelling. He points out that Pacific's feeder plant planning practices have been in transition from the provisioning of POTS, to the provisioning of advanced narrowband and broadband digital services. His testimony traces the reasons why Pacific's fiber feeder cut-off point have been reduced from 12,000 feet to 9000 feet. The 9000 feet cut-off would not make sense in low density, rural zones where demand and capacity requirements are smaller. Additionally, a cut-off of 9000 feet would shift the costs associated with higher bandwidth services onto the costs of providing basic service. As a result, we believe that the CPM's estimate of loop investment costs is overstated, and does not accurately represent the least cost, forward looking, method of providing residential basic service.

The CPM's maintenance expenses reflect Pacific's 1994 experience at a time when the company's plant was almost exclusively copper with far less fiber than even the 12,000 feet cut-off implies. If the 9000 feet cut-off is more appropriate, then the model ought to reflect significant savings in maintenance expense over the 1994 figures used. By changing the parameters in the model, we are not indicating a preference for any particular technology choice. We are simply creating a standard based on what appears to be the least cost technology at the present time.

Accordingly, we adopt the recommendation to extend the cut-off of copper feeder versus fiber feeder from 9000 feet to 12,000 feet. Adopting this modification results in an annual subsidy decrease of $78 million. Such an adjustment is consistent with how we addressed this problem in D.96-08-021.

6. Fill factors

a. Background

The fill factor is a measure of how much of the plant is being used to provide service to customers. The fill factor is also known as the utilization rate. The fill factors are used to determine the size of feeder cables and related facilities. They are also used in the CPM to spread the cost of the resulting feeder investments, together with the costs of conduit and other support structures, over the working feeder lines.

Parties debate what level the fill factors should be for feeder, distribution and pair gain in the model. Pacific's fill levels for copper feeder, fiber feeder, pair gain, and copper distribution are based on the fill levels that Pacific has achieved in its network. These fill levels are called the actual fills. There is another level for fill known as administrative or design fill.

AT&T/MCI argue that Pacific has reported unreasonably low actual fill factors. They state that the low utilization levels are directly attributable to Pacific's announced plans to build a network capable of providing far more services than basic local exchange service. AT&T/MCI do not believe that this excess capacity should be borne by basic local exchange service. To correct this deficiency, AT&T/MCI witness Selwyn suggests changing the copper feeder fill factor to 89% and the copper distribution factor to 71% for all density zones. Such an adjustment results in an annual decrease of $87.2 million. He also suggests raising the pair gain fill factor for density zones 4-7 to 73%, 73%, 82% and 83% respectively. This adjustment decreases the annual requirement by $29.8 million.

CCTA points out that the utilization factors that Pacific uses in this proceeding differ substantially from Pacific's fill factors in OANAD. According to CCTA, this results in a higher allocation of spare capacity costs to the universal support level

than to the OANAD price floors. As a result, the TSLRIC for universal service is higher than the OANAD TSLRIC. CCTA asserts that the actual fill factors should have been used for OANAD instead of in this proceeding. CCTA recommends that due to the interrelationship between OANAD and universal service with respect to the fill factors, the Commission should ensure that the TSLRIC adopted for universal service is no higher than the TSLRIC adopted in OANAD.

DRA recommends that the Commission adopt the administrative fill factors because those are the factors that Pacific is using in OANAD. DRA also states that the lower utilization factors used in the CPM represent the less efficiently designed networks of the local exchange carriers.

GTEC disagrees with DRA and argues that higher fill factors are unrealistic. GTEC states that the design utilization factors used in OANAD were set at an upper bound to establish the theoretical minimum cost of service. The objective in this proceeding is to establish an equitable price for basic service. GTEC asserts that the design utilization rate is not the objective level network designers seek to achieve over time, but rather, is the trigger point for placing additional facilities.

Pacific contends that average fill factors are appropriate for determining universal service funding. Pacific's existing utilization is based upon all of Pacific's engineering decisions which determine the most efficient manner of providing narrowband telephone services. Pacific argues that if design utilization factors are used, such modeling will fail to account for the LEC franchise obligation to have plant ready to serve upon demand. This will result in held orders and service delays.

Pacific argues that the high fill factors recommended by Selwyn could never reach these levels because they do not account for defective pairs, maintenance replacement for defective

pairs, or for the idle assigned pairs that are required for quick dialtone.

b. Discussion

We have stated previously that we intend to have the proxy cost model be reasonably consistent to the practices adopted in the OANAD proceeding. As such, we will adopt the 76% fill factors for feeder and pair gain that were adopted in D.96-08-021.

On the distribution side, we will adopt Pacific's distribution fill factors. We consider this an extremely generous assumption. Given that these distribution fill factors include second lines, we are allowing triple the capacity that would be employed serving only one line per household.

This adjustment results in an annual decrease to the subsidy amount of $64 million.

7. Depreciation

a. Background

The CPM includes a calculation for depreciation of network plant. Pacific used shorter lives in the CPM, which resulted in higher depreciation rates. The "economic lives" used by Pacific in the CPM are shorter than the depreciation lives approved by the Commission.

AT&T/MCI witness Selwyn contends that the depreciation levels proposed by Pacific overstate the universal service funding requirement by $216 million. This is because the rates are based upon Pacific's network modernization strategy and preferred depreciation lives. Selwyn states that the Commission should use, at a minimum, the depreciation rates and lives which the Commission has approved for Pacific. Selwyn points out that a network that is designed to support a primary residential access line to each household will be subject to less technological and market obsolescence than a network designed to accommodate a variety of discretionary and potentially competitive services. AT&T/MCI also argue that there are Commission procedures for

setting and changing depreciation lives and rates, and that Pacific has not formally asked to have their depreciation lives reduced.

DRA agrees with AT&T/MCI that the CPM should reflect Commission approved depreciation lives and depreciation rates. DRA states that the Commission has always prescribed depreciation lives for the intrastate jurisdiction only after staff review, public comment, and a public hearing process. DRA estimates that this adjustment will result in a decrease of $245 million per year.

GTEC contends that since the purpose of the proxy cost model is to estimate forward-looking costs, the depreciation costs must also be forward-looking. GTEC supports the use of economic depreciation as the only forward looking depreciation estimate because it is the best estimate of how long the plant will be economically viable. GTEC argues that the composite book depreciation used in the HPM and BCM, as well as the prescribed Commission lives, reflect a regulatory process that historically kept depreciation low and extended capital recovery beyond the economic lives of the equipment.

Pacific argues that these new economic lives are appropriate for determining depreciation in the CPM because they better reflect the competitive realities which the LECs are facing. Pacific witness Emmerson stated that the use of prescribed lives in the past led to depreciation reserve deficiencies, a practice which is unlikely to be sustainable in a competitive environment. Pacific argues against using the longer lives in the CPUC approved depreciation rates. In Richard Scholl's testimony for Pacific, he states that "Because the implicit investment recovery guarantee from regulators for the franchise monopoly, no longer exists, the regulatory revenue requirement/rate of return framework which allowed excessively long depreciation lives for LECs is no longer valid." (Ex. 86, p. 13.) Scholl claims that using CPUC approved depreciation lives will understate the costs of universal service.

b. Discussion

The August 5, 1996 proposed decision suggested that the CPM use the Commission approved depreciation lives established in D.95-11-009. The proposed decision's rationale was that a distinction should be drawn between the provisioning of residential basic service, and the rapid turnover of equipment associated with building a state of the art network for every conceivable telecommunications service. For that reason, an adjustment to the CPM of $245 million was proposed.

The proposed decision's resolution of this issue generated many comments. The LECs and others argued that the use of longer lives was inconsistent with the CCPs and D.96-08-021, and that the use of longer lives would cause the high cost areas of the state to retain older, less advanced equipment, while the low cost areas would enjoy state of the art equipment. AT&T argued that the incumbent LECs never sought to change the Commission approved depreciation lives, and have failed to submit any evidence to support the shorter depreciation lives. AT&T also argues that the proposed decision correctly noted the distinction between a network designed to supply universal service, and a state of the art telecommunications network.

In deciding that the shorter lives should be adopted for purposes of the OANAD proceeding, the Commission stated that the depreciation lives adopted in D.95-11-009 reflected the previous regulated monopoly environment, and that the longer lives are difficult to justify in an environment of local exchange competition.

We will likewise adopt the CPM's use of shorter lives for depreciation in this proceeding. Such an approach is consistent with what we have done in OANAD, and reflects the forward looking costing principles. It is also consistent with AB 3643's principle that incentives be used "to promote deployment of advanced telecommunications technology to all customer segments."

8. Reordering of Switches

a. Background

Prior to INDETEC's modification of the CPM at the request of GTEC witness Roger White, the CPM classified wire centers into seven zones on the basis of the average population density of the grid squares associated with each wire center. Those density zones determine the cost of the central office switch, as well as the cost of the feeder.

GTEC asserts that the CPM's approach to calculating the switch and the feeder costs is unsatisfactory because the CPM does not consider the line counts in the office to determine those costs. GTEC contends that the size of the switch and the feeder routes are dependent on the number of lines the switch serves. GTEC also contends that designating wire centers by density zones does not adequately capture differences in office size. As a result, the CPM produces inconsistent results. For example, 16,000 line switches are placed in the highest density zone, while larger 40,000 line switches are placed in the middle density zones. In addition, the switching costs in the CPM do not reflect economies of scale and scope.

GTEC recommends that the wire centers in the CPM should be assigned to zones based on the number of business and residence lines in each wire center.[50] According to GTEC, this modification allows the model to calculate the feeder size and the conduit cost of each central office consistent with the size of each office.

50 GTEC witness Roger White worked with INDETEC to make this modification to the CPM. However, the CPM model that the other parties had analyzed during the hearing did not incorporate this modification.

b. Discussion

No one commented on GTEC's switch reordering proposal. Although GTEC witness White agreed with Pacific that the CPM's method of sizing feeder and switch size by density zone was not necessarily an error, Pacific did not rebut the mismatches that White had observed.

Although the proposed decision and revised proposed decision recommended the adoption of GTEC's switch reordering suggestion, upon reflection we will not make this modification to the CPM.[51] The switch reordering would result in a far greater impact than indicated in the revised proposed decision. The magnitude of the impact suggests that GTEC's proposal had more of a wide ranging effect on the model than anticipated in the revised proposed decision. Upon further examination, it appears that this change cannot be adopted in isolation, but must be part of a comprehensive set of changes to all inputs and engineering assumptions affecting feeder and switch plant. The necessary changes go far beyond the limited modifications to inputs proposed by GTEC.

51 The switch reordering estimate of $11 million in the revised proposed decision was incorrect because that change was not incorporated in the CPM, contrary to what the staff was led to believe. As a result, the "cumulative effect" estimate of $988 million in Appendix D of the revised proposed decision is correct.

9. Outside Plant Factor

a. Background

The CPM makes an adjustment to the costs of outside plant based on which density zone the outside plant is placed. If the plant is placed in highly dense urban areas, the outside plant factor is set greater than one to account for the difficulty in placing plant in urban areas.

GTEC states that the CPM's adjustment factor for outside plant is not supported by price quotes, and that the CPM has already included an adjustment for such factors. For example, the CPM uses an adjustment factor for urban areas making it more expensive than average to place outside plant in the most dense zones. However, this adjustment is on top of an adjustment of input prices. GTEC recommends that the Commission should revise the outside plant factor to 1 for dense areas.

Pacific states that this adjustment reflects the fact that cities often restrict the times when their streets can be dug up. Pacific claims that it is more expensive to install outside plant in downtown San Francisco than it is in less dense areas because of scheduling limitations, traffic and difficulty in locating or spotting materials prior to installation.

b. Discussion

We adopt GTEC's adjustment to the outside plant factor. GTEC's actual practices show that no cost difference exists. The model should not artificially create a difference. In addition, as we discussed in reference to cable and conduit costs, the historically based cost estimates of facilities placement Pacific relies on represent an average cost. There is no reason to increase these costs for the relatively densely populated areas where most customers live, and where most facilities to serve them are placed. If an adjustment were necessary, it should only be in atypical areas, for example, extremely dense areas. Average costs should not be augmented to meet typical conditions.

Pacific's anecdote about the additional cost of restrictions placed on construction appears to refer to central business districts and commercial centers. This type of adder may be more appropriate for business lines than residential lines. The residential neighborhoods of California's most dense cities have less inhabitants during the daytime hours, and construction is more likely to be encouraged during those hours than discouraged.

Adoption of this modification results in a $37 million annual decrease.

10. **Switching Costs**

a. **Background**

AT&T/MCI witness Selwyn discussed switching costs in his opening testimony. Selwyn states that Pacific's switching costs are greatly overstated because the CPM uses the figure $239.13 to represent total switch costs per line. Selwyn asserts that these costs are not consistent with expenses incurred on a forward looking basis. Selwyn goes on to say that Pacific announced in a January 1993 press release that it would spend just over $1 billion to replace all of its remaining analog switches with digital ones. These switches would serve 9.1 million lines. Selwyn's calculation based on the press release amount is that the switching cost per line is $110, or $130 less per line than assumed in the CPM calculation. This switching adjustment to the CPM would reduce the annual subsidy amount by $289 million.

DRA had originally recommended in its opening testimony that the switching costs used in the CPM be lowered. DRA examined the vendor prices for DMS-100 and 5-ESS switches, as well as the SCIS model's calculation of the inputs. DRA found that Pacific did not utilize the maximum possible discounts available for both switches. Instead, Pacific used a weighted average of switch discounts. DRA recommended that the switch costs should reflect the higher discount available from manufacturers. In DRA's reply testimony, DRA changed its position on switching costs.

After further analysis and investigation, DRA no longer recommends that there be an adjustment to the switching costs.

Pacific argues that there are life cycle price variations for switching equipment. Pacific witness Scholl states that Pacific does not always get the maximum discount for its switches because it sometimes purchases switches before the models become the standard in the market. Depending on the stage at which the switch is purchased, maximum discounts may not be available.

b. **Discussion**

AT&T/MCI witness Selwyn's calculation of the switching costs has some merit in that it is based on an announced expenditure by Pacific. However, aside from the press release, there is no supporting evidence that the $110 switching cost per line is accurate. Instead, Selwyn suggests that the CPM should assume that maximum price discounts will exist over the technology life cycle for digital switches. According to DRA witness Hassan Mirza, given Pacific's size, one would expect that Pacific has the ability to get the highest discount. But given the price cycle analysis of Pacific, Pacific may not be able to experience a constant level of high discounts over the long run.

We will use Pacific's estimate of the switch costs. As Pacific witness Scholl testified, the prices for new switches are not discounted significantly until the new technology becomes the standard, and a large number of older technology switches are replaced.

11. Shared and Common Costs

a. Background

Shared and common costs have been defined in the CCPs of the OANAD proceeding as follows:[52]

> "Shared costs -- Costs that are attributable to a group of outputs but not specific to any one within the group, which are avoidable only if all outputs within the group are not provided."
>
> * * *
>
> "Common costs -- Costs that are common to all outputs offered by the firm. While these costs are not considered part of a TSLRIC study, recovery of such costs is required. Recovery of common costs is a pricing issue." (D.95-12-016, App. C, pp. 5-6.)

The CPM accounts for shared and common costs, which Pacific states are attributable to universal service. Pacific initially estimated the shared and common costs at $5.00 per line. It subsequently increased that estimate to $6.70 per line. The allocation of these costs was a subject of much dispute in the hearings. Another issue that is related to this discussion is whether or not the loop itself is a shared cost of a family of services.

AT&T/MCI argue that the universal service fund should not recover any greater portion of the shared and common facilities used to provide universal service than the shared cost of the loop. AT&T/MCI witness Cornell stated that the loop is a shared cost of all the services that use the loop. Cornell also asserts that

52 The definition of shared and common costs used in the CCPs were taken from a cost study report submitted to the Oregon Public Utility Commission.

beyond the full cost of the loop itself, all other shared and common costs should be recovered through other services.

Cornell states that if the Commission does not exclude these other shared and common costs it would subvert the purpose of the fund and discourage the development of competition because the other carriers would end up paying the shared and common costs of the incumbent LECs. As a result, the incumbent LECs would have a competitive advantage, and they could use those revenues to unfairly compete against new entrants.

AT&T/MCI also argue that if shared and common costs are to be included, then the associated revenue sources must be considered as well. They point out that Pacific seeks to exclude all revenues except for basic residential service rates. They also argue that the CPM's allocation is unreasonable and arbitrary because the CPM shifts a substantial portion of the costs that are actually service-specific to other services, to basic service.

AT&T/MCI witness Selwyn recommends that the Commission adopt either one of the following two proposals: (1) given that the allocations of shared and common costs among family members are invariably arbitrary, shared and common costs, and the associated family revenues should be left out of the equation; or (2) if shared and common costs are included, then all of the revenue sources that contribute to the shared and common costs to the extent of their assignment to a particular service, must be included.

CCTA argues that inclusion of some shared and common costs in the calculation of the universal service fund is appropriate. CCTA's witness, Dr. Marvin Kahn, argued that: (1) some of Pacific's shared and common costs are actually direct costs associated with providing basic residential service; and (2) that the remaining shared and common costs should be distributed on the basis of the margins on incremental costs Pacific has been willing to accept in competitive markets. This

margin would be reflected in toll and Centrex contracts entered into by Pacific.

CCTA also notes that if the Commission includes shared and common costs in the universal service fund, it must account for the same amount in the OANAD proceeding. CCTA contends that the failure to include the same amount of shared and common costs in the price floors for services could allow the LECs to price anticompetitively.

DRA argues that the recovery of shared and common costs is a pricing issue. Instead of including these costs in the subsidy calculation, DRA recommends that the Commission allow incumbent LECs to make their own pricing decisions regarding the amount of shared and common costs that should be recovered from residential basic service. DRA recommends that this recovery be determined in the OANAD proceeding.

If, however, the Commission wants to determine the appropriate amount of shared and common costs, then DRA proposes that the Commission use Pacific's OANAD PI model, and the allocation factors and results derived in that model. DRA contends that because residential basic services are relatively inelastic, the Commission should limit the amount of shared and common costs that can be recovered by the incumbent LECs through their basic service rates until the market is fully competitive.

In OANAD, Pacific submitted an account by account analysis, and allocated shared and common costs into sixteen family buckets. The allocation was based on the allocation factors developed in the PI model. When the CPM was updated prior to the hearings in this proceeding, Pacific used modified PI allocation factors for two of the sixteen family buckets. The first bucket is labeled "Business-Residential-Public", while the second bucket is made up of "Residence 1" and "Residence 2." DRA points out that this deviation resulted in assigning the costs of the two family buckets to services in those two families. This increased the

shared costs allocated to basic service by 85%. DRA believes that it was unreasonable for Pacific to simply pick two of the buckets and reallocate their cost to services within the family, without applying the same process to the remaining fourteen cost families. DRA recommends that the Commission reject the modified PI allocation factors that Pacific made. Instead, DRA believes that the allocation of costs used in OANAD, using the unmodified PI model, is reasonable and sufficiently reliable.

DRA also recommends that the Commission use Yellow Page revenues to offset the LECs' shared and common costs.

GTEC argues that markups for shared and common costs are appropriate for basic service. GTEC states that in competitive markets, multi-product firms have to obtain contributions to shared production costs and overheads from wherever they are available. The amount of contribution placed on each product depends on the demand elasticity for the product and supply conditions. GTEC describes the Ramsey pricing rule, which details the equilibrium prices in a competitive market. Under the Ramsey pricing rule, services which are less demand elastic will contribute a larger amount to shared and common costs.

ICG agrees with AT&T/MCI and TURN's view that only the shared cost of the local loop should be recoverable in the fund.

Roseville and the Smaller Independent LECs argue that if they are included in the funding mechanism, the Commission must also allow the COLR to recover its shared and common costs.

TURN agrees with Cornell's testimony that the loop is the only shared cost which should be included in the subsidy calculation, and that Pacific should recover all other shared and common costs from other services. In his testimony, TURN witness Long cites from the Telco Act that, "services should bear no more than a reasonable share of joint and common costs." He goes on to explain that the conference report of the Telco Act states that

universal services may bear less than a reasonable share of their joint and common costs.

TURN also contends, based on the allocations of shared and common costs that it has reviewed, that Pacific has vastly overstated the amount that should be treated as the cost of basic residential service. TURN argues that including such costs will significantly increase the number of lines eligible for support from the fund, and for each such line, increase the amount of support.

TURN asserts that Pacific did not meet its burden of proof in showing that these shared and common costs should be attributable to universal service, and that the Commission should not include any of Pacific's shared and common costs in the cost of basic residential service.

Pacific argues that inclusion of a reasonable amount of shared and common costs is both consistent with the Telco Act and necessary for the market to function. They state that the biggest shared costs involve number administration, network test centers and network control centers. Pacific argues that the shared and common expenses to be recovered are for the universal service cost object. The costs affected include billing of residential customers, receiving and answering inquiries from residential customers, and developing methods and procedures for installing and maintaining service to residential customers. Pacific witness Emmerson testified that the loop is not a shared cost. He also states that the universal service fund must make a reasonable contribution to a carrier of last resort's shared and common costs.

b. Discussion

(1) The Loop

We first address the issue of whether the loop is a shared cost of universal service.

AT&T/MCI, and TURN argue that the local loop meets the definition of a shared cost, as defined in the CCPs. TURN also cites the decisions of other public utility commissions wherein this issue was discussed.

This Commission previously touched upon this subject in the Implementation Rate Design (IRD) decision, D.94-09-065. In that proceeding, GTEC and Pacific had argued that the loop was built in response to the end user's subscription to basic telephone service. Therefore, the expense of the line and switch is incurred regardless of whether the facilities are ever used. Thus, much of the loop plant is characterized as nontraffic sensitive (NTS). TURN had argued that the NTS plant costs were actually "joint and common costs" needed to operate the network and to provide both incoming and outgoing local and toll calls. The Commission agreed with the contentions of Pacific and GTEC that the NTS costs should be assigned to basic exchange services. The Commission also recognized that the loop cost for interstate uses of the network received a contribution from the EUCL charge. (D.94-09-065, pp. 43-44.)

Given our previous determination in D.94-09-065, we decline to conclude in this proceeding that the loop is a shared cost, and that only the shared cost of the local loop facility that is not currently recovered in rates should be recoverable from the CHCF-B. However, we believe that Section 254(k) of the Telco Act places a limit on the share of joint and common costs of facilities that should be borne by the service elements that make up basic service. In order to determine what that limit should be, we focus our attention on how the shared and common costs were allocated in the CPM.

(2) <u>Assignment Of Costs</u>

Several of the witnesses testified to the difficulty of allocating shared and common costs, and some of them referred to

such attempts as arbitrary.[53] There were several examples during the hearing of how costs were arbitrarily assigned to basic service. For example, an advertising promotion that was designed to promote the sales of extra telephone lines to existing customers would be attributable 100% to basic service. (26 RT 3617-3618.) The cost of billing residential customers would be assigned to basic service as well. (26 RT 3614-3615.)

Another example of how costs are allocated somewhat arbitrarily are the costs associated with billing inquiries to residential service centers. These shared billing inquiry costs are in addition to the billing inquiry costs the CPM directly identifies as being associated with basic service. These costs also do not include the incremental service related costs associated with ULTS.

According to Pacific, these billing inquiries have to do with residential customers not being able to pay current bills and negotiating payments. The CPM allocates 100% of these costs to basic service. However, as TURN's witness Long points out, the cause of the inability to pay or to negotiate a payment schedule may be due to causes that are unrelated to residential basic service. That is, the inability to pay is likely more attributable to toll calls, to services billed by Pacific for interexchange carriers or information service providers, or for custom calling features. (Ex. 121, pp. 8-9.) Pacific witness Scholl acknowledged that Pacific has not done any study to determine whether customers who request special payment plans do so because of the customer's inability to pay the basic exchange service charge as opposed to any other charge. (24 RT 3132-3133.)

53 This arbitrary allocation problem was also noted in the IRD decision in D.94-09-065 at page 44.

TURN also points to another category of costs that have been allocated 100% to basic service. These costs involve customer inquiries to customer representatives regarding multiple products, and obtaining service turn on dates. In addition, this category of costs includes such items as the customer representative stating "hello, thank you for calling Pacific Bell," and for training, meetings, and waiting to serve. As TURN points out, none of these activities appear to be specifically caused by residential basic service, as opposed to any other residential service offering of Pacific.

TURN also provides other examples of how Pacific's allocation of shared and common costs in the CPM in the Residence 2 family bucket, and the family bucket labeled "Business, Residence, Public", have resulted in unreasonable and arbitrary allocations. Although 90% of the Residence 2 bucket was allocated to basic service, TURN contends that Pacific has not justified why basic service has been allocated that percentage of the shared and common costs. With respect to the costs associated with bill production which are captured in the Business-Residential-Public bucket, TURN points out that, prior to Pacific's revision of its cost model, Pacific had only allocated 16% of the shared costs to residential basic service. The CPM now allocates 81% of those shared costs to residential basic service, while only 19% is allocated to business and public. TURN witness Long suggests that Pacific should be held to its lower initial estimates.

We agree with TURN that Pacific has not demonstrated that the costs described above, and allocated by the CPM to basic service, were wholly or disproportionately caused by residential basic service, as opposed to the many other services offered by Pacific. We believe Pacific was correct in its original assessment that these are shared costs which should be borne by the many services that share them, not just basic residential service. In addition, the modification of only two of the sixteen allocation

factors calls into question the reliability and reasonableness of those allocators. Pacific's own witness testified that only two of the sixteen family buckets had the allocation factors changed. The other fourteen buckets remained the same. In addition, we must keep in mind in reviewing these costs that the PI model is based on direct embedded costs, and thus is not a TSLRIC model.

(3) Treatment Of Shared Costs

As mentioned above, we believe that the Telco Act mandates that a reasonable portion of the shared costs should be included as part of the cost of basic service. Clearly, some amount of the shared costs is attributable to residential basic service. However, the modified PI allocation factors that Pacific used for two of the family buckets for use in the CPM, result in a shifting, or loading up of costs onto basic service.[54] As a result of the modification, basic service bears more than its reasonable share of the shared costs under the CPM.

We have analyzed the unmodified PI allocation factors that Pacific used initially for the proprietary version of the CPM. We believe that those allocation factors result in more reliable and reasonable allocations of shared costs than those proposed by Pacific. We will use those shared allocation factors for the CPM.

As a result of this adjustment to shared costs, the estimate of the annual subsidy requirement is reduced by $282 million.

(4) Treatment Of Common Costs

Turning now to common costs, we believe that Pacific's original CPM estimate placed an undue proportion of these costs on basic service. We are concerned that an excessive

54 The two family buckets that were used were: "Business, Residence and Public", and "Residence".

allocation to basic service, and in turn to the universal service fund, will insulate these costs from competitive pressure, and give rise to possible anti-competitive behavior. As TURN points out, Congress recognized this potential in the Telco Act, which contemplates that universal service should bear no more than a reasonable share of joint and common costs, and in the Conference Report, which suggests that the cost of universal service bear less than a reasonable share. Consistent with that direction, we have reduced common costs per line from $2.91 to $2.00 to safeguard against these possible competitive problems. We note that the revised common costs are a more reasonable allocation. The reduced amount represents approximately an 11% mark-up over direct and shared costs, which is commensurate with the overhead factors experienced in the local exchange industry. (See Exhibit 85, p. 14.)

As a result of the adjustment to common costs, the estimate of the annual subsidy requirement is reduced by an additional $118 million.

(5) Imputation

CCTA contends that by allowing the recovery of the shared and common costs in the universal service proceeding, the LECs may be able to bundle unregulated products or services such as video with Category I and II services in an anticompetitive manner. According to CCTA, this problem arises because under the existing imputation rules, universal service support payments are not imputed into the price floor for the bundled package of basic service and competitive services.

CCTA requests that the imputation rule in conclusion of law 49 in D.96-03-020 be modified to state that in determining whether the price of a package is above the price floor, the revenues received should include the subsidy payment excluding any portion that is intended to recover shared, joint, or common costs.

We decline to modify D.96-03-021 in this proceeding. Any party seeking to modify or clarify the imputation rules established in D.96-03-020 should file a petition to modify that decision.

12. Rearrangement Expenses And The Nonrecurring Burden

a. Background

In the CPM, Pacific includes expenses for the rearrangement of plant, and an item called the nonrecurring burden. These two cost items add up to $268 million.

Rearrangement expenses are the costs associated with rearranging existing facilities to accommodate new and existing customer demand. Some examples of rearrangement expense include rewiring equipment to reflect changing calling patterns, moving existing customer lines from old equipment to new equipment, and rewiring or modifying equipment so additional new equipment and new customers can be added to the network.

The nonrecurring burden expense covers the expenses which a LEC incurs by installing and disconnecting residential telephone lines which the LEC does not recover in its nonrecurring charge.

Parties debated whether rearrangement expenses should be included in the subsidy calculation. AT&T/MCI state that the CPM overstates the costs of basic service because of rearrangement expenses. AT&T/MCI witness Selwyn recommends that rearrangement expenses be eliminated because there will be very little churning of facilities as a result of the Commission's quick dialtone requirement. Selwyn views rearrangement expenses as "the labor costs associated with the reuse of existing loop facilities made available as a result of customer churn." (Ex. 7, p. 88.)

DRA contends that the CPM is supposed to estimate the cost of basic service using forward looking technology for the entire quantity of the service. DRA believes that the CPM should therefore include rearrangement expenses that are associated with

serving the entire quantity of the service, and not those associated with just serving new customers.

Pacific responds that rearrangement costs are properly included in the CPM calculation, and that the elimination of these expenses will understate the costs of providing universal service. Pacific witness Scholl stated that rearrangement expenses involve many more activities than just dealing with existing customer churn. Such expenses are not just for loop facilities, but are also incurred for switching, interoffice facilities, and other investments. Scholl states that these rearrangement expenses are part of the costs of having investment in place to service new customers.

Scholl also states that AT&T/MCI witness Selwyn is wrong in his interpretation of what costs are included in rearrangement expenses. As a result, Selwyn wrongly concludes that rearrangement expenses will go away with the Commission's requirement for quick dialtone. Instead, as economic circumstances change, and the population grows, there will be a continual need to rearrange existing equipment.

With respect to the inclusion of the nonrecurring burden in the universal service subsidy, AT&T/MCI witness Selwyn argues that with quick dialtone, the nonrecurring burden should be minimal as well.

DRA argues that the nonrecurring burden should be treated as a shared cost. As a shared cost, DRA recommends that the LECs should be allowed to determine recovery of the expense.

Pacific states that LECs incur the nonrecurring burden expense because rates for installation have been kept below cost.

b. <u>Discussion</u>

We are somewhat persuaded by AT&T/MCI's argument that rearrangement expenses should be minimal as a result of PU Code § 2883 requiring continuing access to 911. As a result of that

requirement, a large percentage of existing lines are going to remain in place, and rearrangements of wire should be kept to a minimum. Rearrangements will primarily be caused by demand for second and additional lines. However, we agree with Pacific that one cannot ignore future growth, and that there are still likely to be situations where moving, modifying or making changes to facilities will be necessary in order to accommodate demand.

Since the target of the universal service subsidy are primary access lines, we will deduct 75% from Pacific's estimate of its rearrangement expenses. This reduction results in a $170 million annual subsidy decrease. This adjustment is consistent with the rearrangement costs that was adopted in D.96-08-021 for the OANAD proceeding.

Regarding the issue of the nonrecurring burden, our same analysis of rearrangement expenses apply. When a new customer requires service, turn up of that service will be at the central office. Since the primary lines are already in place providing 911 access, it will be a rare occasion when the carrier will have to go out to the field or the customer's premise. We will also deduct 75% from Pacific Bell's nonrecurring burden estimate. This reduction results in a $43 million annual subsidy decrease.

13. Directory Assistance

a. Background

DRA recommended in its opening testimony that if the CPM was to be adopted, relevant cost data from Pacific's and GTEC's proposed OANAD cost studies should be included. DRA noted in its opening testimony that a comparison of the CPM's estimates of GTEC's costs in OANAD to the costs shown in the CPM showed a significant difference. (Ex. 109 or Ex. 110, pp. 3-16 to 3-17, Table 3.2.)

b. Discussion

The Telecommunications Division staff responsible for analyzing the workings of the CPM results questioned the directory

assistance cost reflected in the CPM after reviewing Table 3.2. The Telecommunications Division sent a data request to Pacific in June 1996 requesting the monthly volume of directory assistance calls. The reported volume of calls was compared to the volume and cost per call contained in the CPM, and to GTEC's OANAD cost of providing directory assistance. The staff determined that the CPM cost estimate for directory assistance was overstated. We will adopt the staff's adjustment of the cost of directory assistance. This change results in an annual adjustment of $50 million.

14. Repair and Maintenance Costs

In D.96-08-021 at pages 64-65, the Commission determined that Pacific should reduce its estimates of loop repair costs by 14% to account for the downward trend in loop repair costs. Since the objective of the universal service cost studies is to reflect a similar forward looking view of costs, and because the CPM relies on identical repair costs to Pacific's OANAD costs, a similar 14% downward adjustment in the CPM's repair and maintenance costs should also be made. Accordingly, an adjustment of $46 million should be made to the CPM.

G. Benchmark

1. Introduction

This issue addresses the cut-off point, or benchmark, at which we determine whether a GSA is high cost or low cost. That is, the benchmark serves as the guide for determining which GSAs have "affordable" service, and which GSAs have higher costs, or less affordable service. (See AB 3643, Stats. 1994, Ch. 278, Sec. 2(b)(1).) The benchmark is an important issue because it serves to size the fund by limiting subsidy support only to those GSAs in which the proxy costs of serving that area exceed this cut-off point.

The benchmark also serves as the guide for determining how much support a designated COLR receives for serving high cost areas.

Establishing a benchmark also has implications for future rate design. If the benchmark is set at a level above the current basic local exchange service rate in a particular GSA, that may cause pressure to increase the rate toward the benchmark to more closely reflect the cost of providing service to that GSA.

D.95-07-050 proposed that the GSA should be considered high cost if the proxy cost of serving that GSA was above the revenues generated by the LEC offering basic service in that particular GSA.

In the comments to the August 5, 1996 proposed decision, Pacific and TURN discussed the unfunded "gap" problem that occurs if the benchmark is set above an incumbent LEC's rates. That issue is discussed below as well.

2. **Positions of the Parties**

AT&T Wireless commented that if the high cost GSA was designated as suggested by the proposed rule, that such a rule will make the high cost fund overly dependent on each LEC's revenue requirement. This could lead to a situation where customers in two different GSAs with identical proxy GSA costs, are treated differently for purposes of CHCF support.

AT&T Wireless recommends that the benchmark should be the statewide average proxy costs of all GSAs. If the proxy cost of serving a particular GSA exceeds the statewide weighted average of serving all GSAs, then the GSA would be considered high cost. The subsidy would then equal the difference between the specific proxy cost and the statewide average of serving all GSAs.

CCTA asserts that in determining the size of the fund, support should be given only to the access lines in need of such support. CCTA recommends that only those GSAs with costs above the statewide average should be eligible to receive monies from the fund.

Citizens commented that a high cost GSA should be defined as any GSA where the cost for providing basic residential service

is higher than one standard deviation above the national average loop cost. According to Citizens, the benefits of using such a method are as follows: the criteria is completely neutral because the national average loop cost is a readily available number; it is simple to administer; the numbers can be easily updated; and it can account for changes in the costs of service.

Citizens also recommends that there be a three-year transition period during which the base would move from a direct embedded cost base to the use of TSLRIC as the base. Thus, in the first year, a high cost area would be defined as a specific GSA where the direct embedded cost to provide residential basic service is higher than one standard deviation above the national average loop cost. At the end of the transition period, the high cost area would be a GSA where the TSLRIC cost to provide basic residential service is higher than one standard deviation above the national average loop cost.

In its comments to D.95-07-050, DRA recommended that there be a comparison of costs among the GSAs, rather than comparing cost and revenue as suggested in proposed rule 6.A.6. DRA proposed in its comments that a GSA be considered high cost if the average cost of serving residential customers in that GSA is more than 150% of the weighted statewide average cost of basic service serving residential customers in urban GSAs.[55]

During the hearings, DRA took the position that the reference point should be based on Pacific's existing flat rate service rate of $11.25, plus the EUCL charge of $3.50. The sum of these two items total to $14.75. The density zone which has the highest TSLRIC, but which does not exceed the $14.75, would then be

55 DRA uses the United States Census Bureau definition of urban areas, to define the term urban GSAs.

used as the benchmark zone. The subsidies for a respective zone would then be calculated as the difference between the TSLRIC of the particular zone, and the TSLRIC of the benchmark zone.

According to DRA, the use of its recommended benchmark has two advantages. The first is that it maintains current rates for the vast majority of existing customers because it is based on Pacific's statewide flat rate. Since Pacific has about 80% of the market share in terms of number of lines, the use of Pacific's current flat rate plus EUCL would ensure the maintenance of the same flat and measured rates for most California customers. The second advantage is that it minimizes the size of the fund, while maintaining basic service rates at a reasonable level.

GTEC believes that the universal service fund should be used to prevent rates in a GSA from rising above a level found by the Commission to be affordable. GTEC proposes that the Commission should determine the maximum rate level for basic residential service, and deem that to be the affordable rate. By selecting a statewide affordable rate, the fund is targeted to support rates at affordable levels, rather than to support different rate levels for different companies.

Although GTEC is not proposing that rate rebalancing be done in this proceeding, GTEC believes that rates for basic service which are below this benchmark should be permitted to increase to the benchmark level. According to GTEC, permitting rates to increase to this benchmark will better reflect costs, and reduce the size of the fund. GTEC recommends that the affordable rate be set at $20.00.

GTEC would not use this "affordable" rate benchmark to calculate the support calculation. Instead, GTEC proposes that the COLR serving the high cost area be compensated for the difference between the market rate determined by the proxy cost model, and the rate that the COLR is allowed to charge its customers.

According to the reply briefs filed by the Coalition and TURN, all of the Coalition members, including AT&T, MCI, and TURN, agree that the fund should be sized by first deducting the sum of the incumbent LEC's basic service rate plus the EUCL from the cost of basic service as determined by the model. This results in the gross funding requirement. The second step, as discussed later in this decision, is to deduct the interstate Carrier Common Line Charge (CCLC) revenues, Yellow Pages advertising revenues, and any other revenues from interstate support received by the carrier as offsets. The result of the second step is the net funding requirement.

The United States Department of Defense and All Other Federal Executive Agencies (DOD/FEA) recommend that the Commission establish a rate that would be charged by each provider of residential basic service. DOD/FEA proposes that the rate be based on the average cost of basic service in California's urban areas.

3. **Discussion**

The first issue to decide is whether the LECs' basic local exchange rates should be used to establish the benchmark, or whether some other reference should be used. The other references that parties have suggested are the national average loop cost, and an average of the statewide proxy costs.

We believe that a benchmark based in part on the national average loop cost should not be used. The national average is not specific to California conditions.

Using a benchmark based on an average of the statewide proxy cost result has appeal. The statewide average reflects all the CBGs within California, both urban and rural, and mountainous and flat terrain. In theory, this average should more closely reflect the average cost of providing basic service in California than the present rates of the LECs. Using the adjustments that we have adopted, the CPM results in a statewide average cost of $20.30.

In developing the benchmark, we must balance the economic and social burden of subsidizing basic service, and our universal service policies of encouraging subscribership and maintaining rates at affordable levels. All of these considerations lead us to believe that the benchmark for determining COLR support should be the statewide proxy model weighted average of $20.30, or the carrier's flat rate plus EUCL, whichever is higher. The latter benchmark is designed to address the situation when the incumbent LEC's flat rate plus EUCL exceeds the statewide average cost. The use of this benchmark is consistent with promoting the universal service goals of 95% subscribership while maintaining affordable rates, and an adequately sized fund.

The statewide average cost of $20.30, as generated by the adjusted CPM, should also be used as the cut-off point in determining which CBGs are high cost. Although the cut-off of $20.30 will decrease the number of high cost areas more than a $14.75 benchmark, it provides a targeted and justified level of support to high cost areas. Rates for customers in high cost areas will remain affordable by providing subsidies to carriers willing to undertake the COLR obligation. Affordable prices in high cost areas promote the goal of providing affordable basic telephone service throughout the state.

Accordingly, those GSAs whose adjusted CPM estimate of the cost of providing residential basic service is greater than the $20.30 benchmark shall be deemed to be high cost areas and eligible for subsidy funding. Those GSAs whose adjusted CPM estimate of the cost of providing residential basic service is less than $20.30, shall be deemed ineligible for subsidy funding.

In the August 5, 1996 proposed decision, it was suggested that carriers receive a subsidy for high cost areas based on the difference between the CPM cost estimate of serving a particular CBG, and the benchmark price, less the offsets for revenues from residential basic service, the EUCL charge, the CCLC, and the

interstate USF, if any. This would put Pacific at a disadvantage because its per line revenues was estimated at $16.02, or $4.28 below the statewide average benchmark. Under the August 5, 1996 proposed decision, this gap of $4.28 would not be funded. Such a result would unfairly penalize Pacific for having lower rates than the other incumbent LECs. Accordingly, we will adopt a rule to allow funding of this gap when the revenues that a carrier receives are less than the benchmark.[56] By funding this gap, some of the pressure to increase existing rates should be alleviated. The following rule for determining high cost area support should apply:

> "The subsidy that a designated COLR shall be entitled to will be based on the following:
>
> (1) The benchmark will be defined as the greater of the statewide average cost as determined by the CPM, or the incumbent's flat rate plus EUCL.
>
> (2) If the per line cost of serving a CBG exceeds the benchmark, the COLR will receive the difference between the benchmark and the per line CPM cost estimate for the CBG.
>
> (3) In areas where the incumbent's flat rate plus EUCL is less than the benchmark, the COLR will receive the difference between the benchmark and the incumbent LEC's flat rate plus EUCL, in addition to the subsidy described in subdivision (2) above.
>
> (4) The COLR's draw from the CHCF-B will be offset by the COLR's revenue per subsidized line from the CCLC and the federal Universal Service Fund. The amount of the offset will not exceed the amount of subsidy the carrier

56 Funding Pacific's gap will require approximately $134 million. That amount has been included in the calculation of the CHCF-B surcharge.

would have received without the offset.

Our adopted rules in Appendix B reflect the above discussion.

The adjusted CPM run reveals that using our adopted benchmark, approximately 4.03 million lines out of approximately 12.7 million total lines, will be subsidized.[57] Due to the lengthy printout that would be required for a run result showing the adjusted CPM estimate of cost for each CBG, and whether a CBG is considered to be high cost, such a table has not been included as part of this decision. Interested parties who desire that breakdown may contact the Telecommunications Division staff to obtain that information.[58] As part of the administration of the CHCF-B, the Telecommunications Division will need to maintain a database of this information, and correlate that information with the service areas of the LECs and CLCs through a mapping or database system.

H. What Offsets Should There Be?

1. Introduction

In D.95-07-050 and D.95-12-021, the Commission described its proposed approach for determining the subsidy amount. In addition to including the tariffed rate for flat or measured rate

57 The 4.03 million line figure is after the primary line adjustment. As discussed later in a footnote to the COLR discussion, subsidy support will be disbursed based on the actual reported number of eligible lines.

58 Pacific stated in its opening brief that "Pacific intends to run the revisions required by the Commission's decision, then turn that version of the model over to the Commission." Since the CPM has been adopted as the proxy model upon which to estimate the cost of providing universal service, we believe that Pacific's intentions to forward the revised CPM to the Commission is appropriate.

service as well as the EUCL in the calculation of the subsidy, we stated that other sources of revenues might need to be considered as well. (D.95-07-050, p. 53, fn. 17; D.95-12-021, p. 11.) In the February 21, 1996 ALJ ruling, parties were directed to address the following issue, among others, in their prepared testimony: "Should the Commission consider offsets to the results of the proxy cost model, and if so, what offsets should be considered."

In this proceeding, the parties have debated whether the subsidy should be offset with revenues that the LECs receive from sources such as the federal CCLC, the interstate USF, and revenues from yellow pages. These revenue streams have traditionally been used to keep basic rates low. We discuss below whether these items should be offset against the subsidy.

2. **Positions of the Parties**

AT&T/MCI point out that the parties generally agree that the revenues received from the current level of residential basic exchange prices, the EUCL, and all payments from the current high cost fund should be deducted from the costs of basic universal service in determining the net funding requirement for the fund. The parties, however, differ as to whether the CCLC, interstate USF funds, and revenues from yellow pages, should be used as an offset. AT&T/MCI contend that the offsets to the subsidy should include federal CCLC revenues, monies from the interstate USF, and LEC yellow pages revenues.

AT&T/MCI assert that the CCLC is a rate element which produces revenues that the incumbent LECs receive to help recover the cost of the loop. Under the split between the interstate and state jurisdictions, 25% of the embedded cost of the loop is allocated to the interstate jurisdiction. Most of the 25% of this cost is recovered in the EUCL charge, and the remainder is recovered in the interstate CCLC. The LECs will continue to

receive these revenues to offset the cost of the loop unless the CCLC is abolished by the FCC.[59]

AT&T/MCI witness Cornell testified that, with the exception of federal Lifeline funding, the interstate USF payments should be subtracted from the needed fund level because the monies are explicitly intended to help support universal service.

AT&T/MCI argue that PU Code Section 728.2, Commission precedent, and the history of yellow pages, are good arguments for using yellow pages as an offset. AT&T/MCI assert that Section 728.2 requires the Commission to consider the net revenues of yellow pages when establishing rates. They contend that the Commission recognized in D.89-10-029 that yellow pages profits should provide a contribution to basic rates. AT&T/MCI note that during the AT&T divestiture the Commission successfully fought to support the regional Bell operating companies' (RBOCs) retention of yellow pages in order to keep basic rates low. AT&T/MCI further argue that the yellow pages business continues to be a monopoly, and that it will not be subject to competition soon because of economic barriers to entry.

CCTA argues that incumbent LECs should offset any high cost subsidy to which they are entitled with the profits from the LECs' yellow pages operations. CCTA claims that this is consistent with Section 728.2 of the PU Code, and Commission policy that yellow pages provides a substantial contribution to basic rates. In addition, it is consistent with the disposition of yellow pages to the RBOCs in the Modification of Final Judgment decision wherein the court stated:

59 AT&T/MCI contend that if the CCLC is abolished by the FCC, then all payments received from the federal fund, with the exception of the federal Lifeline fund, should be subtracted from the California fund.

> "When the court required AT&T to turn over its Yellow Pages operations to the operating companies, it assumed that revenue from directory advertising would continue to be included in the rate base of the operating companies, providing a subsidy to local rates." (United States v. Western Electric Co. 592 F.Supp. 846, 865 (D.D.C. 1984).)

CCTA cautions that if the incumbent LECs' revenues from yellow pages are not offset against the fund, the Commission will allow the LECs to double recover these profits.

CCTA also argues that contrary to the assertions of GTEC and Pacific, the yellow pages market remains non-competitive and will continue to be dominated by the LECs because of their immediate direct access to all subscriber information.

CCTA recommends that because the testimony of AT&T witness Patricia vanMidde suggests that the yellow pages profits for Pacific and GTEC are $495 million and $49.5 million, respectively, the Commission should set a minimum yellow pages offset level of $500 million for Pacific, and $50 million for GTEC.

The Coalition contends that the revenues from yellow pages constitute an explicit and sustainable source of universal service support, and should be used to offset the amount of the fund. The Coalition points out that yellow pages profits have historically been, and continue to be designated as a source of funds to support universal service.

DCA argues that yellow pages revenues should not be included as an offset to the new high cost fund because this would amount to continuing an implicit subsidy. DCA also contends that the yellow pages market is not a natural monopoly and is likely to become increasingly competitive.

DRA takes the position that the subsidy for high cost areas should be offset by revenues from the following federal sources, the EUCL, the USF, and CCLC. DRA asserts that these

offsets are necessary in order to avoid double recovery of costs by the COLRs.

With respect to revenues from yellow pages, DRA is opposed to using those revenues as a direct offset to the fund. DRA instead favors calculating the subsidy based on the TSLRIC cost of basic service, and pricing the LEC's basic network functions (BNFs) in OANAD at TSLRIC. Therefore, DRA believes that the revenues from yellow pages should be used by the LECs to provide a source of recovery for the LEC's shared and common costs that the BNFs would not otherwise be able to recover. DRA is also of the opinion that using revenues from yellow pages as an offset would result in the LECs continuing to rely on yellow pages as an implicit subsidy. DRA asserts that this would be contrary to the Commission's goal of making the subsidy for universal service explicit.

DRA states that the USF is an FCC charge to keep basic service rates affordable for high cost companies, and is currently only available to the LECs. As a result of the Telco Act, the USF is expected to be extended to non-LECs as well.

GTEC argues that no offsets should be considered. GTEC maintains that these mechanisms, such as the CCLC and revenues from yellow pages are implicit subsidies which have been used in the past to support universal service. By developing a new and explicit, and competitively neutral funding mechanism to replace the implicit subsidies, GTEC does not believe that the implicit subsidies should be reintroduced as a proposed offset.

With respect to the CCLC, GTEC asserts that the revenues from the CCLC should not be considered in calculating the fund. GTEC points out that the local exchange customer does not pay the CCLC as a result of ordering basic exchange service. Instead, it is only when the customer chooses to use interstate long distance calling that CCLC revenue will be generated. Thus, customers with little or no access demand will generate little, if any, revenue

for the COLR that serves them. If an average amount of CCLC revenue is used as an offset to calculate support, but the LEC loses some of its high volume interstate callers, the COLR will lose those revenues that such an offset would include. GTEC also points out that the FCC has sought comment on the use of a combination of EUCL increases and universal service funding to reduce the CCLC.

GTEC also asserts that there is no risk of double recovery as a result of not including CCLC revenues as an offset. GTEC contends that the total investment estimated by the forward looking CPM for GTEC reflects only 46% of GTEC embedded loop cost.

GTEC argues that yellow pages revenues should not be used as an offset for several reasons. The first is that yellow pages revenue come from an unrelated, non-telecommunications business. Yellow pages advertising is not generated by residential basic service subscribers, but instead by business customers. Second, the inputs required to enter the directory assistance business are available to any publisher, and are not tied to the assumption of any COLR responsibilities. New entrants are not required to develop directory publishing as a condition of entry into the market. Third, revenues from yellow pages differ among the carriers, which would need to be taken into consideration if such an offset was used. And fourth, PU Code § 728.2 provides that yellow pages revenues and expenses may be considered in setting rates for other services offered by telephone corporations. GTEC asserts that this does not mean it should be considered for calculating the size of the universal service fund.

GTEC also asserts that although revenues from yellow pages have been used in the past to support universal service, using such revenues as an offset is inconsistent with the Telco Act that any universal service support should be made explicit. Finally, GTEC maintains that using yellow page revenues as an offset violates Section 728.2 of the PU Code which permits the

Commission to consider yellow pages revenues when setting rates, not for sizing a universal service fund.

Pacific believes that the EUCL should be included in determining revenues for the high cost fund, but that the CCLC, and yellow pages revenues should not be included. Pacific also believes that any new universal funding the FCC establishes in implementing the Telco Act should also be considered in determining revenues for the high cost fund.

Pacific's witness Mitchell noted that the CCLC is currently assessed on interstate switched access charges on a per minute of use basis. Since it is billed in this way, instead of being directly charged to the end user, it will distort the competitive landscape if the CCLC is considered as an offset. Pacific has recommended to the FCC that the CCLC should be eliminated. As for DRA's double recovery argument, Pacific contends that since its current prices were set with reference to state separated costs, and since Pacific will reduce prices for every dollar it receives from the fund, there will be no double recovery.

Pacific argues that the proposal to include revenues from yellow pages as an offset would violate Section 728.2 of the PU Code. Pacific contends that Section 728.2 allows the Commission to take yellow pages revenue into account when setting rates for services, not when establishing surcharge amounts for a fund.

Pacific also contends that such a proposal results in an unconstitutional taking of property, and that using the revenues as an offset would destroy the value of the LECs' yellow pages operations. Under AT&T/MCI's proposal, all the margin from the yellow pages operations would be used to pay for universal service funding. In an extreme case, a LEC could find itself turning over its yellow pages profits even though it doesn't qualify for any subsidies itself. This would eliminate any indirect return to the LECs from their yellow pages business.

Pacific also contends that a yellow pages offset eliminates another source of recovery for shared and common costs. In addition, the offset would reduce or eliminate the other carriers' obligations to contribute to the fund. Also, the revenues from yellow pages is unlikely to be sustainable over the long term.

The Small LECs contend that the proposals to use interstate USF and access pool revenues to offset intrastate costs is inconsistent with the jurisdictional separations responsibilities of the federal and state governments. They contend that interstate support revenues are intended to support interstate costs, and not intrastate costs.

TURN believes that the yellow page offset is "one of the most important steps that the Commission must take in this proceeding." (TURN, Reply Brief, pp. 30-31.) TURN contends that an offset of yellow pages revenue is necessary in order to ensure that carriers are not over compensated for serving high cost areas. TURN argues that yellow pages profits have historically been used to support basic exchange service and that local telephone competition will not alter the long term sustainability of those profits.

3. **Discussion**

There is no disagreement that revenues from basic service should be included as an offset.[57] Therefore, revenues received

57 In the comments of GTEC and Pacific to the August 5, 1996 proposed decision, they argue that the calculation of the LEC's revenues used to offset the support amount should be reduced to account for those customers who have measured rate service. TURN replied that it would be incorrect to reduce the LEC revenue offsets without considering the revenue from local usage generated by measured rate customers. We agree with TURN's position, and for that reason have not made any modifications to the revenues from basic service.

from the carrier's flat rate shall be treated as an offset against the fund. For calculation purposes, it is assumed that the flat rate is incorporated in the benchmark.

We agree with the parties that the EUCL charge should be considered as an offset to the fund. It is an appropriate offset because it recovers a large share of the interstate portion of the LECs' NTS embedded loop costs. In addition, the CPM benchmark does not recognize the receipt of these monies when it calculates the cost of providing universal service on a statewide basis. The residential and single line business EUCL charge is capped at $3.50. Like the flat rate offset, the EUCL offset will be incorporated as part of the benchmark.

As for the CCLC, we agree with AT&T/MCI, DRA, and TURN that the CCLC should be used as an offset. The LECs' argument that the CCLC is a switched access, usage-based rate is irrelevant. What is relevant is that the CCLC recovers the remaining portion of residential and single line business interstate NTS costs that are not recovered by the EUCL charge. To ignore recovery of this amount by the LECs would overcompensate them for the loop.

The CCLC offset will be treated differently from the flat rate and EUCL offsets. The CCLC offset will be deducted from the COLR's total draw from the CHCF-B. The CCLC offset will include only the CCLC revenue for subsidized lines and the amount of the offset will not exceed the amount of the subsidy that would have been received without the offset.

As for the monies that the five large and mid-size LECs may receive from the interstate USF, we agree that those monies should be used as an offset. However, only a portion of interstate USF funding should be considered since the USF is designed to cover the entire cost of a company, not just the cost of serving residential customers or customers in high cost areas. Therefore, the fund should only be offset by the carrier's per line monthly

USF draw multiplied by the percentage of lines eligible for high cost assistance in California.

The USF offset will be treated the same as the CCLC offset. The USF offset will be deducted from the carrier's draw. The USF offset will be confined to the USF revenue for subsidized lines, and capped at the pre-offset amount of subsidy.

With regard to the CHCF-A, GTEC and Pacific are ineligible for this fund. The three mid-size LECs are currently ineligible or are transitioning away from this fund as a source of universal support. Accordingly, no offset is required for monies from the CHCF-A.

With regard to the revenues from yellow pages, we conclude that those revenues should not be included as an offset. As we noted in D.95-12-021, PU Code § 728.2(a) suggests that the revenues and expenses associated with yellow pages should only be considered when establishing rates for other services. (D.95-12-021, pp. 11-12.) We are not establishing rates for other services in this proceeding. All that we are doing is establishing a fund to subsidize high cost areas of the state. Existing rates are calculated based on yellow page revenues. Existing rates would be higher if yellow page revenues were not already accounted for. It would be "double counting" to again offset yellow page revenues against rates. In addition, the use of revenues from yellow pages would significantly reduce the contribution of others to support the fund. Such a result is contrary to the expressed intent in the Telco Act and AB 3643 that there be "equitable" support. For those reasons, we decline to include revenues from yellow pages as an offset.

The offsets are incorporated in Rule 6.C.2. of Appendix B. Our estimate of what offsets there should be are shown in Appendix D.

Until such time the CLCs are authorized to receive monies from the EUCL charge, the CCLC, and the interstate USF, the offsets

described above shall only apply to the five large and mid-size LECs. Also, should the FCC revise these various charges or adopt new charges, we shall revisit the offsets issue.

I. Funding Mechanism Issues

1. Introduction

In our proposed rules, we discussed how the CHCF-B fund should be collected. (D.95-07-050, pp. 60-66) We compared two options: (1) using an AEUS; or (2) a net trans account method.[58]

With an AEUS, a surcharge is imposed on all customers' expenditures for telecommunications services. The surcharge appears as a line item on each customer's bill. The carriers pay the monies that they have collected from their customers into the fund. The fund administrator then issues a check when the carrier submits a claim.

Under a net trans account, the surcharge is collected from carrier contributions. The carrier is assessed a percentage charge on its revenues, net of payments made to other carriers for telecommunications access. Carriers may seek reimbursement for the charge from their customers, to the extent the carriers are able to pass along the charge. Under the net trans account, monetary transactions are reduced. The fund administrator accounts for the amount of money a carrier owes, and subtracts the amount it is entitled to draw. Hence the name, net trans account. For example, if a LEC owes the fund $50 million and is allowed to draw $100 million from the subsidy fund, the administrator simply disburses a check for $50 million to the carrier.

58 AT&T/MCI witness Cornell refers to the net trans account method as a "value-added charge." Like the net trans method, the value-added charge is based on the total revenues received for a service, net of any payments for inputs that will also be subject to the charge. (Ex. 1, pp. 35-36.)

Although proposed rule 6.F. set forth the net trans account as the proposed funding mechanism, we stated in D.95-07-050 at page 64 that the Commission was still undecided as to whether the net trans account system is preferable over an AEUS. We requested parties to provide additional comment on the net trans account system.

In addition to choosing a funding method, we must also make some choices regarding the following: which customers or carriers should pay into the fund; which services should be included in the surcharge calculation; the surcharge for the CHCF-B; and should the CHCF-A be combined with the CHCF-B for purposes of administration.

2. **What Type of Funding Mechanism Should be Adopted?**

a. **Positions of the Parties**

AT&T/MCI support the adoption of a net trans account method. They state that the net trans method is easier to administer than an AEUS because it eliminates the need to collect and then disburse the monies. Instead, under the net trans approach, only the net amounts would change hands. AT&T/MCI acknowledge that with an AEUS, end users would know how much they are paying to support universal service. However, the net trans method could also accomplish this if the charge appears as a separate line item on the customer's bills.

DCA supports the use of an AEUS. DCA contends that an AEUS is already in place, and that it is easy to administer. In addition, an AEUS informs customers about the amount of the subsidy, who pays it, and who benefits from it.

DRA recommends that the net trans account method be adopted. DRA states that with the exception of GTEC and ICG, all of the other active parties support the use of a net trans account. DRA believes that the net trans is consistent with the Telco Act, and that it has distinct public policy advantages over the AEUS. For example, under the net trans approach, the carriers are

required to make payments into the fund. As a result, the carriers have a much stronger incentive to keep the size of the fund reasonable.

GTEC favors the adoption of the AEUS as the preferred mechanism for funding the CHCF-B fund. GTEC comments that an AEUS is easy to administer, simple to collect, and is competitively neutral. GTEC also states that the AEUS is preferable because it is a clear and explicit charge that customers can see as to how much they are contributing to universal service. GTEC asserts that under a net trans approach, the subsidy would not be explicit, but would be buried in the rates that customers pay for service.

GTEC also asserts that an AEUS maximizes competitive neutrality because the surcharge is applied uniformly across all providers and services. That is, under the AEUS, every time a customer spends a dollar on telecommunications, a given percentage of that dollar will go to support universal service. GTEC argues that with a net trans method, recovery of the surcharge amount is unlikely to be uniform across all services rates. This may influence customers to select different services in different amounts. GTEC also argues that the AEUS is a proven method of collection since it has been used in California to collect the ULTS funds.

ICG recommends that the Commission adopt the AEUS because customers will be able to see on their bills how much they are paying to support universal service. ICG states that the AEUS is competitively neutral because all the services of all carriers would be affected in exactly the same way. ICG points out that a net trans account is not competitively neutral because it requires carriers to pay into the fund directly. As a result, smaller carriers are more likely to be impacted because they will have to absorb the contribution to the fund, or they will have to attempt to pass the contribution onto their customers.

Pacific favors the use of the net trans account. Pacific witness Mitchell testified that the net trans approach simplifies implementation, reduces billing costs, and minimizes the potential for significant customer confusion.

The Small LECs support the use of an AEUS. They believe that it is the fairest and most neutral method of distributing the subsidy burden. The Small LECs point out that the AEUS is a simple and proven mechanism, whereas the net trans account exists only in theory. Given all the other complex changes associated with the transition to competition, the Small LECs believe that an AEUS should be adopted.

TURN recommends that the net trans account method be adopted. TURN states that the carrier contribution approach of the net trans is consistent with the requirements of the Telco Act. According to TURN, Section 254(f) of the Telco Act directs state commissions to require telecommunications carriers to contribute to preserve and advance universal service. Under the net trans method, the carriers would pay a percentage of their common carrier revenues net of payments made to other carriers. Although the carriers may attempt to pass this charge onto its customers, market conditions may prevent this from occurring, and carriers may end up contributing some of their own funds. The AEUS, on the other hand, makes customers the sole funding source of the fund.

TURN also argues that with a net trans account method, carriers have a stronger incentive to keep the fund size reasonable. TURN also comments that carriers would have every incentive to keep their customers informed by noting on their bills that customers are paying a certain percentage surcharge to support universal service.

b. <u>Discussion</u>

Both the AEUS and the net trans account method have advantages and disadvantages. In making a decision as to which funding mechanism should be adopted, we are mindful that our

selection should be consistent with the following principles contained in AB 3643:

> "(3) Any subsidy that may be required to ensure that universal service remains a viable reality must have a clearly stated purpose and scope, include a broad based and competitively neutral funding mechanism, and be imposed in a manner that clearly identifies the source of the subsidy".
>
> * * *
>
> "(5) Consumers should be able to have access to all the information needed in order for them to make timely and informed choices about telecommunications products and services, and how to best use them." (Stats. 1994, Ch. 278, Sec. 2(b).)

The two principles described above make clear that the funding mechanism should meet the following criteria: that it is competitively neutral, that it clearly identifies the source of the subsidy, and that consumers have the information they need to make informed choices.

In addition, as pointed out by the parties, Section 254(f) of the Telco Act also provides some guidance. Section 254(f) states in pertinent part:

> "(f) State Authority.--A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State."

An AEUS would appear as a surcharge on each customer's bill. The imposition of such a surcharge is in conformance with AB 3643 because it clearly identifies the source of the subsidy. Customers can see how much they are paying into

the fund which supports universal service and allows residential customers in high cost areas to pay affordable rates. Customers are also informed as to the amount of the surcharge. If after seeing the surcharge amount, customers believe the surcharge is too high, they can make their opinion known by contacting the Commission or their state legislators. In this way, customers provide a check and balance to ensure that the surcharge for the fund is not oversized.

The net trans account method would impose the funding obligation directly on carriers, rather than on customers. The carriers have requested that if a net trans account method is adopted, that they be permitted to state on their customers' bills that part of the customer's bill includes a payment to support the fund. However, as testified to by several witnesses, the carrier could conceivably absorb some or all of the fund charge. If the carrier decided to absorb some or all of the charge, then a net trans method would not be consistent with the principle expressed in AB 3643 that the subsidy "be imposed in a manner that clearly identifies the source of the subsidy" because the customer would not know if such a charge was being imposed on them.[59] Under such a scenario, customers would not have access to "all the information

59 We recognize that an argument could be made that AB 3643 did not intend that the customers of telecommunications carriers be obligated to fund the subsidy to support universal service, and therefore the language in Section 2.(b)(3) of AB 3643 was meant to apply to only carriers. Thus, if the charge was imposed on the carriers only, then it would be consistent with this principle because the carriers would know that the charge was imposed on them to fund universal service. We believe, however, that such an interpretation of AB 3643 would be mistaken. Clearly, when AB 3643 was enacted, the Legislature knew that the longstanding practice of funding universal service came from the ULTS AEUS, and other rate subsidies supported by ratepayers, and not by the carriers. (See Stats. 1994, Ch. 278, Section 1(a), Section 2(a)(2) and (3).)

needed" to know whether the carrier was in fact passing the carrier based charge onto the customer.

In addition, the structure for an AEUS is already in place. An AEUS is used to collect funds for both the ULTS and the CHCF-A. In contrast, in order to establish the net trans account method, all the carriers and the fund administrator would have to design new accounting procedures and systems. As everyone interested in this issue acknowledges, the net trans account method is a new concept and untested in the real world. Also, in order to ensure that carriers are correctly netting out payments paid to other carriers for services subject to the charge, auditing of the carriers is likely to be needed initially.

Further, we believe that the AEUS is a more competitively neutral method of funding than the net trans account method. With an AEUS, the charge is imposed on all telecommunications services and customers. Thus, an AEUS is broad based because everyone who uses telecommunications services in California is affected by the surcharge. It is also competitively neutral because all telecommunications services are subject to the surcharge. The net trans method, on the other hand, may not be competitively neutral because the carrier could pass the charge on to less elastic services such as residential basic service, and relieve the more competitive services of the charge.

The net trans account method could also cause implicit subsidies to continue. Since carriers would be obligated to pay the charge under a net trans approach, carriers may have to raise the money to fund universal service. Some of these carriers will undoubtedly try to raise some of the same rates that currently support below cost rates in high cost areas.

TURN contends that the language of Section 254(k) of the Telco Act requires that telecommunications carriers, and not customers, pay into the fund to preserve and advance universal service. We are not persuaded by TURN's argument that the Telco

Act was intended to prevent us from setting up an AEUS to fund the CHCF-B. Despite the language in Section 254(k), we agree with ICG that it is highly unlikely that Congress intended that carriers only, and not their customers, should contribute to the national fund. This is especially true since carriers are likely to pass that charge onto its customers. Moreover, carriers who collect the AEUS do "contribute" to the fund in the sense that they incur administrative expenses to assess, collect, and remit the monies to the fund. In addition, Section 254(f) of the Telco Act permits the states to adopt regulations pertaining to universal service that are not inconsistent with the FCC's rules to preserve and advance universal service.

We adopt the use of the AEUS to collect the surcharge for the CHCF-B. This is reflected in Rule 6.F.2. of Appendix B.

3. **Who Should be Obligated to Pay Into the Fund**

a. **Introduction**

Having adopted an AEUS funding mechanism, the next issue to address is whether any customer groups should be excluded from having to pay the AEUS. This issue was raised during this proceeding in the context of both an AEUS, and the net trans account.

b. **Positions of the Parties**

AT&T/MCI recommend the exclusion of residential primary service and local coin revenues from public policy payphones. They further recommend that the fund should be supported by:

> "All other common carrier services, whether provided under tariff or under contract; whether provided by an incumbent local exchange carrier, an interexchange carrier, an alternative access provider, an entering competitive local exchange provider, a satellite carrier, a cellular company, a payphone provider, or an alternative operator services provider; and whether involving switched services or dedicated services should be considered part of the base for provision of support." (Ex. 1, pp. 34-35.)

AT&T/MCI assert that the revenues from residential primary access service should be excluded because it is the service eligible for support. AT&T/MCI witness Cornell stated that these lines should be excluded from the charge on the theory that if they are part of the taxing base, more lines will probably need support, thereby making the fund even larger. According to Cornell, a primary service should be viewed as a residential customer's first line, and does not include toll or long distance charges that the customer may make. Coin revenue from public policy payphones should be excluded because it is a subsidized service.

CCTA's witness Kahn, recommends subtracting out basic service revenues from the funding base to remove the service being supported from the source of the support.

DRA's witness, Angela Young, agreed that residential basic service revenue should be excluded from the calculation.

GTEC contends that primary basic exchange revenues should be excluded from the funding base. GTEC asserts that by including them, basic service will become more costly, and increase the number of customers who need support. As for TCG's claim that excluding residential revenues will result in a competitive disadvantage to carriers who only serve business customers, GTEC contends that no such advantages will result.

Pacific argues that basic residential revenues should not be included in the funding base. Pacific states that applying the surcharge to the subsidized revenues will increase the cost of basic service, which in turn increases the size of the subsidy.

Paul Cain, the witness for TCG and MFS Intelenet (MFS), testified that residential customers should not be excluded from the calculation of the surcharge. If basic residential revenues are excluded, a large portion of Pacific's and GTEC's revenues would not be included in the calculation of their net transmission revenues. According to Cain, this would dramatically increase the percentage share of the universal service obligation

that would be borne by carriers serving business customers, which would defeat the goal of a broad based, competitively neutral mechanism. That is, a carrier who only provides service to business customers would end up transferring revenues to a carrier providing both residential and business services, thereby giving a competitive advantage to the carrier receiving the transfer.

TURN supports excluding residential primary basic exchange service from the funding base. TURN states that inclusion of primary basic exchange service in the revenue base would have the effect of increasing the costs and enlarging the fund, and add to the complexity of administering the USF.

This proceeding also heard testimony on whether cellular customers should be excluded from the funding base calculation. The Cellular Carriers Association of California (CCAC) state that cellular carriers should not have to contribute to state universal service programs. CCAC argues that the Omnibus Reconciliation Act of 1993 (Omnibus Act) exempts cellular carriers from state universal service obligations. (Omnibus Budget Reconciliation Act of 1993, Pub. Law No. 103-66, Title VI, Section 6002(b), 107 Stat. 312 (1993).) CCAC argues that the Omnibus Act preempted states from any rate and entry regulations. Although CCAC recognizes that the Omnibus Act acknowledged the importance of the state maintenance of universal service, and specifically provided that commercial mobile radio service (CMRS) are not exempt from such surcharges when the CMRS are a substitute for landline telephone service, CCAC contends that it is exempt from a universal service surcharge because cellular service is not a substitute for

landline service.[60] CCAC also argues that if the Commission does not exclude cellular service from the funding base, the surcharge must be restructured in the way that it is calculated. They state that the current way the surcharge is calculated unfairly discriminates against cellular customers because the charge is paid based on a percentage of total revenue.

DCA contends that cellular customers should contribute to the high cost area subsidy fund. DCA agrees with DRA's position that the Telco Act provides that every telecommunications carrier should contribute to a state based universal service program, and that cellular customers benefit from universal service in the same way that landline customers benefit. DCA also points out that cellular customers generate increased usage on both the landline and wireless networks, and therefore it is appropriate for cellular carriers to share in the funding of the CHCF-B fund.

DRA argues that applying the universal service surcharge to wireless carriers is equitable and non-discriminatory. DRA contends that cellular subscribers receive the societal benefits of universal service, and that it is only fair that they contribute. Broadening the funding base to include cellular customers widens the pool of contributors. DRA also argues that CCAC's suggestion that the universal service surcharge be transformed into a flat uniform dollar amount imposed on a per line

60 Section 332(c)(3)(A) of Title 47 of the United States Code reads in pertinent part: "Nothing in this subparagraph shall exempt providers of commercial mobile services (where such services are a substitute for landline telephone exchange service for a substantial portion of the communications within such state) from requirements imposed by a State commission on all providers of telecommunications services necessary to ensure the universal availability of telecommunications services at affordable rates."

or per call basis would simply shift the burden of universal service onto wireline customers.

DRA points out that cellular customers pay the same surcharge that wireline customers pay. Although this may result in cellular customers paying a greater surcharge per phone call, that is because the cellular carriers receive much more in revenue per phone call.

GTEC disagrees with CCAC's interpretation of the Omnibus Reconciliation Act. GTEC contends that the legislation exempts CMRS providers from state imposed rate regulation except with regard to universal service. GTEC further argues that even if that legislation exempted CMRS providers, the Telco Act explicitly stated that all carriers should contribute to universal service.

TURN states that it is entirely appropriate to impose the surcharge on wireless services. TURN argues that CCAC presents no valid distinction that warrants treating cellular services differently from expensive enhanced services that use the wireline network. TURN asserts that customers who choose wireless services, or wireline enhanced services, voluntarily do so to gain a special benefit, such as increased convenience. TURN further argues that wireless carriers benefit from the universal service policies that increase the ubiquity of telecommunication services.

c. **Discussion**

As previously stated, we have adopted an AEUS for collection of the subsidy funds. With this mechanism, we see no reason to exclude residential local exchange service from the surcharge amount. A broad based support mechanism should include residential basic service in the funding base so as to reduce the overall surcharge percentage rate. All residential customers should support the fund because they benefit from the comprehensive and far-flung network as well. Additionally, with our modifications to the proxy model, we have targeted the subsidy to a minority of access lines in the state, areas of the state which are

truly high cost. The majority of access lines will not be subsidized and should help contribute to the universal service fund. The only residential customer group that will be excluded from the charge are ULTS customers. ULTS customers have certified their need based on specific income levels.

Regarding the issue of excluding cellular carriers, we reaffirm the position which we took in D.94-09-065 at page 292. In that decision, we held that all end users of every LEC, IEC, cellular, and paging company in the state, receive value from the interconnection to the switched network, and that all users should be included in the billing base for the ULTS program and the Deaf and Disabled Telecommunications program.[61]

As noted in CCAC's opening brief at page 2, when the draft decision which led to the adoption of D.94-09-065 was issued, CCAC commented that "cellular subscribers should not be required to subsidize the landline network in any manner, but, if required to do so, subsidization should be subject to an equitable universal service funding mechanism." Despite CCAC's comments, D.94-09-065 left unchanged the imposition of a ULTS surcharge on cellular customers.

Since the Omnibus Act preceded the issuance of the draft decision which became D.94-09-065, CCAC's argument that this 1993 Act exempts cellular customers from having to pay for universal service had been considered in D.94-09-065 and rejected. There is no need to revisit that issue again. Accordingly, we reject the arguments of CCAC to exclude cellular carriers from paying into the fund, or that the fund should be modified to a flat uniform rate instead of a percentage of revenues. We would note that inclusion of cellular customers in the funding base is

61 Other CMRS services, except for one-way paging services, should be included in the billing base for the CHCF-B surcharge as well.

consistent with AB 3643's principle that the funding mechanism be broad based.

Consistent with D.94-09-065 and D.95-02-050, in addition to ULTS billings, the following should also be exempted from the CHCF-B surcharge: coin-sent paid calling; debit card messages; one-way radio paging; usage charges to COPTs; customers receiving services under existing contracts that were executed on or before September 15, 1994; and directory advertising.

4. **The Surcharge for the CHCF-B**

The surcharge that we adopt today was derived from the adjusted CPM estimate of the cost to serve high cost CBGs using the $20.30 benchmark. The annual subsidy was divided by the total number of end user customers to arrive at the gross surcharge. The gross surcharge was then offset by the EUCL, the CCLC, and interstate USF support, if any. This results in a net surcharge, or what end users will see on their bills as the surcharge for the CHCF-B. The net surcharge for the CHCF-B amounts to 2.87%. The steps leading up to the calculation of this surcharge of 2.87% are shown in Appendix D.

As Roseville correctly points out in its comments to the revised proposed decision, the 2.87% surcharge is not intended to establish a fixed support level for the high cost areas. Instead, the high cost area support that designated COLRs will be entitled to is dependent on the actual number of high cost lines served by each COLR.

5. **Combining The CHCF-A And CHCF-B**

In the comments to the August 5, 1996 proposed decision, some of the parties suggested that the CHCF-A and CHCF-B surcharges be combined into a single line item rather than as two separate line items. Since it is our intent to use the same billing base for the CHCF-A and for the CHCF-B, we will adopt that suggestion. For purposes of collecting the funds for the CHCF-B, we will allow the CHCF-A and the CHCF-B to appear side by side as a single line

item on the end user's bill.[62] Since the two funds are for two different funding mechanisms, the carriers shall be responsible for remitting the CHCF-A and the CHCF-B monies to separate bank accounts, and shall account for these two funds separately.

Combining the two surcharges together as a single line item should result in less customer confusion, and a more efficient manner of administering and collecting the surcharge amounts. Customers will be able to see on their bills how much they are contributing to support universal service in high cost areas. The combined CHCF surcharges shall appear on end users' bills starting with the billing cycle that begins on February 1, 1997. This will give the carriers time to implement this change to their billing systems. In addition, it will also give carriers the time needed to prepare and mail a bill insert informing customers of the change.

The bill insert shall be mailed concurrently with the first bill that reflects this new billing format. The bill insert language shall be developed in a workshop to be convened by the Telecommunications Division as soon as possible.

At the present time, the CHCF-A is administered by Pacific. The Commission, as discussed later, will initially administer the CHCF-B. The Commission should also take over the administration of the CHCF-A. This transition should take place over the next six months. Pacific shall be directed to provide for an orderly transfer of the CHCF-A responsibilities, and all the books, accounts, monies, and related paperwork to the Telecommunications Division. In the interim, Pacific shall continue to administer the CHCF-A.

The testimony in this proceeding indicates that draws on the CHCF-A are likely to be minimal in the future. If that remains

62 A carrier may elect to list the CHCF-A and the CHCF-B as two separate line items.

the case, once the Joint Board and the FCC decide on the federal funding mechanisms for universal service, the Commission should revisit the CHCF-A fund to determine whether the fund is still required, or if the subsidy amount should be reduced.

J. Carrier of Last Resort

1. Introduction

The COLR is a regulatory concept rooted in the idea that by accepting the franchise obligation from the state to serve a particular area, the public utility is obligated to serve all the customers in that service area who request service. (D.95-07-050, p. 36; 3 C.R.C. 948, 956-957.) The COLR concept is important to universal service policy because it ensures that customers receive service. Prior to the opening of the local exchange markets to competition, the 22 incumbent LECs served as the COLR in California's 500 plus local telephone exchanges.

As we noted in D.95-07-050 at pages 36 to 37, with the introduction of competition, the COLR may no longer be the single monopolist serving the territory. Instead, certain competitors may choose to serve the same service area, a smaller service area, or group of customers. That may result in more than one COLR in certain service areas, and only one COLR in other areas.

In the proposed COLR rules, the incumbent LECs would continue to serve and be designated the COLR in all of their respective service areas. The incumbent LEC would retain that obligation until another carrier or carriers are designated as the COLR. The incumbent LEC could also decide to remain as a COLR. The proposed rules also provide for a procedure to replace the last remaining COLR who wants to be relieved of its COLR obligation.

Under the proposed rules, only designated COLRs would be able to receive a subsidy for providing providing service to residential customers in high cost areas. The subsidy, which is derived from the proxy model, will vary according to the cost of providing basic service within a GSA.

2. Positions of the Parties

AT&T Wireless commented that proposed rule 6.D.5, which requires a designated COLR in a given GSA to serve the entire GSA, may be discriminatory to wireless carriers because the boundaries of a particular GSA may not fit within the territory covered by that carrier's FCC licenses. AT&T Wireless also points out that incumbent LECs may also experience the same problem if they are required to cover GSA boundaries that are outside their existing exchange territories. AT&T Wireless recommends that the proposed rules be modified to permit any carrier to apply for designation as a COLR in an area that may not cover an entire GSA.

Citizens commented that proposed rule 6.E.2. may be legally deficient because it forces the owner of the facilities to sell its facilities at book value. Citizens also believes that the Commission already has procedures in place to protect against abandonment of a particular service area, and that the auction mechanism provided for in proposed rule 6.E.1.a. is unnecessary.

The Coalition commented that there is no need to require new CLC entrants, who seek to be a COLR in a particular area, to comply with any extra criteria than that which is required as part of the local entry certification process. Accordingly, the Coalition believes that proposed rule 6.D.4. is not required. The Coalition also feels that the NOI process could be streamlined by permitting the CLCs to seek COLR authority by advice letter.

The Coalition commented that in order to eliminate barriers to entry, access to subsidy funds should be allowed to all new entrants, whether or not they are willing to undertake the COLR obligations. The Coalition argues that new entrants in many cases will be required to construct entirely new networks from the ground up. If new entrants are required to serve an entire GSA, the new entrants are likely to refrain from entering the market at all.

If the Commission insists on requiring that a carrier undertake the COLR obligations in order to draw from the CHCF-B,

the Coalition recommends that the geographic area be sized in a manner which makes meeting the obligation possible. The Coalition believes that GSAs which are sized by census blocks would best meet this requirement.

Regarding the safety net auction mechanism, the Coalition cautions that the incumbent LECs may try to use the mechanism as a means of ratcheting up the subsidy amount. The Coalition recommends that in order to prevent this from occurring, the incumbent LECs be prohibited from participating in the bidding if they initiate the auction.

The Coalition agrees that the winner of the safety net auction should be allowed a premium as an incentive to serve a particular area. However, after three years, the Coalition recommends that all the other COLRs serving the same area should be entitled to the entire subsidy premium.

DRA suggests that some minor revisions be made to proposed rules 6.D.4.a., 6.D.4.b., and 6.D.4.c. DRA also recommends that proposed rule 6.G.1., regarding resale, be revised. DRA believes that the Commission should not be directly involved in deciding whether a service or facility that is resold should be priced below its cost. Also, DRA asserts that the high cost subsidy should apply only to the offering of basic service as a whole, and should not apply to the offering of any unbundled part of basic service, such as the loop. Therefore, DRA recommends that rule 6.G.1. be revised as follows:

> If resale of basic service is permitted, the carrier who sells basic service to the end-user residential customer shall receive the subsidy provided that the basic residential service is priced at the affordable price set by the Commission.

GTEC commented that it is reasonable to impose a COLR obligation only on those carriers who are willing to serve any customer in a market, and that all the carriers seeking to

undertake the COLR responsibility should be required to meet Commission established fitness requirements. GTEC believes that the financial qualifications should be more stringent as well, and proposes that in order to become a COLR, that the carrier must possess a minimum of $500,000 of cash or cash equivalent.

Pacific agrees with the Commission's proposed rule that only providers acting as a COLR throughout the GSA should be eligible to receive the high cost subsidy. Pacific states that the eligibility requirement acts as an incentive for carriers to offer service to all subscribers within the GSA. If the subsidy was offered without a carrier having to undertake the COLR obligation, Pacific contends that such a method would simply subsidize entrants for cream skimming.

Pacific supports the use of an auction in the event no single carrier is willing to undertake the COLR obligation, as well as allowing a COLR to opt out of its obligation. However, it disagrees with the Coalition's proposal that if an auction is triggered by the withdrawal of the sole COLR, the withdrawing COLR should be disqualified from bidding in the auction. Pacific argues that such a restriction may actually increase the size of the fund because the incumbent COLR will not be participating. Pacific also points out that proposed rule 6.E. should be clarified regarding when the auction will be held. Pacific recommends that the auction be noticed and held within 180 days after the COLR files its application to withdraw.

Regarding the issue as to whether a COLR should have to meet specified criteria beyond the safeguards contained in the local competition rules, Pacific believes that the local competition rules are sufficient, and that no additional criteria are necessary.

Pacific commented that this proceeding needs to address the issue of resale of residential service, and whether the reseller is entitled to participate in the CHCF-B fund. Pacific

points out that the reseller should not be able to qualify as a COLR because it is not standing ready to serve any customers in the same sense that a facilities based carrier is. Pacific suggests two ways of dealing with this issue. The first is to have the facilities based carrier or COLR receive all the funding. The COLR whose services are resold has no control over whether the reseller is providing all the basic service elements. The second method is to allow a reseller to draw from the fund if the reseller can demonstrate that the service provided meets the COLR requirements.

The Smaller Independent LECs state that they have made significant investments to develop modern, state-of-the-art digital networks, and that they are in the best position to deploy new technologies in their service areas at reasonable rates. Due to this large embedded plant investment, they argue that they should be designated the exclusive carrier for a period of at least seven years.[63] They argue that this designation will allow them the opportunity to recover their capital investment while providing a transition period to determine their future investment in a new competitive environment. Competing carriers could still offer service in these areas, but only the incumbent LECs could draw from the high cost fund.

Both Roseville and the Smaller Independent LECs agree with the discussion in D.95-07-050 that only highly qualified carriers should receive a COLR designation. They believe that the Commission's first criteria should be that only facilities based providers may become a COLR.

As part of the process for qualifying as a COLR, USA proposes that the carrier seeking to become a COLR explicitly state

63 Roseville suggested in its comments that due to this plant investment, it should be designated as the exclusive COLR for a period of no less than five years.

what efforts it intends to make to communicate with non-English speakers in their native language. USA also believes that there should be an ongoing review of all providers to determine if they are meeting their obligations in this area.

3. **Discussion**

As noted earlier, the purpose of the COLR idea is to ensure that there is a public utility which is obligated to serve all the customers in its service area who request service. In D.95-07-050, we proposed that the incumbent LECs be designated the COLR in all their service areas until such time that another carrier or carriers are designated to be a COLR. (D.95-07-050, App. A, 6.D.1.) The process for becoming a designated COLR was explained in D.95-07-050 at page 57, and in proposed rule 6.D.4. The proposed rules also provide that "A designated COLR will be required to serve the GSA." (D.95-07-050, App. A, 6.D.5.)

We wish to make clear that the COLR obligation applies to both residential and business customers, for all areas in which the COLR has been named the designated COLR.

In response to some of the comments that we received about requiring the COLR to serve the entire CBG, we want to clarify the area in which the COLR is obligated to serve. The GSAs, or geographic study areas, serve as the reference point in the proxy models from which cost data and high cost area subsidies can be derived. (D.95-07-050, p. 50.)[64] We did not intend to suggest that the GSA serve as the geographic service area for all CLCs. This would be contrary to the local competition rule which allows the CLCs to designate the service territory that they intend to serve. (D.95-07-054, p. 28; D.95-12-056, App. C, Rule 4.F.)

64 CBGs were selected as the unit sizes from which the GSAs were to derive the cost of providing basic service. (D.95-12-021, pp. 10-11.)

What we did intend is that any designated COLR, in order to avail itself of the subsidy for a high cost area, must serve the GSA upon which the subsidy is based. This enables the Commission to match the subsidy in a high cost GSA to the number of residential customers the COLR serves in that particular GSA. This is consistent with the Telco Act's requirement that an "eligible telecommunications carrier" shall offer the services supported by the federal universal service support mechanisms throughout the service area designated by the state. (Telco Act, § 102, amending 47 U.S.C. § 214(e).)

Due to the existing exchange area boundaries, and the service area boundaries imposed on a carrier by the FCC that AT&T Wireless mentioned, we will modify our proposed requirement that a designated COLR be required to serve the entire GSA to the following:

a. Until such time as provided for in rule 6.D.1., all incumbent LECs, in order to avail themselves of the subsidy for a high cost GSA, shall be required to serve all the high cost GSAs that are within the incumbent LEC's existing exchange area boundaries;

b. All CLCs who are designated COLRs, in order to avail themselves of the subsidy for a particular high cost GSA, shall be required to serve the entire GSA(s) that is (are) within the CLC's designated service territory for which it has elected COLR status. (Rule 6.D.6., App. B.)

The Coalition argues that every carrier serving an area, whether or not the carrier has undertaken the COLR obligation, should be eligible for the subsidy. We disagree. The purpose of allowing only the designated COLRs to draw from the funding mechanism for high cost areas is to attract competition into these high cost areas. In order to draw on the funds, the carrier must be willing to serve all customers in the Rule 6.D.6. designated

area. This will allow consumers to choose from more than one carrier.

Nor do we believe that the requirement that a carrier must be a designated COLR in order to receive CHCF-B funding acts as a barrier to entry. The CBGs, which serve as the GSAs, tend to be smaller in geographic area than exchanges. Thus, the smaller size will tend to encourage a carrier to serve the entire GSA and receive the subsidy, rather than serving a smaller portion of the GSA and remaining ineligible to receive the subsidy.

Several comments to the proposed rules with respect to the issue of who gets to receive the high cost area subsidy in a resale situation were received. The proposed decision that was mailed on August 5, 1996, misinterpreted Pacific's comments to D.95-07-050 regarding when resellers should be eligible for CHCF-B funding, and modified Rule 6.G. Pacific points out in its comments to the August 5, 1996 proposed decision that under proposed Rule 6.G., resellers would get the double benefit of below cost discounted rates, and the CHCF-B subsidy. That is not what we intended. The original rule as proposed in Appendix A will be adopted.

The sale of unbundled BNFs may pose problems for the way in which subsidies should be distributed. If a CLC purchases some BNFs from the underlying facilities based carrier in a high cost area, the issue arises as to whether the subsidy should be apportioned between the CLC and the seller of the BNFs. We plan to examine this issue after the OANAD proceeding has determined what the prices of these unbundled components should be.

We also need to clarify that proposed rule 6.D.3. is meant to ensure that a designated COLR in a high cost GSA will be

entitled to a subsidy on a per residential customer basis.[65] The subsidy that the designated COLR is entitled to is contained in rule 6.C.2. of Appendix B. The estimated amounts that the five large and mid-size LECs might expect are shown in Appendix D.

In order to receive the subsidy for serving the high cost areas, the designated COLR shall report on a monthly basis, the number of residential basic service customers that it served during the prior month to the Commission. The Telecommunications Division shall conduct a workshop within 60 days to develop the type of information that needs to be reported. The Commission retains its right to inspect the books and records of the COLRs to ensure compliance with the CHCF-B.

In D.95-07-050, we described the designated COLR NOI process in the text of the decision, but only referred to the process in proposed rule 6.D.4. We will incorporate the NOI process into the adopted rules as Rule 6.D.4. We will also adopt the Coalition's suggestion that the NOI process be handled by way of an advice letter, instead of the NOI application process that we described in D.95-07-050. The advice letter process to be used by those seeking to be a designated COLR shall become effective on forty days' notice to the Commission unless a protest is received in accordance with the procedures set forth in GO 96-A. The incumbent LECs are not required to submit advice letters seeking to be designated COLRs since that obligation has already been imposed upon them in our adopted rule 6.D.1. in Appendix B, and in rule 5.A. of the local competition rules. (See D.95-12-056, App. C, 5.A.) As CLCs start to file advice letters to seek designated COLR status, the Telecommunications Division staff will need to

65 The CPM's line counts, as shown in Appendix D, are CPM generated estimates. The fund administrator will disburse the subsidy support based on the actual reported number of lines that are eligible for support.

develop a mapping and tracking system to identify the COLRs, and the areas that they are obligated to serve.

Proposed rule 6.D.4. also listed the factors we stated the Commission should consider in determining whether COLR status should be granted. A number of comments responded to our invitation to comment on whether a COLR should be required to meet criteria beyond what is required of the CLCs. Under the Telco Act, it appears that the federal equivalent of a COLR, an eligible telecommunications carrier, will also have to advertise the availability and charges for such services through the media in order to be eligible for universal service support. (Telco Act, § 102, amending 47 U.S.C. 214.)[66]

We have considered those comments, and will delete any additional financial ability criterion beyond what is required of the CLCs. We will retain the criteria regarding a description of the facilities that the carrier has in place or the arrangements the carrier plans to enter into in order to provide local service, as well as the carrier's commitment to promoting universal service to all residential customer groups within the carrier's service territory.[67] We believe that these two criteria should be used to ensure that a carrier desiring to be designated a COLR has a stake in the outcome, that it is unlikely to abandon its customers, and that the carrier is committed to promoting universal service. We will not adopt the suggestions by Roseville and the Smaller

---

66 We decline at this time to adopt the Small LECs' suggestion in its comments to the PD that the 22 incumbent LECs be designated as "eligible telecommunications carriers" under Section 102 of the Telco Act. The FCC has not yet established what services will be supported by the federal universal service support mechanisms.

67 We will modify proposed rule 6.D.4.c. to delete the reference to low income and non-English speaking communities. Instead, we will broaden the rule to include the promotion of universal service among all customer segments.

Independent LECs that because of their size and investments, that these LECs should be designated the exclusive COLR for a period of no less than five years. It is clear under the Telco Act that rural telephone companies may soon be faced with requests for interconnection, and that states will allow such arrangements if the request is not unduly economically burdensome, is technically feasible, and consistent with the federal universal service provision. In addition, PU Code § 709.5(a) clearly provides that

> "it is the intent of the Legislature that all telecommunications subject to commission jurisdiction be opened to competition no later than January 1, 1997." (Emphasis added.)

A number of comments addressed the competitive bidding mechanism that we proposed in the event no carrier wanted to retain the COLR obligation. We will clarify proposed rule 6.E.1.a. to reflect that an auction will be held within 180 days from the date of filing of an application to withdraw as the COLR in a GSA. We will also adopt Citizens' suggestion that proposed rule 6.E.2. be changed to delete the reference to a sale at book value.

The Coalition suggested that after three years, the other competitors who entered after the auction was awarded should be entitled to the full subsidy rather than one-half the subsidy. That suggestion will not be adopted. We intend that the length of the award in such a situation should be limited to three years. Otherwise, the premium that is paid to the winning COLR will continue indefinitely, rather than possibly being bid down. Some changes have been made to proposed rule 6.E.3. to make this intent clearer.

K. Recognition of the Explicit Subsidy

1. Introduction

In order to avoid a situation where the incumbent LEC receives a subsidy from both the CHCF-B fund, and monies from the implicit subsidies contained in rates for services which are priced to help offset the costs of universal service, an adjustment is

needed. Most of the parties refer to this problem as the "windfall" issue.

2. Positions of the Parties

AT&T/MCI contend that the Commission should order the incumbent LECs at the creation of the fund to lower prices on a dollar for dollar basis to prevent the LECs from realizing a windfall due to the creation of an explicit fund to subsidize high cost areas. If the Commission does not reduce prices by the operative date of the fund, AT&T/MCI recommend that the relevant prices of the incumbent LECs be subject to refund.

AT&T/MCI contend that the prices of two essential monopoly input functions, namely the switching component of switched access, and collocation, should be reduced to their direct economic cost or TSLRIC as soon as possible so as to encourage rapid development of competition and provide the greatest benefits to consumers. AT&T/MCI also state that the other essential monopoly input functions should be priced at TSLRIC as well, but the unbundling of those elements and their pricing should be done in OANAD.

AT&T/MCI assert that CCTA's proposal for an across the board reduction is arbitrary and economically inefficient. Such a proposal would reduce the different services by an equal percentage regardless of each service's contribution above cost. The equal percentage reduction is not revenue neutral because it would reduce the differentials between the rates for essential monopoly input functions, and the rates for end user services that use those functions. AT&T/MCI contend that this will only exacerbate the prospect of an anticompetitive price squeeze and discriminatory pricing.

CCTA contends that Pacific's proposal to selectively reduce toll prices rather than the prices of intrastate switched access or other products is self serving because it only affects those services which Pacific claims to have high margins, and in

which it faces greater competition. CCTA believes that fairness requires that there be an equal proportionate reduction to all above cost rates, excluding those which apply to services included in the basic service package, or those that are covered by contract.

The Coalition recommends that the Commission order each LEC to implement rate adjustments that fully offset each LEC's receipts from the fund. To prevent the LECs from serving their own anticompetitive interests, they should not be permitted to unilaterally choose the offsetting rate adjustments. The Coalition also recommends that the fund should not begin to operate until: the Commission determines and implements the appropriate offsetting rate adjustments; or, the Commission has made the rates that might be adjusted, subject to refund, including interest, and eligible for cumulative refunds when the appropriate rate adjustments have been determined and implemented. The Coalition asserts that there should be no other rate rebalancing other than downward adjustments to offset the windfall problem.

DRA agrees with AT&T/MCI that the LECs should reduce rates for essential monopoly input functions, i.e., local switching and collocation services, that are currently in Category I. Such a reduction will most likely foster competitive entry into the local exchange markets. DRA recommends that the Commission reject Pacific's proposal to reduce rates for end user services such as toll. DRA believes that no offsets are needed for toll and other competitive services because the competitive marketplace will force the LECs to reduce rates. DRA believes that it makes more regulatory sense to flow the rate reductions through the LECs' least competitive services in Category I. DRA contends that this will help to achieve the Commission's goal of having prices move closer to costs.

GTEC states that offsetting reductions should be made in rates so as to remove the distortion that is caused by the existing

implicit support in rates. However, none of the parties' proposals dealing with this issue should be adopted because different rates are at different starting points. GTEC suggests that the only practical way to deal with this issue is to allow each LEC to propose a package of rate reductions which exactly offset its anticipated gross receipts from the fund. GTEC recommends that this process occur in another proceeding designed to address these kinds of rate issues.

ICG recommends that the Commission hold further hearings before deciding how the LECs' rates should be adjusted to prevent them from receiving a windfall. In the event the Commission decides not to hold further hearings on this issue, ICG recommends that the Commission adopt CCTA's proposal.

Pacific commented that any universal service funding will generate new revenue sources for the incumbent COLRs, and that offsetting revenue reductions are appropriate. Pacific proposes to make the following reductions: (1) change the peak and off peak price structure for residential customers; (2) change to a subminute billing methodology for both residential and business customers; and (3) reduce the monthly prices for custom calling features for residential customers. If more reductions are needed, Pacific contemplates as an option a possible reduction in business toll rates.

TCG argues that Pacific's plan for rate reductions gives Pacific a competitive advantage because its proposed rate reductions are tied to those services where competitive pressures are going to require reductions in prices. Also, Pacific's plan to use the advice letter process to effectuate the reductions is harmful to competition because of the difficulty of responding to advice letter filings in a timely manner, and because of the potential that the rate changes proposed in an advice letter could become effective while the resolution of a protest is pending. TCG favors CCTA witness Kahn's proposal that any carrier making a net

positive draw from the fund must evenly spread its offsetting rate reductions across all services.[68]

3. **Discussion**

We first note that AT&T/MCI's suggestion that essential monopoly input functions be reduced to their direct economic costs or TSLRIC, is an issue that the OANAD proceeding should be concerned with, rather than this proceeding. It is in the OANAD proceeding that the costs and pricing of essential monopoly input functions are being examined.

The assigned ALJ properly excluded testimony regarding rate rebalancing and deaveraging from this proceeding. (See 14 RT 1387.) The focus of this proceeding is to establish a universal service fund. It was not intended to be an exercise in pricing of services in a competitive marketplace. (D.95-12-021, p. 3.) However, in order to make subsidies for high cost areas explicit, there must be a correlating downward adjustment of rates or price caps through a surcredit or reduction in tariffed rates or price caps so as to prevent the LECs from recovering implicit subsidy support as well. It is only to that extent, that we engage in the rebalancing of rates.

In resolving this windfall issue, we must be cognizant of the motives of the incumbent LECs, and the other parties. By

68 In DCA's reply brief at pages 30 to 31, DCA stated that TCG's proposal, that rates should be reduced across the board over all LEC services, was the most fair. TCG had stated in its opening brief that "rate reductions be spread evenly across all of the LECs' services." In TCG's reply brief, TCG recommended that "any carrier making a net positive draw from the USF must evenly spread its offsetting rate reductions across all services, as proposed by Dr. Kahn." Since TCG's proposal appears to be based on CCTA witness Kahn's proposal, it is unclear whether DCA favors an across the board reduction of <u>all</u> services, including residential basic service, or whether it would exclude residential basic service from such rate reductions.

adopting the proposal of AT&T/MCI, the essential monopoly inputs become cheaper for the CLCs. If, however, Pacific's proposal to reduce only the price caps for certain competitive Category II services is adopted, that allows Pacific to reduce the prices of services for which it faces more competition, and thereby possibly preserving its share of the market.

We do not believe that ICG's suggestion to hold additional hearings into this issue, or that GTEC's proposal, are the most efficient ways to resolve the windfall issue in the short term. What we need to do in this proceeding is to establish a fund to provide explicit support to high cost areas of the state. In order to implement such a fund, and to transition from implicit subsidies to explicit subsidies, we must take immediate action to resolve this problem.

Contrary to AT&T/MCI's assertion that CCTA's proposal is arbitrary and not economically efficient, we believe that CCTA's proposal of ordering an equal percentage reduction for all rates, except for residential basic service, and rates covered by contracts, results in the most competitively neutral outcome in the short term. Neither the CLCs or the incumbent LECs gain an advantage as a result of the adoption of an across the board reduction. Although some of the services provide greater contribution toward universal service than other services, an across the board reduction will result in an immediate offset without much controversy.

By excluding rate reductions for residential basic exchange services, we help ensure that the implicit universal service support that is contained in other rates, is reduced. The exclusion of residential basic service from the rate reductions is appropriate given the purpose of the fund. If we were to reduce rates for basic service as well, this would widen, rather than narrow, the gap between residential rates and their costs.

Concurrent with the effective date of the fund, the five large and mid-size LECs affected by the CHCF-B shall reduce all of their rates, except for residential basic service and existing contracts, by an equal percentage. This overall reduction shall equal the anticipated monthly draw the incumbent LECs anticipate receiving from the fund. The rate reduction shall be accomplished by a monthly surcredit to each customer's bill through an advice letter filing. In order to ensure that the total reductions equal the total amount the LECs receive from the fund, the large and mid-size LECs shall establish memorandum accounts to track the rate reductions, so that a true up with the actual monies received from the CHCF-B, can occur if necessary.

We shall afford the five large and mid-size LECs the opportunity to decide what rates or price caps should be reduced downward to permanently offset the explicit subsidy support. Until that is accomplished, a monthly surcredit shall be used to offset any anticipated monthly draw. These five LECs shall be permitted to file applications describing what rates or price caps they seek to permanently rebalance downward as a result of receiving monies from the CHCF-B. Protests and responses to the applications may be filed in accordance with Article 12 of the Commission's Rules of Practice and Procedure. The Commission, in its discretion, may consolidate the applications with this proceeding. A review of the true up memorandum accounts could also take place as part of the new application filings, or in a subsequent phase of this proceeding.

L. Who Should Administer the Fund

1. Introduction

In D.95-07-050 at page 65, we discussed whether the Commission, or a neutral third party, should administer the CHCF-B fund. We proposed that the Commission should administer the fund because of two reasons. First, by having the Commission administer the fund, it would eliminate the need to pay an administrative fee

to an outside administrator. Second, it would allow for easier enforcement of the fund in the event auditing of the carriers were required, or if a carrier's authority needed to be revoked.

D.95-07-050 invited further comment on who should administer the fund. We were particularly interested in receiving comments about the possible delays and administrative difficulties the Commission might face with doing audits, investigations, and revocations, if the administration of the fund was left up to a third party.

2. Positions of the Parties

Citizens took the position that if a net trans account was adopted an independent third party, such as the National Exchange Carriers Association (NECA), should administer the funds.

The Coalition commented that the administration of the CHCF-B fund should be administered by a third party with fund management experience. This would separate the fund's workings from other resource demands or resource constraints that the Commission staff might face. The budget to administer the fund would be included as part of the funding requirement. The Coalition suggests that the third party administrator be overseen by a committee of Commission, industry, and consumer representatives, similar to the ULTS Trust Administrative Committee. The third party administrator should also have sufficient auditing and legal resources. The Coalition states that if improper behavior on the part of a carrier is detected, the administrator could file a complaint against the carrier with the Commission.

DRA believes that the Commission should appoint itself to administer the high cost fund. DRA states that only the Commission staff has the appropriate expertise to monitor such a program.

GTEC commented that the Commission has the expertise to administer both the high cost fund, and the ULTS fund. GTEC suggests that the Commission must weigh whether the staff has the

time and people to undertake administration of both funds, or whether a neutral third party administrator should administer the funds.

3. **Discussion**

The CHCF-B fund is a new program that will undoubtedly require some adjustments and fine tuning as the fund is implemented. In order for the Commission to make timely adjustments to the operations of the fund, the Commission should be the initial administrator of the fund. Administration of the fund will be handled by the head of the Commission's Telecommunications Division or his/her designee.[69] As the details and the workings of the fund's operations become better known, the staff of the Commission can quickly incorporate changes to the fund which will make it operate more smoothly and efficiently. Also, if problems are detected with the carriers in conjunction with the fund, the Commission can take prompt action to resolve any such problems. In addition, incorporating the CHCF-A into the CHCF-B may require resolution of some operational details. The Commission is in the best position to quickly resolve any possible problems.

The comments correctly observe that resource constraints may impact the Commission's long term administration of the combined CHCF-A and CHCF-B. At the end of one year's time, we will evaluate the operations of the two funds, and their impact on our resources, to determine if we should request proposals from neutral third parties to take over the administration of the funds. At that time, the Telecommunications Division shall prepare a report for the Commission regarding the operations and administration of the two funds, and whether the Commission should continue to

69 The Commission staff shall provide quarterly updates to the full Commission at its meetings concerning the administration and operation of both the CHCF-A and the CHCF-B.

administer the two programs. That report shall be forwarded by the Commission to the Legislature for their information.

In order to make the CHCF-B operational, the Executive Director shall coordinate the details of administering the CHCF-B fund on a day to day basis with the Telecommunications Division and the Fiscal and Administrative Services Branch of the Management Services Division. Such details include, but are not limited to, the following: developing monthly reports for remitting amounts to the fund and claims from the fund; establishing the necessary accounting systems; opening appropriate bank accounts; establishing claim procedures; issuing checks; and creating auditing and investigatory procedures for remittances to the fund and claims on the fund.

The administrative details of day to day operations of the CHCF-B fund shall be resolved as quickly as possible, and before the effective date of the CHCF-B.

M. Review of the Fund Size

1. Introduction

D.95-07-050 proposed that the subsidy amounts derived by the proxy model be reviewed periodically. (D.95-07-050, pp. 55-56, App. B, rule 6.A.7.) The Commission stated that such a review would give us the opportunity to review the effects of competition, advances in technology, and whether the subsidy amounts need to be reduced. We invited further comment on whether a periodic review was necessary, and if so, how often such reviews should take place, and what items would need review or adjustments.

2. Positions of the Parties

The Coalition favors a three year periodic review where the market rates for basic service would be reviewed to determine the new subsidy requirement. The Coalition suggests that the new subsidy requirement reflect the weighted average of the cost of basic service as reflected in the rates charged by all the carriers serving a GSA.

DRA supports a periodic review of the subsidy amount. DRA believes that a review would ensure that technological advances and competitive pressures are reflected in the subsidy amount. Without a review procedure, DRA cautions that the subsidy has the potential for subsidizing providers, rather than promoting universal service.

GTEC commented that the Commission should not attempt to update the proxy costs over time to keep up with changes in cost levels, technology, or with the definition of basic service. Instead, if two or more carriers are willing to be a COLR in a specified area, an auction approach should be used to determine the level of support needed. Instead of the Commission having to decide whose cost studies are more accurate, the bidding would represent what a firm is willing to commit itself to in exchange for undertaking the COLR responsibility. GTEC recommends that the Commission adopt GTEC's proposed auction method.

In its comments to D.95-07-050, Pacific stated that a periodic review of the high cost funding program should not take place for at least seven years. Pacific contends that more frequent reviews will interrupt modernization efforts in high cost areas, and discourage competitive entry. Since the proxy model is to be based on forward looking technologies, Pacific argues that the subsidy fund will automatically reflect major cost saving advances. In addition, if the fund is sized correctly, Pacific asserts that competition will emerge and efficient enhanced technologies will benefit consumers.

After the evidentiary hearings concluded, Pacific's reply brief agreed with GTEC that the Commission should investigate the feasibility of establishing an auction mechanism for providing universal service.

3. <u>Discussion</u>

The parties who commented agree that a review of the CHCF-B fund should take place. However, they disagree as to how

often the review should be, and the type of review mechanism that should be used.

We believe that a review of the subsidies generated by the CHCF-B fund should take place. The review of the CHCF-B funding mechanism will ensure that the overall size of the fund is within reason, and that it will be adjusted as competition and technology evolve. By conducting such a review, the need for ongoing high cost area support may be reduced over time. The CHCF-B surcharge should also be recalculated each year to account for changes in the billing base.

Due to the entry of new competitors, and the use of this untested CHCF-B fund mechanism, a review of the fund should take place in three years.[70] Three years should give us sufficient time to determine whether new entrants are willing to serve high cost areas of the state with the subsidies provided. This initial review will give us the opportunity to adjust the CHCF-B fund. Subsequent reviews will take place every three years thereafter. There may also be a need to reexamine the CHCF-B earlier depending upon what the FCC adopts in response to the Telco Act.

The next issue to decide is the format of such a review. Suggestions have been made to use an auction mechanism, an indexing mechanism, a weighted average of the prices charged for basic service in a GSA, or to conduct a reexamination of the inputs and assumptions used in the proxy model.

An indexing mechanism, or a weighted average, could be useful for readjusting the subsidies derived from the proxy model. However, a drawback to these two forms of adjustment is that they are somewhat dependent upon the numbers derived in the initial

70 We will also adopt GTEC's suggestion in its comments to the proposed decision that was mailed on August 5, 1996, that the Commission rerun the CPM periodically using the actual reported line counts.

proxy model. For example, the indexing mechanism allows the subsidy amount to be increased or decreased by the indexed amount. This does not encourage carriers to become more efficient. As a result, the subsidy tends to remain near the same level as originally set.

If a reexamination of all the inputs and assumptions in a proxy model is used to review the subsidy amounts, based on our most recent experience, such a reexamination is likely to be time consuming and contentious.

After having undergone the process of examining and reviewing the competing proxy cost models, the inputs, the outputs, and the time and expense associated with such a review, the auction mechanism merits additional thought. There should be no doubt, however, that the proxy model exercise has been beneficial. As we noted in D.95-07-050 at page 49, the cost studies serve as "a good starting point for determining whether a subsidy is needed, how large the subsidy needs to be, and how the subsidy should be targeted."

With a subsidy mechanism in place, an auction mechanism appears to be the most efficient mechanism for reviewing the subsidy amounts in the future. By the time the three year initial review comes up, new entrants may have entered the markets and gained experience regarding the cost of providing residential basic service in high cost areas. A properly structured auction mechanism could drive down the cost of the subsidy for high cost areas if a more efficient provider exists in a particular GSA. The CPM proxy costs will remain the basis of the subsidy calculation until an auction for that particular GSA has been initiated by a request and completed.

The auction mechanism also eliminates revisiting whether a particular proxy cost model is better than another, and performing costs studies over again. It also eliminates technology debates as to what type of technology the proxy model should use

since the bidder will take that into account when the bid is made. Also, if new service elements are added to the definition of basic service, that will be accounted for in the auction process. Bidders will also have to consider all sources of revenues when they make their bids.

Over the course of the next two years, the Telecommunications Division staff will monitor how competition develops in high cost areas of the state and keep us informed. If little or no competition develops, then we may reconsider whether the use of an auction mechanism is appropriate for reviewing the subsidy amounts.

Due to the possibility that a COLR may want to withdraw as the only COLR in a particular GSA, the Telecommunications Division staff should hold some workshops within the next six months to discuss with interested parties how the auction mechanism should be organized.[71] The staff shall prepare a workshop report for the Commission's review upon completion of the workshops. The assigned ALJ, after consulting with the assigned Commissioner, will then issue a ruling detailing the steps needed toward developing auction mechanism rules. A Commission decision regarding the auction mechanism will then follow, with the auctions taking place in about three years from today or as needed if a COLR seeks to withdraw from serving a particular GSA. No auction will be held in

71 The following are some of our preliminary thoughts on what an auction mechanism might consider. (1) What qualifications must a carrier meet before being allowed to participate in the auction process; (2) how should the bidding process be structured, and how many rounds of bidding there should be; (3) when does the bid become binding on the carrier; (4) should performance bonds be required to ensure that the winning bidder can carry out its obligations; (5) should CBGs be aggregated for purposes of bidding; and (6) should losing bidders be allowed the same subsidy as the winning bidder.

accordance with rule 6.E. of Appendix B until the Commission has established an auction process.

IX. Universal Lifeline Telephone Service Program

A. Introduction

The ULTS program is designed to promote the use of affordable, statewide, basic telephone service among low income households. The ULTS program is mandated by the Moore Universal Telephone Service Act (Moore Act) contained in PU Code Section 871 et seq. At the present time, there are approximately 3 million ULTS subscribers in California.

Under the ULTS program, all LECs throughout the state charge qualified residential low income customers a discounted installation charge of $10.00,[72] and a monthly fee of $5.62 for flat rate service or $3.00 for measured rate service.[73] Each LEC is then allowed to draw money from the ULTS fund, which covers the difference between the statewide ULTS rate, and the LEC's rate for residential basic service, as well as for certain expenses associated with the ULTS program. The ULTS program is currently funded by a 3.2% surcharge on all end users' bills.

Under our proposed revisions to the ULTS program, a ULTS customer would be free to select any carrier from those who provide residential local exchange service. By selecting a particular

72 Some of the small LECs charge less than $10 for the ULTS installation charge because of the restrictions contained in PU Code § 874(c). (See D.94-09-065, p. 57.)

73 Some of the small LECs' basic exchange rates are lower than Pacific's basic exchange rate. In those cases, the small LECs' ULTS rates will be less than the statewide ULTS rates. In addition, in exchanges with extended area service (EAS), the ULTS customer will pay 50% of the EAS charge.

carrier, that serving carrier would then be permitted to submit a claim to the ULTS program for reimbursement.

B. Position of the Parties

AT&T Wireless believes proposed rule 5.A.1.b., that carriers qualifying for a subsidy from the ULTS program must "charge no more than the statewide ULTS rate, as set by the Commission, to qualifying low income customers," hinders a customer's choice. AT&T Wireless recommends that ULTS customers be allowed to apply the ULTS subsidy to a provider of basic service, whose rate may be priced higher. However, the amount of subsidy that the higher priced carrier would receive, could be no higher than the ULTS subsidy amount received by other carriers for serving other ULTS customers. In effect, the customer who chose the higher priced carrier, would have to pay the ULTS base rate, plus the difference between the higher rate and the ULTS subsidy amount. AT&T Wireless contends that consumers should be permitted to use their virtual voucher to select a higher priced service that reflects the cost of a higher priced technology.

Cal/Neva and Consumer Action are opposed to any change from the current self-certification application process for ULTS, to an income verification process. They argue that an income verification process creates a barrier to enrollment because of the complexity of the process, and the type of information that may be required. They also argue that such a process is expensive. In addition, in a November 1993 study of the ULTS program for the Commission, it was determined that the number of ULTS customers who were ineligible based on income, was too low to justify the administrative costs associated with such an income verification

method.[74] They also fear that any monies received as a result of a change to an income verification method could be diverted to support libraries and public schools, as suggested by DCA. They contend that such monies should be used to benefit affordable telephone service for low income customers.

Cal/Neva also supports expanding the ULTS program to provide discounted basic service to the "working poor", as suggested by Consumer Action. They believe that the ULTS income ceilings are too low to benefit working poor and lower middle income households. They suggest that a second tier of ULTS with a higher income ceiling, and somewhat lower benefit levels, should be established.

Citizens, as well as Pacific, suggests that proposed rule 5.A.1 be clarified to state that only those carriers who provide basic residential service will have access to the ULTS subsidy.

The Coalition is opposed to an income verification process for the ULTS program. The Coalition believes that this issue should be dealt with in R.94-12-001. The Coalition asserts that an income verification process is expensive, and the cost of verification may exceed the extra monies that would be available from the federal government. The Coalition also points to the November 1993 study which concluded that the incidence of fraud in obtaining ULTS service was not significant.

The Coalition believes that the current administrator should continue to administer the fund. However, the administrator's resources for auditing and enforcement should be increased.

74 See A Study to Assess Customer Eligibility and Recommend Outreach Activities for the Universal Lifeline Telephone Service, SRI International, Nov. 1993, pp. 3, 13.)

The Coalition also supports Consumer Action's proposal to eliminate the existing subsidy of ULTS marketing by the LECs. As Consumer Action points out below, in a competitive environment, it is unfair for the customers of one company to underwrite the marketing efforts of other firms to attract customers. The Coalition does not oppose Consumer Action's proposal to use ULTS funds that are earmarked for LEC marketing subsidies to fund community and consumer groups, so long as those organizations' marketing efforts are effective and targeted to all appropriate communities.

Consumer Action agrees that all carriers who provide basic service to low income customers should be able to avail themselves of the ULTS fund. However, they believe that the reimbursement should be limited to the added expenses incurred in providing ULTS service, such as the difference between the ULTS rate and regular service. Consumer Action is opposed to any carrier subsidy to pay for ULTS outreach, advertising, and other marketing efforts. They believe that the existing reimbursement for such efforts must be ended because of the competition that the carriers face, and to avoid multiple subsidies for marketing efforts directed at the same group of customers. Consumer Action favors the use of community and consumer groups to carry out the marketing for increasing telephone subscribership under the ULTS program.

Consumer Action also favors a revision to the once a year discounted installation charge. Consumer Action believes that low income customers tend to move more frequently, and that the current rule limiting the installation discount to once a year serves as a price barrier for households that move twice or more in a given year.

Consumer Action also commented that the Administrative Committee of the ULTS Trust should be maintained as the fund

administrator for the ULTS program, rather than moving the responsibilities to the Commission or another third party.

DCA commented that the ULTS program should adopt the federal verification standards for ULTS applicants. DCA's understanding is that because the ULTS program currently employs a self certification process instead of an income verification method, approximately $50 million per year in potential federal funding for lifeline service is foregone. DCA suggests that an income verification process be adopted, and that the additional federal monies be used to support the ULTS program. The current ULTS surcharge should be retained and those monies should be used to provide schools, libraries, and CBOs with access to advanced technologies.

DRA commented that the Administrative Committee that is currently mandated to administer the ULTS fund should continue to perform this function. DRA recommends that the membership of the Administrative Committee be diversified to include representatives of the CLCs.

DRA pointed out in its September 1, 1995 comments that the marketing of the ULTS program in a competitive environment may need revision. Under the current practice, the incumbent LECs are reimbursed for their recorded expenses associated with administering the ULTS program, including their ULTS marketing expenses. With the opening of the local exchange to competition, the marketing expenses associated with the ULTS program become an issue.

DRA sets forth two approaches for resolving the marketing expense problem, and states that each approach has its own advantages. The first approach is to allow the LECs and the CLCs to market the ULTS program. DRA states that the advantages of this approach are the following:

"o there would be continuity between the marketing and the provision of the service;

"o the LECs and CLCs are in the best position to be knowledgeable about customers and should as a result be able to provide effective marketing;

"o the LECs, especially the larger ones, already have experience marketing ULTS through outreach programs;

"o private enterprise would provide the service, diminishing the role of government (although the neutral third party could also be private);

"o if DRA's proposed modification to Appendix A paragraph 5.A.1.c is implemented (see section E. below), an incentive will be created for low-cost CLCs to market to eligible ULTS customers."

DRA's second approach is to give the responsibility for marketing the ULTS program to a neutral third party, such as the ULTS Trust Administrative Committee. DRA believes that the advantages of having a third party handle the ULTS marketing are as follows:

"o the possibility of cream-skimming would be diminished, since this agency would be impartial;

"o the need for Commission oversight of companies' ULTS marketing efforts would be avoided;

"o coordination of efforts could be improved."

DRA believes that the advantages in favor of the LECs and the CLCs handling the ULTS marketing outweighs the advantages of the neutral third party approach. Consistent with that recommended approach, DRA recommends that a fixed statewide administrative fee

per ULTS customer be paid to the LEC or CLC. DRA suggests that the fee be derived from the historical average expenditures by the LECs in administering the ULTS program, including marketing expenses. This fee could be updated from time to time to reflect the effects of inflation and productivity.

On the subject of whether the existing self certification process should be changed, DRA recommends that the Commission should hold workshops on the feasibility of implementing an income verification process for ULTS. DRA recommends that the Commission first determine if the $50 million of federal funding is available before deciding whether to implement the verification program. DRA points out that an independent verification program may be necessary if the LECs and the CLCs are allowed to do their own ULTS marketing, because some carriers may be tempted to subscribe customers who are ineligible for the ULTS program.

DRA also recognizes the drawbacks of an income verification process for the ULTS program. Such a process may deter some eligible customers from applying for support. Also, the cost of verification may be prohibitively expensive, in light of the relatively small amount of subsidy per customer that the carrier receives. DRA also does not expect to see significant savings in terms of reduced fraud through such a process because of what the November 1993 study concluded.

DRA also suggests revisions to proposed rule 5.A.1.a., 5.A.1.c., and 5.B.3., and recommends that the revised rules for the ULTS program be implemented as soon as possible. DRA also recommends that the amount of the subsidy should be revisited whenever the definition of basic service is changed.

DRA is opposed to a second tier of ULTS with a higher income ceiling and somewhat lower benefit levels. DRA contends that the size of the fund is already significant, and it is likely that demand for ULTS will continue to increase as the population grows. Instead of a two tiered ULTS program, DRA believes that

toll call restriction and bill installment payment plans are ways in which lower income consumers can avoid being disconnected from the network.

GTEC believes that the ULTS program should have an income verification process instead of a self verification process. GTEC contends that such a process would ensure that only those meeting the required eligibility criteria would receive a subsidized rate. Such a process also acts as a deterrent against fraud if a carrier tried to claim a subsidy for a customer who was not eligible for the ULTS program. In addition, the adoption of an income verification program would make available the additional federal monies to help fund the ULTS program.

Pacific recommends that the Commission continue to allow ULTS customers to self certify their eligibility, rather than to adopt an income verification process. Pacific states that an income verification process could have unintended adverse effects on the ULTS program by discouraging eligible customers from applying. In addition, such a process would be costly to administer given the number of ULTS subscribers. Pacific believes that the current self certification process strikes the proper balance of deterring fraud, and ensuring that the universal service goals benefit the greatest number of California customers.

Pacific commented that a neutral third party should oversee the administration of the ULTS fund unless administrative feasibility is better served by having the Commission administer the fund.

Public Advocates recommends that enhanced telecommunications services be made available to qualified ULTS customers at ULTS rates, i.e., no more than 50 percent of the price of the service. Public Advocates also recommends that the ULTS program should retain the self certification process, because of the likelihood that an income verification process will deter many eligible persons from applying.

The Smaller Independent LECs recommend that the self verification process continue. However, they suggest that the Commission investigate how the current self verification process in a substantially similar form, could satisfy federal requirements and make it eligible for the additional $50 million in federal subsidies.

USA believes that with all the other changes occurring in the telecommunications industry, that the Commission should not change the self certification procedure for ULTS at this time.

C. **Discussion**

As we noted in D.95-07-050 at page 67, with the introduction of local exchange competition, the Commission needs to review and revise the ULTS program. These revisions will permit all carriers who provide residential basic service to ULTS customers to avail themselves of the ULTS funds. The changes that we make to the ULTS program are discussed below.

We first address the suggestions to modify some of the proposed rules. We will adopt the suggestion by Citizens and Pacific to clarify rule 5.A.1. by specifying that only those carriers who offer residential basic service will have access to ULTS funds. Such a suggestion is appropriate given that the ULTS program is a residential service. Thus, all that a ULTS customer needs to do is to select a provider of local exchange service. That carrier will then establish the necessary paperwork in order to claim reimbursement from the ULTS program.

We will also adopt DRA's suggestion to modify proposed rule 5.B.3. to make the reporting consistent with the requirements of GO 153, as well as Resolution T-15826. We have also revised this rule to include the requirement that the carrier report the number of ULTS customers that it served that month. Proposed rule 5.B.3. has been renumbered as rule 5.A.1.e. This requirement will enhance the verification process to ensure that the claim for reimbursement per ULTS customer is correct. The Telecommunications

Division staff shall revise the ULTS Monthly Report and Claim Statement to reflect this requirement.

We do not adopt DRA's suggestion to modify proposed rule 5.A.1.c. We believe that rule 5.A.1.c., as drafted, is more competitively neutral than DRA's suggestion that the lower cost provider be provided with a larger subsidy. In a competitive market, prices and subsidies should be driven downward. We have revised rule 5.A.1.c. to clarify how much of a subsidy the carrier serving the ULTS customer is entitled to.

We have also revised rule 5.A.1.b. to clarify that a new entrant serving ULTS customers, shall set their ULTS rate in accordance with PU Code § 874, i.e., the ULTS rate shall not be more than 50% of the new entrant's rates for non-ULTS customers, and that such a rate cannot exceed the ULTS rate set by the Commission.[75] In addition proposed rule 5.B.2. has been revised to reflect the other services that are exempt from the ULTS surcharge as provided for in D.94-09-065 at pages 288 to 293.

As for the recommendation of AT&T Wireless, we believe that PU Code § 874 limits our ability to apply the ULTS subsidy toward the basic service rate of a higher priced carrier. PU Code § 874 states in pertinent part:

> "The lifeline telephone service rates and charges shall be as follows:
>
> "(a) In a residential subscriber's service area where measured service is not available, the lifeline telephone service rates shall not be more that 50 percent of the rates for basic flat rate service, exclusive of federally mandated end user access charges, available to the residential subscriber.

75 The statewide ULTS rate was last set in D.94-09-065 at pp. 50 and 57.

"(b) In a residential subscriber's service area where measured service is available, the subscriber may elect either of the following:

"(1) A lifeline telephone service measured rate of not more than 50 percent of the basic rate for measured service, exclusive of federally mandated end user access charges, available to the residential subscriber.

"(2) A lifeline flat rate of not more than 50 percent of the rates for basic flat rate service, exclusive of federally mandated end user access charges, available to the residential subscriber."

"(c) The lifeline telephone service installation or connection charge, or both, shall not be more than 50 percent of the charge for basic residential service installation and connection charges, or both. The commission may limit the number of installation and connection charges, or both, that may be incurred at the reduced rate in any given period."

The Moore Act was enacted at a time when there was only one monopoly provider of local exchange service. PU Code § 874 did not envision that there would be two or more competing basic service carriers in the same service territory. Due to the specific singular references that the ULTS rate shall not be more than 50% of the rate for basic flat rate service or of the rate for basic measured rate service, and due to our past practice of setting a uniform statewide ULTS rate for GTEC and Pacific that is equal to 50% of Pacific's residential basic exchange rates,[76] we feel compelled to deny AT&T Wireless's request to allow the ULTS

76 See D.94-09-065 at pages 49 to 50.

subsidy to be applied as a credit to a carrier's higher priced basic service rate. This result is also consistent with the Moore Act's declaration that basic residential telephone service be made affordable to low income citizens, and that the use of the word "residential" means "residential use and excludes industrial, commercial, and every other category of end use." (PU Code §§ 871.5(b), 872.) The Moore Act clearly does not contemplate that ULTS program funds be used to subsidize mobile telephones if these are offered to the public at a higher price than standard telephone service.

Despite the conclusion above, we do recognize the importance that mobile telephone technologies, such as cellular and personal communication services, may have for providing basic service in remote rural areas of the state. However, until the Moore Act is amended by the Legislature, the ULTS program funds should not be used to subsidize a service that can be used anywhere.

Our analysis of Public Advocates' recommendation to include enhanced telecommunications services within the ULTS program is similar to our analysis above. The Moore Act contemplates the offering of basic telephone service at affordable rates to the greatest number of citizens. (PU Code § 871.5.) The Moore Act envisions Lifeline service as that class of service necessary to meet minimum residential communication needs. (PU Code § 873(a).) Subdivision (b) of PU Code § 873 states as follows:

> "(b) Minimum residential communications needs includes, but is not limited to, the ability to originate and receive calls and the ability to access electronic information services."

We do not believe that "the ability to access electronic information services" was meant to include access to enhanced telecommunications services. Our basic service definition allows

the calling party to make outgoing calls to the telephone number of the electronic information service. However, access to that type of service, such as the Internet, is not regulated by us, nor should such access be subsidized by the ULTS program. Nor do we believe that PU Code § 882 creates a ULTS entitlement to advanced telecommunications services. Accordingly, we reject Public Advocates' suggestion to broaden the ULTS program to include lifeline rates for enhanced services.

Cal/Neva and Consumer Action have recommended that the ULTS program be expanded to a two tiered income and benefit program so that persons with more modest incomes can afford telephone service. At the present time, there are approximately 3 million ULTS customers, with a fund size of approximately $360 million. Creating a new tier of ULTS eligible customers with a higher income ceiling, and lower benefits, will cause funding requirements to increase even more. Although many of the letters to the Commission, as well as speakers at the PPHs, favored the ULTS program, a number of other letters and speakers were against having such a program at all. Taking all of these concerns into consideration, we have decided against creating a two tiered ULTS program.

The problem that people with modest incomes, who do not qualify for ULTS, may not be the monthly cost of basic service, but rather the toll and long distance calls that they make. The idea of toll restricted calling, and making customers aware of bill installment plans, could go a long ways toward solving some of these problems. For example, toll restricted calling might be imposed by a carrier when a telephone bill with a number of toll and long distance calls is not paid. Instead of disconnecting the customer, toll restricted calling could be imposed so long as the local exchange portion of the bill is paid, and some amount is paid toward the previously incurred toll and long distance bills. Toll call restricted service would allow customers to still make local

calls, and to receive all incoming calls. By keeping the customer's account open while scheduled payments are made, the customer avoids disconnection, and having to overcome deposit and other credit assurances before being reconnected. Carriers who serve residential customers are encouraged to develop such options so that people who may be faced with temporary monetary problems can retain local exchange basic service, or people who may want that option, can select that grade of service.

We now turn our attention to the issue of marketing expenses associated with the ULTS program. When the ULTS program was instituted by the Commission, it adopted GO 153 to govern the administration of the ULTS program. Consistent with PU Code § 879 and the related statutory history which preceded this section,[77] subdivision 5. of GO 153 provides that carriers may seek "reimbursement of expenses incurred and revenues lost as a result of providing ULTS." Included among these reimbursable expenses are "Commercial/Marketing" expenses.

We are persuaded by the argument of Consumer Action and others, that the ULTS program should not subsidize the marketing efforts of each carrier who offers basic service to low income customers. We must remember that the group of potential customers who qualify under ULTS is a finite group. Every carrier who plans to offer residential service will be targeting the same group of customers. It makes no economic sense to have multiple marketing campaigns conducted by each carrier who is trying to sign up the

77 When the Universal Telephone Service Fund was first enacted, former Revenue and Taxation Code sections 44181, 44182, and 44184 indicated that the telephone corporations were to be reimbursed for providing universal telephone service as contemplated by this program. (See Stats. 1983, Ch. 1143, sec. 3; Stats. 1987, Ch. 163.)

same customers, especially when the marketing expense of each carrier is subsidized by the ULTS program.

In addition, multiple ULTS marketing efforts tend to indirectly subsidize the carrier's overall marketing strategy by encouraging the potential customer, whether or not they qualify as a ULTS customer, to sign up with a particular carrier. Such advertising also promotes the name of a particular carrier at the expense of ratepayers. It also indirectly subsidizes the marketing of other services, such as lucrative toll and enhanced services, that the carrier can sell to consumers once they have become customers. Having individual carriers continue to market the ULTS program may lead to abuses of a subsidized marketing system.

DRA makes some compelling arguments as to why the LECs and CLCs should market the ULTS program. In particular, the carriers are the most knowledgeable about the market and ways in which they can reach those markets. However, we do not believe that DRA's suggestion that each carrier be entitled to a portion of a fixed statewide fee for marketing is the solution. Such a scenario could lead to a situation where a carrier, under the pretense of marketing ULTS, claims reimbursement, but uses the money for non-ULTS related activities. Also, it does not eliminate the problem of ratepayers subsidizing carriers to entice those who do not have telephone service, to become that particular carrier's customer. Furthermore, apportionment of the monies available for marketing could disadvantage certain carriers if it was distributed based on the carrier's size or the number of customers the carrier has.

We believe that in a competitive environment, a single entity should be responsible for the marketing of ULTS services. The advantage to this approach is that no particular carrier is directly benefitted by ULTS marketing activity. Instead, potential customers are free to choose which carrier they want to call. A single entity also limits the size of the ULTS marketing expenses.

Instead of ratepayers having to subsidize multiple ad campaigns, there could be a single budget for marketing expenses. A third advantage is that the entity can specifically target the ULTS marketing to customer groups which have lower subscribership rates.

The most logical entity to do the marketing is the Administrative Committee of the ULTS Trust, or a subcommittee of the ULTS Trust. Another possibility is for the Commission to organize a ULTS marketing working group. A third option is to solicit interest from consumer groups.

The drawback to the Administrative Committee idea is that its role as the administrator would be expanded to include developing marketing strategies, and supervising various marketing campaigns. In the decision which ordered the ULTS Trust to be set up, and an Administrative Committee established, the Commission stated that "the administrative committee is financial in nature and should not be construed to include policy decisions." (25 CPUC2d 556, 560.) The Commission also stated the following:

> "Administrative committee members should not be compensated for serving on the committee. Budgetary approved funds should be reimbursable from the ULTS Trust only when actually incurred." (Id., at p. 561.)

Having the Administrative Committee, or a subcommittee of that group, develop marketing strategies and supervise marketing efforts, seems beyond the scope of the committee's intended duties.

Selecting a consumer group or groups to head up the ULTS marketing has drawbacks as well. First, the consumer group might lack knowledge of the ULTS program. This could lead to problems in starting up a marketing campaign, and targeting consumers who are likely to qualify for the ULTS program. Another problem is that the selection of the group or groups to handle the ULTS marketing could cause problems as to which group or groups are the most qualified.

We favor the establishment of a ULTS Marketing Working Group. The purpose of the ULTS Marketing Working Group would be to assist the Commission in developing a budget for statewide marketing strategies for the ULTS program, to develop competitively neutral marketing strategies, and to oversee the development and implementation of ULTS marketing campaigns.

The working group should consist of twelve members: three representatives from the large and medium size LECs; three representatives from the IECs or the CLCs; three representatives from consumer groups or public interest groups; one representative from a small LEC; one representative from the wireless carriers; and the head of the Consumer Services Division or his/her designee. Preferably, the representatives of the carriers should have marketing and sales backgrounds. The advantage of assembling such a working group is that all the members have an interest in making sure that marketing of ULTS services reach as wide an audience as possible.

The ULTS Marketing Working Group will recruit a qualified advertising agency to develop print, billboard, and radio advertising for the ULTS program, as well as qualified nonprofit CBOs to engage in community outreach to promote the ULTS program.[78] The budget for the advertising campaigns, community outreach, and related working group expenses would be paid out of the ULTS program. These expenses should not exceed the annual total average ULTS marketing expenses that were reimbursed over the last three years. The ad campaigns should not result in an advantage or disadvantage for any carrier. The ULTS Marketing

78 The selected advertising agency shall not have any conflicts of interest with respect to the ULTS program. The selected agency may sub-contract portions of the work to other advertising agencies. The selected agency shall adhere to the auditing standards of the Association of National Advertisers, and the work performed for the ULTS program shall be subject to Commission audit.

Working Group should develop competitively neutral ways in which consumers can be informed about which carriers offer ULTS service, and how ULTS service may vary from carrier to carrier. Compensation for participation by working group members should be nominal, especially the LECs, IECs, and CLCs. Implementation of ad campaigns should take place as soon as possible.

As mentioned earlier, the ULTS Marketing Working Group is also positioned to assess how well the 95% subscribership goal is being met. By using targeted marketing, the Marketing Working Group should be able to increase subscribership rates by having access to data concerning income, ethnicity, and geography, as well as other marketing guidelines.

We shall order the CSD to convene a workshop as soon as practicable to determine who should make up the ULTS Marketing Working Group, to develop a budget, to develop marketing strategies, recruit an advertising agency and CBOs, and to lay the groundwork for future meetings and coordination of the marketing efforts. Upon the completion of a written budget, the budget shall be submitted to the Commission for approval by way of a Commission resolution. One year after the formation of this working group, an annual report shall be prepared by the Commission staff assigned to this working group, in conjunction with the members of the working group. The annual report should detail the ULTS Marketing Working Group's activities during the past year, the increase or decrease in ULTS customers, telephone subscribership rates by income, ethnicity, and geography criteria, and its expectations and objectives during the coming year. The annual report shall be submitted to the Commission, who will review the effectiveness of the ULTS Marketing Working Group to determine if alternative marketing solutions are needed.

Effective upon the date this order is signed, ULTS advertising, outreach, and related marketing expenses by individual carriers will no longer be reimbursed by the ULTS fund in

accordance with the following. ULTS advertising campaigns (e.g., posters, billboards, bus shelter interiors, print, and radio and television ads), outreach activities, and related marketing expenses, that are the subject of existing contracts which call for the continued display or commercial air time of the advertising medium, or other continuing ULTS activities, after the effective date of this decision, shall continue to be reimbursed by the ULTS fund for the period called for in the contract or until three months from the effective date of this decision, whichever occurs first.[79] It is our intent that there will be no carrier specific ULTS reimbursement for these kinds of activities after the third month. ULTS advertising, outreach, and related marketing expenses that are not the subject of any contracts will not be reimbursed by the ULTS fund after the effective date of this decision. Should the incumbent LECs decide to continue using existing advertising campaigns to market ULTS after the expiration of the contract or after the third month, the production expenses associated with producing those campaigns shall be reimbursed to the ULTS program.

The Commission also needs to examine whether some of the other expenses that are currently reimbursed by the ULTS program should continue to be reimbursed in a competitive environment. As competition emerges, the expenses that are reimbursed to the carriers should perhaps reflect this competitive environment and its associated efficiencies. Any contemplated adjustments need to be consistent with the provisions contained in the Moore Act. As we noted in D.95-07-050 at page 68, this is an issue the

79 Reimbursement for ULTS activities stemming from contracts that were entered into between August 5, 1996 and the effective date of this decision, may be disallowed if a motivating cause of the carrier to enter into the contract was to promote the carrier's name recognition.

Commission, as well as the Legislature, should consider reviewing in the future.

The next issue we address is whether an income verification process, or the existing self certification process, should be used to determine the eligibility of ULTS customers. Central to this issue is whether by adopting an income verification process, California can avail itself of approximately $50 million in additional federal funds to support universal service.

This is not the first time this issue has been raised. In 25 CPUC2d 556, at pages 561 to 562, the Commission ordered that a workshop be held to determine whether an acceptable verification program could be developed to meet the FCC's requirement so that federal monies to support universal service could be released. The same issue was again raised in comments responding to a rulemaking we issued regarding whether the income-based criteria for the ULTS program, and the Low Income Ratepayer Assistance Program, now known as the California Alternate Rates for Energy program, should be changed. (See R.94-12-001.)[80]

The potential availability of $50 million dollars is too large of a number to ignore. We are not convinced by the arguments that the cost of an income verification process outweighs its benefits. It is highly unlikely that it would cost in the neighborhood of $50 million to do income verification checks of applicants for ULTS service. Although an income verification method might deter some applicants from applying for the ULTS program, a carefully constructed income verification process and an appropriate marketing campaign could alleviate some of these problems.

Before we consider whether an income type verification process should be used, we need to ensure that the federal monies

80 No decision in R.94-12-001 has been issued yet.

will be available if such a switch is made. We also need to determine what type of verification process is required, whether our current self certification process can be modified to meet the FCC requirements, or whether a new verification process is needed. In addition, in light of the Telco Act, we need to determine if these monies will still be available in the future. All of these questions need to be answered before we move forward with modifying our current ULTS application procedures. We will direct the Telecommunications Division staff and the Legal Division to make appropriate inquiries at the FCC, and to conduct the necessary research, to determine the answers to these questions. Upon receiving the staff's evaluation and analysis of these issues, we will inform parties to this proceeding as to the next steps the Commission intends to take. As suggested by Consumer Action in its comments to the proposed decision, among the steps the Commission should take before deciding whether an income verification process is used, are to hold public participation hearings or roundtable discussions with various community groups to assess the impact that an income verification process could have on ULTS subscribership rates.

Consumer Action recommends that the once a year discounted installation charge under the ULTS program should be changed. The ULTS installation charge was thoroughly examined in D.94-09-065 at pages 56 to 58. We decline to adopt Consumer Action's recommendation at this time.

The last issue to address is who should continue to administer the ULTS program. In D.95-07-050 at page 69, we requested comment on who should act as the fund administrator for the ULTS program. The general consensus was that the Administrative Committee should continue to oversee the ULTS program. As there are no major revisions to the ULTS program, we will leave the day to day administration of the program to the Administrative Committee. We would just note that as more

competitors begin to serve ULTS customers, the auditing of carrier accounts may need to be increased. If the Administrative Committee, or any other entity, detects problems in the way in which the ULTS program is operating in this new environment of competition, they should bring these problems to the attention of the Commission.

The Administrative Committee is currently made up of five members, two of whom are members from public interest groups. The other three members are drawn from the LECs, the IECs, and the small LECs. In addition, there is one Commission staff person who acts as the liaison.[81] There does not appear to be a compelling need to expand the size of the Administrative Committee at this time. If parties believe that the size of the committee should be expanded, they should file a petition to modify this decision.

The applicable rules pertaining to the responsibilities of carriers who provide ULTS are set forth in Rule 5 of Appendix B.

X. Miscellaneous Issues

We have considered the various wording changes suggested by the various parties in their comments to D.95-07-050, and have incorporated some of their suggestions in the final rules. We believe that the changes we have adopted have improved the focus and clarity of the rules, as well as our intent.

There are two other issues which have been raised in this proceeding, but which are not addressed in this decision. The first issue concerns itself with AB 3643's directive that the

81 The staff liaison shall be the head of the Telecommunications Division or his/her designee. The staff shall provide quarterly updates to the full Commission at its meetings regarding the Administrative Committee and the ULTS program.

proceeding address the issue regarding "franchise obligations." (Stats. 1994, Ch. 278, Sec. 2.(a)(5).)

In D.95-07-050 at page 75, the Commission stated that "We do not believe that the LECs should be granted any additional recovery for stranded investments." In the September 1, 1995, comments regarding the proposed rules, that statement generated numerous comments regarding the stranded investment/franchise impacts issue. Our discussion of that issue also generated the filing by the LECs of several applications for rehearing of D.95-07-050. In the decision denying those applications for rehearing, the Commission concluded that the issue of "addressing the impact of local competition upon the ability of an LEC to recover the cost of investment in rates, and consequent effect upon LEC earnings" should be heard in the evidentiary hearings that took place in January and February of 1996 in the Local Competition rulemaking and investigation, R.95-04-043/I.95-04-044. (D.95-12-062, p. 2.)

The franchise obligations issue was addressed in the franchise impacts hearing of the Local Competition proceeding. (See D.96-09-089.) D.96-09-089 permits Pacific and GTEC to file an application to show whether the "new regulatory program embodied in the roadmap proceedings combined with the NRF-established depreciation methods will deprive them of the opportunity to earn a fair return on their 'regulated assets'." (Id., at page 72.)

The other issue that the incumbent LECs believe needs to be addressed is the rebalancing of all rates. As competition increases, the incumbent LECs believe that they will be disadvantaged if they cannot lower their prices for services that are subject to competition. In addition, the implicit subsidies contained in the rates of certain services that are priced above the LECs' costs, in order to support the policies and goals of universal service, will not be sustainable in a competitive environment.

The assigned ALJ appropriately excluded testimony regarding network wide rate rebalancing. His ruling was consistent with our pronouncement in D.95-12-021 at page 3 that "the issues surrounding rate deaveraging, the pricing of basic services, and revenue rebalancing should be addressed in the context of the overall incentive-based regulatory framework instead of in this proceeding."

In order for competition to benefit all customers in California, these rate and revenue rebalancing issues need to be addressed sooner, rather than later. Due to the other open telecommunications proceedings, the rate and revenue rebalancing issues were given a lower priority. As we approach 1997, and the other major telecommunications proceedings begin to wind down, these issues need to be given a higher priority. It is our intent to examine these issues in the months to come.

In Pacific's comments to the August 5, 1996 proposed decision, Pacific requests for the first time in this proceeding that it be allowed to recover the implementation costs associated with the universal service program. In its reply comments, TURN responded that because Pacific never raised this issue before, there is no record on whether Pacific will be the only carrier to incur these costs. In addition, TURN argues that no record has been developed regarding the reasonableness of Pacific's implementation cost estimate. TURN also contends that "it is absurd for Pacific, which stands to receive 70% or more of the fund proceeds, to have customers pay for the costs of a program of which Pacific will be the prime beneficiary."

In the revised proposed decision, the assigned ALJ recommended that Pacific's request to recover its implementation costs should be rejected. We take a different view.

We believe that Pacific's comments to the revised proposed decision have some merit. In the local competition proceeding, the Commission authorized the establishment of a

memorandum account to record actual implementation costs associated with local exchange competition. We cautioned, however, that the tracking of these "recorded costs should not be construed as an assurance that recorded costs will automatically be subject to recovery...." (D.96-03-020, p. 91.) The implementation costs that Pacific seeks to recover in this proceeding is not unlike the costs that Pacific seeks to recover in the local competition proceeding. We should similarly authorize the five large and mid-size LECs to record actual implementation costs incurred with respect to the universal service program we adopt today in a memorandum account. We will authorize the tracking of these costs that are incurred on and after the effective date of this decision.

The assigned ALJ and/or Commissioner will establish a schedule in six months to consider whether recovery of these implementation costs should be recovered or not.[82] We reiterate that the recording of these costs is no assurance that the LECs will be permitted to recover these costs.

Findings of Fact

1. R.95-01-020 and I.95-01-021 were opened to develop rules to further the goals of universal service in a competitive telecommunications environment.

2. The enactment of AB 3643 provided some guidance as to the type of universal service issues the Commission should address.

3. D.95-07-050 described and set forth a proposed set of rules pertaining to universal service responsibilities in a competitive environment.

4. Parties were given an opportunity to file written comments on the proposed universal service rules.

5. The Commission, in conjunction with the State and Consumer Services Agency, held thirteen public participation

82 Six months should give us an opportunity to see what type of recurring implementation costs the LECs may face.

hearings throughout the state concerning the proposed universal service rules.

6. D.95-12-021 outlined the framework for structuring the design and development of the proxy cost model.

7. The parties failed to reach any agreement regarding the proxy cost model at the workshops that were held.

8. Thirteen days of evidentiary hearings were held in late April and May of 1996.

9. The matter was submitted on June 10, 1996.

10. On February 8, 1996, the Telco Act was signed into law.

11. GTEC objected to the admission of Exhibit 117 into evidence.

12. On June 6, 1996, AT&T/MCI filed a motion to strike from Pacific's opening brief the references to an article by Dr. Alfred Kahn, and the references at pages 23, 42, and 44 about conversations that allegedly took place between the employees of Pacific, and employees of US West.

13. DCA's motion dated September 4, 1996 requests that its reformatted reply comments, which exceeds the page limitation of Rule 77.5, be accepted for filing.

14. ICG and TURN filed separate motions on October 21, 1996 seeking leave to late file their opening comments to the revised proposed decision.

15. Universal service has developed over the years to mean that: (1) a certain minimum level of telecommunications services must be made available to virtually everywhere in the state; and (2) the rate for such services remain affordable.

16. As the marketplace for local telephone exchange service moves from a monopoly provider to multiple providers, the universal service program needs to be readjusted to meet the challenges of increasing competition.

17. The implicit subsidies of averaged rates, and service priced above cost to support services priced below cost, will not be sustainable in a competitive market.

18. In order to effectuate a policy of universal service throughout the state, the Commission needs to develop a list of the service elements which make up residential basic service.

19. Free telephone directories minimize the number of calls made to directory assistance, and promotes the wide distribution of yellow pages advertising.

20. At the PPHs, many consumers expressed satisfaction with having a choice of flat or measured rate service.

21. The flat and measured rate options preserve customer choice, and provides consumers with a method in which to comparison shop among carriers.

22. The adopted basic service definition enables a telephone customer who has the computer hardware and software, to connect to an Internet provider.

23. Broadening the definition of basic service to include broadband services will impose more costs on the incumbent LEC, and the new carriers who may enter the local exchange market.

24. The service elements that are included in the definition of basic service are contained in Rule 4.B.

25. AB 3643 stated that one of the objectives of this proceeding is to develop a periodic review process to revise the definition of universal service to reflect new technologies and markets.

26. When the Commission solicited comment on the proposals to promote greater access to new technologies, we expressed reservation that the activities contemplated by the proposals involved other industries besides telecommunications, and that the funding for such activities should not come solely from telecommunications carriers and their customers.

27. Many of the advanced services being offered today require hardware, software, and other components, in addition to the information that is provided to the end user.

28. Product design issues and recommendations are more appropriately addressed at the federal level than with this Commission.

29. D.94-09-065 adopted the goal that 95% of the households in California have telephone service, and that customer outreach and educational programs to achieve a 95% subscribership rate for telephone service among nonwhite and non-English speaking households must significantly improve.

30. D.94-09-065 required GTEC and Pacific to set targets, and to map out their marketing strategies to improve their universal service levels.

31. The Commission proposed in D.95-07-050 that the same monitoring requirements that apply to GTEC and Pacific, should also apply to the other providers of local exchange service.

32. Public Advocates made a series of identical recommendations in both the local competition proceeding and in this proceeding regarding the 95% goal, bilingual services, and redlining.

33. Subscribership rates for telephone service should continue to be measured by income, ethnicity, and geography.

34. It may be appropriate to eliminate ethnicity as a measurement criterion at some point because the income and geography criteria provide much of the information that is needed to determine where telephone subscribership rates are low.

35. In D.95-07-050, we suggested that an explicit prohibition against redlining be adopted, and invited comment on whether such language would be effective.

36. No additional pronouncements are needed about redlining because in D.95-12-056, the Commission adopted a rule in the local competition proceeding that states that redlining is prohibited,

and that the Commission shall take strong action against any carrier engaged in redlining.

37. Public Advocates' recommendation that each carrier actively market its services to certain customer groups, and that they furnish their business plans with details about how the 95% subcribership rate can be achieved, are based in part on what the Commission ordered of GTEC and Pacific in D.93-11-011 and D.94-09-065.

38. The reporting requirements imposed on GTEC and Pacific in D.93-11-011 and D.94-09-065 concerned telephone subcribership rates, and awareness and ways of encouraging participation in the ULTS program.

39. In a competitive market, all carriers will need to actively market their available services to all customer segments because the total number of customers in California is limited.

40. In D.95-07-054 the Commission adopted the rule that a CLC making a sale in a language other than English is required to confirm with that customer in writing, in the same language in which the sale was made, the service(s) ordered.

41. In D.95-12-056, the Commission expanded its bilingual information and outreach rules to require the CLCs to inform each new customer, in writing and in the language in which the sale was made, information on the availability, terms, and rates regarding the ULTS program and basic service. In addition, the CLC is to provide bills and notices, as well as access to bilingual customer service representatives, in the language in which the prior sales were made.

42. In D.96-08-027, the Commission ordered that a workshop be held to determine what operational and economic constraints carriers might face in complying with the multilingual billing and notice requirements that are contained in the local exchange competition rules.

43. PU Code § 786 requires every telephone corporation to issue to each of its residential customers on an annual basis, a listing of the residential telephone services that it provides, and the rates or charges for those services.

44. Given this state's diversity, there will be more than one non-English speaking customer per carrier, which will necessitate that bilingual customer service representatives be on hand to serve the non-English speaking customers upon demand.

45. The offering of bilingual services will be a natural result of competition because all of the carriers will have to compete to attract the business of a finite group of customers.

46. With the exception of requiring carriers to have a toll free number to answer questions regarding the customer's calling area, and whether a call is a toll or long distance call, we should adopt the matrix proposed by UCAN in conjunction with TURN.

47. CSD should conduct a workshop to study ways in which new pricing packages can be compared and included in a consumer information matrix.

48. The Commission should adopt UCAN's suggestion that an annual report summarizing the complaint history for each certificated carrier be compiled.

49. The annual report should also include Commission investigations that were opened against the carrier.

50. The Commission needs to take proactive steps to inform the public about the regulatory changes taking place in the marketplace.

51. Two of the principles in AB 3643 expressed the intent that all customer segments, including certain kinds of institutions, benefit from the deployment of advanced telecommunications technology.

52. The Telco Act provides that public or nonprofit health care providers serving rural areas, as well as elementary and secondary schools and libraries, should receive discounted rates.

53. The Telco Act provides that a state may adopt regulations that are not inconsistent with the FCC's rules, and that the state can provide for additional definitions and standards that preserve and advance universal service.

54. A program of discounts for qualifying schools and libraries should be adopted.

55. Qualifying schools and libraries shall be entitled to a discount of 50% off the tariffed price for all 1MB, switched 56, ISDN, T-1, and DS-3 services, or their functional equivalents.

56. Carriers who serve qualifying schools and libraries with these discounted services will receive a subsidy amount that represents: (1) the difference between the tariffed rate for businesses for such services, and the tariffed discount rate for schools and libraries; or (2) if the rate negotiated is below the tariffed discount rate, the carrier shall be entitled to the sum that represents a 50% discount off of the negotiated rate.

57. The issue of discounts for rural health care providers should be deferred until the Joint Board and the FCC have had an opportunity to address this issue.

58. A program of discounts for municipal and county government owned and operated hospitals and health clinics should be adopted.

59. Municipal and county government owned and operated hospitals and health clinics shall be entitled to a 20% discount off of the tariffed price of the service for other businesses for switched 56, ISDN, T-1, and DS-3 services, or its functional equivalents.

60. Carriers who serve municipal and county government owned and operated hospitals and health clinics with these discounted services will receive a subsidy amount that represents: (1) the difference between the tariffed rate for businesses for such services, and the tariffed discount rate for these government owned hospitals and health clinics; or (2) if the rate negotiated is

below the tariffed discount rate, the carrier shall be entitled to the sum that represents a 20% discount off of the negotiated rate.

61. By providing discounts to qualifying CBOs, we can position communities to take advantage of the benefits of the information age, and promote access to the technology and to the information.

62. Qualifying CBOs shall be entitled to a discount of 25% off the normal tariffed business price for switched 56, ISDN, and T-1 services, or their functional equivalents, in accordance with Rule 8.C.(3) of Appendix B.

63. Carriers who serve qualifying CBOs with these discounted services will receive a subsidy amount that represents: (1) the difference between the tariffed rate for businesses for such services, and the tariffed discount rate for CBOs; or (2) if the rate negotiated is below the tariffed discount rate, the carrier shall be entitled to the sum that represents a 25% discount off of the negotiated rate.

64. In order to make the information superhighway accessible to all, and to ensure the success of the discount program which we adopt today, the telecommunications industry, computer and software manufacturers, and the information providers, must all take the lead and provide schools, libraries, hospitals, clinics, and CBOs, with the necessary equipment and services at no cost or substantially reduced prices.

65. D.95-07-050 noted that in an era of competition, the incumbent LECs can no longer rely on internal subsidies between high cost and low cost exchanges, and the price differences between services, to help fund the cost of providing universal service in high cost areas.

66. In the February 21, 1996 ALJ ruling, parties were directed to include in their prepared testimony the additional costs associated with subsidizing business customers in high cost areas.

67. No one presented any estimates of the cost of providing businesses in high cost areas with telephone service.

68. D.95-07-050 and D.95-12-021 proposed that the redesign of universal service should apply statewide.

69. California currently has seventeen smaller LECs, three mid-size LECs, and two large LECs.

70. The Telco Act specifically exempts rural telephone companies from resale, number portability, dialing parity, and interconnection obligations.

71. When D.89-10-031 was issued, it noted that the smaller LECs were expected to face much lower levels of competition than GTEC and Pacific.

72. Local exchange competition may take a longer time to reach the service territories of the smaller LECs.

73. The areas in which GTEC, Pacific, CTCC, Contel, and Roseville operate in, are in, or are located in close proximity to, urban areas.

74. The smaller LECs are regulated under rate of return regulation, while the five large and mid-size LECs are, or have requested to be, regulated under an incentive based ratemaking framework.

75. The federal funding mechanisms for universal service are currently being studied by the Joint Board.

76. The smaller LECs currently receive, most if not all, of the universal service funding needs through the federal funding mechanisms.

77. Once the FCC decides what federal universal service funding mechanisms should be in place, we should revisit the smaller LECs and the CHCF-A.

78. If a bona fide request to enter a smaller LEC's service territory is received, the Commission will make a determination in accordance with § 251(f) of the Telco Act.

79. In shaping the development of the proxy cost models for use in this proceeding, we have attempted to achieve some consistency with the TSLRIC studies being developed in the OANAD proceeding.

80. In D.95-12-016, the Commission adopted a set of costing principles to be used in the OANAD proceeding.

81. D.95-07-050 proposed that the costs for all the GSAs be developed by way of proxy cost studies, and in D.95-12-021, we left open the possibility that there might be competing proxy cost models.

82. No agreement was reached during the workshops as to which proxy cost model should be used.

83. For the evidentiary hearings, Pacific sponsored the statewide CPM, and AT&T and MCI sponsored the HPM.

84. The HPM is based on extensions made to the BCM.

85. In deciding which proxy model to adopt, and what estimate of universal service the Commission should adopt, we must be vigilant that the fund is neither oversized or undersized.

86. If the fund is oversized, the subsidy provided to carriers will exceed the actual cost of subsidizing residential basic service in high cost areas, and allow the recipients of such funds to cross subsidize other services, and to engage in other anticompetitive behavior.

87. If the fund is undersized, the ability of carriers to serve high cost areas may be impaired.

88. The purpose of choosing the CBG as the GSA for determining the subsidy is to reduce the cost averaging that would occur if a larger GSA was used.

89. The Commission first proposed the use of CBGs as the basis for determining the costs to serve an area in D.95-07-050, which was subsequently reaffirmed in D.95-12-021.

90. The CPM can generate cost data for the entire state on a CBG basis, while the HPM generates cost data based on density zones.

91. At the close of hearings, the joint sponsors of the BCM at the FCC were attempting to correct some of the problems with the BCM that others had identified.

92. The BCM erroneously assumes that the population in CBGs is evenly distributed throughout the CBG.

93. The CPM's grid cell design is able to identify the location of population in a more precise manner.

94. The BCM erroneously assumes that structure costs vary in direct proportion to the costs of those facilities.

95. The HPM attempts to correct the structure cost problem by multiplying the installation factor for facilities in the two lowest density areas.

96. The CPM separately identifies costs for facilities placement from their cable costs, and separating per foot and per pair cable costs.

97. The BCM takes irregularly shaped CBGs and assumes that they are square, whereas the CPM relies on a regularly shaped grid.

98. The CPM assigns central offices according to the density of the wire center, rather than according to the number of lines served by the central office, whereas the HPM uses actual central office line counts to size switches.

99. The inputs to the CPM are gathered from a series of tables, which requires one to assume that the underlying data used in the tables is consistent.

100. The BCM allows for the sharing of feeder cable between CBGs on the same feeder route belonging to the same wire center, whereas the CPM does not contain an explicit method for accounting for the sharing of feeder cable by households served from the same wire center.

101. Certain critical assumptions and inputs to the BCM cannot be changed by the end user, whereas the CPM assumptions can be more readily changed.

102. Both the HPM and the CPM use a scorched node approach whereby the current topology of the central offices is assumed, and both models rely on historical LEC data to predict forward looking maintenance and repair costs.

103. Both models can estimate the cost of providing voice grade residential service, but it is unclear whether the HPM fully accounts for directory assistance costs, and billing inquiry costs.

104. Regarding whether the inputs and assumptions can be verified, the HPM relies on: (1) assumptions in the BCM which AT&T/MCI cannot alter or explain; (2) unnamed experts; and (3) selected portions of cost studies from other jurisdictions.

105. Regarding whether the inputs and assumptions can be verified, the CPM depends largely on Pacific's own data, but Pacific's reliance on some of its other models complicates the verification of some of this data.

106. With Pacific's original inputs and assumptions to the CPM, the CPM estimates an annual statewide subsidy of $1.7 billion, of which it is estimated that $1.3 billion would go to Pacific initially.

107. The statewide CPM as sponsored by Pacific, includes the cost of second lines in its subsidy calculation.

108. The subscribership rate for second lines among Pacific's customers is approximately 17%.

109. Subsidizing only one line per household keeps telephone rates affordable for those who live in high cost areas, as well as for everyone who is obligated to support the fund.

110. With two or more sources of connection, it is possible that a household in a high cost area may attempt to subscribe to more than one subsidized primary line.

111. The CPM assumes one buried drop per residence, whereas Pacific's standard engineering practice is to use two copper pairs in drops to each residential subscriber.

112. DRA's drop cost adjustment shares the costs of placing the drop between two lines, rather than being borne by a single line.

113. The CPM accounts for cable, conduit, pole, and pair gain costs in a table called A & B costs.

114. AT&T/MCI contend that the PLAN COSTDEC data represents average field conditions, rather than lower cost normal field conditions, and that when the modifying factors are applied to average field conditions, the CPM overstates the effect of terrain, and other sources of difficulty.

115. When Pacific revised its A & B cost values, the copper cable cost for buried 26 gauge copper cable was reduced from $1.60 to $0.17 per foot.

116. AT&T/MCI witness Selwyn contends that the revised A & B cost for conduit underestimates conduit investment for distances less than 1973 feet, and overestimates conduit investment that is longer than 1973 feet.

117. Since the CPM inputs rely on extensive tables of unit cost factors which have been developed outside the CPM, GTEC proposes that the CPM utilize a spreadsheet of some of the basic cost elements derived from a GTEC contract.

118. In addition to the unit costs, GTEC asserts that the CPM's assumptions such as the ratio of feeder to distribution, and the mix of cable by density zone are based on averages or practices specific to Pacific.

119. The adjustment to the A & B cable cost is supported by Pacific's revised cost of copper cable to $0.17.

120. The conduit costs in the CPM appear overstated.

121. The CPM assumes that if the feeder length exceeds 9000 feet, fiber is used, and if the feeder length is shorter than 9000 feet, copper is used.

122. Pacific's fiber feeder cut-off point has been reduced from 12,000 feet to 9000 feet.

123. A 9000 feet cut-off does not make sense in low density, rural zones, where demand and capacity requirements are smaller.

124. A cut-off of 9000 feet would shift the costs associated with higher bandwidth services onto the costs of providing basic service.

125. The fill factor measures how much plant is being used to provide service to customers, to determine the size of feeder cables and related facilities, and how those costs are spread over the feeder.

126. The CPM uses economic lives for depreciation.

127. The proposed decision reasoned that shorter depreciation lives should not be used because the purpose of this proceeding is to model the cost of providing universal service, and not to model the cost of a state of the art network.

128. Prior to INDETEC's modification of the CPM at the request of GTEC, the CPM classified wire centers into seven zones on the basis of the average population density of the grid squares associated with each wire center.

129. The CPM's use of density zones determine the cost of the central office switch, as well as the cost of the feeder.

130. GTEC recommends that the wire centers in the CPM be assigned to zones based on the number of business and residence lines in each wire center, so that the model can calculate the feeder size and the conduit cost of each central office consistent with the size of each office.

131. The CPM contains an outside plant factor adjustment which is set at greater than one when outside plant is placed in highly dense urban areas.

132. GTEC believes that the CPM's adjustment factor for outside plant is not supported by price quotes, and that the CPM already has an adjustment for such factors.

133. The CPM's use of historically based cost estimates represent average costs, which includes in the average the costs for relatively densely populated areas.

134. Restrictions on construction appear to be more appropriate for business lines rather than residential lines.

135. Based upon an announcement made by Pacific in January 1993, AT&T/MCI witness Selwyn believes that switching costs in the CPM are overstated.

136. The CPM accounts for shared and common costs, which Pacific states are attributable to universal service.

137. Pacific initially estimated the shared and common costs at $5.00 per line, and then subsequently increased the estimate to $6.70 per line.

138. In D.94-09-065, the Commission agreed with the argument of GTEC and Pacific that the loop plant was built in response to the end user's subscription to basic telephone service, and therefore much of the loop plant should be characterized as NTS and assigned to basic exchange services.

139. The allocation of shared and common costs may be somewhat arbitrary.

140. Some of the shared and common costs are attributable to residential basic service.

141. The CPM includes expenses for the rearrangement of plant, and for the non-recurring burden.

142. PU Code § 2883 requires every existing and newly installed residential connection to have continuing access to 911, unless it would preclude providing service to residential subscribers.

143. As a result of PU Code § 2883, a large percentage of existing lines are going to remain in place, and rearrangement

expense and the non-recurring burden expense are likely to be kept to a minimum.

144. DRA noted in its opening testimony that a comparison of the CPM's estimates of GTEC's costs in OANAD to the costs shown in the CPM showed a significant difference.

145. CACD staff determined that the CPM cost estimate for directory assistance was overstated after comparing Pacific's monthly volume of directory assistance calls to GTEC's estimated directory assistance costs in OANAD.

146. In D.96-08-021, the Commission determined that Pacific should reduce its estimates of loop repair costs by 14% to account for the downward trend in loop repair costs.

147. The benchmark serves as the guide for determining which GSAs are high cost areas, and serves to size the CHCF-B by limiting subsidy support only to those GSAs in which the proxy costs of serving that area exceed the cut-off.

148. The benchmark also serves as the guide for determining how much support a designated COLR receives for serving high cost areas.

149. D.95-07-050 proposed that a GSA should be considered high cost if the proxy cost of serving that GSA was above the revenues generated by the LEC offering basic service in that particular GSA.

150. A benchmark based on the national average loop cost should not be used because the national average is not specific to California conditions.

151. The CPM, as adjusted by today's decision, results in a statewide average cost of $20.30.

152. The statewide average cost of $20.30 serves as an appropriate cut-off point in determining which CBGs are high cost.

153. The adjusted CPM run estimates that using our adopted benchmark, approximately 4.03 million lines out of approximately 12.7 million total lines, will be subsidized by the CHCF-B.

154. Due to the lengthy printout that would be required for a run result showing the adjusted CPM estimate of cost for each CBG, and whether that CBG is high cost or low cost, such a table has not been included as part of this decision.

155. In D.95-07-050 and D.95-12-021, the Commission stated that other sources of revenue might need to be considered as offsets to the results of the proxy cost model.

156. No offset to the CHCF-B is needed for monies received from the CHCF-A.

157. PU Code § 728.2(a) provides that the Commission shall investigate and consider the revenues and expenses with regard to yellow pages advertising "for purposes of establishing rates for other services offered by telephone corporations."

158. An AEUS is a surcharge imposed on all customers' expenditures for telecommunications services.

159. Under a net trans account, the surcharge is collected from carrier contributions based on a percentage charge of its revenues, net of payments made to other carriers for telecommunications access.

160. D.95-07-050 proposed that a net trans account be adopted as the funding mechanism, although the Commission stated that it was still undecided as to whether the net trans account is preferable over an AEUS.

161. Section 254(f) of the Telco Act provides in part that "Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State."

162. With an AEUS, customers can see the amount of the surcharge, and contact appropriate government officials if they are concerned about the size of the surcharge.

163. The AEUS method is already in place to collect both the ULTS and the CHCF-A, whereas the net trans account method is a new concept and has not been tested.

164. D.94-09-065 held that all end users of every LEC, IEC, cellular, and paging company in the state, receive value from the interconnection to the switched network, and that they should be included in the billing base for the ULTS program and the Deaf and Disabled Telecommunications program.

165. The COLR is the regulatory concept that by accepting the franchise obligation from the state to serve a particular area, the public utility is obligated to serve all the customers in that service area who request service.

166. The COLR concept is important to universal service policy because that is the way in which customers are assured of receiving service.

167. Prior to the opening of the local exchange markets to competition, the 22 incumbent LECs served as the COLRs.

168. D.95-07-050 noted that with the introduction of competition, that may result in more than one COLR in certain areas, and only one COLR in other areas.

169. D.95-07-050 proposed that the incumbent LECs continue to serve and be designated the COLR in all of their respective service areas, and that other carriers could be designated COLRs as well.

170. D.95-07-050 proposed that only the designated COLRs would be able to receive a subsidy for providing service to residential customers in high cost areas.

171. The COLR obligation applies to both residential and business customers, and in all areas of the state, regardless of whether it is a high cost area or a low cost area.

172. The GSAs serve as the reference point in the proxy model from which cost data and high cost area subsidies can be derived.

173. The purpose behind allowing only designated COLRs to draw from the CHCF-B is to attract competition into the high cost areas

of the state, and to provide consumers with the choice of more than one carrier.

174. In resolving the windfall issue, we must be cognizant of the motives of all the parties.

175. In order to implement a fund which provides explicit support to high cost cost areas, and to transition from implicit subsidies to explicit subsidies, immediate action to avoid the windfall must be taken.

176. Residential basic service should be excluded from the equal percentage reduction proposal to avoid widening the gap between residential rates and their costs.

177. The five LECs subject to the CHCF-B shall be permitted to file applications describing what rates or price caps they seek to permanently rebalance downwards as a result of receiving monies from the CHCF-B.

178. D.95-07-050 proposed that the Commission should administer the CHCF-B.

179. The Commission should be the initial administrator of the CHCF-B so that if any adjustments and changes are necessary, they can be quickly incorporated into the fund.

180. At the end of one year, the Commission will evaluate the operations and administration of the CHCF-A and the CHCF-B, to determine if neutral third parties should take over the administration of the two funds.

181. D.95-07-050 proposed that the subsidy amounts be periodically reviewed.

182. The CHCF-B should be recalculated each year to account for changes in the billing base.

183. The Commission should rerun the CPM periodically using the actual reported line counts.

184. A review of the CHCF-B every three years will ensure that the overall size of the fund is within reason, and that the fund will be adjusted as competition and technology evolve.

185. With a subsidy mechanism in place, an auction mechanism appears at the moment to be the most efficient mechanism for reviewing the subsidy amounts in the future.

186. The ULTS program is designed to promote the use of affordable, statewide, basic telephone service among low income households.

187. With the introduction of local exchange competition, the Commission needs to review and revise the ULTS program so that all carriers who provide residential basic service to ULTS customers can avail themselves of the ULTS funds.

188. The ULTS program currently has approximately 3 million ULTS customers, with a fund size of approximately $360 million, and a surcharge of 3.2%.

189. Subdivision 5 of GO 153 provides that carriers may seek reimbursement for expenses incurred and revenues lost as a result of providing ULTS, including expenses for "Commercial/Marketing".

190. The group of potential customers who qualify under ULTS is a finite group, and every carrier who plans to offer residential service will be targeting the same group of customers.

191. Multiple ULTS marketing campaigns by multiple carriers should not be subsidized by the ULTS program because it indirectly subsidizes each carrier's overall marketing strategy, and increases the ULTS program expenses.

192. In a competitive environment, a single entity should be responsible for the marketing of ULTS services in a competitively neutral manner.

193. A ULTS Marketing Working Group should be established to develop and oversee the implementation of competitively neutral marketing strategies for the ULTS program.

194. The ULTS discounted installation charge was previously discussed in D.94-09-065, and should not be reexamined here.

195. The Administrative Committee of the ULTS Trust should continue to oversee the administration of the ULTS program.

196. The franchise obligations issue was addressed in the franchise impacts hearing of the Local Competition proceeding.

197. Pacific's comments to the August 5, 1996 proposed decision is the first time in this proceeding that Pacific requested that it be allowed to recover the implementation costs associated with the universal service program.

Conclusions of Law

1. GTEC's proposed transcript corrections will be adopted, and the corrections will be made to the Commission's copy of the reporter's transcript.

2. Exhibit 128 shall be received into evidence.

3. The objection to the receipt of Exhibit 117 into evidence is overruled, and shall be received into evidence.

4. AT&T/MCI's motion to strike the references in Pacific's opening brief to the article by Dr. Alfred Kahn is denied.

5. AT&T/MCI's motion to strike the references in Pacific's opening brief at pages 23, 42, and 44, regarding alleged conversations between US West and Pacific, is granted, and those references shall be stricken.

6. Rule 2's reference that the type be "no smaller than 10 points" is mistaken.

7. The intent behind Rule 2 was meant to have all pleadings adhere to a uniform size and format to avoid a situation where a party could circumvent page limit requirements by using a smaller size typeface.

8. Rule 2 was intended to use a typeface in a size that is readily readable, i.e., in 12 point type, or 10 pica.

9. DCA's motion to accept its reply comments in excess of the 5-page limit is granted.

10. The motions of ICG and TURN for leave to late file their opening comments to the revised proposed decision are granted.

11. A uniform definition of basic service should be adopted so that all residential telephone customers in California,

regardless of their location or income, can expect a certain minimum level of service.

12. The use of the term "free" in our adopted basic service definition is intended to recognize that as part of the bundled basic service package, that there are no additional charges incurred by the customer when that service element is used by a customer.

13. The incumbent LECs shall continue to offer the same number of free directory assistance calls as contained in their tariffs until otherwise ordered by the Commission.

14. Except as provided for in subdivision (b) of Public Utilities Code § 728.2, yellow pages directory advertising is not subject to the Commission's jurisdiction.

15. The seventeen smaller LECs shall be exempted from the basic service element that they be required to offer customers the choice of flat or measured rate service, unless the smaller LECs currently offer that option.

16. The Commission only has jurisdiction over the telephone companies whose wires connect the computer to the information provider.

17. A situation may arise that requires a review of the definition of basic service before the three year review period comes up.

18. In order to trigger an immediate review of the definition of basic service, the proponent for the inclusion of a new service element shall be permitted to make a showing that at least three of the four review criteria have been met.

19. The Commission may use the summary denial procedure contained in Rule 47(h) of the Rules of Practice and Procedure when it is clear that the basic service definition should not be expanded or reduced, or in cases where the Commission is not persuaded, based on the petition and the responses, that a service element should be included or deleted.

20. The review criteria that we adopt in Rule 4.C.3. is consistent with PU Code § 709, and the principle enunciated in AB 3643 that there must be an ongoing evaluation of which services are deemed essential, and therefore a part of universal service.

21. In determining whether a new service element should be included in the definition of basic service, the Commission will consider all of the listed review criteria in Rule 4.C.3., as well as the associated policy considerations; however, the weight to give to each criteria should be developed on a case by case basis.

22. The Commission can formulate incentives with respect to the telecommunication services being utilized for advanced technologies, but lacks jurisdiction over the non-regulated companies that are joining together to offer these advanced technologies.

23. The burden should not fall on the telecommunications providers and their ratepayers to fund the design and research of potential new services and applications that are not directly related to telecommunications.

24. As the state agency in charge of regulating the telecommunications industry, we should take the initiative to ensure that the development and deployment of advanced telecommunications technologies do not pass certain customer segments by.

25. The Commission should form the USWG to address ways in which access and deployment of advanced telecommunications technologies can be provided to all customer segments, and how education, health care, community, and government institutions can be positioned to take advantage of these technologies.

26. The USWG should be funded at $250,000 per year for a period of two years from monies in the California Teleconnect Fund.

27. In deciding whether new telephone service should be approved in unserved rural communities, the Commission should

determine on a case by case basis whether it is reasonable and prudent to offer telephone service in those localities.

28. The CSD and the Telecommunications Division shall review the unserved area issue, and present its written recommendations to the Commission within 6 months as to how this problem can be resolved.

29. The CSD and the Telecommunications Division shall jointly contact other state and federal agencies to explore the feasibility of increasing access to emergency communications services along remote state roads and highways.

30. Public Advocates' call for targeted outreach, and submission of marketing plans from all carriers goes beyond the requirements imposed on GTEC and Pacific in D.94-09-065.

31. The ULTS Marketing Working Group is in a better position to assess how well the 95% subscribership goal is being met.

32. If the ULTS Marketing Working Group detects that certain groups or communities do not have as high of a subscribership rate as they should, the ULTS Marketing Working Group can target those groups or areas that need improvement.

33. Utility redlining issues should be addressed by the Commission since it has the express power to prohibit discrimination as to rates, charges, service, and facilities.

34. The Executive Director, in concert with the appropriate Commission divisions, shall develop a plan of action for implementing consumer education programs.

35. Although AB 3643 does not mandate discounts for schools, libraries, rural health care providers, and CBOs, that legislation made clear that these types of organizations are to be positioned to be early recipients of the benefits of the information age, and that incentives should be provided to promote the deployment of advanced telecommunications services to all customer segments.

36. If the Commission waits until the FCC adopts its rules regarding discounts to schools and libraries, our rules on this

subject could be delayed until May 1997, well beyond the time contemplated in AB 3643.

37. With respect to the discounts for schools, only public or nonprofit schools providing elementary or secondary education, and which do not have endowments or more than $50 million may request the discounted rate.

38. Our reference to the term "nonprofit schools" would include schools operated by a religious order that has been incorporated as a nonprofit Public Benefit Corporation or as a nonprofit Religious Corporation.

39. With respect to the discounts for libraries, only those libraries which are eligible for participation in state-based plans for funds under Title III of the Library Services and Construction Act shall be eligible for the discounted rate.

40. Although the FCC has not yet adopted what services can be provided at a discount to schools and libraries, we believe that at a minimum, it will include the service elements that make up a 1MB line, and that discounted rates for switched 56, ISDN, T-1, and DS-3 services, or their functional equivalents, are a strong possibility as well.

41. We agree with DCA that the Telco Act intended to create a different rate discount for rural health care providers than the rate discount for schools and libraries.

42. No one has submitted any evidence in this proceeding about what a reasonably comparable rate should be for a rural health care provider, nor is there any evidence to suggest that health care providers in rural areas are currently charged different rates than their urban counterparts.

43. With respect to the discounts for hospitals and clinics, only municipal and county government owned and operated hospitals and health clinics shall qualify.

44. With respect to the discounts for CBOs, only tax exempt organizations that offer health care, job training, job placement, or educational instruction shall qualify.

45. The phrase "tax exempt organization" shall refer to an organization described in Section 501(c)(3) or 501(d) of the Internal Revenue Code, Title 26 of the United States Code.

46. Funding for these discount programs for qualifying schools, libraries, and CBOs should be funded at $50 million per year through the California Teleconnect Fund, of which a maximum of $5 million shall be targeted for the CBOs, $5 million for local and county government owned and operated hospitals and health clinics, and the remainder for schools and libraries, including any unused portion of the CBO and hospital and clinic monies.

47. The only customer groups that should be excluded from the AEUS for the California Teleconnect Fund surcharge are ULTS billings, coin-sent paid calling, debit card messages, one-way radio paging, usage charges to COPTs, customers receiving services under existing contracts that were executed on or before September 15, 1994, and directory advertising.

48. The California Teleconnect Fund surcharge shall appear as a separate line item on each customer's bill beginning with the billing cycle that begins on February 1, 1997.

49. Beginning with the billing cycle that begins on February 1, 1997, carriers shall mail bill inserts to their customers informing them of the California Teleconnect Fund surcharge.

50. The bill insert for the California Teleconnect Fund surcharge may be combined with the CHCF-B bill insert.

51. The Telecommunications Division shall monitor the estimate of the size of the California Teleconnect Fund over the course of the coming year, and annually thereafter, and shall keep the Commission informed as to the amount of allocated monies that has been spent and whether any adjustments are needed.

52. It is our intent that the above-described discount programs be used exclusively for the direct benefit of the qualifying entities and the population that they serve. None of these discounted services may be resold to, or shared with, any other non-qualifying entity or person.

53. The Telecommunications Division shall convene a workshop within 60 days to develop the type of monthly information that must be reported by carriers who seek reimbursement from the California Teleconnect Fund, and the type of information that qualifying entities may have to report.

54. The Telecommunications Division shall review and compare the FCC's plan for discounts to certain designated entities with the rules we adopt today, and shall inform us of any inconsistencies.

55. In deciding whether basic service for business customers in high cost areas should be subsidized or not, the Commission needs to weigh the cost of such a subsidy, and the burden on ratepayers.

56. The costs associated with providing telephone service to business customers in high cost areas of the state should not be included as part of the CHCF-B.

57. The Legislature in PU Code § 709.5 clearly intended that the local exchange market be opened to competition, and that the rules and regulations regarding universal service be in place by January 1, 1997.

58. PU Code § 709.5 raises the broader issue as to whether different universal service funds can be adopted for different size carriers.

59. At the present time, only GTEC, Pacific, CTCC, Contel, and Roseville should be included in the CHCF-B for the purpose of determining universal service subsidy support in their high cost areas.

60. The seventeen smaller LECs should be excluded from the CHCF-B for the purpose of determining universal service subsidy support in their high cost areas.

61. The seventeen smaller LECs should continue to be eligible to draw from the CHCF-A fund under our existing procedures.

62. For the most part, we should follow the TSLRIC CCPs as the cost standard for the development of a proxy model.

63. Although the CCPs advocate that forward looking and least cost technology be used, the proxy model should not use a HFC network because such technology is unproven.

64. A new technology does not have to be deployed universally before it is incorporated into a universal service cost study.

65. In evaluating which proxy cost model should be used to estimate the cost of providing residential basic service throughout the state, the following criteria should be used: (1) the ability to estimate costs for the the entire state on a CBG level; (2) the degree to which the design of the model can accurately reflect costs; (3) the openness and accessibility of the model to changes in assumptions and inputs; (4) the ability to model costs based on today's placement of technology; (5) the ability to model the proposed definition of basic service and subsequent changes to this definition; and (6) the verifiability of inputs and assumptions.

66. The CPM should be adopted as the proxy model to develop the cost of providing basic service to all residential customers in California.

67. Subsidizing one residential line per household in high cost areas allows each household to have essential telephone service.

68. An adjustment to the CPM estimate of $128 million should be adopted to reflect the subsidy of only one primary line to each household in a high cost area.

69. TURN's suggestion that all subscribers requesting residential basic service in high cost areas be required to certify

that they are not presently receiving residential basic service through any other telephone company will be adopted, and CSD and the Telecommunications Division shall convene a workshop to discuss ways in which the self certification process in GO 153 can be adapted for use with the CHCF-B.

70. An adjustment to the CPM estimate to spread the cost of the drop over two pairs instead of one should not be made.

71. An adjustment to the A & B cable cost of $48 million should be adopted due to Pacific's revision of this cost.

72. An adjustment to the A & B conduit costs should be made in the amount of $40 million.

73. An adjustment to the feeder and distribution cable sizes should not be adopted.

74. An adjustment to the CPM estimate to extend the cut-off of copper feeder to 12,000 feet should be adopted. This change results in a $78 million reduction to the estimated subsidy.

75. The proxy cost model should be reasonably consistent with the practices adopted in the OANAD proceeding.

76. The 76% fill factors that were adopted in OANAD for feeder and pair gain should be adopted, and Pacific's distribution fill factors should be used.

77. The adopted fill factor adjustments result in a $64 million reduction in the estimated subsidy.

78. The economic life depreciation method should be used because it is consistent with: the forward looking cost principles; what we have done in OANAD; and AB 3643.

79. GTEC's switch reordering proposal should not be adopted at this time.

80. GTEC's adjustment to the outside plant factor in the CPM estimate should be adopted.

81. The adoption of the adjustment to the outside plant factor results in an adjustment to the estimated subsidy of $37 million.

82. Pacific's estimate of switch costs should be used in the CPM estimate because it is consistent with the depreciation method adopted for the CPM.

83. Given our previous determination in D.94-09-064, we decline to conclude in this proceeding that the loop is a shared cost.

84. Pacific has not demonstrated that the costs allocated by the CPM to basic service were caused by residential basic service, as opposed to the other services offered by Pacific.

85. Pacific's modification of only two of the sixteen allocation factors calls into question the reliability and reasonableness of those allocators.

86. Section 254(k) of the Telco Act places a limit on the share of joint and common costs that should be borne by the service elements that make up basic service.

87. The modification of the two allocation factors results in a shifting of costs onto basic service, which results in basic service bearing more than its reasonable share of the joint and common costs in the CPM.

88. The unmodified PI allocation factors that Pacific used initially for the proprietary version of the CPM are more reliable and reasonable allocations of shared costs than those proposed by Pacific, and should be adopted as an adjustment to the CPM.

89. An adjustment to the CPM's shared costs results in an adjustment of $282 million to the estimate of the required subsidy.

90. The Telco Act contemplates that universal service should bear no more than a reasonable share of joint and common costs.

91. Consistent with the Telco Act, the Commission should reduce the common costs per line from $2.91 to $2.00 to safeguard against cross subsidy and anticompetitive behavior.

92. An adjustment to the CPM's common costs results in an adjustment of $118 million to the estimate of the required subsidy.

93. Any party seeking to modify the imputation rules established in D.96-03-020 should file a petition to modify that decision.

94. An adjustment to the CPM's estimate of rearrangement expenses should be made, which results in an adjustment of $170 million.

95. An adjustment to the CPM's estimate of the non-recurring burden should be made, which results in an adjustment of $43 million.

96. An adjustment to the CPM's estimate of the directory assistance expenses should be made, which results in an adjustment of $50 million.

97. An adjustment to the CPM's estimate of the repair and maintenance costs of 14% should be made, which reduces the subsidy estimate by $46 million.

98. Selection of the benchmark will have ramifications in other proceedings that seek to address competitive pricing issues.

99. In developing the benchmark, the Commission must balance the economic and social burden of subsidizing basic service, and the universal service policies of encouraging subscribership and maintaining rates at affordable levels.

100. The benchmark for determining COLR support should be the statewide proxy model weighted average of $20.30, or the carrier's flat rate plus EUCL, whichever is higher.

101. The statewide average cost of $20.30 should be used as the cut-off point in determining which CBGs are high cost.

102. Those GSAs whose adjusted CPM estimate of the cost of providing residential basic service is greater than the $20.30 cut-off point, shall be deemed to be a high cost area and eligible for subsidy funding through the CHCF-B.

103. Those GSAs whose adjusted CPM estimate of the cost of providing residential basic service is less than the $20.30 cut-off

point, shall not be eligible for subsidy funding through the CHCF-B.

104. The August 5, 1996 proposed decision suggested that carriers receive a subsidy for high cost areas based on the difference between the CPM cost estimate of serving a particular CBG, and the benchmark price, less the offsets for revenues from residential basic service, the EUCL charge, the CCLC, and the interstate USF, if any.

105. The August 5, 1996 proposed decision's methodology of calculating the subsidy support would not fund the gap between the benchmark and carrier's per line revenues.

106. By funding the gap, some of the pressure to increase existing rates should be alleviated.

107. The Commission should adopt a methodology for calculating the subsidy support that allows for funding of the gap when the revenues that a carrier receives are less than the cost benchmark.

108. Revenues received from residential basic service is an appropriate offset to the CHCF-B, and for calculational purposes, it is assumed that the flat rate is incorporated in the benchmark.

109. The EUCL charge is an appropriate offset to the CHCF-B because it recovers a large share of the interstate portion of the LECs' NTS embedded loop costs.

110. The EUCL charge offset of $3.50 is incorporated in the benchmark.

111. The CCLC is an appropriate offset to the CHCF-B because it recovers the remaining portion of residential and single line business NTS costs that are not recovered by the EUCL charge.

112. The CCLC offset will be deducted from the COLR's total draw from the CHCF-B, and will include only the CCLC revenue for subsidized lines, and the amount of the offset will not exceed the amount of the subsidy that would have been received without the offset.

113. To the extent that any of the LECs receive support from the interstate USF, that is an appropriate offset to the CHCF-B, and should be offset by the carrier's per line monthly USF draw multiplied by the percentage of lines eligible for high cost assistance in California.

114. For caculational purposes, the USF offset shall be treated in the same manner as the CCLC offset.

115. Yellow pages revenues should not be included as an offset to the CHCF-B because this proceeding is only establishing a fund to subsidize high cost areas of the state, and is not "establishing rates for other services offered by telephone corporations."

116. The use of yellow pages revenues would significantly reduce the contribution of others to support the fund, which would be contrary to the intent in the Telco Act and AB 3643 that such funding be equitable.

117. In deciding which type of funding mechanism to adopt, the following criteria should be met: (1) that it is competitively neutral; (2) that it clearly identifies the source of the subsidy; and (3) that consumers have the information they need to make informed choices.

118. An AEUS conforms with AB 3643 because it clearly identifies the source of the subsidy, customers can see how much they are paying into the fund, and customers are informed as to the amount of the surcharge.

119. With a net trans account funding mechanism, if the carrier decided to absorb some or all of the fund charge, or chose not to disclose that part of their bill pays to support the CHCF-B, then the AB 3643 principle that the subsidy be imposed in a manner that clearly identifies the source of the subsidy would not be met.

120. The AEUS method of funding is a more competitively neutral method of funding than the net trans account method because it is imposed on virtually all telecommunications services and customers.

121. We are not persuaded by TURN's argument that Section 254(k) of the Telco Act limits our ability to impose an AEUS to fund the CHCF-B, since Section 254(f) of the Telco Act permits the states to adopt regulations pertaining to universal service that are not inconsistent with the FCC's rules to preserve and advance universal service.

122. Carriers who collect the AEUS contribute to the CHCF-B because they incur administrative expenses to assess, collect, and remit, the monies to the fund.

123. An AEUS should be adopted to collect the surcharge for the CHCF-B.

124. D.94-09-065 considered and rejected CCAC's argument that they should be exempt from subsidizing the landline network in any manner, and that same argument should be rejected for the CHCF-B surcharge as well.

125. In addition to ULTS billings, the following should also be exempted from the CHCF-B surcharge: coin-sent paid calling; debit card messages; one-way radio paging; usage charges to COPTs; customers receiving services under existing contracts that were executed on or before September 15, 1994; and directory advertising.

126. For purposes of collecting the funds for the CHCF-B, the CHCF-B may appear next to the CHCF-A as a single line item on each customer's bill beginning with the billing cycle that begins on February 1, 1997.

127. Carriers shall be responsible for remitting the CHCF-A and the CHCF-B monies to separate bank accounts, and shall account for these two funds separately.

128. The carriers shall mail bill inserts beginning on February 1, 1997, informing customers of the new surcharge amount.

129. The Telecommunications Division shall convene a workshop as soon as possible to develop a bill insert notifying customers of the CHCF-B surcharge.

130. Pacific shall provide for an orderly transfer to the Telecommunications Division of all the responsibilities associated with the CHCF-A.

131. The GSAs are not intended to serve as the service area for all CLCs, because CLCs are free to designate the service territory that they intend to serve.

132. A designated COLR who is the incumbent LEC, in order to avail themselves of the subsidy for a high cost GSA, shall be required to serve all the high cost GSAs that are within the incumbent LEC's existing exchange area boundaries.

133. All CLCs who are designated COLRs, in order to avail themselves of the subsidy for a particular high cost GSA, shall be required to serve the entire GSA(s) that is within the CLC's designated service territory for which it has elected COLR status.

134. The selection of CBGs to serve as the GSAs will not act as a barrier to entry because the CBGs tend to be smaller in geographic area than exchanges.

135. A reseller may draw from the CHCF-B in accordance with Rule 6.G of Appendix B.

136. A designated COLR in a high cost GSA shall be entitled to draw subsidy support in accordance with rule 6.C.2. of Appendix B.

137. In order to receive the subsidy for serving high cost areas, the designated COLR shall submit on a monthly basis the required report showing, among other things, the number of residential basic service lines over which it provided service during the prior month.

138. The Telecommunications Division shall convene a workshop within 60 days to develop the type of monthly information that designated COLRs must report.

139. CLCs seeking to be designated a COLR, shall follow the procedure set out in Rule 6.D.4. of Appendix B.

140. The incumbent LECs listed in Attachment A of Appendix B are designated the COLRs in their existing service areas.

141. AT&T/MCI's suggestion that essential monopoly input functions be reduced to their direct economic costs or TSLRIC, is an issue that the OANAD proceeding should handle, rather than this proceeding.

142. The testimony that was offered regarding rate rebalancing and deaveraging was properly excluded from this proceeding.

143. In order to make subsidies for high cost areas explicit, there must be a correlating downward adjustment of rates through a surcredit or reduction in tariffed rates so as to prevent the LECs from recovering implicit subsidy support as well.

144. CCTA's proposal of an equal percentage reduction for all prices, except for residential basic service, and rates covered by contracts, results in the most competitively neutral outcome in the short term.

145. To avoid double recovery of universal service support, the five large and mid-size LECs shall reduce all of their rates, except for residential basic service and existing contracts, by an equal percentage reduction, in an amount that equals the anticipated monthly draw that they anticipate receiving from the fund.

146. The equal percentage rate reduction shall be accomplished by a monthly surcredit to each customer's bill through an advice letter filing.

147. The large and mid-size LECs shall establish memorandum accounts to track the rate reductions, so that a true up to ensure that the total rate reductions equal the total amount the LECs receive from the fund can occur, if necessary.

148. A review of the true up memorandum accounts may take place as part of the new application filings to permanently rebalance certain rates or price caps.

149. The Telecommunications Division shall provide quarterly updates at the Commission's meetings regarding the administration

and operation of the CHCF-A, the CHCF-B, and the California Teleconnect Fund.

150. The Telecommunications Division shall prepare a report for the Commission within one year with its recommendations as to how the CHCF-A, CHCF-B, and the California Teleconnect Fund should be administered in the future.

151. The Telecommunications Division staff will monitor how competition develops in high cost areas of the state over the next two years in order to determine if an auction mechanism should be used as a means of reviewing the CHCF-B subsidy support.

152. The Telecommunications Division staff shall conduct some workshops within the next six months concerning the auction mechanism, and shall prepare a workshop report for the Commission's review upon completion of the workshops.

153. After review of the workshop report on the auction mechanism, the assigned ALJ, after consulting with the assigned Commissioner, shall issue a ruling detailing the steps to be taken toward developing auction mechanism rules.

154. No auction will be held in accordance with rule 6.E. of Appendix B until the Commission has established the auction process.

155. The Telecommunications Division staff shall revise the ULTS Monthly Report and Claim Statement to have the carrier report the number of ULTS customers that it serves each month.

156. Our analysis of the ULTS statutes lead us to conclude that the ULTS subsidy cannot be applied as a credit to a carrier's higher priced basic service rate.

157. Until the Moore Act is amended by the Legislature, the ULTS program funds should not be used to subsidize a mobile telephone service that can be used anywhere.

158. The Moore Act contemplates the offering of basic telephone service at affordable rates, which enables a user to have

a class of service necessary to meet minimum residential communication needs.

159. The Moore Act was not meant to include access to enhanced telecommunications services, nor was PU Code § 882 intended to create a ULTS entitlement to advanced telecommunications services.

160. The ULTS program will not be broadened to include Lifeline rates for enhanced services.

161. A two tiered ULTS program should not be adopted because of the increased funding requirements, and concern over the size of the program.

162. The advertising agency selected to do work for the ULTS program shall permit the Commission to audit its records and operations in connection with all ULTS related work.

163. The CSD shall convene a workshop as soon as practicable to determine who is interested in serving on the ULTS Marketing Working Group, and to discuss other details concerning the group.

164. The ULTS Marketing Working Group shall submit a budget for approval by the Commission.

165. The ULTS Marketing Working Group shall submit an annual report to the Commission regarding its activities during the prior year.

166. ULTS advertising, outreach, and related marketing expenses by individual carriers will no longer be reimbursed by the ULTS fund except as provided for Rule 5.A.2. of Appendix B.

167. Should the incumbent LECs decide to continue using existing advertising campaigns to market ULTS after the contract has expired or after the three months has elasped, whichever occurs first, the LECs shall reimburse the ULTS program for the production expenses associated with producing that material.

168. Before deciding whether an income verification process should be adopted for the ULTS program, CACD and the Legal Division shall investigate whether such a process will lead to additional

federal monies for universal service support, and the Commission should hold meetings to assess the impacts of such a change.

169. The Telecommunications Division staff shall provide quarterly updates to the Commission at its meetings regarding the Administrative Committee and the ULTS program.

170. Rate and revenue rebalancing issues should be given a higher priority in the months to come.

171. The five large and mid-size LECs shall be authorized to establish memorandum accounts to record actual implementation costs associated with the universal service program that we adopt today.

172. Recording of these implementation costs shall be on a going forward basis.

173. The assigned ALJ and/or Commissioner shall establish a schedule in six months to consider whether recovery of these implementation costs should be recovered or not.

O R D E R

IT IS ORDERED that:

1. Exhibits 117 and 128 shall be received into evidence.

2. The motion of AT&T Communications of California, Inc. (AT&T) and MCI Telecommunications Corporation (MCI) to strike the references in Pacific Bell's (Pacific) opening brief to the article by Dr. Alfred Kahn is denied.

3. The motion of AT&T and MCI to strike the references in Pacific's opening brief regarding certain alleged conversations, is granted, and those references shall be striken from Pacific's brief.

4. The motion of the California Department of Consumer Affairs (DCA) to accept its reply comments in excess of the page limit is granted, and the Docket Office is directed to file DCA's reformatted reply comments as if it was filed on September 3, 1996.

5. The motion of ICG Telecom Group, Inc. (ICG) to late file its opening comments to the October 9, 1996 revised proposed decision is granted, and the Docket Office is directed to accept the late filing of ICG's opening comments.

6. The motion of Toward Utility Rate Normalization (TURN) to late file its opening comments to the October 9, 1996 revised proposed decision is granted, and the Docket Office is directed to accept the late filing of TURN's opening comments.

7. The universal service rules attached hereto as Appendix B, are adopted.

a. All incumbent local exchange carriers (LECs), and all competitive local carriers (CLCs), who offer local exchange residential service, shall provide all of the service elements listed in Rule 4 of Appendix B.

b. All telecommunications carriers providing eligible low income customers with residential basic service, as defined in Rule 4.B. of Appendix B, under the Universal Lifeline Telephone Service (ULTS) program, shall be eligible to receive subsidy support for those customers from the ULTS program in accordance with Rule 5 of Appendix B.

c. Effective immediately, telecommunications carriers will no longer be able to claim reimbursement for their advertising and marketing expenses associated with the ULTS program except as provided for in Rule 5.A.2. of Appendix B.

d. Except as provided for in Rule 5.B.2. of Appendix B, all telecommunications carriers are required to charge their end users the ULTS surcharge, as set by the California Public Utilities Commission (CPUC), and to remit such monies to the ULTS program.

e. The 22 incumbent LECs shown in Attachment A of Appendix B are designated the carriers of last resort (COLRs) in their respective

service areas, and shall adhere to Rule 6.D. and Rule 6.E. of Appendix B.

f. All LECs and CLCs shall comply with Rule 9.B. and Rule 9.C. of Appendix B.

8. The Cost Proxy Model (CPM), as adjusted by this decision, is chosen as the proxy model from which to develop an explicit universal service funding mechanism to support the high cost areas of the following incumbent LECs: GTE California Incorporated (GTEC), Pacific, Citizens Telecommunications Company of California, Inc. (CTCC), Contel of California, Inc. (Contel), and Roseville Telephone Company (Roseville).

a. The funding mechanism to support the high cost areas within the service areas of GTEC, Pacific, CTCC, Contel, and Roseville, shall be known as the California High Cost Fund-B (CHCF-B).

b. The applicable rules for the CHCF-B are contained in Rule 6, Rule 7.D., and Rule 8.A.

c. The cut-off benchmark for determining whether an area is high cost for purposes of the CHCF-B shall be $20.30. A geographic study area (GSA) shall be considered high cost if the cost of serving residential customers in that GSA, as generated by the adjusted CPM, is above the benchmark price.

d. The benchmark for purposes of determining COLR support shall be the statewide average proxy cost of $20.30, as derived by the adjusted CPM, or the carrier's flat rate plus the end user common line (EUCL) charge, whichever is higher.

e. GTEC, Pacific, CTCC, Contel, and Roseville, to the extent that they expect to receive any high cost area subsidy support from the CHCF-B, shall file advice letters offsetting any anticipated receipt of funds by an equal percentage rate reduction for all services except for residential basic

service, and rates set by contracts. Such rate reductions shall be accomplished through a monthly surcredit equal to the expected receipt of funds for that month, and shall continue until terminated by a Commission order.

f. GTEC, Pacific, CTCC, Contel, and Roseville shall establish memorandum accounts to track the rate reductions that they may make to offset funds they may receive from the CHCF-B for high cost area support. Review of whether any true up is necessary shall occur in a subsequent phase of this proceeding, or in the proceedings where the applications to rebalance certain rates or price caps to offset the CHCF-B are addressed.

g. All telecommunications carriers are required to charge all end users the CHCF-B surcharge as set by the Commission, except for ULTS billings, coin-sent paid calling, debit card messages, one-way radio paging, usage charges to COPTs, customers receiving services under existing contracts that were executed on or before September 15, 1994, and directory advertising.

h. The CHCF-B surcharge is set at 2.87%, and shall be collected from end users beginning with the billing cycle that begins on February 1, 1997.

i. The CHCF-B surcharge may be shown side by side with the CHCF-A surcharge as a single line item on a customer's bill, or as a separate line item.

j. Effective with the billing cycle that begins February 1, 1997, and until all customers have been sent the bill insert, all telecommunications carriers shall include in their billing statements to customers, a bill insert notifying customers of the CHCF-B surcharge.

k. Pacific shall incorporate the adjustments to the CPM that this decision has adopted, and shall tender the adjusted CPM to the

CPUC within 45 days from the effective date of this decision, for the CPUC's use in administering the CHCF-B.

1. After the issuance of this decision, the Telecommunications Division staff shall meet with interested parties to review the adjusted CPM results for any geographical placement or mathematical errors.

9. The seventeen smaller LECs, whose names appear on Attachment A of Appendix B, shall continue to be eligible to receive universal service support through the existing California High Cost Fund (CHCF-A); a smaller LEC shall not be eligible for funds from the CHCF-B to support high cost areas unless it becomes a designated COLR outside its existing service area in accordance with Rule 6.D.4. of Appendix B.

10. Qualifying schools, libraries, hospitals and health clinics, and community based organizations (CBOs) shall be eligible for discounts for certain services as provided for in Rule 8 of Appendix B.

a. All telecommunications carriers offering the services described in Rule 8.B., Rule 8.C., and Rule 8.D. shall revise their tariffs within 45 days from the effective date of this decision to reflect these discounts.

b. Reimbursement of telecommunications carriers from the California Teleconnect Fund for these discounts shall begin to accrue as of February 1, 1997.

c. This discount program shall be funded through the California Teleconnect Fund, and will be set initially at $50 million per year, with $5 million allocated to qualifying CBOs, $5 million to qualifying hospitals and health clinics, and $40 million to qualifying schools and libraries. In the event the monies allocated in the first year for the hospitals and health clinics, and CBOs are not exhausted, those excess funds shall be

used for the benefit of the discount for schools and libraries in the subsequent year.

d. All telecommunications carriers are required to charge all end users, the California Teleconnect Fund surcharge, as set by the Commission, except for ULTS billings, coin-sent paid calling, debit card messages, one-way radio paging, usage charges to COPTs, customers receiving services under existing contracts, and directory advertising.

e. The California Teleconnect Fund surcharge is set at 0.41%, and shall be collected from end users beginning with the billing cycle that begins on February 1, 1997.

f. The California Teleconnect Fund surcharge shall appear as a separate line item on a customer's bill.

g. Effective with the billing cycle that begins February 1, 1997, and until all customers have been sent the bill insert, all telecommunications carriers shall include in their billing statements to customers, a bill insert notifying customers of the California Teleconnect Fund surcharge.

h. The Telecommunications Division shall monitor the estimate of the size of the discounts and shall inform the Commission as to whether any adjustments are needed in accordance with the text of this decision.

11. The Executive Director shall meet with the various divisions of the CPUC as soon as possible to coordinate the establishment and administration of the CHCF-B, the California Teleconnect Fund, and to take over the administration of the CHCF-A.

a. The CHCF-B and the California Teleconnect Fund shall become operative as of February 1, 1997.

b. The CPUC shall take over the administration of the CHCF-A from Pacific within 6 months.

c. Pacific shall provide for an orderly transfer to the CPUC of the CHCF-A responsibilities, and all the books, accounts, monies, and related paperwork.

12. The Executive Director shall meet with the various divisions of the CPUC within 90 days to develop a plan of action for implementing consumer education programs.

13. The Commission staff shall compile an annual report regarding the complaint history and open investigations for each certificated carrier. The first report shall be available for dissemination on or about January 30, 1997, and shall cover the reporting period of July 1, 1995 to June 30, 1996. Subsequent annual reports shall be available by August 1st of each year thereafter. Unless extended by the Commission, the last annual report will be for the reporting period of July 1, 1998 to June 30, 1999.

14. Workshops shall be convened by the Consumer Services Division for the following purposes:

a. A workshop to determine who is interested in participating in the Universal Service Working Group (USWG), and on the Steering Committee, and to discuss the purpose and organizational framework of the USWG shall be convened within 90 days from the effective date of this decision.

(1) Upon completion of the workshops, the staff shall submit a workshop report, along with the names of persons interested in serving on the USWG Steering Committee. The Commission will then issue a decision regarding the composition of the USWG Steering Committee, and its role and purpose.

(2) The USWG shall be funded through the California Teleconnect Fund, and will be set initially at $250,000 per year.

b. A workshop to determine how different types of pricing packages and discounts can be accommodated in the customer information matrix shall be convened within six months from the effective date of this decision.

(1) Upon completion of the workshop, the staff shall prepare for the Commission a workshop report containing its recommendations.

c. A workshop shall be convened within 45 days to determine who is interested in serving on the Universal Lifeline Telephone Service Marketing Working Group (ULTSMWG), and to discuss its goals, purpose and organizational framework.

(1) Upon completion of the workshops, the staff shall submit a workshop report, along with the names of persons interested in serving on the ULTSMWG. The Commission will then issue a decision regarding the composition of the ULTSMWG, and its role and purpose.

(2) The ULTSMWG shall be funded through the ULTS program in accordance with the discussion in the text of this decision.

15. Workshops shall be convened by the Telecommunications Division for the following purposes:

a. A workshop to formulate a joint bill insert to advise end users of the CHCF-B and the California Teleconnect Fund surcharges shall be convened within 20 days from the effective date of this decision. The assigned Administrative Law Judge (ALJ), in conjunction with the Public Advisor's office, shall review the draft(s) of the bill insert, and shall notify the service list in an ALJ ruling as to which bill insert to use.

b. A workshop shall be convened within 60 days to develop the type of monthly information that designated COLRs must report, and the types of information that qualifying

schools, libraries, hospitals and health clinics, and CBOs may be required to report. The staff's workshop report and recommendation shall be forwarded to the Commission and to the assigned ALJ.

(1) The assigned ALJ, in consultation with the assigned Commissioner, shall issue a ruling prescribing the monthly reports the COLRs must report.

(2) The Commission shall decide whether the qualifying entities and organizations should be required to submit reports describing how the discounts were used to directly benefit the qualifying entities and the population they serve.

c. A workshop shall be convened within 60 days to develop the type of monthly information that carriers who serve qualifying schools, libraries, hospitals, health clinics, and CBOs, must report. The staff's workshop report and recommendation shall be forwarded to the Commission and to the assigned ALJ.

(1) The assigned ALJ, in consultation with the assigned Commissioner, shall issue a ruling prescribing the monthly report that the California Teleconnect Fund will require.

d. A workshop shall be convened within 180 days to discuss the development of auction mechanism rules for the universal service program. Staff shall prepare and disseminate a workshop report for the Commission.

(1) The assigned ALJ, in consultation with the assigned Commissioner, shall issue a ruling detailing the steps to be taken toward developing auction mechanism rules.

16. The Consumer Services Division, in conjunction with the Telecommunications Division, shall do the following:

a. A workshop shall be convened within 90 days to explore ways in which the self certification format contained in General Order 153 can be used by residential customers in high cost areas of the state to ensure that each household is receiving only one subsidized line. Following the workshops, the staff shall prepare a Commission resolution to address the manner in which this certification shall take place.

b. The staff shall review and develop written recommendations on the issue of providing service to previously unserved areas. The staff shall present these recommendations to the Commission within six months.

c. The staff shall initiate contact with other state and federal agencies within 30 days to form an interagency task-force to investigate the feasibility of increasing access to emergency communications services along remote state roads and highways. The staff shall report back to the Commission about the status of the task-force within six months.

17. The Telecommunications Division shall review and compare all the universal service rules that the Federal Communications Commission may adopt, and shall identify issues that are inconsistent with the universal service rules adopted today, or which have not yet been addressed by the CPUC. Upon the completion of the staff's review, the staff shall recommend to the Commissioners what issues need to be resolved.

18. The CPUC staff shall conduct the necessary reviews and provide the reports as indicated in this decision.

19. GTEC, Pacific, CTCC, Contel, and Roseville shall establish memorandum accounts to record actual implementation costs incurred on and after the effective date of this decision.

This order is effective today.

Dated October 25, 1996, at Sacramento, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
Commissioners

Commissioner Daniel Wm. Fessler, being necessarily absent, did not participate.

I will file a dissent.

/s/ JOSIAH L. NEEPER
Commissioner

UNIVERSAL SERVICE RULES AS PROPOSED IN D.95-07-050

1. DEFINITIONS

A. All End User Surcharge (AEUS): A funding mechanism used to collect money for Commission-mandated programs. The AEUS is applicable to all telecommunications providers, with the exception of one-way paging companies. The surcharge is a percentage of the customers' total expenditures on telecommunications services. The surcharge is visible on customers' bills as a line item charge.

B. Basic Service: A certain defined minimum level of telecommunications service available to virtually everyone in each telephone exchange. Sometimes referred to as basic exchange service.

C. California High Cost Fund (CHCF): A fund established by the Commission to ensure that customers in areas served by small and mid-size LECs have access to telephone services at reasonable rates. The Commission collects money for the fund through an AEUS and distributes it to the small and mid-size LECs based on the individual need of the companies as authorized by a Commission resolution.

D. Carrier of Last Resort (COLR): A local exchange service provider that stands ready to provide basic service to any customer requesting such service within a specified area. To be a COLR, the provider must meet Commission-approved qualifications.

E. Census Block Group: An area defined by the United States Census Bureau which serves as the geographic service area.

F. Common Carriage: Provision of telecommunications services available to the public on a non-discriminatory basis.

G. Competitive Local Carrier (CLC): A common carrier which has been issued a Certificate of Public Convenience and Necessity to provide wireline local exchange telecommunications service for a geographic area specified by such carrier.

H. Competitive neutrality: The idea that all telecommunications service providers should be required to contribute to and be allowed to receive subsidies from the universal service programs on an equitable basis.

I. Geographic Study Area (GSA): A Commission designated geographic area that will serve as a reference point from which cost data and high cost subsidies can be derived for the designated carrier or carriers of last resort.

J. High Cost Voucher Fund: the fund developed in this proceeding to subsidize high cost areas of the state. The fund includes a collection mechanism, a distribution mechanism, and a method for calculating the amount of the required subsidy.

K. Local Exchange: A telecommunications system providing service within a specified area within which communications are considered exchange messages except for those messages between toll points.

L. Local Exchange Carrier (LEC): The incumbent carrier or carriers whose names appear on Attachment A of these rules.

M. Loop: A transmission path capable of delivering analog voice grade signals or digital signals at less than 1.544 Mbps between the network interface at a customer's premises and the main distribution frame or any other point of interconnection to the LEC network. Also known as the basic level network access channel.

N. Net Trans Account: A funding mechanism which may be used to collect money for the Commission's high cost voucher fund. Under this mechanism, the Commission bills carriers a percentage of their transmission path revenues after netting out the carrier's access charges and contributions to universal service.

O. Open Access Network Architecture Development (OANAD): Order Instituting Rulemaking and Order Instituting Investigation (R.93-04-003 and I.93-04-002) to govern access to bottleneck services and establish a framework for network architecture development of dominant carrier networks.

P. Proxy Costs: Geographically specific costs developed using proxy factors rather than direct measurement of costs.

Q. Proxy Factor: Factor associated with costs, such as loop length or population density, which can be used to estimate costs when direct measurement is unavailable or impractical.

R. Rate Cap: Upper limit or a ceiling level on prices.

S. Total Service Long Run Incremental Costs (TSLRIC): The definition of TSLRIC that is developed in the OANAD OIR/OII.

T. Transmission path revenues: A carrier's revenues from local service, intraLATA toll, interLATA toll, mobile telephone calls, access, interconnection and collocation payments received, reseller payments, private lines and high capacity business services, transmission services for information providers, packet switched transmission services, transmission parts of integrated systems packages, basic Centrex services and central office switching functions.

U. Universal Lifeline Telephone Service (ULTS): The ULTS program is a statewide explicit customer subsidy that ensures low income households have access to basic telephone services at a fixed and affordable rate. The ULTS program was created in response to the Moore Universal Telephone Service Act which became law in September, 1983. The ULTS program is sometimes referred to as Lifeline.

V. Universal Service: The provision of basic service to virtually everyone in California at reasonable rates.

W. Voucher: A mechanism used to distribute a credit to a customer or customers in connection with the Commission's universal service funding programs. The credit to the customer is based on the difference between the cost of serving the customer and the rate deemed affordable by the Commission.

2. SCOPE OF RULES

These rules govern universal service to California telecommunications users. For the purposes of funding universal service, these rules apply to all California telecommunications carriers. For the purpose of providing universal service, these rules apply to all California telecommunications carriers providing basic service.

3. UNIVERSAL SERVICE PRINCIPLES AND OBJECTIVES

A. Principles:

1. It is the policy of the Commission to ensure that high-quality basic telecommunications services remain available and affordable to all Californians regardless of linguistic, cultural, ethnic, physical, geographic, or income considerations.

2. It is the policy of the Commission to provide for the progressive expansion of the definition of basic service as service capabilities advance and the need for advanced services ubiquity becomes prevalent, in order to avoid information rich and information poor stratification.

3. It is the policy of the Commission to ensure that consumers have access to information needed to make timely and informed choices about basic service and ULTS.

4. It is the policy of the Commission to provide consumers with the ability to choose among competing basic universal service providers regardless of the technologies employed by competing firms.

5. It is the policy of the Commission to ensure that universal service providers adhere to interconnectivity, interoperability, common carriage, reliability, privacy and security guidelines;

6. It is the policy of the Commission to provide incentives for efficient provisioning of universal services, and which will reduce the aggregate subsidy required for universal service over time.

7. It is the policy of the Commission to provide a competitively neutral universal service mechanism which will minimize market distortions. The mechanism must provide for competitive provisioning of basic service, access to universal service funds, and a funding source which is broad-based and sustainable.

B. Objectives:

1. It is the objective of the Commission to develop a fully operable, competitively neutral universal service financing source and distribution mechanism no later than January 1, 1997. The funding mechanism must provide efficiency incentives to significantly reduce the aggregate subsidy required for universal service over time.

2. It is the objective of the Commission to adopt universal service policies which allow education, health care, community and government institutions to be in a position that allows them to be early recipients of the benefits of the information age;

3. It is the objective of the Commission to improve the penetration rate of basic service to non-English speaking and low income households by means of the following mechanisms:

a. All LECs and CLCs shall be responsible for pursuing the objective of achieving a 95% penetration rate among low income and non-English speaking households in their service territories.

b. LECs and CLCs shall have the flexibility to develop innovative strategies to contribute to the attainment of this objective.

c. LECs and CLCs shall submit the required annual reports describing their efforts to attain this objective.

d. In service territories where there is a substantial population of non-English speakers, a carrier's efforts to communicate with such customers in their native languages shall be a factor that the Commission considers in assessing each local carrier's contribution to pursuit of universal service targets.

4. BASIC SERVICE

A. Carriers providing residential service shall, at a minimum, provide all elements of basic service.

B. Basic service includes the following services:

1. access to single party local exchange service;

2. access to interexchange carriers;

3. ability to place and receive calls;

4. touch tone dialing;

5. free access to emergency services, 911/E911;

6. access to directory assistance;

7. lifeline rate for eligible customers

8. customer choice of flat or measured rate service;

9. access to directory assistance;

10. access to a directory listing;

11. access to operator services;

12. voice grade connection to public switched telephone network;

13. access to information services and 800 services;

14. one-time free blocking for information services and one time billing adjustments for charges incurred inadvertently, mistakenly, or that were unauthorized;

15. access to telephone relay service as provided for in PU Code § 2881;

16. access to public policy pay telephones;

17. free access to customer service for information about ULTS, service activation, service termination, service repair and bill inquiries.

C. Periodic Review of Basic Service

1. Parties may petition for a new review of the composition of basic service three years after the conclusion of a review of basic service. The adoption of final universal service rules in this proceeding (R.95-01-020 and I.95-01-021) will constitute the first review of basic service. The petition for modification shall be filed on or before the 180th day before the review date.

2. In evaluating whether services should be added to or deleted from basic service the Commission will consider the following criteria:

   a. the service is essential for participation in society;

   b. a substantial majority, 65%, of residential customers subscribe to the service;

   c. the benefits of adding the service outweigh the costs;

   d. availability of the service, or subscription rates would not increase without intervention.

3. Providers will maintain and make available to the Commission upon request sufficient information for the Commission to determine whether the above criteria have been satisfied.

5. UNIVERSAL LIFELINE TELEPHONE SERVICE (ULTS)

A. Carrier Responsibilities

1. All carriers providing basic service will have access to the ULTS fund.

a. Carriers are required to inform customers of the option for ULTS service when customers first inquire or sign up for basic exchange service.

b. Carriers must charge no more than the statewide ULTS rate, as set by the Commission, to qualifying low income customers.

c. Carriers may collect the difference between their tariffed rate for other residential customers and the Lifeline rate from the ULTS fund, but they may not collect more on a per customer basis than the incumbent LEC.

d. Carriers must serve each eligible customer requesting Lifeline service within the carriers' specified serving area.

B. ULTS Funding Source

1. All telecommunications carriers are required to charge the appropriate surcharge, as set by the Commission, on all end users of telecommunications services.

2. End users of one-way paging companies are excluded from the collection of the surcharge.

3. Carriers shall submit the number of customers who sign up for the ULTS program to CACD's Telecommunications Branch on a monthly basis.

6. THE HIGH COST VOUCHER FUND

A. Identifying The Cost To Serve High Cost Areas

1. High cost voucher fund subsidies will vary according to the cost of providing service within a GSA.

2. The GSA is used for the purposes of identifying the cost of providing universal service to a particular area. A census block group shall serve as the GSA.

3. Total Service Long Run Incremental Cost (TSLRIC) will serve as the measure of costs for providing basic service to residential customers. The methodology for determining the TSLRIC will be developed as part of this proceeding and the OANAD proceeding.

4. Costs for providing customers with basic service in individual GSAs will be determined by factors which serve as proxies for the characteristics associated with costs, including, but not limited to, population density and average loop length. The methodology for determining proxy costs and the initial proxy factors will be developed in this proceeding and the OANAD proceeding.

5. Small and medium sized LECs can:

   a. develop TSLRIC studies of their own; or

   b. select the proxy costs developed by one of the large LECs.

6. A GSA will be considered a high cost GSA if the average cost of serving residential customers in that GSA is above the average revenue generated by the LEC offering basic service in that particular GSA.

7. Subsidy amounts will be reviewed periodically. This review will consider the amount which subsidies should be reduced due to efficiencies gained through technological advances and competitive pressures.

B. Carrier Responsibilities

1. Carriers shall report the following information to CACD's Telecommunications Branch on a monthly basis:

   a. The number of residential basic exchange customers being served by the carrier in each GSA.

   b. The rate for basic exchange service the carrier is charging in each GSA.

   c. A calculation of the subsidy amount that the carrier should receive for providing basic exchange service to the high cost areas.

C. Subsidy Applicability

1. The high cost voucher fund will apply only to residential basic services priced at the tariffed rate in high cost GSAs.

2. The Commission will periodically review the subsidy in each GSA.

D. Carrier of Last Resort

1. All incumbent LECs will be designated as the COLR in all their service areas at least until such time that another carrier or carriers are designated as the COLR.

2. Other qualified providers may seek to become a designated COLR, or to compete in a GSA without being designated a COLR.

3. Only designated COLRs will have access to the high cost voucher fund subsidy.

4. Those carriers seeking to be designated a COLR shall file a Notice of Intent to be Designated a COLR (Designated COLR NOI). The Commission will consider the following factors when evaluating whether COLR status should be granted:

   a. the facilities the carrier has in place or the arrangements that the carrier plans to enter into in order to provide local service;

   b. the financial ability of the carrier to undertake the COLR obligation;

   c. the ability of the carrier to promote the goals of universal service in low income and non-English speaking communities.

5. A designated COLR will be required to serve the entire GSA.

6. A designated COLR may opt of its obligations in a GSA by advice letter, unless it is the only carrier remaining in the GSA, in which case it must file an application to withdraw as the COLR, and continue to act as the COLR until the application is granted or a new COLR has been designated as a result of an auction.

E. Competitive Bidding To Serve As The COLR

1. If there is only one carrier in a GSA and that carrier has filed an application to withdraw as the COLR in that GSA, and no other provider is willing to assume the COLR responsibility at the current subsidy level:

   a. The Commission will initiate an auction whereby service providers bid to be the COLR.

   b. Providers will bid for an amount, over and above the previously established per-line subsidy. The lowest bidder would become the subsidized COLR prepared to provide service to all customers for three years. Competitive entry would be allowed, but only 1/2 the subsidy would be available.

2. A COLR who loses the bid shall have the option to sell its facilities in the area to any interested party at book value.

3. 180 days prior to the expiration of the three-year COLR obligation, other carriers desiring to become a designated COLR in the GSA shall file a Designated COLR NOI. The Commission will then determine whether the same designated COLR should be retained, whether multiple carriers of last resort should be permitted, or if another auction should be held.

F. Funding The High Cost Voucher Fund

1. The Commission will require all telecommunications service providers to contribute to the high cost voucher fund.

2. The Commission will collect and distribute money for this fund through the net trans account method.

3. Carriers will be required to submit records to the Commission regarding:

   a. all transmission path revenues, and

   b. access payments to other carriers.

4. The Commission will be the administrator of the high cost voucher fund mechanism.

5. The Commission will calculate each carrier's payment (or receipt) from the fund and will bill (or distribute) the appropriate amount to carriers.

G. Distributing The High Cost Area Subsidy In A Resale Environment

1. If resale of basic exchange service or loops is allowed, the subsidy for residential basic exchange service for that customer shall be treated as follows:

a. If the price of the service or facility resold is below its cost, the underlying facilities based provider receives the subsidy for the services sold.

b. If the price of the service or facility resold is market based or based upon actual deaveraged costs, then the carrier who sells basic exchange service to the end-user residential customer shall receive the subsidy provided that the basic residential service is priced at the affordable (but below cost) price set by the Commission.

7. CONSUMER INFORMATION RULE

A. All providers of basic exchange services must provide the following information to consumers in any marketing information that targets residential customers and which explains the telecommunication service offerings available. The required information will be set apart from other marketing information with the following statement: "The following information is required by the California Public Utilities Commission to allow comparisons with rates charged by other providers for the same type of service."

B. The required information shall consist of the following:

	BASIC SERVICES ONE TIME CHARGE TO INSTALL	**COST PER MONTH**
Flat Rate Service: A set monthly rate for unlimited local calling, within a minimum of 12 miles.	$____	$____
Measured Rate Service: A reduced monthly rate plus per-minute charges for each local call above a minimum $3.00 allowance.	$____	$____
Universal Lifeline Telephone Service: Subsidized, low-priced service for qualifying limited income customers.		

-**Flat Rate Universal Lifeline:** Unlimited local calling.	$____	$____
-**Measured Rate Universal Lifeline:** Provides, at a minimum, 60 <u>untimed</u> local calls. Local calls over 60 cost ___ cents each.	$____	$____

Price information is current as of (month, date, and year).

(END OF APPENDIX A)

ADOPTED UNIVERSAL SERVICE RULES

1. DEFINITIONS

A. All End User Surcharge (AEUS): A funding mechanism used to collect money for Commission-mandated programs. The AEUS is applicable to all telecommunications carriers, with the exception of one-way paging companies. The surcharge is a percentage of the customers' total expenditures on telecommunications services. The surcharge is visible on customers' bills as a line item charge.

B. Basic Service: A certain defined minimum level of telecommunications service which each carrier of local exchange service is required to provide to all of its residential customers who request local exchange service. Basic service is sometimes referred to as basic exchange service.

C. California High Cost Fund (CHCF or CHCF-A): An existing fund established by the Commission to ensure that customers in areas served by small and mid-size LECs have access to telephone services at reasonable rates. The Commission collects money for the fund through an AEUS and distributes it to the small and mid-size LECs based on the individual need of the companies as authorized by a Commission resolution.

D. California High Cost Fund-B (CHCF-B): the fund developed in this proceeding to subsidize high cost areas of the state. The fund includes a collection mechanism, a distribution mechanism, and a method for calculating the amount of the required subsidy.

E. California Teleconnect Fund: the fund developed in this proceeding to provide discounts for telecommunications services to qualifying schools, libraries, hospitals, health clinics, and community based organizations.

F. Carrier of Last Resort (COLR): A carrier who provides local exchange service, and stands ready to provide basic service to any customer requesting such service within a specified area. To be a COLR, the provider must meet Commission-approved qualifications.

G. Census Block Group (CBG): An area defined by the United States Census Bureau for purposes of the CHCF-B. The CBG serves as the geographic study area.

H. Common Carriage: Provision of telecommunications services available to the public on a non-discriminatory basis.

I. Competitive Local Carrier (CLC): A common carrier which has been issued a Certificate of Public Convenience and Necessity effective on or after January 1, 1996, to provide

local exchange telecommunications service for a geographic area specified by such carrier.

J. Competitive neutrality: The concept that regulation of the telecommunications industry should be structured in such a way that it neither favors nor impedes one telecommunications carrier or group of telecommunications carriers, over any other carrier or group of carriers.

K. Geographic Study Area (GSA): A Commission designated geographic area that serves as a reference point from which cost data and high cost subsidies can be derived for the designated carrier or carriers of last resort.

L. Local Exchange: A telecommunications system providing service within a specified area within which communications are considered exchange messages except for those messages between toll points.

M. Local Exchange Carrier (LEC): The incumbent local exchange carrier or carriers whose names appear on Attachment A of these rules.

N. Loop: A transmission path capable of delivering analog voice grade signals between 300 and 3,000 Hz only, between the network interface at a customer's premises and the main distribution frame or any other point of interconnection to the LEC network. Also known as the basic level network access channel.

O. Open Access Network Architecture Development (OANAD): Order Instituting Rulemaking and Order Instituting Investigation (R.93-04-003 and I.93-04-002) to govern access to bottleneck services and establish a framework for network architecture development of dominant carrier networks.

P. Proxy Costs: Geographically specific costs developed using proxy factors rather than direct measurement of costs.

Q. Proxy Factor: Factor associated with costs, such as loop length or population density, which can be used to estimate costs when direct measurement is unavailable or impractical.

R. Total Service Long Run Incremental Costs (TSLRIC): The definition of TSLRIC that is developed in the OANAD OIR/OII.

S. **Universal Lifeline Telephone Service (ULTS):** The ULTS program is a statewide explicit customer subsidy that ensures low income households have access to basic telephone services at a fixed and affordable rate. The ULTS program was created in response to the Moore Universal Telephone Service Act which became law in September, 1983. The ULTS program is sometimes referred to as Lifeline.

T. **Universal Service:** The concept that basic service should be available to virtually everyone in California at affordable rates.

2. SCOPE OF RULES

These rules govern universal service to California telecommunications users. For the purposes of funding universal service, these rules apply to all California telecommunications carriers. For the purpose of providing universal service, these rules apply to all California telecommunications carriers providing basic service.

3. UNIVERSAL SERVICE PRINCIPLES AND OBJECTIVES

A. Principles:

1. It is the policy of the Commission to ensure that high-quality basic telecommunications services remain available and affordable to all Californians regardless of linguistic, cultural, ethnic, physical, geographic, or income considerations.

2. **It is the policy of the Commission that in order to avoid stratification between information rich and information poor consumers, there should be a progressive expansion of the definition of basic service, as appropriate, and through the implementation of other policies, programs, and incentives to promote the deployment of advanced telecommunications technology to all customer groups.**

3. It is the policy of the Commission to ensure that consumers have access to information needed to make timely and informed choices about basic service and ULTS.

4. **It is the policy of the Commission to provide consumers with the ability to choose among competing basic service carriers regardless of the technologies employed by the carriers who provide basic service.**

5. It is the policy of the Commission to ensure that basic service carriers adhere to interconnectivity, interoperability, common carriage, reliability, privacy and security guidelines.

6. **It is the policy of the Commission to provide incentives as needed to promote deployment of advanced telecommunications technology to all customer segments, and to position health care, community, and government institutions to be early recipients of the benefits of the information age.**

7. It is the policy of the Commission to provide a competitively neutral universal service mechanism which will minimize market distortions. The mechanism must provide for competitive provisioning of basic service, access to universal service funds, and a funding source which is broad-based and sustainable.

B. Objectives:

1. It is the objective of the Commission to develop a fully operable, competitively neutral universal service financing source and distribution mechanism no later than January 1, 1997. The funding mechanism must provide efficiency incentives to significantly reduce the aggregate subsidy required for universal service over time.

2. It is the objective of the Commission to adopt universal service policies which allow education, health care, community and government institutions to be in a position that allows them to be early recipients of the benefits of the information age.

3. **It is the objective of the Commission to improve the subscribership rate of basic service to all customer groups, including low income, disabled, non-white, and non-English speaking households, by means of the following mechanisms:**

   a. **All LECs and CLCs shall be responsible for pursuing the objective of achieving a 95% subscribership rate among all customer groups, including low income, disabled, non-white, and non-English speaking households, in their service territories.**

   b. **LECs and CLCs shall have the flexibility to develop innovative strategies to contribute to the attainment of this objective.**

   c. In service territories where there is a substantial population of non-English speakers, a carrier's efforts to communicate with such customers in their native languages shall be a factor that the Commission considers in assessing each local carrier's contribution to pursuit of universal service targets.

4. BASIC SERVICE

A. Carriers providing local exchange residential service shall, at a minimum, provide all elements of basic service, except as provided for in Rule 4.C. below.

B. Basic service includes the following service elements:

1. access to single party local exchange service;

2. access to all interexchange carriers offering service to customers in a local exchange.

3. ability to place calls;

4. ability to receive free unlimited incoming calls;

5. free touch tone dialing;

6. free and unlimited access to 911/E911;

7. access to local directory assistance, and access to foreign NPAs;

8. Lifeline rates and charges for eligible customers;

9. customer choice of flat or measured rate service;

10. free provision of one directory listing per year as provided for in D.96-02-072;

11. free white pages telephone directory;

12. access to operator services;

13. voice grade connection to public switched telephone network;

14. free access to 800 or 800-like toll free services;

15. one-time free blocking for information services and one time billing adjustments for charges incurred inadvertently, mistakenly, or that were unauthorized;

16. access to telephone relay service as provided for in PU Code § 2881;

17. free access to customer service for information about ULTS, service activation, service termination, service repair and bill inquiries.

C. The seventeen smaller LECs shall be exempted from the basic service element that they be required to offer customers the choice of flat or measured rate service, unless the smaller LECs currently offer that option.

D. Periodic Review of Basic Service

1. Except as provided for in paragraph 2 below, petitioners may petition for review of the service elements which make up basic service three years after the conclusion of a review of basic service. The adoption of final universal service rules in this proceeding (R.95-01-020 and I.95-01-021) will constitute the first review of basic service. The petition shall be filed on or before the 180th day before the review date.

2. Petitioners may petition the Commission to review the service elements which make up basic service at any time provided that the petitioner makes a prima facie showing that at least three of the four criteria contained in paragraph 3 below have been met. Petitions for review will be acted upon in accordance with subdivisions (c), (e), (f), (g). and (h) of Rule 47 of the Commission's Rules of Practice and Procedure.

3. In evaluating whether service elements should be added to or deleted from basic service the Commission will consider the following criteria:

   a. the service is essential for participation in society;

   b. a substantial majority, 65%, of residential customers subscribe to the service. Assess the following:

      (1) availability of the service;

      (2) the degree to which the service has been promoted by the carrier;

      (3) the level of customer education which has been provided for the service;

      (4) the communities which are presently being targeted for marketing and use of the service.

   c. the qualitative and quantitative benefits of adding the service outweigh the costs;

   d. availability of the service, or the number of subscribers would not increase without intervention.

5. UNIVERSAL LIFELINE TELEPHONE SERVICE (ULTS)

A. Carrier Responsibilities

1. All carriers providing eligible low income customers with residential basic service, as defined in rule 4.B. shall have access to the ULTS fund.

   a. Carriers are required to inform customers of the option for ULTS service when customers first inquire or sign up for basic exchange service, and annually thereafter.

   b. A carrier's ULTS rates shall be set in accordance with Public Utilities Code Section 874 and General Order (GO) 153, and in no event, shall the carrier charge more than the statewide ULTS rate, as set by the Commission.

   c. Carriers, on a per ULTS customer basis, shall be entitled to collect from the ULTS fund, the difference between their tariffed rate for other residential customers for the corresponding service, and their ULTS rate.

   d. Carriers must serve each eligible customer requesting Lifeline service within the carriers' specified serving area.

   e. Pursuant to provisions established in GO 153, Resolution T-15826, and the workshops held on April 3, 4, and 5, 1995, carriers shall submit the required "monthly report and claim statement" for reimbursement. In addition to the information required by GO 153, Resolution T-15826, and the April 1995 workshops, the monthly report shall include the number of ULTS customers served that month. The ULTS customer categories shall indicate the number of ULTS customers with measured service, and those with flat rate service.

2. Individual carriers will no longer be able to claim reimbursement for its marketing expenses asociated with the ULTS program except as provided for below:

   a. ULTS advertising campaigns, outreach activities, and related marketing expenses, that are the subject of existing contracts which call for the continued display or commercial air time of the advertising medium, or other continuing ULTS activities, after the effective date of this decision, shall continue to be reimbursed by the ULTS fund for the period called for in the contract or until three months from the effective date of this decision, whichever occurs first. It is our intent that there will be

no carrier specific ULTS reimbursement for these kinds of activities after the third month from the effective date of the decision adopting this rule.

B. ULTS Funding Source

1. All telecommunications carriers are required to charge the appropriate ULTS surcharge, as set by the Commission, on all end users of telecommunications services, and to remit such monies to the ULTS program.

2. The services excluded from the collection of the ULTS surcharge are those set forth in D.94-09-065 and D.95-02-050, specifically: ULTS billings, coin-sent paid calling, debit card messages, one-way radio paging, usage charges to COPTs, customers receiving services under existing contracts that were executed on or before September 15, 1994 and directory advertising.

6. <u>THE CALIFORNIA HIGH COST FUND-B</u>

A. Identifying The Cost To Serve High Cost Areas

1. CHCF-B subsidies will vary according to the cost of providing service within a GSA.

2. The GSA is used for the purposes of identifying the cost of providing universal service to a particular area. A CBG shall serve as the GSA.

3. Costs for providing customers with basic service in individual GSAs will be determined by factors which serve as proxies for the characteristics associated with costs, including, but not limited to, population density and average loop length. The methodology for determining proxy costs and the initial proxy factors will be developed in the Cost Proxy Model.

4. The five large and mid-size LECs shall be included in the CHCF-B. The seventeen smaller LECs shall be excluded from the CHCF-B, and instead are eligible for high cost support through the CHCF-A. The mid-size LECs can:

   a. develop forward looking cost studies of their own; or

   b. select the proxy costs developed by one of the large LECs.

5. A GSA will be considered a high cost GSA if the cost of serving residential customers in that GSA is above the statewide average cost as generated by the CPM.

B. Carrier Responsibilities

1. Carriers shall report the following information to the Telecommunications Division on a monthly basis:

   a. The number of eligible residential basic service lines being served by the carrier in each high cost GSA. An eligible residential basic service line is a line that is used to provide service to a residential customer in a high cost GSA.

   b. The rates for residential basic service the carrier is charging in each high cost GSA.

   c. A calculation of the subsidy amount that the carrier is claiming for providing its residential customers with basic service in each high cost GSA.

   d. Such other information as may be required by the Commission.

C. Subsidy Applicability

1. The CHCF-B will apply only to residential basic service, priced at the tariffed rate, in high cost GSAs. Only one residential line per household shall be subsidized. For purposes of this rule, the term "household" shall have the same meaning as provided for in General Order 153. Carriers shall be required to obtain from their high cost area customers, a certification, in a form to be prescribed by the Commission, that the household is not presently receiving residential basic service through any other telecommunications carrier.

2. The subsidy that a designated COLR shall be entitled to will be based on the following:

   (a) The benchmark will be defined as the greater of the statewide average cost as determined by the CPM, or the incumbent's flat rate plus EUCL.

   (b) If the per line cost of serving a CBG exceeds the benchmark, the COLR will receive the difference between the benchmark and the per line CPM cost estimate for the CBG.

   (c) In areas where the incumbent's flat rate plus EUCL is less than the benchmark, the COLR will receive the difference between the benchmark and the incumbent LEC's flat rate plus EUCL, in addition to the subsidy described in subdivision (2) above.

(d) The COLR's draw from the CHCF-B will be offset by the COLR's revenue per subsidized line from the CCLC and the federal Universal Service Fund. The amount of the offset will not exceed the amount of subsidy the carrier would have received without the offset.

3. The incumbent LECs shall adjust the prices of all services, other than basic service and rates covered by contracts that were executed on or before September 15, 1994, downward in an equal amount across all of those services to reflect the receipt of the explicit subsidy through the CHCF-B. The downward adjustment shall equal the subsidy support received by the incumbent LEC from the CHCF-B.

4. The Commission shall periodically review the subsidy in each GSA. The initial review shall take place in three years from the date of the establishment of the fund, and every three years thereafter.

   a. The review process may be in the form of an auction mechanism, with specific auction mechanism rules to be developed at a later time.

D. Carrier of Last Resort

1. All of the incumbent LECs listed in Attachment A of these rules shall be designated as the COLR in all their respective service areas at least until such time that another carrier or carriers are designated as the COLR.

2. Other qualified CLCs may seek to become a designated COLR, or to compete in a GSA without being designated a COLR.

3. Only designated COLRs shall have access to the CHCF-B subsidy based on the number of residential customers that it serves in high cost GSAs.

4. Designated COLR NOI: Those CLCs seeking to be designated a COLR shall file an advice letter in compliance with GO 96-A, stating that the carrier intends to be designated a COLR. The advice letter shall become effective in 40 days from the date of filing, unless a protest to the advice letter is filed. The advice letter shall contain a statement of the following, which the Commission will consider in deciding whether the COLR status should be granted:

   a. the facilities the carrier has in place or the arrangements that the carrier plans to enter into in order to provide basic service;

b. the ability of the carrier to promote the goals of universal service to all customer segments throughout the COLR's service area.

5. A designated COLR shall be required to serve all customers upon request, both residential and business, who are located within the COLR's designated service area as specified in subsection 6. below.

6. A designated COLR shall be required to serve the following:

   a. Until such time as provided for in rule 6.D.1. above, all incumbent LECs, in order to avail themselves of the subsidy for a high cost GSA, shall be required to serve all the high cost GSAs that are within the incumbent LEC's existing exchange area boundaries;

   b. All CLCs who are designated COLRs, in order to avail themselves of the subsidy for a particular high cost GSA, shall be required to serve the entire GSA(s) that is (are) within the CLC's designated service territory for which it has elected COLR status.

7. A designated COLR may opt out of its obligations in a GSA by advice letter, unless it is the only carrier remaining in the GSA, in which case it must file an application to withdraw as the COLR, and continue to act as the COLR until the application is granted or a new COLR has been designated as a result of an auction.

E. Competitive Bidding To Serve As The COLR

1. If there is only one carrier in a GSA and that carrier has filed an application to withdraw as the COLR in that GSA, and no other provider is willing to assume the COLR responsibility at the current subsidy level:

   a. The Commission will initiate an auction whereby service providers shall bid on the amount of subsidy each would require to operate as the COLR. Such auction will be held within 180 days from the time the application to withdraw as the COLR is filed.

   b. The qualified bidder who places a bid representing the lowest amount of subsidy required to offer service in the GSA would become the subsidized COLR for a period of three years. Competitive entry would be allowed, but only 1/2 the subsidy would be available to the competitor.

2. A COLR who loses the bid shall have the option to sell its facilities in the area to any interested party.

3. 180 days prior to the expiration of the three-year COLR obligation, all carriers desiring to become a designated COLR in the GSA shall file applications stating their intention to become the designated COLR for that particular service area. The Commission will then determine whether the same designated COLR should be retained at the current subsidy, whether multiple carriers of last resort should be permitted and at what subsidy amount, or if another auction should be held.

F. Funding The CHCF-B

1. The Commission will require all end users of telecommunications services to pay the CHCF-B surcharge except for: ULTS billings, coin-sent paid calling, debit card messages, one-way radio paging, usage charges to COPTs, customers receiving services under existing contracts that were executed on or before September 15, 1994 and directory advertising.

2. All telecommunications carriers are required to charge the appropriate CHCF-B surcharge, as set by the Commission, on all end users of telecommunications services in accordance with Rule 6.F.1. above.

3. The Commission shall be the administrator of the CHCF-B mechanism until such time the Commission may decide otherwise.

4. The Commission will calculate each carrier's support from the CHCF-B and distribute the appropriate amount to the carriers.

G. Distributing The CHCF-B In A Resale Environment

1. If resale of basic exchange service or loops is allowed, the subsidy for residential basic exchange service for that customer shall be treated as follows:

   a. If the price of the service or facility resold is below its cost, the underlying facilities based provider receives the subsidy for the services sold.

   b. If the price of the service or facility resold is market based or based upon actual deaveraged costs, then the carrier who sells basic exchange service to the end-user residential customer shall receive the subsidy, provided that the basic residential service is priced at the affordable (but below cost) price set by the Commission.

7. UNIVERSAL SERVICE WORKING GROUP

A. The Commission shall form the Universal Service Working Group (USWG).

B. The purpose of the USWG shall be to address ways in which access and deployment of advanced telecommunications technologies can be provided to all customer segments, and how education, health care, community, and government institutions can be positioned to take advantage of these technologies.

C. The Steering Committee of the USWG shall be composed of 24 members. There shall be eight representatives from the telecommunications industry, representing a spectrum of telecommunications carriers. There shall be two representatives each from the following kinds of concerns: education, health care, community, libraries, and local government; for a total of ten representatives. There shall be two representatives from the business sector, two representatives from this Commission, one representative from the disabled community, and one representative from another state agency.

D. The USWG will be funded at $250,000 per year for a period of two years from monies in the California Teleconnect Fund. These funds are intended to provide administrative support, and reimbursement for a participant's reasonable expenses related to their participation in the USWG. Absent Commission action, the USWG shall terminate on December 31, 1998.

4. The Steering Committee of the USWG shall prepare an annual report of a summary of the USWG meetings, their objectives, the issues raised, their accomplishments, and their recommendations. The report shall be submitted to the Commission, and forwarded by the Commission to the Legislature for their information.

8. DISCOUNTS TO CERTAIN ENTITIES

A. In response to the Telecommunications Act of 1996, and the principles expressed in AB 3643, a program of rate discounts for certain kinds of qualifying entities shall be created and funded through the California Teleconnect Fund. Nothing in this rule precludes a carrier from offering a larger discount than what is provided for in this rule.

B. Qualifying schools and libraries shall be entitled to a discounted rate for measured business service, switched 56, Integrated Services Digital Network (ISDN) service, T-1 service, and DS-3, or their functional equivalents, and such other services that the Federal Communications Commission (FCC) may determine are appropriate.

(1) Only public or nonprofit schools providing elementary or secondary education, and which do not have endowments of more than $50 million, shall qualify for the discounted rates for schools.

(2) Only those libraries that are eligible for participation in state-based plans for funds under Title III of the Library Services and Construction Act (20 USC §335c et seq.), shall qualify for the discounted rates for libraries.

(3) All carriers offering the services listed in subdivision B. above, shall provide in their tariffs that the rates for qualifying schools and libraries for such services shall be 50% below the rates charged to other businesses for those services.

(4) There is no limit on the number of subsidized lines that a school or library can have.

C. Qualifying municipal and county government owned and operated hospitals and health clinics shall be entitled to a discounted rate for switched 56, ISDN, T-1, and DS-3, or their functional equivalents.

(1) All carriers offering the services listed in this subdivision, shall provide in their tariffs that the rates for qualifying government owned hospitals and health clinics for such services shall be 20% below the rates charged to other businesses for those same services, or their functional equivalents.

D. Qualifying community based organizations (CBOs) shall be entitled to a discounted rate for switched 56, ISDN service, and T-1, or their functional equivalents.

(1) Only a tax exempt organization offering health care, job training, job placement, or educational instruction, shall qualify for the discounted rates for CBOs. A "tax exempt organization" shall refer to an organization described in Section 501(c)(3) or 501(d) of the Internal Revenue Code, Title 26 of the United States Code.

(2) In order to qualify for the CBO discount, the CBO must provide proof at the time of application that it is a tax exempt organization, and that it offers health care, job training, job placement, or educational instruction.

(3) All carriers offering the services listed in this subdivision, shall provide in their tariffs that the rates for qualifying CBOs for such services shall be 25% below the rates charged to other business for those same services, or their functional equivalents.

(4) The CBO shall be limited to a total number of: two switched 56 lines or their functional equivalents; two ISDN lines or their functional equivalents; one switched 56 line or its functional equivalent and one ISDN line or its functional equivalent; or one T-1 line or its functional equivalent.

E. Carriers who provide the above-referenced entities with those discounted services shall receive a subsidy for each qualified entity that it serves. The subsidy amount shall be: (1) the difference between the tariffed rate for businesses for such services, and the tariffed discount rate; or (2) if the rate negotiated is below the tariffed discount rate, the carrier shall be entitled to the sum that represents the percentage discount off of the negotiated rate.

F. These discounted rates may not be resold to, or shared with, any other non-qualifying entity or person.

G. Funding The California Teleconnect Fund

1. The Commission will require all end users of telecommunications services to contribute to the California Teleconnect Fund except for: ULTS billings, coin-sent paid calling, debit card messages, one-way radio paging, usage charges to COPTs, customers receiving services under existing contracts that were entered into on or before September 15, 1994, and directory advertising.

2. All telecommunications carriers are required to charge the appropriate California Teleconnect Fund surcharge, as set by the Commission, on all end users of telecommunications services in accordance with Rule 8.G.1. above.

3. The Commission shall be the administrator of the California Telconnect Fund until such time the Commission may decide otherwise.

4. Carriers supplying telecommunications services to qualifying institutions and organizations at discounted rates shall report the information required by the Commission to the Telecommunications Division on a monthly basis.

5. The Commission will calculate each carrier's support from the California Teleconnect Fund, and distribute the appropriate amount to the carriers.

9. CONSUMER INFORMATION RULE

A. The Commission shall compile an annual report that summarizes the complaint history of each certificated carrier, and any open investigations into such carrier. Such report shall be made available to the public.

B. All LECs and CLCs must provide the applicable information contained in subsection C. below to residential consumers: (1) whenever any marketing information regarding telecommunications service offerings described in the matrix is mailed to residential customers; or (2) upon request by a consumer. The required consumer information must be on a separate sheet, and contain the following statement at the beginning: "The following information is required by the California Public Utilities Commission to allow comparisons with rates charged by other carriers for the same type of service."

C. The required consumer information shall consist of the following:

"The following information is required by the California Public Utilities Commission to allow comparisons with rates charged by other carriers for the same type of service.

[NAME OF CARRIER]

1. LOCAL CALLS: [Name of Carrier] local calling area consists of any calls within a ___ mile radius of the rate center for your location.

SERVICE	DESCRIPTION OF SERVICE	INSTALLATION FEE	COST PER MONTH	COST PER MINUTE
Flat Rate Service	A set monthly rate for unlimited local calling in your local calling area.	$_____	$_____	N/A
Measured Rate Service	A reduced monthly rate plus per-minute charges for each local call above a minimum $____ allowance.	$_____	$_____	After $_____ 1st min./each addit. min. Day: ___/___ Evening: ___/___ Night/ Weekend: ___/___
Universal Lifeline Telephone Service	Low priced service for qualifying customers on a limited income.	$10.00 Limited to 1 installation per year.		(ULTS)
o Flat Rate ULTS	Unlimited local calling		[Not to exceed $5.62]	N/A
o Measured Rate ULTS	60 untimed local calls. After 60 calls, a per call charge of ____ cents.		[Not to exceed $3.00]	After 60 calls: ___ cents

2. TOLL CALL/INTRALATA TOLL CALL: A toll call, or what is sometimes referred to as intraLATA toll call, consists of any call made beyond your local calling area, but within your Local Access Transport Area (LATA).

SERVICE	DESCRIPTION OF SERVICE	INSTALLATION FEE	COST PER MONTH	COST PER MINUTE
IntraLATA Toll Call	A call made beyond your local calling area, but within your LATA.	N/A	N/A	[carrier to describe rate structure by variables used such as time, distance, charge for first minute and each additional minute.] *

3. LONG DISTANCE CALLS/INTERLATA CALLS: A long distance call, or what is sometimes referred to as an interLATA call, consists of a call made outside your LATA.

SERVICE	DESCRIPTION OF SERVICE	INSTALLATION FEE	COST PER MONTH	COST PER MINUTE
InterLATA Toll Call	Calls made outside your LATA.	N/A	N/A	[carrier to describe rate structure by variables used such as time, distance, charge for first minute and each additional minute.] *

4. OTHER CHARGES:

CHARGE	WHEN ASSESSED	AMOUNT
Late Payment Charge	Payment not received by due date.	$_____
Returned Check Charge	Customer's check returned to the carrier from the bank.	$_____
Switching Fee	Charge for changing long distance carrier.	$_____
Reconnect Charge	Charge for reconnecting service after service has been terminated for late payment.	$_____

*This informational brochure does not reflect the prices associated with the various kinds of discount calling plans that might be offered.

Price information current as of [month, date, and year]."

ATTACHMENT A

Calaveras Telephone Company
California-Oregon Telephone Company
Citizens Telecommunications Company of California Inc.
Contel of California, Inc.
CP National[1]
Ducor Telephone Company
Evans Telephone Company
Foresthill Telephone Company
GTE California Incorporated
GTE West Coast Incorporated
Happy Valley Telephone Company
Hornitos Telephone Company
Kerman Telephone Company
Pacific Bell
Pinnacles Telephone Company
The Ponderosa Telephone Company
Roseville Telephone Company
Sierra Telephone Company, Inc.
Siskiyou Telephone Company
Tuolumne Telephone Company[2]
The Volcano Telephone Company
Winterhaven Telephone Company

(END OF APPENDIX B)

1 Now known as Citizens Telecommunications Company of the Golden State.
2 Now known as Citizens Telecommunication Company of Tuolumne

APPENDIX C

Impact of Changes on Pacific Bell's Initial Estimate of Subsidy Amount

Modification To CPM	Incremental Change In Subsidy ($ millions)	Percent Decrease	Per Line
Original Pacific Bell Estimate ($1,720 million)	None		
Feeder and Pair Gain Utilization	$64	3.7%	$0.42
Fiber/Copper Feeder Cut Off at 12,000 feet	78	4.5%	0.51
Revised A&B Cable Costs	48	2.8%	0.31
Conduit Cost	40	2.3%	0.26
Outside Plant Adjustment Elimination	37	2.2%	0.24
Non-Recurring Burden Adjustment	43	2.5%	0.28
Repair and Maintenance Productivity Adjustment	46	2.7%	0.30
Rearrangements Adjustment	170	9.9%	1.10
Directory Assistance Adjustment	50	2.9%	0.32
Shared Cost	282	16.4%	1.84
Common Cost	118	6.9%	0.77
Only Price Cap LECs	$54	3.2%	NA
Cumulative Effect of Cost Related Adjustments	**$988**	60.5%	

	Compared to Cumulative Effect of Cost Related Adjustments
Single Line Adjustment	**$128**

Note: The per line column is calculated using the total number of lines including lines for small, non-price cap local exchange carriers.

Initial Subsidy Amount by Company

Statewide Average Cost Benchmark: $20.30

First Lines Only

Company (A)	Total Lines (B)	CPM Estimated Subsidized Lines (C)	Basic Rate/Line (D)	Cost/Subsidized Line (E)	Annual Subsidy Pre-Offset (F)	Effective Rev/Line (G)	Offset (H)	Annual Subsidy Post Offset (I) = (F) - (H)
CTCC	59,926	42,649	21.35	33.94	6,441,920	35.36	3,928,518	2,513,402
Contel	278,198	224,556	20.35	30.79	28,139,107	25.55	11,039,431	17,099,676
GTEC	2,685,264	1,048,508	20.75	25.54	60,301,563	24.20	33,836,507	26,465,056
Pacific	9,620,458	2,671,814	14.75	25.28	337,620,588	15.76	32,382,391	305,238,196
Roseville	68,421	40,199	20.35	25.93	2,287,771	26.97	1,772,298	515,473
Total	12,712,267	4,027,727			434,790,949			**351,831,804**
Surcharge								**2.87%**

(B) Total Lines estimated by the CPM.

(C) Estimated Subsidized Lines includes First Lines in CBGs above the Benchmark.

(D) Basic Rate = Flat Rate + End User Common Line Charge.

(G) Effective Rev = Flat Rate + EUCL + Federal Carrier Common Line Charge per Residential and Single Line Business Line + Federal Universal Service Fund per Total Access Lines.

(H) Offset reduces subsidy by the amount of revenue collected for subsidized lines from the CCLC and USF. This offset is capped at the total cost of the CBG.

(END OF APPENDIX D)

Calculation of Surcharges

	Fund Amount (millions)	Surcharge
California High Cost Fund		
California High Cost Fund A*	*$26.66*	*0.27%*
California High Cost Fund B	$351.83	2.87%
Total California High Cost Fund	$378.49	3.09%
California Teleconnect Fund		
Schools and Libraries	$40.00	0.33%
Community Based Organizations	$5.00	0.04%
Health Care	$5.00	0.04%
Universal Service Working Group	$0.25	0.00%
Total California Teleconnect Fund	$50.25	0.41%
California Relay Service and Communications Device Fund*	*$43.04*	*0.36%*
Universal Lifeline Telephone Service*	*$383.0*	*3.20%*
Total For California Universal Service Programs	*$854.8*	*7.06%*

*: California High Cost Fund A, California Relay Service and Communications Devices Fund and Universal Lifeline Telephone Service Fund 1996 budgeted expenditures and surcharge rates are provided for illustrative purposes, actual 1997 levels will differ.

(END OF APPENDIX E)

List of Appearances

Respondents: Michael Hurst, and McCutchen, Doyle, Brown & Enersen, by Alfred C. Pfeiffer, Jr., for AT&T Communications of California, Inc.; AT&T Wireless Services, Inc., by J. Walter Hyer III, Davis Wright Tremaine, by Daniel M. Waggoner, Joseph S. Faber, and Mark P. Trinchero, for Alpine CA-3, L.P., Chico MSA Cellular, Inc., Fresno Cellular Telephone Company, Oxnard Cellular Telephone Company, McCaw Communications of Stockton, Inc., Redding Cellular Partnership, Sacramento Cellular Telephone Company, and Santa Barbara Cellular Systems Ltd.; Pillsbury Madison & Sutro, by Mary B. Cranston, and Megan W. Pierson, and Walter J. Sleeth, for Airtouch Cellular, Los Angeles SMSA Limited Partnership, Sacramento-Valley Limited Partnership, and Modoc RSA Limited Partnership; Beck & Ackerman, by Jeffrey F. Beck and Jillisa Bronfman, for CP National, Evans Telephone Company, GTE West Coast.Incorporated, Kerman Telephone Company, Pinnacles Telephone Company, The Siskiyou Telephone Company, Tuolumne Telephone Company, and The Volcano Telephone Company; Cooper, White & Cooper, by Alvin H. Pelavin, E. Garth Black, Mark P. Schreiber and Sean P. Beatty, for Calaveras Telephone Company, California-Oregon Telephone Company, Ducor Telephone Company, Foresthill Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Ponderosa Telephone Company, Sierra Telephone Company, and Winterhaven Telephone Company; Citizens Utilities Company, by Susan M. Redner, Jacqueline R. Kinney, and Barbara L. Snider, for Citizens Telecommunications Company of California Inc., Citizens Telecommunications Company, dba Citizens Long Distance, Electric Lightwave, Inc., Citizens Telecommunications Company of Tuolumne, and Citizens Telecommunications Company of the Golden State; Orrick, Herrington & Sutcliffe, by Robert J. Gloistein, for Contel of California, Inc.; Elaine M. Lustig, Kathleen S. Blunt, and Ondrea Dae Hidley, for GTE California Incorporated; Cindy Z. Schonhaut, and the Law Offices of Earl Nicholas Selby, by Earl Nicholas Selby, for ICG Access Services, Inc.; William C. Harrelson, for MCI Telecommunications Corporation; Marlin D. Ard, and Timothy S. Dawson, for Pacific Bell; Cooper, White & Cooper, by E. Garth Black, Mark P. Schreiber and John M. Ross, for Roseville Telephone Company; Teresa Marrero, Michael Morris, Karen Notsund, and Davis Wright Tremaine, by Joseph S. Faber, and Traci Bone, for Teleport Communications Group, Inc.

Interested Parties: Mitchell, Silberberg & Knupp, by Alan L. Pepper, for California Alarm Association; Glenn Semow and the Law Office of Peter A. Casciato, by Peter A. Casciato, for California Cable Television Association; Virginia J. Taylor, and Richard A. Elbrecht, for California Department of Consumer

Affairs; Sharon Haynes-Creswell, and Jeff Kositsky, for California/Nevada Community Action Association; William C. Harrelson, Thomas J. Long, Michael Morris, Alfred C. Pfeiffer, Jr., and Glenn Semow, for California Telecommunications Coalition; Stanley W. Hulett, for Californians for Advanced and Affordable Telecommunications; Wright & Talisman, by Michael B. Day, Jeanne M. Bennett, and Jerome F. Candelaria, for Cellular Carriers Association of California; Ken McEldowney, for Consumer Action; Dhruv Khanna, for Intel Corporation; Edward J. Perez, for City of Los Angeles; Swidler & Berlin, Chartered, by Andrew D. Lipman, and Russell M. Blau, for MFS Communications Company, Inc.; Public Advocates, Inc., by Mark Savage, Carmela Castellano, and Abigail Trillin, for Southern Christian Leadership Conference, National Council of La Raza, Korean Youth and Community Center, Filipinos for Affirmative Action, Filipino Civil Rights Advocates, Association of Mexican-American Educators, California Association for Asian-Pacific Bilingual Education, California Association for Bilingual Education, California Rural Indian Health Board, Chicano Federation of San Diego County, Council for the Spanish Speaking, El Proyecto del Barrio, Escuela de La Raza Unida, Foundation Center for Phenomenological Research, Hermandad Mexicana Nacional, Korean Community Center of the East Bay, Lawyers' Committee for Civil Rights of the San Francisco Bay Area, Motivating Adolescents to Succeed, Mountain View Community Health Center, Multicultural Area Health Education Center, Spanish Speaking Citizen's Foundation, and Spanish Speaking Unity Council; Armando Valdez, for Telecommunications Education Trust; Law Office of Peter A. Casciato, by Peter A. Casciato, for Time Warner Communications, Inc.; Thomas J. Long, for Toward Utility Rate Normalization; Office of the Judge Advocate General, by Robert N. Kittel and Cecil O. Simpson, Jr., for the United States Department of Defense and all other Federal Executive Agencies; Jacquelyn Brand, and Markham & Oshiro, by Carl K. Oshiro, for Universal Service Alliance; Michael Shames, and Lisa Briggs, for Utility Consumers' Action Network.

Commission Advisory and Compliance Division: Jonathan Lakritz, Brian Roberts, and Cory Texeira.

Division of Ratepayer Advocates: Rufus G. Thayer, Patrick S. Berdge, Janice Grau, Ira Kalinsky, Helen M. Mickiewicz, and Angela Young.

(END OF APPENDIX F)

D.96-10-066
R.95-01-020/ I.95-01-021

Commissioner Josiah L. Neeper Dissenting

I dissent in part, but only in part, from the Order adopted by the majority. I dissent to that part of the decision providing for a subsidy to educational, community and health care facilities for particular telephone services. The subsidy will be funded by ratepayers. In my view, there is insufficient statutory or record support for the program. There is no definition of the need the program is to satisfy. There is no mention of any point in time when need will be satisfied and the subsidy can be ended. There is no limitation against the subsidy growing over time. There is no explanation as to what extent schools and libraries budgets need to be supplemented beyond what the Boards of schools and libraries decide to provide.

Underlying this issue is my belief that the Commission has no business under its existing jurisdiction to engage in what amounts open-ended subsidization of chosen social programs or entities. What the Commission is doing is taxing the public. If the basis for these subsidies is embodied in AB 3643, I fail to see it the way the majority Order describes it. The statute does not say that we establish a dollar-based incentive program for these groups. Nor does it say that we periodically review the funding level to determine increasing the spending.

The statute simply says these entities must be positioned to be early recipients of the benefits of the information age. These entities are positioned to be early recipients. Schools, libraries and health care facilities have capital and operating budgets. They have established revenue sources. Their Boards decide how to spend their revenues and determine what revenues to raise. They can and do decide what to spend to be early recipients of the benefits of the information age.

If the Legislature wanted the Commission to provide discounts and subsidies to schools, libraries, community based organizations (CBOs), and health care facilities, I would expect the legislative language in the statute to have said that in plain terms. It does not. The Telecommunications Act of 1996 does not at this time provide a basis for the discount levels. The Federal Communications Commission (FCC) has yet to act.

Requiring telecommunications customers to finance the connection of schools and libraries to the "information highway" is a controversial idea not because the idea is inherently unacceptable to the public but because of questions, among others, as to who will carry the burden of cost. The idea is ambitious and imaginative. It is also complex. Apparently, the FCC may establish a federal program requiring carriers to spend as much as $2.0 billion on discounts for schools and libraries to provide T-1 and high speed data services which are essentially the same type of services the Universal Service Order discounts. When and if the FCC adopts a proposal, will Californians be required to pay their share of that subsidy as well? The answer is, in all likelihood, yes. Will the $50 million subsidy proposed by this decision partly offset the amount that will be required of Californians to pay, or are the two subsidies separate and unrelated? The majority Order is silent on this issue. When the matter is decided my expectation is that Californians will be required to make contributions to fund the federal program as well. It is under these uncertain and unknown circumstances the majority has adopted an order that appropriates funds for the California Teleconnect Fund.

The majority decision epitomizes to me the fallacy of certain publicly funded social programs whose goals may be desirable, but because of lack of a connection between need and mitigating policies, the need is never satisfied and the mitigation, often throwing money at projects, results in self-sustaining ever-expanding public expenditures. In this regard, I find the $50 million fund -- which is bound to balloon over time -- lacking in in the following areas:

(1) This Order did not benefit from inputs by the governing bodies (including the State of California) and the potential beneficiaries of the program. In fact, there is no evidence in this case from schools and libraries that shows whether any efforts have been undertaken by the beneficiaries to be connected to advanced telecommunications network. The subsidy for these entities is determined by this Order without direct knowledge of the amount needed for subsidy.

(2) The Order, without justification, excludes for-profit schools while it offers a 50% discount to public schools and non-profit schools including those run by religious orders as long as they do not receive endowments in excess of $50 million. In this regard, the order appears unfair to a class of students.

(3) The Order fails to consider the extent to which competition for these segments of the market will be affected by the adoption of a subsidy program. For example, the 50%, 25%, and 20% discounts (for schools, CBOs, and health care facilities, respectively) have no cost basis.

(4) It is uncertain what services the FCC will require states to discount for schools and libraries because the FCC is still awaiting the recommendations from the Joint Board.

(5) The Order imposes social program obligations on carriers under the guise of regulatory compliance by requiring them to process and validate qualifying entities for these subsidies - which is a function outside of their normal business calls - and imposing a monthly reporting requirement in order to claim reimbursements.

(6) The Order does not define to what extent telecommunications customers should be encumbered with surcharges to finance the teleconnect fund leaving all options including elevation of the surcharge open for future consideration.

(7) Our legislative authorization for this subsidy program, if it exists, is time constrained. We are authorized to position the recipients to be "early" recipients. "Early" lasts for a few years, not forever.

The Order adopted by the majority has increased the fund for the program by 150% from the amount in the original proposed decision. This was done without any additional justification either for the increased fund or the additional recipients. To my puzzlement, I find no more justification for the $30 million increase in the fund than what existed for the $20 million total subsidy proposed in the proposed decision. This is

troubling all the more because the decision implies that the $50 million fund is an initial level of funding, which means subsequently the fund is subject to be reviewed and increased as needed. I suppose this is a fair assessment given three factors: (1) the subsidy amount is not capped, (2) there is no mention in this decision of any desire to reduce the subsidy amount for these purposes in the future, and (3) the type of subsidy the decision proposes to establish is, by its very nature, expected to balloon over time due to the resource -intensive nature of this subsidy.

What is lacking in this effort is a legal and record basis to establish a discount fund in the first place, let alone to open an uncapped, undefined sinking fund mechanism that essentially is a tax on the consuming public. In this manner, it appears to me that the Commission has taken the task, on its own, to "teleconnect" California schools without due consideration to alternative ideas, and the specifics of the program's implementation.

As such programs go, if no limit is set, I see no end to the demand schools, libraries, hospitals, and CBOs will place on a growing and more complex telecommunications market.

For all the above reasons, I will dissent in part.

/s/Josiah L. Neeper
Josiah L. Neeper
Commissioner

Sacramento, California
October 25, 1996