

VII. Intrastate Access, Commission Issue No. 5

Q. Responding to Issue No. 5, regarding intrastate access rates. First, what are intrastate access charges?

A. Intrastate access rates are charged by LECs (in Hawaii, GTE Hawaiian Tel) to IXC's for the local switching and transport of intrastate toll calls. They are not the same as the rates charged by one LEC to another for the transport and termination of local calls, although they use the same equipment and serve a similar purpose. The FCC notes that the network functions are the same and it believes that "the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge." However, since TA96 "preserves the legal distinctions," the FCC has concluded that the reciprocal compensation provisions of section 251(b)(5) for transport and termination of traffic do not apply to the transport or termination of interstate or intrastate interexchange traffic. [*Interconnection Order*, para. 176.]

The existing system of interstate access charges is currently undergoing extensive review and modification. This "reform" process will continue over the next few years. In its recent First Report and Order, *In the Matter of Access Charge Reform*, CC Docket No. 96-262 (FCC 97-158, adopted May 7, 1997, the *Access Charge Reform Order*), the FCC explained in broad strokes its plan for modifying the interstate charges. However, most of the details have yet to be worked out. Currently, most intrastate access charge tariffs follow a similar structure as the FCC tariffs, although there can be significant differences in both rate levels and rate design. Hence, it is reasonable to anticipate that many states will also be reviewing and rethinking their intrastate access charges over the next few years-- both in response to the FCC's initiatives and in response to underlying changes in the industry resulting from TA96 and other factors.

Q. What types of access charges are currently prevalent in other jurisdictions?

A. Access charges include multiple "rate elements" that are designed to recover different types of costs. These rate elements generally fall into two main categories, switched access and special

access. Switched access service is designed to recover the costs of originating and terminating toll calls over the LEC network using ordinary phone lines connected to the LEC's end office switch. In contrast, special access service typically provides a dedicated circuit that connect the customer's premise directly to the IXC; these circuits are used to form or complete private line networks, but they are also used to create a direct connection to an IXC's public toll network without the necessity of going through an LEC's switch.

Most switched access rates are designed to recover the costs of both the traffic-sensitive (TS) and non-traffic-sensitive (NTS) functions of the LEC. TS costs are those that vary depending upon the usage placed over the network (e.g., the portion of the switching equipment which varies in size and cost, depending upon call volumes). In comparison, NTS costs are those costs that do not tend to increase as the number of calls placed over the network increases (e.g. the cost of ordinary copper loops is largely fixed, regardless of the volume of traffic carried by the loop).

Q. Can you briefly describe the current access charge system in Hawaii?

A. Yes. Toll competition is relatively new to the state. As described in more detail in the testimony of Consumer Advocate witness William W. Dunkel, the Company recently eliminated the CCLC and residual interconnection charge (RIC) rate elements that previously helped recover the intrastate access share of NTS costs. Claiming a revenue shortfall as a result of this action, the Company now proposes to increase local exchange rates to make it whole.

Q. Is a local rate increase necessary to restore the Company's rate levels?

A. No. As Mr. Dunkel correctly notes, this proposal would essentially give the IXCs a "free ride" on the NTS portions of the local network. Mr. Dunkel has made an alternative proposal that would recover the revenue shortfall through per-line charges assessed on the IXCs. As described in Mr. Dunkel's testimony, his intrastate proposal resembles the new federal plan in several particulars.

Q. Before you discuss this alternative method, please provide some background into the

federal access charge system. How are federal access charge rates developed?

- A. The annual process of establishing the rates for each access charge rate element involves a number of steps. The steps involved in the federal access charge process are explained by the FCC as follows:

Incumbent LECs first record all their booked expenses and their cost of investment in the accounts prescribed by the Commission's Part 32 Uniform System of Accounts (USOA). They next divide the recorded investment and expenses between regulated and nonregulated services, pursuant to Part 64 of our Rules. Incumbent LECs then divide regulated expenses and investment between state and interstate jurisdictions pursuant to the separations procedures contained in Part 36 of the Commission's rules. Incumbent LECs then apportion their regulated interstate costs among the interstate access and interexchange service categories. Finally, to recover their access costs, incumbent LECs charge IXCs and end users for access services in accordance with the Part 69 access charge rules and, for incumbent LECs under price cap regulation, with the provisions of the Part 61 price cap rules.

[Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, Notice of Proposed Rulemaking, FCC 96-182 (rel. Apr. 19, 1996), 61 Fed. Reg. 18311 (Apr. 25, 1996) (NPRM), para. 22.]

Under a regulated monopoly regime, various market segments are priced simultaneously. Policy makers are able to set the prices of some services significantly above cost in order to maintain relatively low prices for other services. Under regulation, the market prices of specific services need not recover their costs in either the short run or the long run. It is possible therefore, under monopoly regulation, to sustain prices, like affordable rural rates, that are in the public interest, but might not emerge or survive in an unregulated market.

Absent regulatory intervention, prices that deviate greatly from costs are not likely to survive in an effectively competitive market over the long term. Competition has not yet led to a fully deregulated market, and regulators continue to perform important functions during the transition to a more competitive market. For instance, care must be exercised to ensure that intrastate mechanisms designed to maintain support for affordable rural rates are sustainable in the long run, achieve their intended purpose, and do not unduly distort the market. One way to

reduce market distortions and ensure sustainability is to make support mechanisms more explicit, as required by TA96.

To meet this end, the FCC plans or has instituted proceedings to reform its access charge and separations processes to comply with the requirement that support be as explicit as possible. This Commission also has been charged with ensuring that its access charge and support mechanisms comply with the requirements of TA96, including the requirement that support be as explicit as possible.

TA96 prohibits certain cross subsidies:

SUBSIDY OF COMPETITIVE SERVICES PROHIBITED- A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, 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. [Section 254(k).]

Nevertheless, the FCC points out, this prohibition does not prevent universal service support for access:

Regarding GCI's argument that interexchange service should not be supported because it is a competitive service, we emphasize that universal service support will be available for access to interexchange service, but not for the interexchange or toll service. [note omitted] We find that the record does not support including toll service among the services designated for support, although, as discussed in section V below, we find that the extent to which rural consumers must place toll calls to reach essential services should be considered when assessing affordability. Nevertheless, universal service should not be limited only to "non-competitive" services. One of the fundamental purposes of universal service is to ensure that rates are affordable regardless of whether rates are set by regulatory action or through the competitive marketplace. GCI's argument implies that, if there were multiple carriers competing to provide, for example, basic dialtone service at \$1000 per month, there could be no universal service support because the price was set through competition. Such a result would be inconsistent with Congress's intentions to preserve and advance universal service in adopting section 254. We note that section 254(k), which forbids telecommunications carriers from using services that are not competitive to

subsidize competitive services, is not inconsistent with our conclusion that it is permissible to support competitive services. [note omitted] [*Access Charge Reform Order*, para. 77.]

Q. How do separations relate to access?

A. Jurisdictional separations are the rules governing how the total costs of firms like GTE Hawaiian Tel are divided between the state and federal jurisdiction.

The result of the separations process determines the amount of revenue recovery needed under the access charge system. As outlined in the *Universal Service Order* and the *Access Charge Reform Order*, the FCC is in the process of changing the entire existing system of cost allocation and recovery, shifting the interstate system applied to larger LECs away from embedded cost recovery and toward some form of forward-looking costs like TSLRIC or Long Run Average Cost (LRAC). Furthermore, it may adjust the separations procedures to reduce the interstate contribution. ("We will soon begin a related proceeding to examine our jurisdictional separations rules in light of the 1996 Act." [NPRM, para. 6.]) It appears that the FCC is intending to gradually shift interstate NTS costs support from the (traffic-sensitive) CCLC to a flat-rated Presubscribed Interexchange Carrier Charge (PICC) [*Access Charge Reform Order*, para. 38.] It is also planning to shift NTS costs away from IXCs, by increasing the level of interstate charges that are imposed directly on some end users (retail customers). [Id., para. 39.]

The FCC has also promised a separate proceeding this year "to undertake comprehensive review of our regulation of rate-of-return incumbent LECs. That inquiry will take up the issue of whether substantial changes in our Part 69 cost allocation rules for the development of access charges for rate-of-return carriers are needed." [NPRM, para. 52. The referenced rules are 47 C.F.R. Part 69, Subparts D and E.]

...[H]owever,... we propose to apply to all incumbent LECs the rules discussed in Section VII.A, which addresses allocation of universal service support to the interstate revenue requirement, and Sections III. D and E, which propose reforms to the transport rate structure, including the TIC. Because rate-of-return incumbent LECs will collect revenues from the new universal service support mechanism, we need to

determine in this proceeding how these payments should alter the access charges currently assessed by such incumbent LECs. Moreover, any changes we adopt to the TIC pursuant to the court's remand in *CompTel v. FCC* [note omitted] should also apply to rate-of-return incumbent LECs because their transport rules were subject to the rates that were remanded by the court in that decision. [NPRM, para. 53.]

Thus, even before the promised reviews of rate-of-return incumbent LECs and separations, at least some of the access charge elements that produce revenues for the Company may be modified or eliminated.

Q. Do changes in access charges affect universal service?

A. Yes. Despite their treatment in different FCC proceedings, it is difficult, if not impossible, to separate concerns about access charge from concerns about universal service support. The FCC recognized this in its *Access Charge Reform Order*:

[T]hrough this *First Report and Order* in our access reform docket and our *Universal Service Order*, we set in place rules that will identify and convert existing federal universal service support in the interstate high cost fund, the dial equipment minutes (DEM) weighting program, Long Term Support, Lifeline, Link-up, and interstate access charges to explicit federal universal service support mechanisms. [Para. 5.]

Terms of the 1996 Telecom Act require that federal universal service support be explicit and recovered on an "equitable and nondiscriminatory basis" from all telecommunications carriers providing interstate telecommunications service.

Q. Is the FCC also making changes in transport rates?

A. Yes. Other changes directly affecting non-price-cap ILECs are those involving transport rate elements and the traffic interconnection charge (TIC). "The TIC is a per-minute charge assessed on all switched access minutes, including those of competitors that interconnect with the LEC switched access network through expanded interconnection." [*Access Charge Reform Order*, para. 756.] According to the USTA, approximately 70 percent of incumbent LEC

transport revenues, or \$3.1 billion, are generated through TIC charges.[USTA Comments, Attachment 11.] The FCC is in the process of shifting this cost burden, preparatory to eliminating the TIC altogether:

While the current rulemaking record will not permit us to prescribe specific amounts that individual incumbent LECs must shift from the TIC to specific access rate elements, it does permit us to direct incumbent LECs to make certain cost reallocations and to require them to calculate the appropriate level of the reallocation in the supporting materials filed with the tariffs implementing the changes.[*Access Charge Reform Order* , ¶214.]

Q. In the federal jurisdiction, are access charges levied on unbundled elements?

A. No. The FCC has tentatively concluded "that unbundled network elements should be excluded from the Part 69 access charge regime," since "the requesting carrier has already paid for the ability to originate and terminate interstate calls." [NPRM, para. 54.] While this exclusion is logical, it will tend to reduce the Company's access revenues. It seems likely that IXCs will concentrate much of their marketing efforts on high volume toll customers. If the IXCs are successful in convincing their largest customers to use them for both local and toll service, the IXCs will be able to avoid paying access charges by serving these customers using unbundled network elements.

Q. How is the FCC treating NTS costs?

A. The FCC has announced its intention to replace the NTS portion of the CCLC with flat-rated charges:

First, we will reduce usage-sensitive interstate access charges by phasing out local loop and other non-traffic-sensitive (NTS) costs from those charges and directing incumbent local exchange carriers (LECs) to recover those NTS costs through more economically efficient, flat-rated charges. Because NTS costs, by definition, do not vary with usage, the recovery of NTS costs on a usage basis pursuant to our current access charge rules amounts to an implicit subsidy from high-volume users of interstate toll services to low-volume users of interstate long-distance services.[*Access Charge Reform Order*, para. 6.]

The subscriber line charge (SLC) is in effect a flat-rated access charge levied on end-users by LECs. In its *Access Charge Reform Order*, the FCC followed the Joint Board's recommendation and did not increase the current \$3.50 SLC cap for primary residential and single-line business lines (the same category of lines that will be eligible for universal service fund (USF) support under the new federal benchmark system). The FCC is increasing the SLC for second and subsequent lines. However, this increase does not generally apply to rate-of-return LECs. As noted earlier, the FCC is phasing out the interstate CCLC, which is a per-minute charge to IXCs, and replacing it with the presubscribed interexchange carrier charge (PICC), which is a per-line charge to IXCs. Together, these charges are intended to recover the entire interstate portion of NTS local exchange costs.

Q. Let's return now to discussion of Mr. Dunkel's plan for Hawaii. Is it similar to the FCC's plan for interstate access charges?

A. Yes. It is similar to the FCC's plan in several ways--it is flat-rated, assessed on presubscribed carriers, and phased in. However, Mr. Dunkel's intrastate plan also includes a dial-around charge (DAC) which is not found in the FCC's plan. As he notes, the inclusion of the DAC improves upon the federal model by ensuring that carriers who are not assessed the PICC for some subscribers that they serve are still required to pay their fair share of intrastate access costs.

Q. Why is a PICC-type approach preferable to the Company's direct approach of a rate increase? Won't end-users pay for the access in either case?

A. To the extent that IXCs pass along the assessed charge to their subscribers, of course end-users will wind up paying. However, there is a good possibility that competing carriers will structure their charges in different ways. Some may fold the expense into their per-minute charges; others may impose a flat fee on subscribers; others may impose it on low-usage subscribers and forgive it after monthly usage passes a certain level. There are various ways the charge can be defrayed; the point is that the PICC creates the possibility of competitive alternatives to which end-users may respond differentially, whereas the Company's approach

simply raises rates on all end-users.