

*State Telecommunications Policy and Federal Requirements*

**Promoting Competition**

and

**Reforming Universal Service**



A Report

to the

WASHINGTON STATE LEGISLATURE

Required by ESSB 6622, Chapter 337, Laws of 1998

Prepared by the

Washington Utilities and Transportation Commission

November, 1998



## EXECUTIVE SUMMARY

Universal telecommunications service is the policy of providing access to the telephone network at an affordable price. In areas where the cost of providing service is very expensive, service is provided at a price to the customer that is below cost. Customers in low-cost locations pay above-cost prices so that every citizen can have access to the network. The estimated cost of service in Washington per month, by exchange, varies from a low of \$15.90 to a high of \$476.21 for customers served by non-rural telephone companies (GTE, U S WEST, and Sprint/United). The cost of service by rural carriers (all other local exchange carriers) is yet to be estimated, but some exchange costs will likely be found to be higher than \$476.00 per month. The totals are:

<b>Non-rural Carriers</b>	<b>Rural Carriers</b>
☐ Total Residence Lines.....2,354,144	☐ Total Residence Lines.....188,383
☐ Total Business Lines.....998,938	☐ Total Business Lines.....55,432
☐ Supported Residence Lines.....233,066	☐ Supported Residence Lines.....162,165
☐ Supported Business Lines.....19,171	☐ Supported Business Lines.....15,935
☐ Percent Lines Supported..... 8%	☐ Percent Lines Supported..... 73%

☛ Total Support - All Lines....\$70,282,014    ☛ Total Support - All Lines...\$55,000,000<sup>1</sup>

---

<sup>1</sup> In our Order Establishing Costs in Docket No. UT-970311(a), we determined present explicit state support is \$10 million and should be increased to \$15 million. Another \$40 million is explicit federal support. *See* WUTC Docket No. UT-970380, Joint Petition to the FCC of the WUTC and twenty rural telephone companies.

The total amount needed to support affordable service for customers in high-cost locations is estimated to be approximately \$125 million dollars. This amount is presently embedded in customer bills; no additional customer dollars are needed to maintain the present level of support for universal service.<sup>2</sup>

Universal service has been the policy in the nation and in Washington State for more than 60 years. Washington State reaffirmed its policy when the legislature adopted the Regulatory Flexibility Act in 1985 and again in 1998 with passage of ESSB 6622 (C 337, L 98). Congress reaffirmed universal service as a national policy with the adoption of the Telecommunications Act of 1996. This report presents a plan to keep telephone service affordable throughout the state.

The Legislature and Congress have also made promotion of competition in the local service market their policy, as they did previously with the long-distance market.

Universal service policies today are based on a monopoly service environment that is incompatible with competition. The introduction of competition requires changes in the way universal service is maintained. States do not have a choice between competition and universal service; federal and state law require the promotion of one and the preservation of

---

<sup>2</sup> Although we determined that utilizing cost studies (either embedded or proxy) for rural companies is not prudent at this time, we recognize that under either scenario total support may increase or decrease once all implicit support is determined and made explicit. Accordingly, the total for rural and non-rural carriers of approximately \$125

the other. This report presents a plan that will make universal service funds available to any carrier willing to compete for customers in high-cost areas.

This report, the Order Establishing Costs in Docket No. UT-970311(a), and the proposed rules for a state universal service program respond to the requirements of ESSB 6622. Combined, they represent a reformed program of universal service, make explicit the amount of implicit support customers currently pay to maintain universal service, and explain the policy options considered and chosen by the Washington Utilities and Transportation Commission (WUTC) in preparing the new program.

In this report, we recommend:

- ? Continuation of support for all lines in high-cost locations
- ? Determination of the cost of basic service at the local exchange level
- ? Adoption of a revenue benchmark to prevent cost-shifting
- ? Assessment of contributions from all technologies, including wireless
- ? Payments to all technologies providing service in high-cost locations
- ? Determination of contributions based on total end-user retail revenue
- ? Treatment of carrier contributions as a cost of doing business
- ? Preservation of universal service without increases in customer rates
- ? Non-disclosure of carrier contributions or complete, accurate disclosure
- ? Reductions in customer rates equal to carrier draws from the fund
- ? Establishment of a service quality requirement to draw from the fund
- ? Implementation reports to track progress toward program goals
- ? Delegation of authority from the Legislature to the WUTC
- ? Continued study of a minimum network data transmission speed of 28.8 Kbps

---

million is a best estimate.

These recommendations represent our effort to strike a balance where there is no consensus. Overall, the recommendations set the stage for fair competition that will permit all carriers and technologies to compete no matter their strengths and weakness while assuring the preservation of universal service.

As we developed these rules and this report over eight months, and presided over eight days of cost hearings, we have learned that there is no consensus on the issues facing telecommunications carriers and their customers. The lack of consensus means no easy decisions lie ahead. What does lie ahead is a dynamic period in which flexibility will be needed by the WUTC to maintain or change these rules as circumstances warrant. The most important recommendation we make is that the Legislature grant sufficient authority to the WUTC to implement this program and maintain it as the telecommunications industry continues through very changing times.

Finally, many interested parties and policy makers have asked if this is the time to make changes in universal service. The program today exists in a monopoly environment that is eroding and some day will no longer support universal service. Already, some carriers are disadvantaged by the requirement to support universal service while other carriers have the advantage of the full use of the telephone network with no obligation to contribute support to universal service. One group that is disadvantaged is consumers. Until universal service reforms are adopted, promotion of competition outside any but the most lucrative markets will not take place and customers will not see the benefits that

competition can bring. This is the best time to reform universal service, to remove both advantages and disadvantages experienced by carriers, and to deliver the benefits of competition to consumers.



**TABLE OF CONTENTS**

- I. INTRODUCTION
  - A. Progress in Universal Service ..... 1
    - 1. Purpose of Engrossed Substitute Senate Bill 6622 ..... (Ch
    - 2. Requirements of ESSB 6622 ..... 4
    - 3. The Report..... 4
  - B. No Easy Decisions Lie Ahead..... 6
    - 1. Competition and Consensus ..... 6
    - 2. Timing..... 7
    - 3. Change Will Benefit Consumers ..... 9
    - 4. Grant of Authority..... 9
  
- II. THE PROCESS..... 11
  - A. Process Followed Administrative Procedure Act ..... 11
    - 1. Broad Participation Sought..... 12
    - 2. Participation in the Adjudication ..... 13
    - 3. Legislative Oversight ..... 14
  - B. Schedule of Activities..... 15

IV.	BACKGROUND: FROM MONOPOLY TO COMPETITION .....	16
A.	<u>State and Federal Law Mandate Competition</u> .....	16
B.	<u>Universal Service and the Monopoly Utility Structure</u> .....	16
1.	<u>The Breakup of AT&amp;T and Long-Distance Competition</u> .....	18
2.	<u>Washington Adopts Regulatory Flexibility In Response</u> .....	
3.	<u>The Breakup of AT&amp;T and Competition in the</u> .....	<u>Loc</u>
C.	<u>The Federal Telecommunications Act of 1996,Local Competition and Universal Service</u>	
D.	<u>Universal Service and the Transition From Monopoly To Competition</u> .....	24
V.	A PROGRAM OF UNIVERSAL SERVICE.....	27
A.	<u>Competing Views of Goals for Universal Service</u> .....	27
1.	<u>Competition</u> .....	28
2.	<u>Support for One Line or All Lines</u> .....	29
	Chart 1 Comparison of Support Required for One Line v. All Lines.....	30
3.	<u>Support for All Lines Maintains the Status Quo</u> .....	31
4.	<u>Support for All Lines Avoids Administrative Costs</u> .....	33
B.	<u>Advanced Telecommunications and Information Services</u> .....	34
1.	<u>Network Capability Options</u> .....	36

2. Comments on Transmitting at 28.8 Kbps ..... 36

3. Discussion of 28.8 Kbps Transmission Speed .....

4. WUTC Position on 28.8 Minimum Transmission Speed .....

5. Discussion of 28.8 Kbps Transmission Speed .....

6. WUTC Position on 28.8 Minimum Transmission Speed .....

7. AReasonably Comparable@Standard..... 43

VI. The Size of the Fund Necessary to Maintain the Network..... 45

A. Wireline Cost of Supported Lines: Geographic Levels of Cost Determination46

1. Wireless Cost of Service..... 48

Chart 2 Exchange-by Exchange Estimated Annual  
Implicit Support.....49A-D

2. Affordability and Shared Costs ..... 51

B. Benchmark..... 53

1. Cost Benchmark ..... 53

2. Price Benchmark..... 54

3. Revenue Benchmark..... 54

4. Benchmark Discussion..... 55

5. WUTC Chooses Revenue Benchmark..... 57

C.	<u>Establishing a Benchmark</u> .....	58
1.	<u>Statewide Average Revenue Benchmark</u> .....	58
	Chart 3 Total Support Based on Competitive Effects on Revenue Per Line .....	58
2.	<u>Exchange-by-Exchange Benchmark</u> .....	59
3.	<u>Residential and Business Benchmarks</u> .....	60
4.	<u>A Single Wireless Revenue Benchmark</u> .....	61
D.	<u>Included Revenue</u> .....	62
1.	<u>Inclusion of Access Revenue</u> .....	63
E.	<u>How Much Should Implicit Support Be Minimized</u> .....	66
VII.	<u>CONTRIBUTIONS AND CONTRIBUTORS TO THE FUND</u> .....	68
A.	<u>Equitable and Nondiscriminatory Contributions</u> .....	68
1.	<u>Who Should Contribute</u> .....	68
2.	<u>Private Telecommunications Networks</u> .....	69
B.	<u>The Basis for Contributions</u> .....	70
1.	<u>Carrier Contributions Required by Law</u> .....	72
2.	<u>Taxation of Contributions</u> .....	74
3.	<u>Universal Service Not an Exceptional Cost</u> .....	of I
C.	<u>Information on Customer Bills</u> .....	75

D. Should Wireless Carriers Contribute ..... 77

E. Net Contributors and Net Recipients ..... 82

F. Implicit Support Reductions Required..... 84

Chart 4 Annual Carrier Contribution and Draw from Fund85

VIII. DISTRIBUTIONS FROM THE FUND..... 88

A. Eligible Telecommunications Carriers ..... 88

B. Geographic Service Areas and Promotion of Competition..... 91

1. Wireless Geographic Service Areas ..... 92

2. Competitive Service Areas ..... 93

C. Deaveraged Unbundled Network Elements..... 94

IX. OUTCOME MEASURES AND AFFORDABILITY ..... 98

A. Annual Measurement..... 98

B. Affordable Service ..... 98

C. Affordability and Competition Measures..... 100

**APPENDICES**

Washington Utilities and  
Transportation Commission



Washington Utilities and  
Transportation Commission

Appendix **A**: Schedule of Activities Adjudication and Rulemaking UT-980311 ..... Tab 1

Appendix **B**: Order Determining Costs, WUTC Docket No. UT-980311 ..... Tab 2

Appendix **C**:4th Draft Rules for a Revised Program of Universal Service . . . . . Tab 3

Appendix **D**: Small Business Economic Impact Statement ..... Tab 4

Appendix **E**: Cost of Administration of the Fund ..... Tab 5

Appendix **F**: ESSB 6622 (C 337, L 98) ..... Tab 6

Appendix **G**: ?Preserving and Advancing Universal Service In a Competitive Environment?  
Report to the Legislature, January 1998 ..... Tab 7

Appendix **H**: Model Universal Service Legislation ..... Tab 8



## I.

### INTRODUCTION

#### A. Progress in Universal Service

Universal, affordable telecommunications service has been the national and state policy for more than 60 years. At the time of the Telecommunications Act of 1934, approximately one-third of American homes had telephone service.<sup>3</sup> In that Act, Congress codified the notion of universal telephone service. Section 1 of the Act states its purpose is "...to make available, so far as possible, to all the people of the United States a rapid, efficient, nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges..."<sup>4</sup>

---

<sup>3</sup> Kellogg, Michael K. et al, Federal Telecommunications Law, Little Brown and Company, Boston (1992), p. 453.

<sup>4</sup> 47 U.S.C. § 151.

Under the 1934 Act, the provision of telephone service was treated as a natural monopoly which was to be regulated and for which charges were to be just and reasonable. This regulation was carried out by both the FCC and state utility commissions. In order to achieve universality, there had to be access to the network at affordable rates. The purpose of regulation became to ensure sufficient investment in infrastructure to provide access to the network and at the same time keep the price for local service affordable. At first, average pricing was used to spread the cost of the network so that the customer farthest from the switch paid a rate not significantly higher than the customer closest to the switch.<sup>5</sup> Over time, strategies which depended on shifting costs onto businesses<sup>6</sup> and long distance users were employed by state and federal policy makers to maintain affordable rates for local residential service. In Washington today, 95%<sup>7</sup> of all households have affordable telephone service based on this structure of rate averaging by companies that are regulated monopolies.

State law and the federal Telecommunications Act of 1996, now also require the

---

<sup>5</sup> For many years, mileage charges reflecting distance from the switch were added to the cost of local service for outlying customers. See comments of Washington Independent Telephone Association, WUTC Docket No. UT-971121, p. 8.

<sup>6</sup> Businesses are charged a higher rate than residential customers. The term "business rate" refers to the rate paid by non-profits and governments at all levels, as well as businesses.

<sup>7</sup> Alexander Belinfante, "Telephone Subscribership in the United States (Data Through March 1998)," Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission. Released: July 1998. Washington D.C. In "Preserving and Advancing Universal Service in a Competitive Environment," WUTC, January 1998, the penetration rate for Washington was reported as 97% based on comments of Public Counsel made in Docket No. UT-950724. See p. 52, n 95. State penetration rates are based on survey data and are subject to statistical

promotion of competition in local telecommunications services. In recognition of this requirement, the Legislature directed the Washington Utilities and Transportation Commission (WUTC) to devise a plan for the reform of universal service that is no longer dependent on a monopoly structure. The plan is to be competitively and technologically neutral, minimize implicit sources of support and maximize explicit sources of support, and benefit telecommunications ratepayers.

1. Purpose of Engrossed Substitute Senate Bill 6622  
(Chapter 337, Laws of 1998)

---

sampling error. The variation between this year's value and last year's is not statistically significant.

Engrossed Substitute Senate Bill 6622 (ESSB 6622) started as a request bill from the WUTC made necessary by the decision in the 1994 case WITA v. TRACER.<sup>8</sup> That decision voided the WUTC's attempt in 1993 to create an explicit fund for a different purpose, to support expansions of local calling areas to provide all customers with toll-free access to community services. To comply with the federal Telecommunications Act regarding the support of universal service, Washington must have an explicit, competitively neutral fund from which all telecommunications companies can draw support when service is provided in high-cost locations.<sup>9</sup> This is the very type of fund that the WITA court found the WUTC was lacking in authority to create without legislative approval. ESSB 6622 did not give the WUTC the necessary authority to establish an explicit fund, but it did direct the WUTC to plan and prepare to implement a new program that includes such a fund. This report reiterates the need for authority from the Legislature before the WUTC can act to

---

<sup>8</sup> WITA v. TRACER, 75 Wash. App. 356, 880 P.2d 50 (1994).

<sup>9</sup> A high-cost company is one that has costs greater than 115% of the statewide average cost to provide service. *See* 47 C.F.R. Part 36 ? 36.631, and WUTC Cause No. U-85-23, et al., Eighteenth Supplemental Order (December 30, 1986), p. 29 and Finding of Fact 22. VIII.C.

create a competitively and technologically neutral program of universal service.

2. Requirements of ESSB 6622

ESSB 6622 directs the WUTC to ? plan and prepare to implement a program for the preservation and advancement of universal telecommunications service which shall not take effect until the Legislature approves the program.?<sup>10</sup> The WUTC is required by section one of the legislation:

- ? to estimate the cost of supporting all lines and the cost of supporting only the first line for residential and business customers;
- ? to determine the assessment on carriers and the manner of collection necessary to provide support;
- ? to designate carriers eligible to receive support; to adopt or prepare to adopt all necessary rules for administration of the program;
- ? and to provide a schedule of all fees and payment proposed under subsection (4)(d) (expense of an independent program administrator).

The WUTC is also required to report to the Legislature on the steps taken to

---

<sup>10</sup> ESSB 6622, Sec. 1(1).

Washington Utilities and  
Transportation Commission

prepare for implementation.<sup>11</sup>

### 3. The Report

---

<sup>11</sup> All of the requirements are found in Sec. 1 of the legislation.

This report and the rules prepared by the WUTC are an attempt to resolve the conflicting goals of market-based competition and preservation of universal telecommunications service. The report, the attached draft rules, and our Cost Order<sup>12</sup> containing the findings from the adjudication of the cost of providing service, fulfill the requirements of ESSB 6622. The draft rules constitute a ? plan...to implement a program for the preservation and advancement of universal telecommunications service.? The report presents the policy options considered by the WUTC, the comments of interested parties on those options, and the choices the WUTC made based on those comments.

The requirement to designate carriers eligible to receive universal service support has been accomplished in part; initial designations were made in 1997, for federal purposes only. The draft rules describe the procedure to be used in the future to designate carriers eligible to receive either state or federal support, or both.

The cost of administration is presented in Appendix E. In the absence of information offered by parties on the cost of administration by an independent administrator<sup>13</sup> (which is favored by the WUTC), the material in the appendix sets out the

---

<sup>12</sup> In the Matter of Determining Costs, WUTC Docket No. UT-980311(a), Tenth Supplemental Order, Order Establishing Costs (November 20, 1998). Hereafter referred to as ?Cost Order.?

<sup>13</sup> The WUTC asked for comment on the expected cost of administration in both the rulemaking and the adjudication but received no information from interested parties.

expected cost were the WUTC to administer the program and provides information on the cost of administration in several other states.

In addition to discussion about the policy options and the choices made by the WUTC as it drafted rules, the report also contains a description of the process followed in both the rulemaking and the adjudication, and contains recent information about the development of competition in the long-distance and local telecommunications markets. These sections, on process and history, precede the discussion of policy options.

B. No Easy Decisions Lie Ahead

Policy makers searching for consensus will not find it reflected in this report or in the collection of documents cited by this report. No easy decisions lie ahead. The root of this lies in the nature of competition. Much praised at a distance, up close it represents the possibility of significant risk to telecommunications carriers who have traditionally experienced rate of return regulation. Utility managers, too, have not faced competitive circumstances, nor have regulators attempted to maintain affordable service in a competitive environment. Competition represents considerable risk to all involved.

1. Competition and Consensus

During the monopoly era, the Legislature, the WUTC and the telephone companies found it possible to reach consensus on issues because interests tended to converge. With

the advent of competition in the market for local telecommunications service, interests tend to diverge and consensus remains in only the broadest sense. All parties say they support universal service and competition, but agreement ends there. Not only has competition opened wide the fissures between local exchange providers, long-distance providers, wireless carriers and new competitors in wireline service, but it has opened fissures between different classes of customers, large businesses and small businesses, for example. With more than three billion dollars annually at stake in Washington alone, these fissures are not likely to narrow.

## 2. Timing

Is this the best time to reform the universal service program? The question is a difficult one because it presents a false choice. A competitively and technologically neutral program of universal service is the only means to maintain universally affordable service *and* promote competition. The question about when to do this is raised by those who have an advantage in the present. Because of the lack of consensus that results from competition, or its prospect, there will always be interests that perceive themselves to have an advantage and will therefore oppose change.

A reason often advanced for taking no action is that competition is not fully developed. This should not be a deciding factor, however, because, as we say in our Cost Order, the lack of a fund impedes the development of competition and federal law does not

condition the establishment of a competitively and technologically neutral universal service program upon the development of competition.<sup>14</sup>

Another reason offered for taking no action is that the FCC has not completed all its actions in this area. Just as we need not wait for the development of competition, we need not wait for the FCC<sup>15</sup>. Again, absence of a reformed state program impedes

---

<sup>14</sup> Cost Order at ¶ 28-29 and 41. In addition, the position that the Washington Legislature did not suggest that the establishment of the fund was contingent on the development of competition was advanced by US WEST. *See* Cost Order at ¶ 27.

<sup>15</sup> The FCC has recently reiterated its intention to implement a new universal service support mechanism for non-rural carriers on July 1, 1999. ¶ 1, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998). FCC Chairman Kennard told Congress in his statement accompanying a recent report to Congress on universal service, "I believe we will all be better off if both we and the States act expeditiously to preserve existing sources of support by converting existing implicit support into explicit sources of support." Separate Statement of Chairman William E. Kennard, April 10, 1998, <http://www.fcc.gov/speeches/kennard/statements/stwek822.html>. The FCC has stated it will provide for a federal program that will support only 25% of the funds needed for universal service support, clearly leaving a role that must be filled by each state. While the federal share is under review at this time, none of the participants expect the FCC to accept total responsibility for universal service. *See* ¶ 268-72, First Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (May 8, 1997), and ¶ 2, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

competition, and changes may be made at a later time if needed to ensure consistency with the FCC.<sup>16</sup>

---

<sup>16</sup> Cost Order at ? 39, 52 and 75.

Timing is also an issue in other areas in which the WUTC is in the process of making decisions. Universal service is only one area where the WUTC must act to promote competition. We must also make determinations regarding the price of unbundled network elements,<sup>17</sup> review policies related to obligation to serve, continue our work on interconnection issues, reduce access charges toward cost and act to take the best advantage of FCC decisions on these same topics. Without the authority to create a reformed program including an explicit fund, it may not be possible for the WUTC to take actions in these other areas without creating new impediments to competition that replace the ones that are removed.

### 3. Change Will Benefit Consumers

The question to ask is, will a change at this time benefit consumers? The answer is yes. It will likely be more difficult to restore universal service than to preserve it. The sooner universal service is guaranteed for the future through competitively and technologically neutral means, the sooner the natural strengths and weaknesses of the competitors can be left to determine their future. At present, universal service places burdens on monopoly incumbents that result in benefits to those competitors who do not have any responsibility for universal service. Once support for universal service becomes

---

<sup>17</sup> Discussed in full in Part VIII C of this report.

the shared responsibility of all competitors, then all carriers will compete on an equal footing. Now is the best time to reform universal service.

4. Grant of Authority

What is needed more than a set of rules is the flexibility to adjust pro-competitive policies to keep pace with the change that comes every day in telecommunications. The source of that flexibility can only come from the Legislature. What we recommend today is that the Legislature grant sufficient authority to the WUTC so that the pro-competitive and universal service policies of Washington state can be realized completely and all consumers can receive the full benefits that competition can bring.



## II.

### THE PROCESS

#### A. Process Followed Administrative Procedure Act

The WUTC began preparations to comply with the requirements of ESSB 6622 immediately after the 1998 Legislature adjourned. The earliest decision was that the WUTC should proceed in a formal manner, following the requirements of the Administrative Procedures Act, Chapter 34.05 RCW. The APA prescribes the procedure for rulemaking when an agency acts in a legislative role and also prescribes procedures for fact-finding for those agencies with quasi-judicial powers. Because some of the activities required by ESSB 6622 involved fact-finding, and others were in the nature of making policy, the universal service docket (UT-980311) was bifurcated and the adjudication and rulemaking were carried on simultaneously. The adjudication (UT-980311(a)) focused on determining the cost of providing basic service in high-cost locations. The rulemaking (UT-980311(r)) focused on preparing a revised program of universal service that would provide support for service in high-cost locations as determined by the results of the adjudication.

1. Broad Participation Sought

Throughout the process, the WUTC sought broad participation in both the rulemaking and the adjudication. The initial notice of the WUTC's plans to commence both an adjudication and a rulemaking was mailed to over 500 companies registered with the WUTC as providing telecommunications services, and to interested parties who had participated in other WUTC dockets on universal service.

In subsequent mailings concerning the rulemaking portion of the process, the WUTC made an effort to provide notice and information to a much broader audience, including groups which might have an interest in telecommunications or were likely to use telephone service in high-cost locations. The Washington Department of Agriculture provided a mailing list of organizations active in agriculture. Groups that would be operating in low-cost locations were not overlooked; included in the outreach effort, for example, were the state's 20 largest corporations. Most of the lists were likely to reach people in both low and high-cost locations. Notices were mailed to over 150 chambers of commerce. Also notified were service club presidents, library, port and hospital districts, county commissioners and other county officials, trade associations and approximately 75 mayors or staff from cities ranging in size from Touchet to Seattle. In all, more than 1,700 organizations and individuals received notice of activities in this proceeding.

In addition to using mailing lists for broad outreach, the WUTC also made an effort to speak in person with as many people as possible. WUTC staff made presentations to six

Rotary Clubs, held three public meetings in Ferndale, Colville and South Bend, and the Commissioners presided over two meetings held on interactive television, one in Seattle, Lacey and Vancouver and the other in Yakima, Spokane and Kennewick.

## 2. Participation in the Adjudication

The adjudicative process was initiated on March 23, 1998, when the WUTC invited more than 500 carriers and 100 other interested parties to participate in meetings intended to lead up to a prehearing conference for an adjudication to determine the cost of providing basic telecommunications service in high-cost locations. Two meetings were held with interested parties, on March 31 and again on April 23. The prehearing conference was held May 15, which began the formal phase of the adjudicative process.

Twenty-seven parties chose to participate formally in the adjudication. This process produced over 400 exhibits and created a transcript of more than 2100 pages in eight days of hearings presided over by the Commissioners. Every incumbent carrier<sup>18</sup> participated, along with Nextlink, AT&T and MCI. Non-carrier participants were Telecommunications Ratepayers Association for Cost-based and Equitable Rates

---

<sup>18</sup> An incumbent telephone company, most often referred to as an incumbent local exchange company (ILEC), is a carrier that was under rate of return regulation and providing service in a given area at the time the Telecommunications Act of 1996 was passed. Examples of incumbent providers are US WEST, GTE, CenturyTel, and Yelm Telephone.

(TRACER)<sup>19</sup>, the Public Counsel section of the Office of Attorney General, and WUTC staff.<sup>20</sup>

Carriers and other parties filed written testimony in June, July and August and hearings were held from September 9 through September 18. In the course of the hearing, 27 witnesses appeared and were cross-examined on their written testimony. Simultaneous briefs, totaling more than 700 pages, were submitted by the parties on October 7 and the WUTC issued its Cost Order establishing the cost of basic service in high-cost locations on November 20. That Order is attached as Appendix B.

### 3. Legislative Oversight

---

<sup>19</sup> TRACER is an association composed of large users of telecommunications services. *See* TRACER June 8 comments at 1.

<sup>20</sup> In contested cases, WUTC telecommunications staff appear as a party and are subject to the same procedural rules as all other parties. One of the rules to which staff is subject is the prohibition on ex-parte communication with Commissioners, who sit in their quasi-judicial capacity in contested cases.

Throughout this process, legislative staff have been active observers of the rulemaking and adjudication. At the initiation of the adjudication, WUTC staff proposed that legislative staff be included for the purpose of having access to all testimony and exhibits, including confidential exhibits. Legislative staff declined the opportunity but nevertheless were provided with copies of all testimony and exhibits except those that were determined by the parties to be confidential.<sup>21</sup> All submissions in the rulemaking file have been copied and supplied to legislative staff throughout the proceeding.

In addition to the material supplied throughout the adjudication and rulemaking, the Energy and Utilities Committee of each house received a complete set of hearing transcripts. To the extent the docket remains open and material is filed, legislative staff will continue to receive copies of all non-confidential material.

B. Schedule of Activities

A schedule of activities related to the adjudication and rulemaking appear in

---

<sup>21</sup> Even after the hearing record has been closed and an order issued, legislative staff may have access to confidential exhibits if parties agree to such a request to see an exhibit and staff sign and abide by the standard confidentiality agreement.

appendix A.



## IV.

### **BACKGROUND: FROM MONOPOLY TO COMPETITION**

#### A. State and Federal Law Mandate Competition

This section of the report provides some history on the development of competition and explains that promotion of competition is required by both state and federal law. Federal policy, with respect to long-distance competition, was changed by the courts in 1982 with the breakup of the Bell system. In 1985, with enactment of laws concerning wireless telecommunications, Congress embarked on a policy shift toward promotion of competition. The same year, Washington enacted the Regulatory Flexibility Act, which makes promotion of competition one of several state telecommunications policies. The federal Telecommunications Act of 1996 is the first clear legislative enactment by Congress that mandates competition in the local exchange market for wireline telecommunications. It is without argument that both state and federal law mandate actions that promote competition and reduce barriers to market entry.

#### B. Universal Service and the Monopoly Utility Structure

The State of Washington has a very well functioning program of universal service in place in 1998. The program is the result of federal and state legislative decisions, federal

and state regulatory actions, and active compliance by regulated telecommunications carriers over a period of more than 60 years. This successful program has resulted in an affordable price for basic telecommunications service for most households and businesses regardless of the actual cost of providing service to any particular household or business. As a result, 94.8% of Washington households subscribe to telecommunications service. This subscription rate has been achieved in part by averaging both costs and prices for basic telecommunications services. This situation could continue if it were not for the combination of legal requirements to promote competition, the mandate to exchange implicit support for explicit support, and the advent of actual competition in the market for telecommunications services.

Washington, like all states, has a long history of monopoly utility services. This was true for both long-distance and local telephone service through the 1970's. It began to change in the 1980's with the breakup of the AT&T long-distance monopoly, and the market for local telephone service has changed in the 1990's with the appearance of competitive local exchange providers.<sup>22</sup> The changes came first in practice, with new companies challenging regulated monopoly providers. The resulting change in the marketplace soon became reflected in federal and state legislation, and is now reflected in regulatory actions

---

<sup>22</sup> A competitive local exchange company (CLEC) is a new entrant in previously monopoly markets. Examples of CLECs are ELI, Shared Communications Service, and Nextlink. *See* 47 U.S.C. 251(h).

at both the federal and state levels.

1. The Breakup of AT&T and Long-Distance Competition

In 1963, Microwave Communications Incorporated was started with the intention of competing with AT&T for a share of the business long-distance market. It took Microwave Communications nearly a decade to offer private line service between St. Louis and Chicago. By that time, the company had changed its name to MCI and had nearly gone bankrupt fighting not only AT&T, but also the Federal Communications Commission (FCC). MCI persisted, however, and by the mid-seventies federal regulators were taking actions to promote competition in the long-distance market.<sup>23</sup>

In 1974, the Department of Justice sued AT&T in antitrust in an effort to break up the monopoly on long-distance telecommunications. That suit resulted in a settlement in 1982 that separated the AT&T long-distance service from the local operating companies (known then as the Bell System and now as the Baby Bells or Regional Bell Operating

---

<sup>23</sup> This portion of the report relies upon The Deal of the Century: The Breakup of AT&T, S. Coll, Athaneum, New York, 1986.

Companies--RBOCs<sup>24</sup>) and established a framework for competition in the long-distance market. Among other things, the settlement resulted in a prohibition that prevented the RBOCs from providing most long-distance service.<sup>25</sup>

The RBOCs were prohibited from participating in the interstate long-distance market because it was believed they would immediately dominate the market in their respective territories because of their continuing monopoly over local telecommunications service. A goal of the settlement that concluded the antitrust suit against AT&T was to permit a new long-distance market to grow, energized by the entrance of new firms. This occurred with the growth of MCI, the creation of Sprint, and the appearance of many more long-distance providers.

---

<sup>24</sup> US WEST, composed of three former Bell System companies, Pacific Northwest Bell, Northwestern Bell, and Mountain Bell, is an RBOC.

<sup>25</sup> US WEST may provide toll service only within Local Access and Transport Area, of which there are three in Washington. For information on interLATA service restrictions, *see* Kellogg, Michael K. et al, Federal Telecommunications Law, Little Brown and Company, Boston (1992).

Most consumers did not see the effects of competition at first. It took several years before competition was widespread. In the first few years of competition, many customers elected to stay with AT&T or, quite likely, were not even aware they could choose an alternative if they had one available to them. By 1989, in Washington state, MCI and Sprint were well enough established that regulators gave the competitive market a boost through the "Fresh Look" requirement. Where 1+ dialing for interstate long-distance was available, every customer was given a one-time opportunity to change providers without incurring a fee for making the change in long-distance carrier. Since 1989, there has been a vigorous market for long-distance services in Washington and as a result the service is largely unregulated.<sup>26</sup>

2. Washington Adopts Regulatory Flexibility In Response To AT&T Breakup

---

<sup>26</sup> One of the seldom-mentioned provisions of ESSB 6622 is authority for the WUTC to expedite competitive classifications. The WUTC now uses that authority to classify new long-distance companies as they enter the state. A company that is competitively classified is minimally regulated.

In 1985, the Legislature adopted the Regulatory Flexibility Act,<sup>27</sup> which declared a telecommunications policy that supported preservation of affordable universal service and promoted competition.<sup>28</sup> Specifically, our state's policy is to advance efficiency and availability of telecommunications services; ensure that customers pay only reasonable charges; ensure that non-competitive telecommunications services do not subsidize the competitive services; promote diversity in the supply of services and products in the market; and permit flexible regulation of competitive telecommunications companies and services.<sup>29</sup> These legislative goals continue to guide Washington's regulation of telecommunications services and have guided our efforts to deregulate as well.

---

<sup>27</sup> Chapter 450, Laws of 1985.

<sup>28</sup> See RCW 80.36.300.

<sup>29</sup> Id.

In the 13 years since the Regulatory Flexibility Act, the goals of that legislation resulted in preservation of affordable universal service, encouragement of competition, and comparability of services available statewide. The preservation of affordable universal service is evident based on Washington's high rate of subscription to telephone service. The increase in competition is most evident in long-distance service. Competition is just beginning for local service.<sup>30</sup> Maintenance of comparable services statewide is evident from actions taken by the WUTC, including the 1989 requirement that all carriers convert to single-party service, the recent actions to adjust minimum local calling areas and to require implementation of 1+ dialing for intrastate, intraLATA long distance.<sup>31</sup>

---

<sup>30</sup> CLEC earnings rose from \$9 million dollars in 1995 to nearly \$40 million dollars in 1997, however a portion of the earnings reported to the WUTC include revenue from long-distance service. The source of this information is company reports to the WUTC. Most CLECs operating in Washington did not respond to our request for a copy of their FCC Form 457 on which they report local exchange revenue. In any event, CLEC earnings represent at most only a little more than 1% of the three billion dollar telecommunications industry in Washington.

<sup>31</sup> LATA stands for Local Access and Transport Area, a term coined in the decree divesting AT&T of local telephone service. In the break-up of AT&T, remaining regional Bell operating companies (RBOCs) were restricted to supplying local telephone service and toll service within regions known as LATAs. Washington has two complete LATAs and parts of two others (one shared with Oregon and another shared with Idaho). *See United States v. AT&T*, 524 F. Supp. 1336 (D.D.C. 1981). *See also United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982).

3. The Breakup of AT&T and Competition in the  
Local Telecommunications Market

The breakup of AT&T was not intended to bring competition to the local telecommunications market, but it has led, if indirectly at first, to that end. As telecommunications companies saw the effect of competition on the long-distance market, they began to conceive of ways to enter local markets. At the same time, in the mid-1980s, Congress and the FCC developed and implemented plans for a largely unregulated wireless telecommunications industry. In Washington state, companies like Electric Lightwave, Incorporated (ELI) appeared with the intention of competing for business customers in the local market at the same time they offered long-distance service to those customers. Just as MCI had started more than two decades earlier to challenge AT&T by using new technology (microwave rather than landline transmission of long-distance communications), companies like ELI would employ new fiber-optic technology and digital switching in an effort to compete with the existing copper wire, analog technology of the local monopoly provider. As with MCI, the new companies did not wait for regulators to pave the way for them; they forged ahead, competing directly with regulated monopoly providers.<sup>32</sup>

---

<sup>32</sup> In 1990, ELI applied to the WUTC for approval to be registered as a telecommunications company. While that application was approved, the WUTC denied ELI permission to offer intraexchange services (services between customers in the same exchange). On a vote of 2-1 the WUTC determined that local exchange companies (LECS) had ?exclusive? rights to provide all intraexchange services. That decision was appealed and reversed by the Washington Supreme Court, citing, inter alia, the pro-competitive policy found in RCW 80.36.300. See In re Electric Lightwave, Inc., 123 Wn.2d 530, 869 P.2d 1045. Of more than passing interest is the WUTC's most recent decision

C. The Federal Telecommunications Act of 1996,  
Local Competition and Universal Service

---

where promotion of competition was at issue. In ordering toll dialing parity so that all customers in Washington will be able to choose their preferred long-distance carrier by dialing 1+ (rather than, for example, 10-10-321 plus the number), the WUTC relied, in part, on the promotion of competition embodied in the policies established by the Legislature in RCW 80.36.300. *See* WUTC Docket No. UT-980340, Commission Order Granting Summary Determination; Ordering Implementation of 1+ Toll Dialing Parity (October 14, 1998).

At the same time new companies were starting up in local markets around the nation, RBOCs were still regulated and still prohibited from entering the interstate long-distance market. As the new companies began to make very small inroads<sup>33</sup> into the local markets of the RBOCs, the RBOCs sought deregulation and entry into the interstate long-distance market. The alternative entry stratagems for the RBOCs were either to convince the court to re-open the AT&T antitrust case or to go to Congress for legislation that would let them enter the long-distance market.

After a number of years of debate, Congress adopted the Telecommunications Act of 1996. The Act essentially embodies the quid-pro-quo that RBOCs will be permitted to enter the interLATA long-distance market once they open their local markets to competition. The Act prescribes a process involving both state and federal regulators in making a determination that an RBOC has or has not opened its local market to competition.<sup>34</sup>

---

<sup>33</sup> In Washington, no competitor in the local market has a share equal to even 1% of the market controlled by US WEST. This is based on information provided by USWC to Commission staff for the purpose of comparing potential company contributions to a program of universal service.

<sup>34</sup> Around the country, there is considerable controversy over the degree to which RBOCs have, or have not, opened their local markets to competition. In Washington, US WEST has not filed for approval to enter the interstate long-distance market under section 271 of the Act. To date, no RBOC has been found by the FCC to have

---

opened its market to local competition.

The Act also requires the FCC and states to preserve and advance universal service.<sup>35</sup>

This requirement, stated explicitly for the first time in federal law, is a recognition that present programs of universal service were designed to operate, and do operate, in a monopoly local service environment and must be reformed to allow for competition. The Act set out a planning process and a set of principles to guide the restructuring of universal service.<sup>36</sup> It also gave permissive authority to states to adopt programs of universal service so long as they are not inconsistent with FCC rules and do not burden the federal program.<sup>37</sup>

D. Universal Service and the Transition From Monopoly To Competition

As was stated at the beginning of this section, Washington has a program of universal service that has worked well for decades in the regulated, monopoly environment. As described in the WUTC's January 1998 report on universal service, the present

---

<sup>35</sup> See 47 U.S.C. ? 254.

<sup>36</sup> See 47 U.S.C. ? 254(b) and ?Preserving and Advancing Universal Service in a Competitive Environment,? WUTC, January 1998. p. 19-21.

program relies most heavily on price averaging, financial support from substantially higher than cost network access charges, a small state universal service fund based on access charges, and substantial amounts of federal support.<sup>38</sup> These mechanisms, however, cannot be sustained in a competitive environment.<sup>39</sup>

---

<sup>37</sup> See 47 U.S.C. § 254(f).

<sup>38</sup> See "Preserving and Advancing Universal Service in a Competitive Environment," WUTC, January 1998, p. 52-58.

<sup>39</sup> Id. p. 3-5. See also § 6, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

As the WUTC explained in the previous report on this subject, a new competitor with no subsidy cannot compete against a provider with a subsidy. The subsidized firm can always offer a lower price because of the subsidy. At the same time, if the subsidy available to the firm providing service in a high-cost location is from its operations in a low-cost location, then the firm's price in the low-cost area will usually be higher than the new entrant's price. *In a competitive environment, an incumbent provider participating in the present program of universal service will never face competition in high-cost locations, but will almost always be at a disadvantage in low-cost locations.*<sup>40</sup> What this means to customers is that they will see competition if they reside in low-cost locations, but that competition will be distorted by a system that still requires the incumbent provider to price service sufficiently above cost to provide support for service in high-cost locations. The customer in the high-cost location will not see competition and, over time, may find the monopoly provider less and less willing to expend resources in the high-cost location if it is losing customers to competition in its low-cost markets. Eventually, the tendency for prices to rise toward cost will take hold and the price of service in high-cost locations will increase. The successful promotion of competition not only dooms a universal service program based on monopoly delivery of local telecommunications

---

<sup>40</sup> See ¶ 6 n.14, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

service, but may be impossible to achieve without a reformed program.

The remainder of this report presents the issues encountered by the WUTC in the process of developing a revised program of universal service. For each issue, the WUTC describes policy options, presents positions of interested parties, and explains its decisions.



## V.

### A PROGRAM OF UNIVERSAL SERVICE

#### A. Competing Views of Goals for Universal Service

There are competing views of what the goal of a program of universal service should be. At one end of the spectrum is the view that a program of universal service should be the minimum possible to ensure one basic voice grade connection to the public switched telephone network.<sup>41</sup> At the other end is a view that the Federal Act requires universal service to ensure that all areas of the state, including high-cost locations, should have access through multiple connections to telecommunications and information services<sup>42</sup> that are comparable to those found anywhere in the state.<sup>43</sup> The only goal on which there is agreement is that a revised program of universal service should promote competition. This

---

<sup>41</sup> TRACER June 8 comments at 10. AT&T comments on 2nd draft rules at 5.

<sup>42</sup> For an extensive discussion of the difference between telecommunications services and information services, *see* Chapter III, C, Report to Congress, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (April 10, 1998).

<sup>43</sup> Public Counsel June 8 comments at 7, 8 and *See also* 47 U.S.C. ? 254(b) and ? 10, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

section of the report covers several topic areas that define the goal of a program of universal service.

1. Competition

The title of the federal Telecommunications Act of 1996 is to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new technologies.<sup>44</sup> As described earlier in the report, Washington state policy since 1985 has been that competition should be promoted in telecommunications services. Most parties have commented that a revised program of universal service should promote competition<sup>45</sup> and no commenters have said that competition should not be promoted.<sup>46</sup>

Because of the stated purpose of the federal act, state law requirements, the support of commenters and the WUTC's view that it is the advent of competition in the local telecommunications market that requires a change in the state's approach to universal service, the WUTC prepared draft rules with the promotion of competition as a guiding

---

<sup>44</sup> Public Law 104-104, 110 Stat. 154 (originally S. 652), approved February 8, 1996.

<sup>45</sup> Sprint Spectrum June 8 comments at 2, and GTE June 8 comments at 1.

<sup>46</sup> See, generally, comments of interested parties filed June 8, 1998 in response to WUTC questions on universal service.

principle.<sup>47</sup>

2. Support for One Line or All Lines

---

<sup>47</sup> Promotion of competition is not in conflict with the FCC's principle of implementation of the Telecommunications Act of 1996 based on "competitive neutrality." Promotion of competition is one of the purposes of the Act. The manner in which competition is promoted must not be carried out in a way that favors one interest over another. For example, state law or regulatory rules should promote competition between incumbents and new entrants, but must do so in a manner that is competitively neutral, that is, in a manner that does not create or permit an advantage for any competitor. *See* ¶ 47, First Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (May 8, 1997) and ¶ 6, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

The Legislature directed the WUTC to address the issue of support for one or all lines.<sup>48</sup> The question posed divided the issue into support for one or all residential lines and support for one or all business lines.

As noted above, TRACER and AT&T oppose support for all lines and they are joined by Airtouch Communications.<sup>49</sup> MCI proposes support for only one residential line and no support for business lines.<sup>50</sup> US WEST agrees, but does not believe such a limitation on support could be readily administered.<sup>51</sup> Sprint/United and GTE, however, favor support for all residential lines, but only one business line.<sup>52</sup>

---

<sup>48</sup> See ESSB 6622 (C 337, L 98) Sec. 1(2)(a) and Sec. 1(3).

<sup>49</sup> See footnote 40, above, and Airtouch comments on 2nd draft rules at 20. See also TRACER comments on 2nd draft rules at 27-28.

<sup>50</sup> MCI June 8 comments at 3.

<sup>51</sup> ? Ideally, the definition of universal service should only include the first line to a primary residence and lines other than a customer's primary line should be priced at a rate that fully recovers cost. However, the ability to administer such an approach...could increase administrative costs significantly.? US WEST June 8 comments at 5.

<sup>52</sup> Sprint/United June 8 comments at 3. GTE June 8 comments at 7.

◆ *See next page* CHART 1 - Comparison of Support Required for One  
Line v. All Lines

**CHART 1 - Comparison of Support Required for One Line v. All Lines**

Non-rural Carriers (GTE, U S WEST, Sprint/United)

Support for All Lines	Support for One Line
☞ Total Residence Lines.....2,354,144	☞ Total Residence Lines.....2,354,144
☞ Total Business Lines.....998,938	☞ Total Business Lines.....998,938
☞ Supported Residence Lines.....233,066	☞ Supported One-Line Residence.....186,085
☞ Supported Business Lines.....19,171	☞ Supported One-Line Business.....8,242
☞ Percent Lines Supported..... 8%	☞ Percent Lines Supported..... 6%
☞ Total Support - All Lines.....\$70,282,014	☞ Total Support for One-Line....\$55,204,557

Public Counsel advocates support for all lines and asserts that the federal Act's comparability language means the state cannot restrict support to primary lines.<sup>53</sup> WITA notes that historically all lines have been supported and advocates support for all lines.<sup>54</sup> US Cellular, a wireless carrier, states that support should be available to a wireless carrier even if it is not the customer's primary carrier.<sup>55</sup> The Independent Business Association

<sup>53</sup> Public Counsel June 8 comments at 7.

<sup>54</sup> WITA June 8 comments at 3.

<sup>55</sup> US Cellular June 8 comments at 5, referencing 146 First Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (May 8, 1997).

supports inclusion of all lines, stating that 91% of its members approve of this position even if firms in urban areas will pay higher rates so that all lines will be supported.<sup>56</sup> The WUTC received dozens of letters from small businesses advocating support for all lines. The Washington State School Directors and the Washington Association of School Administrators also favor support for all lines because to do otherwise would result in disparity between what schools in high-cost locations can afford in the way of high technology in comparison to schools where costs may be much lower.<sup>57</sup>

TRACER raises the concern that support for more than one voice line will have the anti-competitive effect of depressing demand for alternative technologies that can provide voice and data services. Cable modem voice and Internet access are examples of such alternatives.

### 3. Support for All Lines Maintains the Status Quo

The comments opposed to support for all lines can generally be described as concerned with the effect on carriers and the size of the universal service fund. Some of them are simply incorrect. For example, one commenter states that support for all lines

---

<sup>56</sup> Independent Business Association letter to Commission, August 12, 1998.

<sup>57</sup> WSSDA and WASA June 11 comments.

? would be a marked departure from past and present universal service policies?<sup>58</sup> In fact, all lines in our state have historically been supported by either implicit or explicit subsidies, or both.

---

<sup>58</sup> TRACER comments on 1st draft rules at 7.

Support for all lines is consistent with state law. The WUTC interprets the legislative adoption of the principles in RCW 80.36.300 as support for viewing the importance of the state's telecommunications network in the broadest context possible. This includes economic development, distance learning, and telecommuting. The WUTC has prepared a set of draft rules that preserve affordable service for all areas of the state,<sup>59</sup> maintain and advance the availability of telecommunications service,<sup>60</sup> and promote diversity of services in markets throughout the state.<sup>61</sup> Support for all lines is one cornerstone of this set of rules.

Support for all lines is also warranted at this time because alternatives are not available even in most low-cost areas. When alternatives begin to be widely available in low-cost areas, then it would be appropriate to review the effect of all universal service policies that affect alternatives to traditional wireline technology.

---

<sup>59</sup> See RCW 80.36.300(1).

<sup>60</sup> See RCW 80.36.300(2).

<sup>61</sup> See RCW 80.36.300(5).

We are convinced that, taken as a whole, both the Regulatory Flexibility Act and the federal Telecommunications Act of 1996 require availability of reasonably comparable services at reasonably comparable prices throughout the state.<sup>62</sup> The great variation in price of a second line resulting from a program that supports only the first line could not be considered reasonably comparable. Washington will suffer if our laws and policies create telecommunications ?haves? and ?have nots.? Maintaining the status quo of support for all lines is an important decision in preventing the creation of telecommunications ?have nots.? Universal service is intended to support service in high-cost locations, not punish people for living in those locations.<sup>63</sup>

---

<sup>62</sup> See ? 10, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

<sup>63</sup> While our recommendation on support for all lines was not made based on cost considerations, in our Order we note that a network designed to serve single-line customers would overstate the cost of providing service because it would not benefit from the economies of scale that exist in today?s multi-product network. See Order at ? 65 and Appendix B. In other words, on an incremental basis, it costs more to construct a network to provide one line

4. Support for All Lines Avoids Administrative Costs

---

than to serve all lines.

In addition to being the best policy for maintaining a network that serves economic development throughout the state, supporting all lines avoids many administrative costs. As noted by WITA, supporting only a primary line would be difficult to administer.<sup>64</sup> They raise the example of a husband and wife each ordering a primary line as either a simple way around support for only one line or, in the alternative, an administrative problem. U S WEST goes farther and says that administration of support for only one line per customer would be almost impossible in a multi-carrier environment.<sup>65</sup> TRACER, on the other hand, suggests that the fund administrator can administer a program of support only to one line with documentation from carriers.<sup>66</sup> AT&T also views the administrative problems as surmountable and a better choice than supporting all lines. One way to reduce the administrative burden, it suggests, is to follow Puerto Rico and stop support for any line once a second one is ordered.<sup>67</sup>

We do not have to rely upon differing opinions of what might happen if we attempt to restrict support to one line. We have recent experience with a now abandoned tariff that imposed significantly greater costs for business lines after the fifth line. This approach was abandoned because it dampened business growth in some instances, but in many others it

---

<sup>64</sup> WITA June 8 comments at 4.

<sup>65</sup> U S WEST June 8 comments at 5.

<sup>66</sup> TRACER June 8 comments at 14-15.

<sup>67</sup> AT&T June 8 comments at 5.

simply spawned clever ways to have more than one account so that there were never more than five lines per account. We believe the exact same evasions would occur and there would be a great deal of wasted effort by all involved; customers would spend their time and energy avoiding the restriction and carriers would be placed in the position of attempting to police their customers. This is not a good outcome, just as stifling business activity is not a good outcome.

B. Advanced Telecommunications and Information Services

The present definition of basic services in ESSB 6622 does *not* include advanced telecommunications and information services.<sup>68</sup> An important policy issue facing Washington is the degree to which advanced telecommunications and information services are necessary to a healthy economy. Congress considers advanced services important enough to make their availability a principle intended to guide decision-making by the FCC in revising the federal universal program.<sup>69</sup> The WUTC is aware of legislative interest in the spread of increased bandwidth capability as an important economic development issue. US

---

<sup>68</sup> See ESSB 6622, Sec. 1(7)(b). See also ?Preserving and Advancing Universal Service in a Competitive Environment,? WUTC, January, 1998. p 31-33 and see n.41, supra, for references related to information services.

<sup>69</sup> ?Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.? 47 U.S.C. ? 254(b)(3). See also 47 U.S.C. ? 254(b)(2), which states: ?ACCESS TO ADVANCED SERVICES. --Access to advanced telecommunications and information services should be provided in all regions of the Nation.?

WEST, WITA and AT&T also advocate access to advanced services.<sup>70</sup>

---

<sup>70</sup> US WEST June 8 comments at 2. *See also* WITA June 8 comments at 1, and June 8 comments of AT&T at 1. Note that AT&T, while quoting the same passage from the federal Act as this report and advocating the same principle, states that "support should be narrowly targeted to the primary residential line[.]" AT&T June 8 comments at p. 4. It is difficult to harmonize support for the principle of access to advanced services at reasonably comparable rates with AT&T's position that universal service should not support business lines.

As stated above, the WUTC is concerned about the impact on our entire state if we permit a situation to develop in which there are telecommunications ?haves? and ?have nots.? For this reason, and because of the concern of legislators that higher bandwidth capability be available to the greatest number of businesses and residences, we have asked interested parties to comment on draft rules that would have the effect of assuring a network throughout the state that is capable of delivering advanced telecommunications and information services. The WUTC has heard from the public on this issue. It is apparent from the comments of individuals and small business operators that they are interested in increased services and especially want better quality, faster connections to the Internet.<sup>71</sup>

1. Network Capability Options

The options on which the WUTC requested comment would have required recipients of state universal service support to provide, by the year 2003, a network that is either capable of transmitting information at 28.8 kilobits per second (Kbps), or provide a network that delivers telecommunications and information services in rural areas that are reasonably comparable to those in urban areas. It is important to note that if either of these options were implemented, it would apply only to carriers that receive universal service support; market forces in most non-high-cost areas have resulted in construction of a

---

<sup>71</sup> See ?Preserving and Advancing Universal Service in a Competitive Environment,? WUTC, January, 1998. p. 32, n 53. Similar desires were expressed in other public meetings held throughout the state by the WUTC.

network that permits modem speeds at 28.8 Kbps or greater.

2. Comments on Transmitting at 28.8 Kbps

Support for a minimum transmission capability came from the Washington Association of Internet Service Providers and the Independent Business Association (IBA). Internet providers state that the only technology that could provide transmission capability at 28.8 Kbps in rural areas is the public switched network. They believe it would be unfair if rural customers, through their telephone bill, contribute to universal service but do not realize the opportunity to access the Internet as a result of universal service.<sup>72</sup>

The IBA supports the 28.8 Kbps transmission speed and suggested language that would require 20% annual progress toward the goal of availability of that transmission speed.<sup>73</sup> The IBA also advocates reducing support for carriers that do not meet the transmission speed with the determination of the amount of the reduction to be left to the WUTC.

WITA supports access to the Internet through supported second and third lines for residential and business customers.

What appears to be happening in rural as well as urban areas is that the second line is developing into the line that is used for Internet access....Supporting only the primary line and requiring the second line or

---

<sup>72</sup> WAISP comments on 3rd draft rules at 1.

<sup>73</sup> IBA comments on 2nd draft rules at 2-3.

third line to be at a price much higher than the primary line would discourage the purchase of that line and thereby discourage access to the Internet and other advanced services.<sup>74</sup>

At the same time, noted in detail below, WITA does not support action on a minimum transition speed standard.

---

<sup>74</sup> WITA June 8 comments at 3-4.

TRACER opposes a network capability standard that results in a minimum transmission speed of 28.8 Kbps for all customers.<sup>75</sup> TRACER considers the transmission speed standard inconsistent with the ESSB 6622. It believes wireless carriers will not be able to transmit at 28.8 Kbps and will therefore be unable to receive support for service in high-cost locations. TRACER observes that other technologies can transmit at 28.8 Kbps and higher; examples are cable modem, cellular digital packet data, Ricochet and satellite. It considers the presence of these competitors will provide sufficient incentive to ILECs to maximize their data speed transmission capabilities. At the same time as TRACER raises arguments in opposition to 28.8 Kbps, it acknowledges the FCC's Model Platform Order that cost proxy models should not assume a network design that impedes the performance of 28.8 Kbps modems, but TRACER states the Order does not say that transmission speeds no less than 28.8 are a defining characteristic of basic service to be supported by universal service.

---

<sup>75</sup> TRACER comments on 2nd draft rules at 12-15.

WITA, on behalf of rural carriers, takes strong exception to the 28.8 transmission speed.<sup>76</sup> It states there is nothing in the record to provide the Commission with any indication of the cost of providing service at 28.8 Kbps. It states that many of the digital loop carriers<sup>77</sup> on loops<sup>78</sup> between 9 and 12 kilofeet will not carry this speed. It points out that many loops in rural areas are longer than 12 kilofeet. It asks if the WUTC is prepared to fund the additional investment, including replacing 19 gauge copper cable with fiber or replacing digital loop carriers. WITA states that its members support rural infrastructure development but do not believe the WUTC has sufficient information to make a decision about transmission speed.

---

<sup>76</sup> WITA comments on 2nd draft rules at 3-4.

<sup>77</sup> Digital Loop Carrier (DLC) is a carrier system deployed on the loop side (see footnote immediately below) of the switch that converts 24 analog voice channels (loops) into a digital carrier system similar to T-1 (24 lines at 64 kilobits per second (Kbps) each on a carrier operating at 1.5 megabits per second (Mbps)). Two copper pairs are needed for each 24 channel digital loop carrier system. There is at least one DLC product that carries the equivalent of 96 channels on 4 T-1s.

<sup>78</sup> ?Local loop? or ?loop? means the connection between the telephone company?s central office and the customer?s premises. See n.523, First Report and Order, In the Matter of Federal-State joint board on Universal Service, CC Docket No. 96-45 (May 8, 1997).

US WEST neither favors nor opposes a 28.8 Kbps minimum transmission speed.<sup>79</sup>

It considers the minimum transmission speed to be in violation of ESSB 6622 and states that it would take at least five years to meet the minimum transmission speed. It also states that the WUTC would have to reset all incumbent carrier depreciation schedules ? with commensurate end user rates.?

---

<sup>79</sup> US WEST comments on 2nd draft rules at 6.

Public Counsel suggests caution.<sup>80</sup> Its concern is that a minimum transmission speed might ?lock in? only one direction for technological advance. It is also concerned about the cost and does not believe the WUTC cost adjudication developed explicit cost estimates that enable those involved to know the cost of a 28.8 minimum transmission speed. As an alternative, Public Counsel suggests that the WUTC be granted authority to review the definition of supported services from time to time and choose a minimum transmission speed or such other services to be supported when warranted by circumstances not present today.

3. Discussion of 28.8 Kbps Transmission Speed  
for Non-Rural Carriers

The appropriate length of local loops to be modeled, and network capability with respect to transmission speed, continue to be issues in the process of selecting engineering models and determining the appropriate services to be supported by universal service funds.

The concerns of those opposed to a minimum transmission speed of 28.8 Kbps are not insignificant. TRACER's concerns that wireless carriers not be excluded is important because the WUTC considers wireless technology the most likely to provide a competitive

---

<sup>80</sup> Public Counsel comments on 2nd draft rules at 5-6.

alternative for consumers in rural areas.

With respect to Public Counsel's concern that the WUTC not "lock in" only one direction for technological advance, that has already been addressed by the WUTC. We have recommended to the Legislature that policies regarding universal service should not favor one technology over another.<sup>81</sup>

4. WUTC Position on 28.8 Minimum Transmission Speed  
for Non-Rural Carriers

We consider adoption or rejection of a minimum transmission standard an important subject that warrants public discussion and legislative attention. In the draft rules approved for publication and formal comment on November 23, 1998, the WUTC asked parties to comment further on adoption of a minimum transmission speed standard.

It has been only recently that the FCC has adopted its Model Platform Order and stated:

We agree that a reasonable standard for ensuring that a model's network does not impede provision of advanced services would ensure the reasonable performance of 28.8 Kbps modems. We find that proponents of the BCPM, HAI and HCPM have demonstrated that their models can allow

---

<sup>81</sup> See "Preserving and Advancing Universal Service in a Competitive Environment," WUTC, January, 1998. p. 39.

28.8 modems to work at reasonable rates, which will permit all customers to have access to high-speed data transmission.<sup>82</sup>

The WUTC will take time in December and January to explore this issue further with interested parties. We will do this through work sessions with interested parties and additional examination of the FCC's findings on cost proxy models. We will pay particular attention in our additional efforts to the effects of a transmission standard upon technological neutrality in general and wireless service in particular.

5. Discussion of 28.8 Kbps Transmission Speed  
for Rural Carriers

In general, the federal law requires that the level of service in rural areas be reasonably comparable to that in urban areas. Rural carriers often note that their networks are more up to date and have been designed to avoid the long loop lengths that can impede reasonable speeds. Indeed, rural carriers often assert that their networks are more advanced than networks found in comparable exchanges of the larger carriers.

---

<sup>82</sup> ? 67, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

Those assertions of superiority are not merely that. As recently as 1997, fourteen rural carriers, in a filing with the Rural Utilities Service (RUS),<sup>83</sup> accepted a short-term requirement for all construction to provide transmission and reception of data at one megabit per second (four times faster than 28.8 Kbps).<sup>84</sup> In the same document, required for loan eligibility by RUS, the rural carriers agreed to a medium-term requirement to provide for transmission of voice, data, *and video* within in six years (or 2003).<sup>85</sup> Most of Washington's rural telephone carriers have already begun the process of building a network that far exceeds the minimum transmission standard under consideration.

6. WUTC Position on 28.8 Minimum Transmission Speed for Rural Carriers

In our additional examination of this issue we will consider the effect of a transmission standard on rural carriers and their customers. We note that WITA, too, wants rural customers to have access to advanced services.<sup>86</sup> We will examine further the

---

<sup>83</sup> The RUS is a department of the U. S. Department of Agriculture, and is authorized to make loans pursuant to 7 U.S.C. ? 921 *et seq.*

<sup>84</sup> *See ? State of Washington, State Telecommunications Modernization Plan,? Rural Utilities Service Borrowers of Washington, July 28, 1997, p. 5.* (Submitted by the Washington Independent Telephone Association as the authorized representative of the RUS Borrowers of Washington). The listed carriers are Asotin Telephone (part of TDS of Wisconsin), Cowiche Telephone (now CenturyTel of Louisiana), Hood Canal, Inland Telephone, Inter Island Telephone (now also CenturyTel), Kalama Telephone, Lewis River Telephone (also TDS), Mashell Telecom, Pioneer Telephone, St. John Telephone, Toledo Telephone, Tenino Telephone, Wahkiakum West Telephone, and Yelm Telephone.

<sup>85</sup> This standard is required by 7 C.F.R. ? 1751.106. *Id.* at 6.

<sup>86</sup> WITA June 8 comments at 4.

agreement between RUS borrowers to determine their obligation to provide the level of service apparently expected in exchange for financial support. As with our review of issues related to non-rural companies, we will consider the effect of such a transmission standard on technological neutrality and the prospect of wireless competition in areas served by rural carriers.

7. ?Reasonably Comparable? Standard

The WUTC asked for comments on a network capability option that results in a network that would deliver telecommunications and information services in rural areas that are comparable to those in urban areas. Because we have settled upon the alternative, 28.8 Kbps standard as the one to examine more fully, it is not necessary to summarize the comments on the ?reasonably comparable? option. Readers may find comments on this option in the responses of interested parties to the 2nd draft proposed rules, copies of which have been provided to legislative staff and are available on the WUTC web site.



## VI.

### **The Size of the Fund Necessary to Maintain the Network**

By shifting the universal service support dollars buried in today's rates to a more explicit program of support targeted to customers in high-cost locations, a revised program of universal service will establish clear incentives for network investment and maintenance. No longer will support be spread throughout a carrier's rate structure. Instead, a specific support amount will follow each customer in a high-cost area, creating the maximum possible incentive for companies to invest in and compete for business.

The support level for each customer in a high-cost location will depend on the area's average cost of basic service minus the amount the carrier is expected to earn (based initially upon a statewide average) from each customer. As simple as the equation sounds, it involves several important decisions, such as what services to support and the amount of cost that should be borne by vertical<sup>87</sup> and other services.

The size of the fund depends upon the level of support needed to provide basic

---

<sup>87</sup> Vertical features, sometimes called special features, include call waiting, call forwarding, caller ID and similar services.

service in each exchange and the number of lines that will be supported. But because the reformed program of universal service will be reducing implicit support already existing in rates today, there will be no need for consumers as a whole to spend more for telecommunications than they currently do today.

A. Wireline Cost of Supported Lines: Geographic Levels of Cost Determination

The determination of the cost of providing basic service in high-cost locations was the primary purpose of the adjudication in Docket No. UT-980311(a). In that Order we determined that the record was sufficient to make cost estimates for the purpose of informing the legislature about the approximate cost of providing basic service, but not sufficient for actual assessment and disbursement within a fund.<sup>88</sup> The accurate and precise determination of costs for non-rural carriers must await the refinement of cost models (discussed below) and achievement of adequate input data.<sup>89</sup> With respect to rural carriers, we have concluded that neither the models nor the testimony on embedded cost were an

---

<sup>88</sup> Cost Order at page 1.

<sup>89</sup> Cost Order at ? 14, 15.

adequate basis for determining the cost of basic service.<sup>90</sup> We have accepted the FCC's phased approach and will not recommend application of cost models to rural carriers prior to 2001.<sup>91</sup>

---

<sup>90</sup> Cost Order at ¶ 309, *see also* ¶ 1 n.4, Fifth Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (October 28, 1998).

<sup>91</sup> Cost Order at ¶ 15(l).

Because it is not possible to determine the cost of providing telecommunications service line by line, we look at costs on a larger scale than individual lines. In order to estimate the cost of basic service in high-cost locations served by the non-rural<sup>92</sup> companies, US WEST, GTE and Sprint/United, we employed engineering cost models of forward-looking economic costs.

---

<sup>92</sup> The FCC has determined that non-rural and rural providers should have their costs determined in a different manner. The WUTC, in its adjudication, chose to use the determination methods adopted by the FCC. *See ? Preserving and Advancing Universal Service in a Competitive Environment? Report to the Legislature, WUTC, January, 1998 p. 44-45.*

Using those models, parties proposed that cost be determined at one of four geographic levels: the grid (1500' by 1700'), the census block group (CBG),<sup>93</sup> the wirecenter<sup>94</sup> and the study area.<sup>95</sup> Costs vary by geographic level because each level represents a different amount of averaging. The larger the geographic level, the lower the cost as a result of averaging a substantial number of low-cost lines with relatively few high-cost lines. In the adjudication, as stated above, cost determinations were proposed for the grid, the CBG, the wirecenter and the study-area level. Supporters of the grid level of cost determination, based on the Benchmark Cost Proxy Model (BCPM) were US WEST and Sprint/United. There were no supporters of determining cost at the CBG level, but CBG level calculations are an integral part of BCPM and were relied upon in part by rural companies and WUTC staff in an examination of embedded costs. Both WUTC staff, acting as a party in the adjudication, and GTE supported cost determination at the wirecenter level for eventual determination of costs at the exchange level.<sup>96</sup> Wirecenter costs are modeled

---

<sup>93</sup> ? A census block group generally contains between 250 and 550 housing units, with the ideal size being 400 housing units.? 1990 Census of Population, General Population Characteristics, Washington. Washington D.C.: U.S. Dept. of Commerce (1992), p. A-4. See ?Preserving and Advancing Universal Service in a Competitive Environment? Report to the Legislature, WUTC, January 1998, p. 77.

<sup>94</sup> A wirecenter is a switch and all the loops that connect customers to that switch. Many exchanges have only one switch and the wirecenter and exchange are synonymous. Larger exchanges may have multiple switches and thus multiple wirecenters. The Seattle exchange, for example, has five wirecenters.

<sup>95</sup> A "study area" is generally an incumbent LEC's pre-existing service area in a given state. The study area boundaries are fixed as of November 15, 1984. MTS and WATS Market Structure: Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order, 50 Fed. Reg. 939 (1985).

<sup>96</sup> Wirecenter costs are synonymous with exchange costs for the majority of exchanges because there is only one wirecenter in most exchanges. Where there are multiple wirecenters, the cost of the exchange is determined

by the HAI model. The HAI model was sponsored in the adjudication by AT&T and MCI, with both favoring the ultimate determination of costs at the study-area level.

In our Order there is extensive discussion of this issue and we there set forth the reasoning that resulted in our choice to determine costs at the exchange level.<sup>97</sup>

◆ *See next page*      CHART 2 - Exchange-by-Exchange Estimated Annual  
Implicit Support

1.    Wireless Cost of Service

In this effort to determine the cost of service, the WUTC would have welcomed participation in the adjudication by wireless carriers. None came forward.

---

by totaling the average cost of the included wirecenters.

<sup>97</sup> See Cost Order at ? 72 and n.22.

This Sheet Left Blank for Chart Insert

See 4-page Excel Spreadsheet

<suppfin.xls>



This Sheet Left Blank for Chart Insert

See 4-page Excel Spreadsheet

<suppfin.xls>

The practical consideration that no doubt kept wireless carriers from joining the cost adjudication is that they would have had to open their finances and business practices to scrutiny. As a competitive industry, they keep a very close guard over their cost, revenue and market information. It would not make good business sense to open themselves up to scrutiny by competitors in exchange for an opportunity to seek a small portion of the market represented by potential customers in high-cost locations.

Allowing wireless carriers to draw from the fund will not increase the size of the universal service fund because support is linked to the high-cost customer, not the company. At present rates, a customer in a high-cost location who considers adding an additional line will still consider the price of service before choosing to make the additional expenditure. We do not expect customers who today do without an extra line from either technology to spend money on wireless service because the carrier qualifies for support in high-cost locations.

If wireless service costs less to provide than wireline service in some high-cost locations, the wireless carrier reaps the benefit of being a more efficient provider. At the same time, customers are not harmed because the overall size of the fund is not increased by customers choosing wireless service. Western Wireless presented information to the WUTC at its July workshop that indicated wireless may be the cheaper alternative in some very-high-cost areas. We hope it and other carriers will pursue opportunities in such locations.

At some point in the future it may be necessary to inquire into wireless carrier costs. That is not the case at present and we do not expect it to be the case in the near future. If that time should come, it will be important for the inquiry to be conducted in a manner that creates more benefit than burden.

## 2. Affordability and Shared Costs

The Telecommunications Act of 1996 requires that rates be set at just, reasonable and affordable levels.<sup>98</sup> The Act added affordable to the previous requirement that rates

---

<sup>98</sup> Quality services should be available at just, reasonable, and affordable rates. 47 U.S.C. § 254(b)(1); See also 47 U.S.C. § 254(i).

be just and reasonable.<sup>99</sup> States are also expected to see that rates are affordable.<sup>100</sup>

The most capital-intensive part of the service is the local loop which is the wire that runs between the customer's home or business and the telephone company's switch or wirecenter. Because the local loop is essential to most telecommunications services, its cost is shared among the services that require a loop, including local service, long distance service, and optional features.

In setting rates, the WUTC must always answer the question: What share of the loop cost local, long-distance and features should bear? The Telecommunications Act

---

<sup>99</sup> Section 201(b) of the Telecommunications Act of 1934 requires that "All charges...be just and reasonable", but not "affordable" as found in 47 U.S.C. 254(i). The Section 201(b) requirement can be traced from the original Interstate Commerce Act, 24 Stat. 379 (1887) and common law. At common law, common carriers were prohibited from discriminating against persons or places and could not give preferences. See Paglin, Max D., ed., A Legislative History of the Telecommunications Act of 1934, New York, Oxford University Press, 1988. In Washington, the WUTC is to ensure that "...rates...shall be just, fair, reasonable and sufficient..." RCW 80.36.080.

<sup>100</sup> See 47 U.S.C. ? 254(i).

anticipated a move to shift common costs to basic services in order to increase the amounts carriers collected from a universal service fund. To guard against this, Congress required a reasonable sharing of common costs:

The [FCC], with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to *ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs* of facilities used to provide those services.<sup>101</sup>

Because Supported services are to bear *no more than a reasonable share* of joint and common costs, therefore other services must also share in the cost of the local loop.<sup>102</sup> If the price for basic monthly service is affordable, then the actual cost in high-cost locations, as determined by the WUTC in the adjudication, must be covered by a contribution from services other than basic services and by the explicit fund.

---

<sup>101</sup> 47 U.S.C. § 254(k) (emphasis added).

<sup>102</sup> The WUTC has previously determined that the loop is a shared cost. *See* WUTC Cause No. U-85-23, et al., Eighteenth Supplemental Order, p. 20 (December 30, 1986); WUTC Docket No. UT-950200, Fifteenth Supplemental Order, p. 85 (April 11, 1996); and WUTC Docket No. UT-970325, Order Adopting rules permanently, p. 15 (September 23, 1998).

B. Benchmark

How much of the cost should be covered by services other than the charge for basic monthly service is the key decision in establishing a benchmark. A benchmark is the amount a local exchange company is expected to collect from its customers in high-cost locations. It is the amount subtracted from the cost of basic service to determine the amount of support per line.<sup>103</sup> Three suggestions have been made for determining a benchmark. One is to base it on cost, another is to base it on the price of local service, and a third is to base it on average revenue per-loop received by local carriers.

1. Cost Benchmark

---

<sup>103</sup> See ESSB 6622, Sec. 1(7)(c).

A cost benchmark is advocated by GTE and US WEST.<sup>104</sup> GTE suggested that the WUTC ? simply state an intention to intervene in the market by providing universal service support in areas where basic service costs exceed an affordable or acceptable level.?<sup>105</sup> US WEST stated that a ? cost-based benchmark gives the [WUTC] more flexibility to initially size the Washington high cost fund? and went on to suggest ?[t]he [WUTC] could also consider defining the high cost threshold in Washington to be in the range of 120% to 130% of the statewide average costs.?<sup>106</sup>

## 2. Price Benchmark

WITA proposes a price benchmark.<sup>107</sup> Sprint/United, while less clear, appears also to advocate a price benchmark.<sup>108</sup> A price benchmark is one that would provide explicit support from a fund for all costs above the monthly price of basic local exchange service. As WITA stated, ? [i]f the benchmark reflects what a customer in a high cost area can afford

---

<sup>104</sup> GTE comments on 1st draft rules at 9. US WEST June 8 comments at 13.

<sup>105</sup> GTE comments on 1st draft rules at 9. In its response to staff questions, GTE seemed to be advocating a price benchmark rather than a cost benchmark. *See* GTE June 8 comments at 19, 20.

<sup>106</sup> US WEST June 8 comments at 13-15.

<sup>107</sup> WITA comments on 1st draft rules at 4, 5. In the comments on the 2nd draft rules, WITA advocates an ? affordability? benchmark, which we interpret to be the same position. *See* comments on 2nd draft rules at 2.

<sup>108</sup> Sprint/United comments on 1st draft rules at 4.

to pay, the [WUTC] is assured that the universal service fund is fulfilling its purpose.<sup>109</sup>

3. Revenue Benchmark

---

<sup>109</sup> WITA comments on 1st draft rules at 4, 5.

TRACER, Public Counsel, MCI and AT&T support a revenue benchmark.<sup>110</sup> In response to the draft rules, Public Counsel commented that “[t]he network is used to deliver many services and its costs can and should be recovered across the full range of services that use the network.”<sup>111</sup> TRACER agrees that the revenue benchmark should take account of “all revenues the [carrier] receives as a result of providing service, including vertical service revenue and revenue from all access services.”<sup>112</sup> AT&T suggests that the revenue benchmark should include revenues from “local service, discretionary services such as call waiting, call forwarding and caller ID, directory assistance, operator services, toll services, white pages, yellow pages, subscriber line charges, and access services (to the extent that rates for access have not been reduced to forward-looking economic costs).”<sup>113</sup>

---

<sup>110</sup> TRACER June 8 comments at 19; and its comments on 1st draft rules at 15-17. Public Counsel June 8 comments at 23-44; and its comments on 1st draft rules at 2. MCI June 8 comments at 9. AT&T June 8 comments at 11; and its comments on 1st draft rules at 11-12.

<sup>111</sup> Public Counsel comments on 1st draft rules at 2.

<sup>112</sup> TRACER comments on 1st draft rules at 15.

<sup>113</sup> AT&T June 8 comments at 11. Note that the WUTC adopted access charge rules in July intended to reduce terminating access to forward-looking economic costs. *See* WUTC Docket No. UT-970325.

#### 4. Benchmark Discussion

The WUTC in its draft rule rejected a cost benchmark because it does not provide a principled guide for determining what amount of the shared cost of the local loop should be borne by services other than basic services. GTE's proposal that the WUTC intervene when the cost of basic service exceeds "an affordable" amount does not provide guidance. If explicit support is provided above that amount, then no costs are shared by the many other services provided over the local loop in direct contradiction to section 254(k). Providing explicit support when costs are above "an acceptable level" also provides no guidance. If acceptability is not tied to something specific (e.g. earnings from other than basic services provided over the local loop) then it is merely arbitrary.

We also found wanting US WEST's suggestion that a cost benchmark be used because it gives the WUTC more flexibility in sizing the fund. This suggests that the benchmark is a tool to keep the fund from being unacceptably high or low rather than being related by some principle to the costs to be shared by other than basic services. The suggestion that the cost benchmark should be pegged "in the range of 120% or 130% of the statewide average costs" without any showing that those percentages reflect in some manner the costs required by section 254(k) to be shared by services other than basic services is also without foundation. Without some substantiation in fact, choosing either

120% or 130%, or any other percentage, would be arbitrary.<sup>114</sup>

We rejected a price benchmark based on the price of monthly local exchange service because it does not reflect any contribution to the cost of the local loop from services other than basic services. If a price benchmark is used, then other services that share the loop are not required to provide support. Put another way, in high cost locations, all ratepayers across the state, through the explicit fund, would bear the cost of delivery of other than basic services and the local carrier would keep all revenue from vertical and advanced services, providing earnings without cost. An analogy would be letting trucks that carry luxury goods travel our highways without making any contribution to the cost of the roads and, continuing the analogy, requiring those who haul milk, food, and similar necessities of life to pay the entire cost of our road system.

## 5. WUTC Chooses Revenue Benchmark

---

<sup>114</sup> WITA, in response to staff questions, suggested that "[s]upport could be provided at a percentage above statewide average cost, such as 115% or 120%." Like US WEST, its comments did not provide a foundation for choosing one percentage over another. See WITA June 8 comments at 10.

The revenue benchmark is preferred by the WUTC and is incorporated into the draft rules.<sup>115</sup> A revenue benchmark incorporates the requirement in section 254(k) of the Act that basic services bear no more than a reasonable share of joint and common costs. The purpose of section 254(k) is to prevent a shift of costs from non-regulated (competitive) services to regulated services.<sup>116</sup> If a carrier can recover all joint and common costs from supported services, discretionary services will receive a free ride.<sup>117</sup> This would harm the development of competition because an incumbent's competitive products would have a lower cost floor and the lower cost floor would not be due to economies of scope or scale.

---

<sup>115</sup> See draft rule WAC 480-123-190.

<sup>116</sup> See Cost Order at ? 286.

<sup>117</sup> ? Monopoly providers will subsidize their competitive services, if they can, and they will certainly maximize the recovery of joint and common costs from those customers with the fewest options.? Public Counsel June 8 comments at 30. Note that evidence in the adjudication suggests that Sprint/United proposed that no overhead costs be recovered from vertical services. See Cost Order at ? 283.

A revenue benchmark prevents windfalls by prohibiting cost shifts.

A revenue benchmark also fulfills the requirements of section 254(k) that basic services bear no more than their share of joint and common costs. If discretionary services and other non-basic services do not share in the cost of the network, then the full cost would be borne by the consumer through the bill for basic monthly service and by the explicit fund. Consumers would in effect be required to subsidize non-basic services.

**CHART 3 - Total Support Based on Competitive Effects On Revenue Per Line**

Support Based on \$31 Residence and \$51 Business Revenue Benchmarks	Support Based on \$29 Residence and \$49 Business Revenue Benchmarks	Support Based on \$33 Residence and \$53 Business Revenue Benchmarks
Total.....\$70,282,014	Total.....\$76,823,478	Total.....\$64,608,286

C. Establishing a Benchmark

1. Statewide Average Revenue Benchmark

The rules propose setting a wireline and a wireless benchmark at the statewide average revenue per line. In the short term, a revenue benchmark based on the statewide average revenue per line represents the best understanding of what is affordable to ratepayers and what carriers receive for their services. In the medium term, the WUTC

believes there is a possibility that competitive pressure will reduce carrier per-line revenue and that the benchmark may need to be adjusted if this occurs.<sup>118</sup> The total size of the fund will climb somewhat if the benchmark is reduced and costs do not decline. In the long term, however, a revenue benchmark holds the potential of keeping basic rates from rising. As Public Counsel stated, “[a]s the uses of the network expand in the information age, the burden placed on consumers for basic services should decline.”<sup>119</sup>

## 2. Exchange-by-Exchange Benchmark

Another way to view the statewide average per-line revenue is as a proxy for affordability for ratepayers and the value of the network to carriers with respect to non-basic services. As stated above, the statewide average is the best choice for an initial benchmark. Among other things, it is simple to administer and it smooths out the effects of a wide variety of pricing policies developed in a monopoly service environment. Over the long run, it has the virtue of reducing the likelihood that a carrier could successfully shift costs onto the universal service fund by unreasonably lowering its prices in high-cost locations. The lack of success would be due to inclusion of per-line revenue averages from

---

<sup>118</sup> See draft rules WAC 480-123-360, 370.

<sup>119</sup> Public Counsel comments on 1st draft rules at 2.

low-cost locations in the calculation of the statewide average.

Notwithstanding the reasons that make a statewide average revenue per-line the proper initial choice for a benchmark, the WUTC has proposed a rule that would allow deviation from that standard if circumstances warrant. One option that will be considered in the 18 month review under the rules will be consideration of exchange-by-exchange revenue benchmarks.<sup>120</sup> Concern that average revenue in a given exchange might be considerably lower or higher than the statewide average is found in comments of the IBA.<sup>121</sup>

### 3. Residential and Business Benchmarks

The WUTC proposes to establish a separate benchmark for wireline residential service and for business service. Wireline carriers provide service to residences and

---

<sup>120</sup> Information about exchange-by-exchange revenue is limited. The WUTC asked for this information from carriers in the adjudication and the rulemaking but it was not forthcoming from many incumbents. Prior to implementation of the proposed rules the WUTC will make a third attempt to obtain this information.

<sup>121</sup> IBA comments on 2nd draft rule at 2.

business at different rates and the amount of support needed will be more accurately determined if this fact is recognized and accounted for in determining high-cost locations and the amount of support needed to provide basic service.

Because not all carriers have responded to requests for revenue information, the WUTC has used amounts developed by the FCC as average revenues for residential and business service to estimate the size of the fund necessary to support universal service.<sup>122</sup> The amounts are \$31 per line for residential service and \$51 per line for business service.<sup>123</sup> We do not expect Washington averages, once ascertained, to vary significantly from these amounts.

#### 4. A Single Wireless Revenue Benchmark

---

<sup>122</sup> See Cost Order at ? 15(h).

<sup>123</sup> See ? 267, First Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (May 8, 1997).

Wireless service is provided without regard to residential and business distinctions. As a result, there is only one benchmark for wireless service. That amount is \$37.20.<sup>124</sup>

---

<sup>124</sup> Based on reports to the Department of Revenue from the largest wireless carriers operating in Washington.

GTE, TRACER, US Cellular, and WITA all state their opinion that a wireless benchmark should be the same as the wireline benchmark and result in identical payments.<sup>125</sup>

As a practical matter, because there are two wireline benchmarks, a single wireless benchmark cannot be the same. Just as the industry sets separate prices for business and residential service, it sets separate prices for wireless and wireline service. To ignore this difference by setting the same benchmark for both types of service would produce a windfall for wireless providers and could result in unaffordable service for wireline customers. The wireless benchmark reflects, like the wireline benchmarks, a combination of the affordability of the service to the consumer and the value of the network to the carrier, and it is therefore appropriate to set it in the same manner.

Additionally, WITA is concerned that the WUTC does not have the information necessary to determine the per-line average revenue for wireless and that the WUTC does not have the jurisdiction to require reporting of this information.<sup>126</sup> The jurisdiction to collect the information from otherwise unregulated wireless carriers is in section 1(8) of ESSB 6622. The information was gathered in July from cooperating carriers representing the eight largest suppliers of wireless service in Washington.

---

<sup>125</sup> GTE comments on 2nd draft rules at 16-17. TRACER comments on 2nd draft rules at 23-24. US Cellular comment on 2nd draft rules at 7-8. WITA comments on 2nd draft rules at 6-7.

<sup>126</sup> WITA comments on 2nd draft rules at 6-7.

D. Included Revenue

The revenue considered in setting the benchmark is revenue from telecommunications services provided by carriers to residences and businesses. It includes revenue from local exchange service, advanced features, network access, subscriber line charge and the presubscribed interexchange carrier charge (access substitutes), and limited toll revenues. The rule permits the WUTC to consider other revenue when setting the benchmark and to consider what portion of a bundled service price should be included in the calculation of a benchmark.

TRACER supports the list of revenues in the rule.<sup>127</sup> WITA, on the other hand, expresses concerns about some of the included revenues. One concern is that inclusion of access revenue ?unfairly skews the benchmark as it relates to rural companies.?<sup>128</sup> WITA is also concerned that including access revenue is contrary to the WUTC access reform rule intended to remove implicit support from access.<sup>129</sup> However, in lieu of inclusion of local exchange carrier toll revenue, WITA suggests including the imputed access revenue portion of such local exchange carrier toll revenue.

---

<sup>127</sup> TRACER comments on 2nd draft rules at 12.

<sup>128</sup> WITA comments on 2nd draft rules at 2-3.

<sup>129</sup> *See* WUTC Docket No. UT-970325. The access reform rule is not intended to remove implicit support from access. It is intended to identify implicit support so that the price of terminating access, a bottleneck service, can be set at cost and previously implicit support for universal service can either be moved to a competitively neutral fund or placed on terminating access as an identified rate element above the cost of providing terminating access. While not intended to remove implicit support from access, it will make that task easier when universal service rules are adopted and implicit support found in substantially above cost access rates will be removed.

Finally, WITA considers the latitude provided the WUTC to include ? such other revenue as the Commission determines? is an improper exercise of rulemaking. US WEST joins WITA in expressing concern about including ? other revenues? at the discretion of the WUTC and finds unclear the purpose of the bundled service language.<sup>130</sup> GST also raises the issue of the bundled service language and believes greater specificity is necessary.<sup>131</sup>

1. Inclusion of Access Revenue

As explained previously, the purpose of a revenue benchmark is to approximate the amount paid by consumers for basic service and the joint and common costs that should be contributed by services other than basic services and to ensure that the customer?s overall telephone bill does not exceed an affordable cost. A revenue benchmark also helps avoid cost shifting from competitive to monopoly services.

---

<sup>130</sup> US WEST comments on 2nd draft rules at 5.

<sup>131</sup> GST comments on 2nd draft rules at 2.

A major source of revenue for all local exchange carriers is access revenue received for originating and terminating toll calls. Rural companies, in particular, receive high amounts of access revenue; access revenue constitutes between 20% and 60% of their total revenue.<sup>132</sup> This is received as both implicit support and as explicit support through an existing access rate add-on permitted by the WUTC for high-cost companies.<sup>133</sup> WITA is concerned that inclusion of access unfairly skews the benchmark as it relates to rural companies because of their reliance on this form of revenue. While it is not clear what WITA means by "unfairly skews", it is not necessary to determine what effect if any the high access rates have. It is not necessary because the WUTC plans to set the revenue benchmark for wireline companies on a statewide average. Using the statewide average ameliorates the effect of any skewing, to the extent it may be a legitimate concern. Moreover, to the extent the rural companies have high access revenues to support service in high-cost locations, those revenues can be reduced when a competitively neutral fund is created.

WITA is also concerned about continued inclusion of access revenue in the benchmark after implicit support is removed. The benchmark is, in part, a measure of the

---

<sup>132</sup> See WUTC Docket No. UT-970325, Order Adopting Rules Permanently (October 5, 1998), p. 4; and "Staff Report on Access Charge Reform Options," January 13, 1998, Appendix (this was a handout at a WUTC rulemaking workshop for industry representatives). The industry average is about 20%; rural carriers tend to have access revenue closer to the top of the 20 to 60% range.

<sup>133</sup> See WUTC Cause No. U-85-23, et al., Eighteenth Supplemental Order, p. 20 (December 30, 1986).

value of other than basic services provided over the network. That value will increase or decrease as revenues change and will affect the level of the statewide average revenue per line. So long as access is a source of revenue it must be included; the level of revenue from any one service included in the benchmark is not an issue so long as all revenues are accurately counted so the resulting calculation of the average is accurate.

With respect to inclusion of imputed access in lieu of local exchange carrier toll revenue, that too would result in an inaccurate proxy of the value of the network that should be shared by services other than basic services.

The concern expressed by WITA and US WEST that permitting the WUTC to consider and include other revenues at the discretion of the WUTC, and GST's and US WEST's concern that inclusion of revenue from bundled service prices is problematic, goes to the heart of the complexity of arriving at a balance in the administration of a program that must operate in a competitively and technologically neutral manner. Discretion is necessary if the WUTC is to alter the benchmark in response to changes in the telecommunications industry. A static program will not serve a dynamic industry.

Flexibility is also necessary to prevent "gaming" the system. The portion of the rule relating to bundled services is necessary to prevent carriers from providing a variety of services but attributing most of the revenue to a service that is not covered by the definition of the revenue benchmark. An example would be charging \$19.95 for voice mail, a service not included in the definition, and bundling it with local exchange service, call forwarding

and other covered services at no charge. The benchmark would be artificially reduced if this were done to any great degree and the size of the fund would be inflated resulting in customers being forced to pay for non-basic services through the universal service fund.

E. How Much Should Implicit Support Be Minimized

In ESSB 6622, the WUTC was directed to prepare a program of universal service that would minimize implicit support and maximize explicit support. Providers of local telecommunications service point to this goal as a reason to support a price benchmark or a cost benchmark. While the WUTC has prepared a set of draft rules that would reduce implicit support and provide explicit support for basic services in high-cost locations, it does not go so far as to ignore the nature of the local loop as a shared facility with joint and common costs attributable to many services, including long-distance access, local service, and discretionary services.

GTE argues that rates for access and vertical features must be set equal to cost in order to eliminate implicit support.<sup>134</sup> Rates for these services are well above cost, but it does not follow that the margin is implicit support. In a multi-product network, every service will be priced above its individual cost in order to pay for the cost of the network itself.

---

<sup>134</sup> This argument was made in a meeting between GTE and WUTC staff.

As competition increases, the margins on various services may change. The prospect of such change is one reason to set the benchmark based on revenue from all services and not on the price of any one service.



## VII.

### CONTRIBUTIONS AND CONTRIBUTORS TO THE FUND

#### A. Equitable and Nondiscriminatory Contributions

The Telecommunications Act of 1996 requires every telecommunications carrier that provides intrastate telecommunications services to contribute to the preservation and advancement of universal service on an equitable and non-discriminatory basis. To be equitable, contributions must be determined on a basis common to all carriers. To be nondiscriminatory, contributions must be required of companies providing like services.

##### 1. Who Should Contribute

The WUTC has previously recommended that contributions be required of all telecommunications carriers<sup>135</sup> and the FCC also concluded that all carriers should contribute.<sup>136</sup> The WUTC recommendation is reflected in Section 1(2)(b) of ESSB 6622, which requires assessments on all telecommunications carriers. Accordingly, the WUTC in

---

<sup>135</sup> See "Preserving and Advancing Universal Service in a Competitive Environment," WUTC, January 1998, p. 63.

<sup>136</sup> See "780, First Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (May 8, 1997).

its draft rules requires contributions from all telecommunications carriers.<sup>137</sup> Requiring contributions from the same carriers in Washington as is called for in federal law will result in a nondiscriminatory contribution requirement.

## 2. Private Telecommunications Networks

TRACER has stated that it does not support contribution requirements for private telecommunications networks that do not impact the public switched telephone network. The WUTC agrees with TRACER on this issue and we maintain the position taken last January that completely separate, private networks should not be required to contribute to universal service. In this we are congruent with the position of the FCC. The FCC includes as telecommunications carriers those networks "effectively available to the public" and interprets this to mean "systems not dedicated exclusively to internal use..." or systems that provide services to "users other than the significantly restricted classes."<sup>138</sup> In our previous report on universal service, we stated that it is the sale or lease of excess capacity

---

<sup>137</sup> US WEST supports the proposed rule that includes all telecommunications carriers. US WEST comments on 2nd draft rules at 7. See draft rules WAC 480-123-130 and 210.

<sup>138</sup> "788, Recommended Decision, In the Matter of Federal-State Joint Board on Universal Service, CC

on a private network that should trigger a contribution requirement.<sup>139</sup>

B. The Basis for Contributions

---

Docket No. 96-45 (November 8, 1996).

<sup>139</sup> See "Preserving and Advancing Universal Service in a Competitive Environment," WUTC, January 1998, p. 61.

In order to comply with the requirement that contributions be equitable, it is necessary to base contributions on a factor common to all telecommunications carriers. In *Preserving and Advancing Universal Service in a Competitive Environment*,<sup>140</sup> the WUTC recommended basing contributions on gross revenue net of payments to other carriers while rejecting contributions based on end-user retail revenue, gross revenue, and per-line or per-minute (non-revenue-based) factors.<sup>140</sup> At that time, the WUTC concluded that contributions based on gross revenue net of payments to other carriers would result in greater equity than the other bases and would be no more administratively burdensome than other approaches, particularly the end-user retail basis for determining contributions.<sup>141</sup>

---

<sup>140</sup> See *Preserving and Advancing Universal Service in a Competitive Environment*, WUTC, January 1998, p. 67. Sprint Spectrum June 8 comments support a per-line charge at 7.

<sup>141</sup> See *Preserving and Advancing Universal Service in a Competitive Environment*, WUTC, January 1998, p. 65.

Preparation of draft rules and efforts to collect information related to carrier gross revenue net of payments to other carriers has proven difficult. What was anticipated to be more fair and less administratively burdensome than relying on end-user retail revenue has turned out not to be so. Comments reflected the concerns of carriers. TRACER, US WEST, WITA, US Cellular, and Public Counsel all advocate the use of end-user retail revenue.<sup>142</sup>

At the same time the WUTC was finding its approach less than simple, the FCC had successfully begun a contribution program based on end-user retail revenue.<sup>143</sup> Given the success of the FCC in implementing its program, the comments of carriers and others urging the WUTC to use end-user retail revenue, and especially because a great deal of administrative burden is eliminated for carriers and the fund alike, the WUTC has chosen to adopt the FCC approach as a substitute for one of its own. The result will be an equitable basis for contribution with minimal reporting requirements because the WUTC can use the same form as carriers file with the FCC twice a year. The amount of contribution to the fund will be the same, with the difference being that carriers without end-users (a carriers? carrier<sup>144</sup> that, for example, carries long distance traffic from one LEC to another) will not

---

<sup>142</sup> TRACER comments on 1st draft rules at 14. US WEST comments on 1st draft rules at 8, 11, 12. WITA comments on 1st draft rules at 3. US Cellular June 8 comments at 16. Public Counsel June 8 comments at 50.

<sup>143</sup> See 47 C.F.R. ? 54.703

<sup>144</sup> Worldcom is a major carriers? carrier, also in this class would be the carrier access division of US WEST.

contribute directly, but will do so indirectly based on the prices agreed to with the carriers they serve.<sup>145</sup>

1. Carrier Contributions Required by Law

---

<sup>145</sup> The FCC acknowledged that this approach may cause some problems for intermediate (carriers? carriers) providers that have long-term contracts to provide service. *See ? Preserving and Advancing Universal Service in a Competitive Environment? Report to the Legislature, WUTC, January, 1998 p. 65-66, citing ? 850, First Report and Order, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (May 8, 1997).*

Though federal law clearly calls for contributions from carriers, most interested parties have advocated that a line-item charge be placed on customers' bills.<sup>146</sup> The preferred form of the line-item charge is a percentage surcharge on the end-user retail telecommunications services bill which means the amount would vary from month to month.<sup>147</sup> Public Counsel and WITA oppose a line-item on customer bills.<sup>148</sup>

The WUTC recommends that carriers contribute to a new universal service fund directly as a cost of doing business. This approach has three arguments in support.

The first reason is that it appears to be what the law requires. Every reference in the federal Act is to carrier contributions; there are no references to customer contributions.<sup>149</sup>

In ESSB 6622, it is the same; the WUTC was directed to determine the amount of

---

<sup>146</sup> ?The customer charge approach should be used.? GTE comments on 2nd draft rules at 5. *See also* US WEST June 8 comments at 20. AT&T June 8 comments at 14. GTE June 8 comments at 26. MCI June 8 comments at 12. TRACER comments on 1st draft rules at 25.

<sup>147</sup> Not every carrier proposes a line-item charge. Airtouch recommends funding from ? the general treasury of the State of Washington.? Airtouch comments on 2nd draft rules at 10.

<sup>148</sup> Public Counsel June 8 comments at 51-53. WITA June 8 comments at 14.

<sup>149</sup> *See* 47 U.S.C. ? 254(b), (e) and (f).

assessment that must be made on carriers.<sup>150</sup>

Second, a line-item charge bypasses the benefits that competition and residual rate regulation provide customers. If the universal service contribution is treated as a cost of doing business, a company offering competitive services will need to make decisions whether to raise their rates to cover the cost. For a company offering regulated services, it would need to demonstrate to the WUTC that it would not be earning its authorized rate of return. In either case, the financial impact on customers would be minimized by the effects of competition and regulatory oversight.

The third reason is to treat universal service contributions in the same manner as compliance with other requirements. Carriers are required to adhere to maintenance and service quality standards as a cost of doing business. In other areas of commerce, farm commodities for example, producers recover their commodity commission payments in the price they charge for their product. Similarly, grocery stores do not add a line item at the checkout stand for the cost of pension contributions, Labor and Industry premiums, sanitary code compliance or other costs of doing business. Support for universal service, like routine costs faced by other businesses, has always been a cost of doing business.

---

<sup>150</sup> ESSB 6622 Sec. 1(2)(b).

Carriers have argued that charging the customer directly is competitively neutral.<sup>151</sup>

While this may be so, it is also competitively neutral to require contributions from companies on an equitable basis and to let them adjust their prices. This is the approach advocated by Public Counsel.<sup>152</sup> It notes that in other markets different firms choose to recover their costs in different ways as they compete in the marketplace.<sup>153</sup>

## 2. Taxation of Contributions

TRACER states that if carriers include the cost of contribution in their charges for service, the contribution would be treated as revenue and would be subject to federal and state taxes.<sup>154</sup> TRACER has correctly identified the situation as it is today. Most universal service support is implicit and it is found in higher-than-cost rates for local exchange service and access service, both of which are revenue to carriers that is subject to taxation. The treatment of the contribution as a cost of doing business does not change the status quo with respect to state and federal taxes. Tax policy is beyond our jurisdiction. TRACER should ask the Legislature and Congress to create deductions for contributions paid by carriers to the state universal service fund.

---

<sup>151</sup> US WEST comments on 1st draft rules at 5-7. GTE comments on 1st draft rules at 5.

<sup>152</sup> Public Counsel comments on 1st draft rules at 5, 6.

<sup>153</sup> Id.

<sup>154</sup> TRACER comments on 2nd draft rules at 20.

3. Universal Service Not an Exceptional Cost  
of Doing Business

Requiring that companies treat their USF contributions as a cost of doing business does not mean that customers will not ultimately bear the cost of this program (as they bear it today) or that customers will receive a windfall with implementation of this program. All companies, regulated or not, will have an opportunity to recover all reasonable costs of providing services. Universal service contributions are no exception as a cost of doing business and should not be treated exceptionally.

C. Information on Customer Bills

As stated above, most carriers support placing a surcharge directly on customer bills.<sup>155</sup> Even though we have rejected that as unnecessary, we expect many interested parties to argue for, at a minimum, a statement on each customer's bill that states the percent of the customer's total bill that is taken by the carrier and contributed to universal service. The WUTC does not favor such a proposal because it cannot be done accurately.

Carriers, like all enterprises that must cover the costs of doing business through

---

<sup>155</sup> See US WEST comments on 1st draft rules at 13.

prices for various products, will cover the cost of universal service in a variety of ways, just as they recover all their other costs of doing business in a variety of ways. If a carrier faces competition on all fronts, it may have to forego recovery through higher prices. If a carrier faces competition in long-distance but not in features, then it will likely recover its costs of doing business in feature prices. Other carriers, in order to gain or keep market share, offer promotional prices from time to time, thus shifting the recovery of their costs of doing business onto non-discounted services. Customers who take advantage of a promotional price will contribute less than another customer to cover the carrier's costs of doing business, including universal service support. In each of these examples, the percent of a given customer's total bill that is being contributed by the carrier to support universal service cannot be accurately determined. If it cannot be determined accurately, it cannot be reported accurately.

While the WUTC is not opposed to providing customers with information about universal service contributions, it rejects portraying universal service support as a percentage of the customer bill. That would imply that customers are paying the full and equal amount of a company's contribution. This would not be true; companies will be paying the contribution.

Inaccurate statements should not be placed on consumer bills. In this opinion, the WUTC is not alone. AT&T agrees, and stated it must acknowledge that the state has a legitimate interest in a carrier's communication to consumers regarding how the subsidy is

described and ensuring that those communications are not misleading.<sup>156</sup> Consumer complaints about confusing telephone charges have grown in recent years.<sup>157</sup> The addition of information that is inaccurate and cannot be used by consumers to make economic choices would not serve consumers or carriers. As Public Counsel noted, “[w]e believe that it is fundamentally misleading to claim that the surcharge needs to be on the bottom of the bill in order to inform consumers, when that information is useless for purposes of economic decision making.”<sup>158</sup>

As an alternative, the proposed draft rules require disclosure by carriers of the amount the carrier receives from the fund each month, the carrier’s contribution each month, the amount of support per-line received by the carrier in the customer’s exchange,<sup>159</sup> and a recurring statement of the carrier total per-line rate reduction ordered under the proposed rules.<sup>160</sup> These disclosures can be accomplished with accurate, verifiable, and uniform information. In addition, the fund administrator will inform the public of the

---

<sup>156</sup> AT&T comments on 1st draft rules at 17-18.

<sup>157</sup> Complaints to the WUTC related to billing have more than doubled in two years and continue at an increasing rate.

<sup>158</sup> Public Counsel comments on 1st draft rules at 5.

<sup>159</sup> In low-cost locations, this amount will be zero; only in high-cost locations that require support to maintain affordable service will there be an amount of more than zero.

<sup>160</sup> See draft rule WAC 480-123-290 and draft rule WAC 480-123-390.

purpose and operation of the universal service program each year.<sup>161</sup>

D. Should Wireless Carriers Contribute

---

<sup>161</sup> See draft rule WAC 480-123-300.

In the WUTC's first report on this issue, we recommended that wireless carriers contribute to the fund and that they be eligible to draw from the fund to the extent they serve customers in high-cost locations.<sup>162</sup> US WEST, AT&T, WITA, MCI, GTE, Shared Communications Services, TRACER, Sprint/United, and Public Counsel agree that wireless carriers should contribute to the fund.<sup>163</sup> Airtouch, US Cellular and Sprint Spectrum (PCS) all oppose wireless contribution to the fund.<sup>164</sup>

The opposition to contribution from wireless companies is based on their view that the Telecommunications Act of 1996 preempted states from requiring contributions from wireless carriers.<sup>165</sup> Airtouch considers the contribution requirement, coupled with the

---

<sup>162</sup> See "Preserving and Advancing Universal Service in a Competitive Environment," WUTC Report to the Legislature, January, 1998, at p. 60-63.

<sup>163</sup> US WEST June 8 comments at 20. AT&T June 8 comments at 14. WITA June 8 comments at 14. MCI June 8 comments at 12. GTE June 8 comments at 25. Shared Communications Service June 8 comments at 4. TRACER June 8 comments at 30. Sprint/United June 8 comments at 15. Public Counsel June 8 comments at 50.

<sup>164</sup> See generally the June 8 comments of Sprint Spectrum (PCS), US Cellular and their comments on the 1st draft rules and the Airtouch comments on the 1st draft rules.

<sup>165</sup> See Airtouch comments on 1st draft rules at 5-9. This issue is being litigated; see US Cellular June 8

limitation on billing customers directly, to be impermissible rate regulation under 47 U.S.C. ? 332(c)(3)(A).<sup>166</sup> Airtouch contends that the prohibition of a line-item charge for universal service will require wireless carriers to raise service rates and imposes conditions on profit margins. In support of its position, Airtouch quotes the first sentence of 47 U.S.C. ? 332(c)(3)(A).

---

comments at 2, n 1. *See also* US Cellular comments on 2nd draft rules at 8.

<sup>166</sup> Airtouch comments on 2nd draft rules at 9-10.

Notwithstanding sections 2(b) and 221(b), no state or local government shall have any authority to regulate the entry of or the rates charged by any commercial mobile service or any private mobile service, except that this paragraph shall not prohibit a state from regulating the other terms and conditions of commercial mobile services.<sup>167</sup>

---

<sup>167</sup> This section of federal law may also relate to the earlier topic of billing statements. With respect to the requirement for full and accurate billing statements concerning universal service, 47 U.S.C. § 332(c)(3)(A) is not as sweeping a section of law as Airtouch might have us think. The Washington Supreme Court, rejecting a claim by AT&T that state courts are preempted from deciding cases of negligent misrepresentation concerning wireless billing contracts, recently had occasion to interpret this section and quoted approvingly the House Report filed at the time of adoption. "It is the intent of the Committee that the states would be able to regulate the terms and conditions of these services. By 'terms and conditions,' the Committee intends to include such matters as customer billing information and practices and billing disputes and other consumer protection matters..." Tenore v. AT&T Wireless Servs., 136 Wn.2d 322 (1998), quoting H.R. Rep. No. 103-111, 103rd Congress, 1st Sess. 211, 261, reprinted in 1993 U.S.C.A.A.N. 378, 588. Just as 47 U.S.C. § 332(c)(3)(A) does not prevent state courts from considering issues related to billing disputes, we believe it does not preclude us from requiring full, accurate statements on bills regarding universal service.

We note the sentence that immediately follows the one quoted by Airtouch..

Nothing in this subparagraph shall exempt providers of commercial mobile services (where such services are a substitute for land line telephone exchange service for a substantial portion of the communications within the State) from requirements imposed by a State commission on all providers of telecommunications services necessary to ensure the universal availability of telecommunications service at affordable rates.

It is clear that Congress intended wireless carriers to participate in state programs of universal service that are applied to all providers of telecommunications services. The only issue is whether wireless services are a substitute for land line telephone exchange service for a substantial portion of communications within Washington. Because there are over 1.1 million wireless customers in Washington, equaling about one-quarter of all access lines, wireless service is clearly a substantial substitute for using land line pay phones when one is away from home or the office.<sup>168</sup> Because of the substantial substitution, and because the requirements to which Airtouch objects are imposed on all providers of telecommunications services in order to ensure the universal availability of telecommunications service at affordable rates, wireless carriers should not be exempt

---

<sup>168</sup> This does not mean that incumbent local exchange companies do not maintain *de facto* monopolies in their serving territories.

from these proposed regulations.

The WUTC has considered wireless views and the views of other commenters who support participation in the fund by wireless carriers. It is not an insignificant issue because the eight largest wireless carriers in Washington serve over 1.1 million customers and have telecommunications services revenue in excess of \$500 million annually.<sup>169</sup> The basis for the WUTC's original recommendation was that it conforms with federal law and the FCC interpretation of federal law. If all telecommunications carriers are to be treated alike, without respect to technology or services, then wireless companies must be included in the universal service program. We also based our decision on the fact that wireless and wireline carriers trade millions of calls each day. Both services add substantial value to each other's network. Because the purpose of universal service is to have a network available to all citizens for their personal benefit and the benefit of commerce, both technologies serve that purpose and wireline and wireless should be treated equally in respect to contributing to the network.

The WUTC shares the concern of wireless providers that they not be regulated by state commissions. Requiring a contribution for the support of the network that they need and are part of, however, is not regulation as commonly understood. A wireless company

---

<sup>169</sup> This information was collected by the Department of Revenue with the assistance of the wireless carriers and the WUTC gratefully acknowledges the assistance and cooperation provided in obtaining this information. To put the number of subscribers and revenue in perspective, the 1.1 million wireless loops is less than half the number of wireline loops served by US WEST, but the revenue of over \$500 million annually is more than half of what US WEST reports as its revenue from regulated services. There are more than 3 million wireline loops in Washington.

that does not choose to be a participant in the fund, will not have to meet any of the requirements placed on carriers that do draw from the fund. If a wireless carrier does choose to become an eligible telecommunications carrier and draw from the fund, the only expectation is that it comply with the same minimal requirements as any other carrier. Those requirements are that the carrier offer its service without discrimination, advertise the availability of its service, and maintain its quality,<sup>170</sup> that it use any money drawn from the fund for support of the network,<sup>171</sup> and that if it discloses the portion of the local monthly service charge that is contributed to the state fund that it will make a full disclosure.<sup>172</sup> Technological neutrality is maintained by requiring the same minimal standards of both wireline and wireless carriers.

For the reasons set forth above, the WUTC continues to maintain its position that

---

<sup>170</sup> See draft rules WAC 480-123-310 to 340. See also 47 U.S.C. ? 214(e).

<sup>171</sup> See draft rule WAC 480-123-490, requiring funds received to be used for preserving and advancing universal service, and 47 U.S.C. ? 254(f).

<sup>172</sup> See draft rule WAC 480-123-300.

wireless carriers should contribute to the USF on the same basis as all other telecommunications carriers and be permitted to draw from the fund on the same basis as other eligible carriers.

E. Net Contributors and Net Recipients

Any system designed to provide support for a service in an area that cannot support that service alone will have net contributors and net recipients. That is true for the present system of universal service, as it will be for the reformed program presented here. With two exceptions, the net contributors and net recipients are the same and the two exceptions represent carriers and their customers who today have the benefits of a universal network without any of the cost.

The net contributors today are customers in low-cost locations served by GTE and US WEST and all customers of long-distance carriers. The customers in low-cost locations contribute revenue that is used to support service by their monopoly provider in high-cost locations. Long distance customers contribute because they pay rates that include revenue necessary for AT&T, MCI and other long-distance carriers to pay substantially-above-cost access rates charged by high-cost companies serving high-cost areas. These customers will continue to support local service in high-cost locations even in a competitively and technologically neutral system of universal service. But unlike the present circumstances, the promotion of competition that results from the reformed program can serve to lower

costs for these customers. One of the primary benefits of competition is that it drives prices toward cost, or in high-cost locations, toward the benchmark (which is lower than the cost of service). The best recent example is the tremendous reduction in wireless prices in the last year as a result of competition between several wireless carriers in Washington.

There is also a benefit to the carriers. GTE and US WEST presently must charge prices above cost in locations like Everett and Seattle, where the costs are the lowest in the state, in order to support their exchanges that require support. By moving away from the monopoly system to a competitively neutral approach, GTE and US WEST have an opportunity to lower prices in the low-cost locations where they face competition from CLECs that have no obligation to support high-cost locations in rural areas of the state.

Long-distance carriers will benefit from the reductions in access charges that will result from these proposed rules. Because the greatest source of implicit support is in access charges that long-distance carriers pay to local exchange carriers, a universal service program that reduces implicit support and replaces it with explicit support will result in greatly reduced access charges. In areas where access charges today can run as high as 15 cents a minute, they may drop several fold. Indeed, the group of customers and carriers that may benefit the most from this reform are heavy users of long distance service and their carriers. Large businesses most notably should benefit from a reformed program of

universal service.<sup>173</sup>

The two new groups that will become net contributors are CLECs and wireless carriers. These two groups have not contributed to universal service because, unlike the customers of GTE and US WEST, they do not have any responsibility to provide service in high-cost locations at a price below cost. While they have not contributed, they have had all the benefits of a universal network available to them. Their inclusion introduces an element of fairness that has been missing. Competitive neutrality requires that these customers, through their carriers, contribute to the support of universal service.

◆ *See next page*      CHART 4 - Annual Carrier Contribution and Draw  
from Fund

F. Implicit Support Reductions Required

The proposed rules require incumbent carriers to reduce revenues in an amount equal to what they will draw from the USF. Incumbent carriers give up in rates what was once implicit support in exchange for explicit support. The result is that customers do not pay for network support once through an implicit subsidy and a second time through explicit

---

<sup>173</sup> Because implicit support is found in different amounts in different services, we cannot say that every customer will benefit to the same degree as every other customer.

support. This approach is supported by AT&T and TRACER.<sup>174</sup> TRACER? s

---

<sup>174</sup> AT&T comments on 1st draft rules at 23. TRACER comments on 1st draft rules at 30-32.

This Sheet Left Blank for Chart Insert

See 1-page Excel Spreadsheet

<supprede.xls>

comments are particularly thoughtful:

The reduction in prices of services containing implicit support should reflect the amount of support the [carrier] is entitled to before any netting against its contribution obligations takes place. It is widely recognized that one of the primary sources of implicit support for high-cost areas is the use of averaged prices. Since the average costs that must be covered in retail rates will decline because of USF support for high-cost lines, the retail prices can be reduced. Also, higher than necessary business prices could be reduced.<sup>175</sup>

---

<sup>175</sup> TRACER comments on 1st draft rules at 30-32 (emphasis in original).

Two commenters, US WEST and WITA, suggest that non-regulated carriers should also be required to reduce revenue in an amount equal to support received from the USF.<sup>176</sup> The implicit support reduction required of incumbent carriers is because they are presently receiving implicit support in their existing, WUTC regulated rates. Non-competitively classified companies are not required to reduce revenue because their rates do not contain implicit support and therefore there is no implicit support to be removed in exchange for an equal amount of explicit support. They are not monopolies with captive customer bases who have been required by past legislative and regulatory decisions to set some rates above cost in order to permit regulators to order local service in some areas to be priced below cost. WITA expresses this same concern about wireless companies.<sup>177</sup> Wireless companies, like CLECs, do not have implicit support built into their rates even though their customers have the advantage of using the wireline network that is supported by implicit support.



---

<sup>176</sup> US WEST comments on 1st draft rules at 5-7. WITA comments on 1st draft rules at 12.

<sup>177</sup> WITA comments on 2nd draft rules at 7-8.

## VIII.

### DISTRIBUTIONS FROM THE FUND

#### A. Eligible Telecommunications Carriers

The Telecommunications Act of 1996 establishes two requirements for carriers to qualify to draw funds from the federal program of universal service support. Carriers must be willing to serve all customers in a high-cost service area who request service, and they must advertise the availability of their service and the rates for service in media of general distribution. A carrier that complies with the two requirements is eligible to receive federal universal service support and is to be designated by a state commission as an eligible telecommunications carrier (ETC).<sup>178</sup>

The Act also requires an ETC to use federal universal service funds for the provision, maintenance and upgrading of facilities and services for which the support is intended.<sup>179</sup> ESSB 6622 also speaks to this issue. In it, the WUTC is directed to ensure the support received by a telecommunications carrier is used only for the purposes of the

---

<sup>178</sup> 47 U.S.C. § 214(e).

<sup>179</sup> 47 U.S.C. § 254(e).

Washington Utilities and  
Transportation Commission

program.<sup>180</sup>

---

<sup>180</sup> ESSB 6622 (C 337, L 98) ? 1(5).

States are permitted to adopt additional definitions and standards to preserve and advance universal service if the additions do not rely on or burden the federal program of universal service.<sup>181</sup> The WUTC believes the two federal requirements for eligibility to draw funds are insufficient to guarantee network quality and quality of service. The first principle for universal service established in the federal Act is that “[q]uality services should be available at just, reasonable, and affordable rates.”<sup>182</sup> Accordingly, the WUTC proposes rules that require carriers to provide service at a level of quality that is sufficient to allow customers to use the network in the expected manner, and rules that require funds to be used for the purpose for which they are intended, as is required of those carriers that receive federal funds.<sup>183</sup>

Two commenters oppose the additional requirement that quality of service be considered in determining eligibility to draw funds. AT&T considers the requirement for

---

<sup>181</sup> 47 U.S.C. § 254(f).

<sup>182</sup> 47 U.S.C. § 254(b)(1) (emphasis added).

<sup>183</sup> See draft rules WAC 489-123-330 and 490.

sufficient levels of service to be impermissible based on federal law.<sup>184</sup> TRACER does not believe the quality of service requirement should be applied to wireless and private communications services.<sup>185</sup>

In order to accommodate AT&T's legal concern, the draft rules create a designation process for eligible telecommunications carriers that plan to draw from the *state* fund that is separate from the designation of ETCs for purposes of drawing from the *federal* fund. Companies that do not want to be held to the requirement that service delivery be of sufficient quality may petition the WUTC for designation as a federal ETC (FETC). Companies that will offer service at least at sufficient levels to permit use of the network in the expected manner may also choose to request designation by the WUTC as a state eligible telecommunications carrier (SETC).

TRACER's position is that wireless carriers should not be required to meet adequate service delivery standards. It correctly identifies the legal argument that under RCW 80.36.370 the WUTC may be prohibited from adopting this rule and applying it to

---

<sup>184</sup> AT&T comments on 1st draft rule at 20.

<sup>185</sup> TRACER comments on 1st draft rule at 26. *See also* RCW 80.36.170.

wireless carriers. It did not, however, advance a policy argument why a wireless carrier should not be required to provide an adequate level of service in order to draw support from the fund.

The federal policy principle implicated is competitive neutrality. It is not competitively neutral to require some carriers to have plant and equipment to provide service at sufficient levels of service to meet customer needs in exchange for eligibility to draw support when there are other carriers who may draw an equal amount of support but will not be required to invest the amount necessary to provide even sufficient service. Given the substantial amount of support that will be available to providers, we think the requirements should be the same and that sufficient service is not too much to ask of any carrier. A more tangible, state principle is that service quality is closely tied to issues of comparability and access. Service must be sufficient to provide the service needed. Given the support that customers will pay, a requirement that service be at sufficient levels to meet basic customer needs is a reasonable requirement.

B. Geographic Service Areas and Promotion of Competition

Eligible telecommunications carriers are designated to serve particular geographic areas that are high-cost.<sup>186</sup> For rural carriers, the service area is the carrier's study area

---

<sup>186</sup> See 47 U.S.C. ? 214(e)(5).

unless the FCC and the WUTC agree that it should be some smaller area.<sup>187</sup> For non-rural companies, including CLECs, wireless and other non-wireline technology, the service area can be any geographic area established by the WUTC. The WUTC has taken the position that geographic service areas should be chosen based on promotion of fair competition.<sup>188</sup>

---

<sup>187</sup> The WUTC and twenty rural companies petitioned the FCC on August 17, 1998, for its concurrence with designations of rural companies in Washington at other than the study-area level. Rural company participation in the petition was conditioned on FCC consideration and approval of a method for disaggregating federal universal service support from the study-area level to the sub-exchange level. *See* WUTC Docket No. UT-970380.

<sup>188</sup> *See* draft rule WAC 480-123-320.

A carrier that wishes to compete against an incumbent in the incumbent's service area should not be permitted to do so at an advantage; competition should be fair. In order to be certain that competition in high-cost locations is fair, the WUTC has determined that support must be given on equitable terms to the incumbent and its competitors. In practice, for wireline carriers, this requires that support be provided over the same geographic area for which costs were calculated and at which the obligation to serve applies. Because the determination of cost per line is an average of the cost of individual lines in a geographic area, it would not be competitively neutral to permit a competitor to serve only the low-cost portions of a geographic area<sup>189</sup> while requiring the incumbent to serve the high-cost as well as the low-cost portions. Competitors have an incentive to serve only the low-cost portions of a service area and it is therefore necessary to require the same obligation to serve customers in all portions of service areas.

1. Wireless Geographic Service Areas

The circumstances are different for wireless carriers. There is no evidence that

---

<sup>189</sup> Generally, the closer to the switch, the shorter the local loop and the lower the cost of service is to the carrier.

their cost of service is greater or lower based on the distance a customer is from the cell site. A wireless carrier, unlike a wireline carrier, has no incentive to avoid customers that happen to live some distance from the cell. As a result, there is no need to impose the same service areas on wireless carriers as are imposed on wireline incumbents. There is a need, however, to define the area for which a wireless carrier is eligible to receive support and for which it has a corresponding obligation to serve customers that request its service.

The WUTC finds that it is competitively neutral to permit wireless carriers to be designated for service areas that are related to their service ?foot print? or a portion thereof, rather than to require wireless carriers to conform to wireline exchange boundaries. This is a reversal of the position taken in November 1997, when the WUTC made its first ETC designations for purposes of federal support payments. The draft rules proposed at this time will permit wireless carriers to propose any reasonable geographic service area to the WUTC for approval, with a presumption toward designation of a carrier?s entire footprint.

## 2. Competitive Service Areas

The draft rules require a carrier petitioning for ETC designation to include with its petition a statement why the proposed service area promotes competition.<sup>190</sup> Two

---

<sup>190</sup> See draft rule WAC 480-123-320.

commenters object to this requirement.<sup>191</sup> AT&T considers the requirement an unwarranted expansion of the requirements for ETC designation.<sup>192</sup> GTE complains that the requirement seems vague and unnecessary.<sup>193</sup>

AT&T might be correct if the requirement were necessary for designation and continuing status as a federal ETC. The requirement, however, is part of the petitioning process and it will assist the WUTC to assure competitive neutrality in service area determinations, particularly with respect to wireless carriers. GTE's concern that the requirement is vague and unnecessary also fails to take into account the context in which the requirement is made. The WUTC permits carriers and citizens alike to petition on any matter. In general, the petitioner decides what is included in a petition. This requirement does not restrict what is included in a petition but does ensure that a topic that is important in the evaluation of a service area determination is included. What GTE characterizes as

---

<sup>191</sup> In addition to AT&T and GTE, it appears that US WEST also opposes the requirement.

<sup>192</sup> AT&T comments on 1st draft rules at 19, 20.

<sup>193</sup> GTE comments on 1st draft rules at 11.

vague is actually helpful guidance without unnecessary prescription.

C. Deaveraged Unbundled Network Elements

Unbundled network elements (UNEs) are those portions of a telecommunications network that can be provided to multiple carriers for their use in combination with their own facilities. An example would be the use of a local loop provided by US WEST to a business that chooses to purchase its telecommunications service from a CLEC. The CLEC would arrange to connect its switch to the US WEST local loop of that particular customer so that the CLEC does not have to duplicate the facility that is already in place (the local loop to the business). Under the terms of the federal Telecommunications Act of 1996, US WEST is required to make the local loop available to the CLEC and the CLEC is obligated to pay US WEST a negotiated price or a price determined by the WUTC.<sup>194</sup>

As with the cost of service, which can be low or high for a variety of reasons, the cost of UNEs varies depending upon circumstances. In WUTC Docket Nos. UT-960369, 370 and 371, the WUTC determined the cost of UNEs on a statewide average basis. At present, in the same dockets, the WUTC is in the midst of an adjudication of the price for UNEs.

Several commenters stated that a revised program of universal service will not be

---

<sup>194</sup> The WUTC determines the price if the CLEC and ILEC are unable to negotiate a mutually acceptable price. *See* 47 U.S.C. ? 252.

competitively neutral unless UNE costs and prices are determined on the same geographic scale as costs for universal service.<sup>195</sup> Nextlink in particular believes the rules, which provide distribution of funds to the provider of UNEs if they are priced on a statewide average and to the CLEC if UNEs are priced on a deaveraged basis, will result in reduced or no competition. Nextlink also believes that the lack of established prices on a deaveraged basis will result in a windfall to incumbent local exchange companies (ILECs).

---

<sup>195</sup> Nextlink comments on 1st draft rules at 11, 12. Sprint/United comments on 1st draft rules at 9. TRACER comments on 1st draft rules at 34, 35. US WEST comments on 1st draft rules at 21. WITA comments on 1st draft rules at 13.

In our Cost Order, we stated that ?If unbundled network element rates continue to be averaged, the implicit support currently provided by low-cost areas will be perpetuated.?<sup>196</sup> The solution, however, is not to deaverage UNE prices at this time. In our Cost Order we rejected this suggestion by TRACER. There is an interrelationship between universal service, UNE prices and the extent of competitive activity in Washington.<sup>197</sup> A responsible approach requires that changes to universal service and UNE policy be considered together. That is why we stated in our Order that, if the Legislature authorizes creation of an explicit universal service fund, we ?will initiate a proceeding at the time of implementation in which [we] will consider simultaneously de-averaging the prices of retail service and unbundled network elements, and further reducing access charges.?<sup>198</sup>

---

<sup>196</sup> Cost Order at ? 31.

<sup>197</sup> Cost Order at ? 34.

<sup>198</sup> Cost Order at ? 32.

Finally, AT&T and MCI, joined by Nextlink and TRACER, suggest that UNE price determinations from WUTC Docket No. UT-960369, et. al., be used to set universal service support.<sup>199</sup> In our Order we explain that the information developed in UT-960369 is inadequate for universal service purposes. Retail and wholesale services differ and thus the examination of related costs are different. We reject this approach in our Order and will proceed as stated above to deaverage prices for UNE's at such time as there is an explicit universal service fund.<sup>200</sup>



---

<sup>199</sup> Cost Order at ? 35.

<sup>200</sup> Cost Order at ? 36.

## **IX.**

### **OUTCOME MEASURES AND AFFORDABILITY**

#### **A. Annual Measurement**

Universal Service has been a goal of telecommunications legislation and regulation since the Telecommunications Act of 1934. The FCC has been measuring telephone service penetration rates since 1983; prior to that the Bureau of the Census has tracked penetration rates for telephone service. The WUTC believes that measuring the effects of changes in universal service and related telecommunications programs is important as we move into an era of competition in the market for local service. In draft WAC 480-123-070 the WUTC announces its intentions to prepare annual reports on the progress made toward achieving the purposes of a reformed program of universal service. Among these goals are promotion of competition, preservation of affordable service, and ensuring comparability of services between urban and rural areas.

#### **B. Affordable Service**

The WUTC in the past has not faced the explicit requirement that it set rates that are affordable. This requirement is new, appearing for the first time in the

Telecommunications Act of 1996.<sup>201</sup> In the WUTC's previous report we stated that, based on the relatively high penetration rates, current rates are affordable.<sup>202</sup> At the same time, we are aware that the high penetration rates mask discrepancies within the population.

Telephone service penetration has not reached saturation as it has for other information services such as radio and television. Telephones have been available for nearly 120 years, but for some sectors of the public, like black households headed by a 15 to 24 year old, penetration rates are under 75 percent.<sup>203</sup> Other examples of low penetration rates are for single women with children, where the penetration rate was only 83 percent in 1993. For families in multi-unit housing the penetration rate is 84 percent.<sup>204</sup> In comparison, from 1925 to 1950, radio penetration went from 10 percent of households to

---

<sup>201</sup> See 47 U.S.C. § 254(i).

<sup>202</sup> See "Preserving and Advancing Universal Service in a Competitive Environment," WUTC Report to the Legislature, January, 1998, at p. 60.

<sup>203</sup> Schement, Jorge Reina, "The Persistent Gap in Telecommunications: Toward Hypotheses and Answers (DRAFT)," Institute for Information Policy, Penn State University, University Park, PA, October 1998, p. 11.

<sup>204</sup> Id.

virtually 100 percent of households.<sup>205</sup> This information makes it clear that implementation of changes in universal service, and the affordability requirement, should be monitored to determine any significant consequences on not only the overall penetration rate but also on various subsets of the population.

C. Affordability and Competition Measures

---

<sup>205</sup> Id. at 8-10.

There are a variety of ways to determine the effect of price changes on affordability of telephone service. A recent article in the June 15, 1998 edition of *Public Utilities Fortnightly* suggested five objective performance criteria. The five criteria suggested are: (1) the frequency of service terminations; (2) customer compliance with deferred payment agreements; (3) money at risk, or the utility's financial exposure to nonpayment of bills; (4) customers in arrears (and not part of a payment plan); and (5) weighted arrears, reflecting the size of monthly residential bills and indicating the extent to which residential service lies in jeopardy of termination. While these measurements relate primarily to low-income customers, as Public Counsel pointed out, they may also provide useful information on the effect of rate changes on customers with somewhat higher incomes.<sup>206</sup>

---

<sup>206</sup> Public Counsel comments on 1st draft rules at 9.

Competition measures must also be developed.<sup>207</sup> While competition has been growing in Washington, as can be seen by the number of competitors and their revenue, no systematic effort has been undertaken to measure the level of competition and its increase. The WUTC will undertake to measure the progress of competition in telecommunications.

---

<sup>207</sup> GTE agrees that progress should be measured but believes the outcome measures should be developed before the rule is adopted. *See* GTE comments on 2nd draft rules at 10-11. US Cellular believes that until the meaning and purpose of outcome measures is defined, the rule is ?useless.? US Cellular comments on 2nd draft rules at 7.