

1 **Overview/Policy**

2  
3 **Q. Please turn to the second section of your testimony. What is the purpose of**  
4 **establishing a state USF for non-rural carriers?**

5 A. The federal USF mechanism for non-rural carriers is focused on a limited portion of the high  
6 cost problem—providing support for carriers whose statewide average cost greatly exceeds  
7 the national average. It does not provide support for states like Idaho, where the non-rural  
8 carriers serve a mixture of high and low cost areas which tend to cancel out, leaving the  
9 statewide average at a level which is less than the national benchmark. Stated differently, the  
10 federal mechanism only deals with extreme differences between the average costs  
11 experienced in different states. It doesn't deal with differences in costs which occur within a  
12 state. Accordingly, the logical focus of an Idaho USF would be to provide targeted support  
13 for high cost areas within the state. To achieve this purpose, the Commission should  
14 accurately identify high cost areas in Idaho, determine how much support should be  
15 provided to these areas, and determine the extent to which rates which should be reduced,  
16 thereby changing from a system of implicit support to one of explicit, targeted support for  
17 high cost lines.

18 *Idaho Code § 62-610A* declares it state policy that “[a]ll consumers in this state,  
19 without regard to their location, should have comparable accessibility to basic  
20 telecommunication services at just and reasonable rates.” Historically, this goal has been  
21 achieved by rate averaging, with customers in both urban and rural areas paying similar  
22 rates, regardless of the underlying cost patterns. This historic system of implicit support (e.g.  
23 through rate averaging) has been very successful in achieving and maintaining universal  
24 service. However, as the industry becomes more competitive, it makes sense to partially or

1 entirely replace implicit support mechanisms with an explicit mechanism—one that is designed  
2 to be competitively neutral.

3 The existing system of rate averaging requires urban customers to help support the  
4 high cost of serving low density, rural areas. If a competitive carrier exclusively operates in  
5 low cost, urban areas, it won't necessarily share in the burden of supporting universal  
6 service in high cost areas. Thus, the existing system of implicit support isn't competitively  
7 neutral.

8 *Idaho Code § 62-610A* “authorize[s] the Idaho public utilities commission to  
9 establish a competitively and technologically neutral funding mechanism which will operate in  
10 coordination with federal universal service support mechanisms.” An appropriately designed  
11 Idaho USF would help advance and preserve universal service in a manner which is more  
12 consistent with the trend towards increased competition.  
13

14 **Q. What do you believe should be the key features of an appropriate universal service**  
15 **funding mechanism for Idaho?**

16 A. I believe that the chosen mechanism should be:

- 17 1. Competitively neutral;
- 18 2. Economical;
- 19 3. Effective;
- 20 4. Equitable; and
- 21 5. Portable

22  
23 **Q. Let's discuss these criteria one by one. To begin with, would you please explain**  
24 **what you mean when you say that the mechanism should be *competitively neutral*?**

1 A. Simply stated, the fund should not be tailored for the exclusive benefit of any one carrier or  
2 group of carriers. Contributions should be derived on a very broad base, including all  
3 competing carriers, to the extent feasible. Similarly, the funds should flow to any carrier that  
4 is helping to maintain universal service, based upon appropriate criteria which are not  
5 skewed in favor of any particular carrier, or technology. For instance, if a cable TV  
6 company offers telephone service to residential customers in a rural area, it would be  
7 appropriate for it to have as much opportunity to receive USF support as the incumbent  
8 LEC in that area.

9 I believe the IUSF should promote, rather than discourage, effective competition.  
10 An appropriately designed, competitively neutral program would help reduce barriers to  
11 entry by allowing new entrants to participate in the program on an equal footing with  
12 incumbent carriers.

13 Reducing barriers to entry does not mean the fund should encourage development of  
14 duplicate facilities, where these would not be cost effective. Rather, an appropriately  
15 designed universal service mechanism would let market participants (customers and carriers)  
16 determine the extent and scope of investment in new network facilities. The fund would  
17 neither encourage nor discourage building of new facilities in particular locations. Instead, it  
18 would make support available to competitors on a neutral basis—leaving to them decisions  
19 concerning the extent and manner of competitive entry into rural areas. In some instances,  
20 competitive entry might be accomplished by renting portions of the incumbent's network.  
21 This will help ensure that customers in high cost areas are given a variety of competitive  
22 options, without forcing competitors to build their own network.

23 I believe that the Commission should design a IUSF mechanism that will encourage  
24 all carriers to participate as fully as possible in helping achieve universal service, and bringing  
25 the benefits of increased competition to rural, as well as urban, parts of the state. The

1 universal service goal is so important, it should not be left to the incumbent LECs alone.  
2 Furthermore, if high cost funding were limited to the incumbent carriers, the IUSF might  
3 inhibit the competitive process, or skew that process to the advantage of incumbents.

4 Competitive neutrality is desirable not only because it is fair, and will help encourage  
5 effective competition, but also because it gives a universal service plan the longest assured  
6 life. A plan that favors or disadvantages certain players (e.g. new entrants) is likely to  
7 become politically vulnerable in time, and there is always a danger, when these players press  
8 for reform, that the baby will exit with the bath water.

9  
10 **Q. Would you please explain what you mean when you say that the mechanism should**  
11 **be *economical*?**

12 A. The universal service funding mechanism should not be excessively costly, either  
13 administratively or in its overall magnitude. Assuming other factors are equal, administrative  
14 costs should be minimized. For instance, it is desirable to make the program largely self-  
15 effectuating with limited reporting requirements, and limited need for auditing and “policing”  
16 Similarly, assuming all other factors are equal, it should involve the narrowest possible focus  
17 and the smallest possible level of funds flowing in and out.

18 In practical terms, this means that actual cash subsidies should be tightly targeted to  
19 unusually high cost areas and those subscriber groups that might be lost to the network in the  
20 absence of support. If the IUSF is providing support for customers or carriers that do not  
21 truly need support, the fund will be larger than necessary, undermining its long term viability  
22 and limiting the Commission’s ability to advance and maintain the universal service goal over  
23 the long term. To the extent the Commission can take appropriate steps to narrow the  
24 scope of the fund, and to reduce the level of support provided to geographic areas that do  
25 not have extraordinarily high cost levels, this is desirable and in the public interest.

1                   Furthermore, in striving to keep the fund *economical*, the Commission should realize  
2                   that the IUSF mechanism is just one of several tools in the Commission’s arsenal. Other  
3                   regulatory policies can also help advance and maintain universal service.

4  
5   **Q.    Would you please explain what you mean when you say that the mechanism should**  
6   **be *effective*?**

7   A.    A worthwhile program must also be measurably *effective* in advancing the Commission’s  
8           public policy goals. More specifically, its operations should have a significant positive  
9           impact on penetration rates. A universal service support program should operate to at least  
10          maintain subscribership at current levels, and preferably to increase penetration towards  
11          100%. Stated differently, modifications to the IUSF should not be a zero sum game,  
12          pushing some customers off the network while encouraging others to join. As I explain later  
13          in my testimony, such might be the case if the rates for some customers were significantly  
14          increased, while rates for other customers are maintained at their current levels, or just  
15          moderately reduced. Rate “rebalancing” strategies should be viewed with caution, since they  
16          could induce some nonsubscribers to join (as penetration studies indicate), but they might  
17          also force off the network subscribers whose rates would be increased.

18  
19   **Q.    Would you please explain what you mean by *equitable*?**

20   A.    There are many aspects of equity, and I won’t attempt to catalog them here, but I would  
21          note that equity requires consideration of more than simply whether some customers are  
22          paying less than the cost of serving them, or less than they would be willing to pay, if forced  
23          to do so by the lack of sufficient competitive alternatives. Universal service is beneficial to  
24          society as a whole. Equitable treatment of customers suggests that all types of carriers and  
25          customers should contribute to the cost of maintaining universal service.

1                    *Idaho Code § 62-610F* specifies that any telephone corporation providing  
2 telecommunications services for compensation within this state including “municipal,  
3 cooperative or mutual telephone companies and telecommunications companies providing  
4 wireless, cellular, personal communications services and mobile radio services for  
5 compensation” may be eligible for support, and it provides that carriers may recover their  
6 contributions to the fund from their customers, thereby spreading the burden of support  
7 across a wide spectrum of customers.

8                    Equitable treatment of carriers doesn’t necessarily mean equal treatment, nor does it  
9 imply that every carrier should be treated identically, regardless of circumstances. Rather,  
10 equity implies a mechanism that avoids unduly favoring or disadvantaging any carrier or class  
11 of carriers. For example, while all carriers should participate in the effort to maintain or  
12 achieve universal service, one cannot reasonably expect every carrier to carry an equal  
13 share of the overall burden. Large carriers obviously can and should contribute more to the  
14 IUSF than small carriers. Similarly, the “carrier of last resort,” function would normally be  
15 assumed by the incumbent LEC, which alone possesses the ubiquitous network and other  
16 infrastructure necessary to carry out that responsibility. Incumbency confers many  
17 competitive advantages on its possessor, such as ownership of ubiquitous facilities, a  
18 dominant market share, and name recognition. In developing equitable policies, the  
19 Commission can and should recognize the advantages of incumbency, while also recognizing  
20 offsetting burdens and obligations.

21                    Nor does the principle of equity require that a universal service support mechanism  
22 treat all customers identically. To fully advance the goal of universal service, “targeting” of  
23 particular customers or groups of customers is inevitable and appropriate. Penetration rates  
24 never reach 100% in any wire center in the nation. This is attributable not to any single  
25 cause but to at least three--each associated with a particular group or category. The

1 primary groups who tend not to maintain telephone service are (1) impoverished residents  
2 (e.g., with annual incomes under \$5,000) found in all geographic areas but concentrated in  
3 minority neighborhoods in the inner cities; (2) residents and small businesses in areas where  
4 costs and rates are high relative to the value of the service provided; (3) a structural residue  
5 of customers that are not inclined to have a telephone, either because they are transients, or  
6 because they don't place much value on having a telephone in their home or place of  
7 business.

8 To maximize network participation, each of these distinct groups must be targeted.  
9 In particular, regulatory policies can and should target high cost areas and low income  
10 customers, to encourage continued and/or expanded participation on the public network,  
11 even though such policies provide benefits to the targeted groups that aren't available to  
12 others. The remainder of my testimony is concerned with policies that can encourage  
13 universal service in high cost areas. Lifeline and other programs targeted at low income  
14 customers are also an important part of the Commission's universal service policies, but  
15 these lie outside the scope of my testimony in this proceeding.

16  
17 **Q. Would you please explain what you mean when you say that IUSF support should be**  
18 ***portable*?**

19 A. Yes. By *portable* I mean that the IUSF support should be readily transferrable from one  
20 carrier to the next, when the customer changes carriers. Portability logically follows from the  
21 principles of competitive neutrality and equitable treatment, discussed above, since IUSF  
22 support should not be limited to the incumbent carrier. However, the concept of portability  
23 is sufficiently important, it deserves to be listed and discussed separately. In general, the  
24 philosophy should be one of providing support to *customers* who might otherwise not  
25 participate on the network, even though the IUSF payments may be made to *carriers*. The

1 support payment associated with a particular customer (whether one with low income or  
2 one living in a high cost area) should be *portable*, in the sense that the support moves  
3 whenever the customer moves (changes carriers).

4 Competing carriers can thus receive support payments by serving customers in the  
5 targeted group. Portability also ensures that the IUSF does not grow as competition grows,  
6 since the amount of support would not increase merely because a customer changes  
7 carriers.

8 It is important for the Commission to remember that the IUSF is designed to  
9 promote the public policy goal of universal service, not simply to provide funds to particular  
10 carriers. Portability of support also helps to ensure that customers in high cost and hard-to-  
11 serve areas will be economically attractive to serve.

12  
13 **Q. Let's turn to your suggestions concerning the proper mechanics of the IUSF. Would**  
14 **you briefly outline the approach you recommend?**

15 A. Yes. The mechanism I recommend can be described as a quasi-voucher approach. As I  
16 will discuss in further detail below, the IUSF would disburse funds to carriers to the extent  
17 they provide service to customers in area where forward looking costs exceed a specified  
18 benchmark. I will discuss the types of benchmarks available to the Commission in more  
19 detail in Section 5.

20 There are a variety of possible methods of structuring the IUSF. One is the issuance  
21 of direct vouchers to subscriber households which would be used to help pay their monthly  
22 telephone bill. Under this system, rates in low density rural areas would increase to reflect  
23 the higher cost of serving them, but the voucher would help these customers pay the higher  
24 rates. Another is to invite carriers to bid for the right to provide service to the target areas  
25 or market segments (e.g., high cost areas or low income groups). The latter approach has

1           been advocated by GTE in some jurisdictions, but regulators have generally not found it to  
2           be a viable choice. Probably the administratively simplest method is via quasi-vouchers: the  
3           carrier provides relatively low (average or discounted) prices to qualifying subscribers and  
4           receives supplemental compensation from the fund. Like a pure voucher system, this  
5           provides explicit, targeted support which is directed by rural customers to the carriers that  
6           actually serve them. This is accomplished in a competitively neutral manner, with support  
7           potentially available to any carrier willing to serve high cost customers. This approach has  
8           the further advantage of having lower administrative costs than a pure voucher system.  
9           Hence, I recommend that it be used for the new IUSF.

10           Payments would continue to be made to local exchange carriers, but the amount  
11           they receive will be a function of the specific customers they serve—the payment they receive  
12           would be determined by the number of supported lines provided by the carrier. All qualified  
13           carriers would be eligible to receive funds. Customers would determine the amount received  
14           by each carrier, based upon the carrier they select to provide them with service.

15  
16       **Q.    How widely distributed should such support be?**

17       A.    Support should be narrowly targeted where it is most needed, as indicated by the fact that  
18           costs exceed a fairly high benchmark. Using an appropriate benchmark, most non-rural wire  
19           centers in Idaho will need little, if any, funding from the IUSF. But where service costs are  
20           extraordinarily high, support is needed and it should be provided, in order to maintain and  
21           advance universal service. The more closely targeted the support is, the more cost effective  
22           it will be and the less burdensome it will be for its contributors.

23           Cost studies specific to Idaho will be needed to determine which geographic areas  
24           in the state will need explicit subsidies. Support should only be provided in those  
25           geographic areas where costs significantly exceed the normal level of revenues or costs,

1 making it unprofitable to serve customers in the absence of higher than normal local rates, or  
2 support from the IUSF. Because high costs tend to be correlated with low population  
3 density, there will typically be relatively few customers in these high cost wire centers. Thus,  
4 the magnitude of the high cost problem should be relatively modest when viewed from a  
5 statewide perspective, assuming the fund is a targeted approach, as I recommend.

6 Since the function of the IUSF is to fill the gap between the cost of providing service  
7 and the affordable price for that service, the magnitude of any required subsidy will vary  
8 according to locality. The revenue shortfall or subsidy requirement will vary from place to  
9 place, both because of variations in the cost of service and because of variations in the  
10 prevailing level of revenues. Variations in cost are of the greatest concern, since they tend to  
11 be greater in magnitude, more difficult to measure, and more difficult to eliminate or control  
12 (High cost areas cannot simply be eliminated by regulatory fiat.) Revenues can also vary,  
13 and the Commission should take this into account when administering the fund. For  
14 example, both intrastate and interstate switched access rates are at least partially cost-  
15 based. Carriers serving high cost areas tend to charge higher access rates and generate  
16 higher switched access revenues per line than they would if they only served low cost areas.  
17 The amount of IUSF support should take into consideration this existing form of support.  
18 Otherwise, carriers might benefit from a double recovery—being compensated for the same  
19 high costs implicitly through access charges and explicitly through the IUSF.

20 Local rates and revenues, on the other hand, may actually be lower in low density,  
21 rural parts of the state. To the extent local rates are higher in urban areas and lower in rural  
22 areas, it might be appropriate to “rebalance” rates when the new mechanism is adopted. For  
23 instance, local rates in urban areas might be reduced, thereby shifting support from the  
24 implicit rate averaging mechanism to the explicit IUSF mechanism.