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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own)
Motion into Universal Service and to)
Comply with the Mandates of Assembly)
Bill 3643.)

R.95-01-020
(Filed January 24, 1995)

Investigation on the Commission's)
Own Motion into Universal Service)
and to Comply with the Mandates of)
Assembly Bill 3643.)

I.95-01-021
(Filed January 24, 1995)

ORIGINAL

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INTERIM OPINION

preferences, which may change significantly before we issue the

I. Introduction

California's telecommunications markets are undergoing tremendous technological and regulatory changes. In addition to the planned opening of local exchange markets to competition, new technologies and declining costs will provide traditional providers and new entrants with the opportunities to offer new telecommunications products and services.

As we move toward open competition, there will no longer be a monopoly provider. Instead, there will be multiple companies competing for the same customers. This has important ramifications for universal service, the concept that all members of society have access to telephone service. The current regulatory structures affecting universal service will need to reflect the introduction of competitive forces. Those companies who offer local exchange services in this competitive environment will have opportunities as well as obligations associated with universal service.

The purpose of today's decision is to issue a set of proposed rules pertaining to universal service responsibilities in a competitive environment. These proposed rules outline the Commission's commitment to maintaining affordable, high quality service within a competitive environment. This competitive marketplace will foster economic growth and lead to an improved telecommunications infrastructure for California.

We emphasize that these are only proposed rules, and that a final set of rules will be developed after public hearings are held, comments regarding the proposed rules are filed, and after evidentiary hearings, if needed, are held, or legislative changes are made. These draft rules are intended to provide a starting point; we find that parties are better able to structure their comments if they have rules in front of them to which they can react. The draft rules in Appendix A reflect some initial

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preferences, which may change significantly before we issue the final rules.

II. Background

The issuance of these draft rules is part of our efforts to open all telecommunications markets in California to competition by January 1, 1997. The groundwork for a competitive marketplace was laid in our November 1993 report to the Governor entitled

Enhancing California's Competitive Strength: A Strategy For

Telecommunications Infrastructure (Infrastructure Report), and Assembly Bill (AB) 1289 (Statutes 1993, Chapter 1274). The California Legislature subsequently passed AB 3606 (Statutes 1994, Chapter 1260), which was enacted into law on January 1, 1995. Among other things, AB 3606 added PU Code § 709.5 to express the intent of the Legislature that all telecommunications markets be opened to competition no later than January 1, 1997.

In September 1994, the Commission issued Decision (D.) 94-09-065 which opened the intraLATA toll markets to competition beginning January 1, 1995.

In December 1994, we adopted a plan to facilitate the opening of all local exchange telecommunications markets to competition (D.94-12-053). That decision recognized the coordination required for addressing the technical and policy

issues. We emphasize that these are only proposed rules, and that

AB 1289 amended Public Utilities (PU) Code § 709 and added PU Code § 882. AB 1289 made a legislative finding and declaration that a state of the art communications infrastructure would promote economic growth, create jobs, and provide social benefits to all of California. In order to implement a strategy of ensuring that investment in the infrastructure would occur, the legislation directed the Commission to pursue action that would ensure that advanced telecommunications services are made available as ubiquitously and economically as possible.

issues related to local competition. Issues were grouped into three subject areas: technical issues, such as the unbundling of network components, which are being managed by Commissioner Duque; local competition which are being managed by Commissioner Conlon; and consumer protections and regulatory streamlining, which include universal service issues, which are being managed by Commissioner Knight. Staff teams were formed to develop proposed rules in each of the three areas. The President of the Commission is responsible for ensuring that the overall process stays on track.

In April 1995, we issued the Local Competition proceeding, Order Instituting Rulemaking (OIR or R.) 95-04-043 and Order Instituting Investigation (OII or I.) 95-04-044. That OIR/OII proposed interim local exchange competition rules in R.95-01-020 and I.95-01-021, which were combined and filed on January 24, 1995. The Commission opened this proceeding to develop rules to pursue universal service goals in a competitive telecommunications environment. Part of the impetus for the universal service OIR/OII was AB 3643 (Statutes, 1994, Chapter 278), which became effective January 1, 1995. The universal service OIR/OII set forth five objectives. They are:

- 1. Define the goals of universal service given the new technologies and increasingly competitive markets with emphasis on the role of basic service in education, health, care, and in the workplace.
- 2. Develop a process to periodically review and revise the definition of universal service to reflect new technology and market conditions.
- 3. Delineate the subsidy support needed to maintain universal service in the new independent market conditions.
- 4. Design and recommend equitable and broad-based subsidy support for universal service based on a free competitive market conditions.

Address the issues of "carrier of last resort" and "franchise obligations."

The universal service OIR/OII solicited comments from interested parties as to how to best meet the above universal service objectives. Eighteen different comments were filed by commenting parties in March 1995.²

On or about June 23, 1995, the California Department of Consumer Affairs (DCA) filed a motion to accept the late filing of its comments and recommendations to the universal service OIR/OII. DCA's motion states that it has no full time staff assigned to

2 The following entities filed written comments: AirTouch Cellular (and its affiliates: Los Angeles SMSA Limited Partnership, Sacramento Valley Limited Partnership, and Modoc RSA Limited Partnership); California Alarm Association; Cellular Carriers Association of California; Citizens Utilities Company (on behalf of Citizens Utilities Company of California, Electric Lightwave, Inc. and Citizens Telecommunications Company); City of Los Angeles; Coalition of consumers, interexchange carriers and alternative access providers, (AT&T Communications of California, Inc., California Association of Long Distance Telephone Companies, California Cable Television Association, California Association of Long Distance, ICG Access Services, Inc., MCI Telecommunications, Metropolitan Fiber Systems Communications Company, Inc., Sprint, Teleport Communications Group, Time Warner AXS of California, and Toward Utility Rate Normalizations (TURN)); Contel of California, Inc.; Division of Ratepayer Advocates; GTE California Incorporated; McCaw Cellular Communications; Inco; MFS Communications Corporation; Pacific Bell; Public Advocates, Inc. (on behalf of Southern Christian Leadership Conference, National Council of La Raza, Korean Youth and Community Center, Filipinos For Affirmative Action; Filipino Civil Rights Advocates); Roseville Telephone Company; the small LECs (CP National, Evans Telephone Company, GTE West Coast Incorporated, Kerman Telephone Company, Pinnacles Telephone Company, the Siskiyou Telephone Company, Tuolumne Telephone Company, The Volcano Telephone Company); the Smaller Independent LECs (Calaveras Telephone Company, California-Oregon Telephone Co., Ducor Telephone Company, Foresthill Telephone Co., Happy Valley Telephone Company, Hornitos Telephone Company, The Ponderosa Telephone Co., Sierra Telephone Company, Inc., and Winterhaven Telephone Co.); Telecommunications Education Trust; and Utility Consumers' Action Network; MCI Telecommunications, Teleport Communications Group, and TURN also attached separate statements regarding certain issues to the Coalition's comments.

Commission matters, and that it participated in Commission proceedings on a highly selective basis. In mid-February 1995, DCA began participating in the local competition OIR/OII. Through that effort, DCA gained an awareness of the importance of the other related proceedings. DCA believes that its comments and insights have been welcomed by the various parties in the local competition OIR/OII, and that its comments in this proceeding would be of assistance as well.

We will grant DCA's motion to accept the late filing of its June 21, 1995 comments and recommendations on Universal service. ABP 3643 stated that the universal service proceeding shall include public hearings that encourage participation by a broad and diverse range of interests, including such state agencies as the State and Consumer Services Agency, of which DCA is a part.

In proposing today's draft rules, we are cognizant of the relationship that other Commission proceedings have with universal service. Many of the parties have emphasized that in their comments. Our framework for achieving our universal service goals will, to some extent, depend on the work that is to be completed in the other Commission proceedings.

We are also aware that the Federal Communications Commission (FCC) has opened a proceeding to review its Universal Service Fund (USF). The changes the FCC makes to the USF could affect the amount of money that many California LECs collect from the fund. We will monitor the FCC's proceeding and will evaluate how those actions may affect our own. The FCC may also open a more comprehensive proceeding on universal service policy in the future. We believe that it is likely that any FCC action on universal service policy will occur after this Commission has already adopted a revised universal service plan for California.

In the event the FCC does open such a proceeding, we will evaluate whatever results, to determine if our universal service plans need to be revised.

Our task in this proceeding is to determine the goals of universal service in a competitive environment, and what, if any, funding mechanisms will be needed in a competitive market.

III. The Concept of Universal Service

To put this proceeding into perspective, it is useful to first discuss what is meant by the term universal service. Universal service means essentially two things. First, that a minimum level of telecommunication services is available to virtually everyone in the state; i.e., there is a ubiquitous presence of telecommunication services throughout the state. Second, universal service means that the rates for such services remain reasonable. The latter meaning of universal service has resulted in the development of various kinds of universal service funding programs. However, these programs must be evaluated, and revised, if necessary, to promote universal service in a competitive environment.

The first funding mechanism is the California High Cost Fund (CHCF) (P.U. Code § 73923). The CHCF allows high cost companies, such as the small and medium size local exchange carriers (LECs), to receive funds to recover the relatively high network costs of providing service in areas of the state that produce less revenue. This fund ensures that both residential and business customers in high cost service areas of the smaller size LECs have access to telephone services at reasonable prices. The funds are used to keep both residential and business rates priced

Another universal service related program is the Deaf and Disabled Telecommunications Program. However, at the present time, this program does not appear to be in need of a reevaluation.

below the actual cost of providing service.⁴ Because rates are averaged between high and low cost areas, and profitable and less profitable areas, Pacific Bell (Pacific) and GTE California, Incorporated (GTEC), whose service territories are quite large, do not receive funds from the CHCF. Instead, their high cost areas are internally subsidized by their more profitable exchanges, through subsidies between product lines, and other sources of revenues.

The second funding mechanism is the Universal Lifeline Telephone Service (ULTS) program. The ULTS program was created in response to the Moore Universal Telephone Service Act which became law in September 1983.⁵ (PU Code § 871 et seq., General Order 153.) The ULTS program assures that income eligible households have access to telephone services at a fixed and affordable price, by offering these customers basic exchange services at substantially lower prices. The ULTS program is a statewide explicit subsidy that is available to the LEC serving the particular local exchange.⁶

Associated with the concept of the ubiquitous presence of telecommunications services, and reasonable rates, is the "basic service" or "basic exchange service" concept. This is the idea that a certain minimum level of service should be made available to everyone as part of universal service. Basic service forms the basis upon which subsidies are derived, and which services are kept at reasonable rates.

This is because the utility needed to provide that could accommodate touch tone technology. As the switches throughout the utilities' systems were changed over (something that happens with regularity in the telecommunications industry today),

⁴The current CHCF subsidy is approximately \$48 million.

⁵ Prior to the enactment of the Moore Universal Telephone Service Act, Pacific and GTEC had "lifeline service" programs in place. Those programs offered discounted measured rate service. (See 14 CPUC 2d 616, 624; 77 CPUC 117, 184; and 69 CPUC 601, 676.)

⁶ The current ULTS subsidy is approximately \$360 million. Universal service is generally recognized as pertaining to residential customers.

IV. The Goals of Universal Service

below the actual cost of providing service. Because rates are averaged between high and low cost areas, and profits are shared...

A. Background

In the simplest terms, universal service is the idea that all people have access to those telecommunications services necessary for participation in contemporary society. Most people would agree that this means a telephone in every home. Dispute may arise over whether the telephone should, as part of universal service, do more than the bare minimum of provide dial tone, and provide access to free operator and emergency services.

Universal service has evolved over time. In the early days of the industry, universal service meant access to a telephone, perhaps not even in one's home. It then evolved to mean a phone in one's home, but access to a party line. Eventually, it evolved to mean a single party line in the home.

This evolution can be explained in economic terms. When a new telephone product or service is introduced, the marginal cost of providing an additional unit is frequently above average cost. In order to deploy the service, capital outlays must occur.

Business will recover those costs from customers. As the service becomes more widely deployed, marginal cost drops. When marginal cost falls below average cost, the business might consider making it a standard option. For example, many Californians probably remember when using a touch tone phone meant paying an additional charge. This is because the utility needed to install switches that could accommodate touch tone technology. As the switches throughout the utilities' systems were changed over (something that happens with regularity in the telecommunications industry today), touch tone capability became commonplace. At the same time, with

2 Prior to the enactment of the Moore Universal Telephone Service Act, Pacific and GTEC had "lifeline service" programs in place. Those programs offered discounted measured rate service. (See 14 CPUC29 616, 624; 17 CPUC 117, 184; and 19 CPUC 601, 616.)

6 The current UTS subsidy is approximately \$360 million.
7 Universal service is generally recognized as pertaining to residential customers.

the opening up of AT&T's monopoly on consumer telephone equipment, consumers were able to purchase touch tone telephones, increasing demand even more. Eventually, the Legislature directed that touch tone became part of basic service. (PU Code § 2882.)

[Not every service becomes part of basic service. Take, for example, call waiting. While most switches in California today can provide call waiting, the phone company still charges for the service. It is not considered necessary to participate in society, and, more important, is not wanted by all consumers.

Despite the recognized benefits to society of ensuring that all people have telephone service, there are still some people for whom the cost of basic service is a financial obstacle. As described earlier, the Legislature therefore has mandated that all customers except low income residential customers pay into a fund that subsidizes basic telephone service for low income individuals. Similarly, there are some areas where the marginal cost of building and maintaining a telephone network exceeds the average cost. The CHCF exists to ensure that people in these areas still have service that is affordable.

B. Positions of the Parties

In the OIR/OII that launched this proceeding, we asked parties to comment on the universal service goals stated in the Infrastructure Report and AB 3643. Those goals were summarized in the OIR/OII:

- o Guarantee that high-quality basic telecommunications services remain available and affordable to all Californians regardless of linguistic, cultural, ethnic, physical, geographic, or income considerations;
- o Progressively expand the definition of basic service as technologies advance to avoid information rich and information poor stratification;

Ensure consumers have access to all the information needed in order for them to make timely and informed choices about telecommunications products and services and how to best use them.

Ensure that universal service programs will allow consumers to select among various technologies offered by competing firms, and ensure that carriers adhere to the same guidelines regarding mutual interconnectivity and interoperability, common carriage, reliability, privacy, and security.

Redesign universal service financing so it is "competitively neutral" and has an identified funding source.

Provide incentives for efficiency, to significantly reduce the aggregate subsidy required for universal service and to maintain affordable prices for basic service.

Provide incentives as needed to promote deployment of advanced telecommunications technology to all customer segments.

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

Preserve and develop opportunities for local flexibility and innovation.

The commenting parties generally agree with these goals, but differ somewhat as to how the Commission can achieve the goals. Differences that parties have with the stated goals are summarized below.

Progressively expand the definition of basic service as technologies advance to avoid information rich and information poor stratification.

...GTEC would add structural neutrality as a goal. The smaller Independent LECs suggest that the goals should be divided into short-run, attainable goals and long-run goals. The smaller LECs suggest that the goals are really objectives and that a realistic policy is less obvious. Citizens does not agree that universal service should be progressively expanded, nor does it agree that interconnectivity and interoperability belong in the universal service docket.⁹ Citizens also believes there should be a clearer definition of competitively neutral.

Public Advocates suggests that a goal of universal should be to ensure that all providers of local exchange services be required to achieve a universal service penetration rate of at least 95% for non-white and limited English speaking households. The Coalition, which represents some of the potential providers of local exchange service, agrees with this goal.

As for positioning education, health care, community and government institutions to be early recipients of the benefits of the information age, many of the parties favors such a move. The parties who commented on this issue believe that these types of institutions serve a larger audience and that such a policy will help to eliminate the stratifications between the information rich and the information poor. Some programs are now in place to target these kinds of institutions. However, few parties presented ideas about how this goal can be realized over the long run.

The City of Los Angeles suggests creating incentives to encourage telecommunication providers to subsidize educational access. Citizens believes that the competitive market will

10 D.94-04-003, pp. 6-7.

9. Our reference to CIC has the same meaning as that defined in the Interconnection and Interoperability Standards are best left to the Open Access and Network Architecture Development (OANAD) proceeding, R.94-04-003 and I.93-04-002. CIC be renamed.

recognize education, health care, and community and government institutions as niche markets, and that market forces will ensure availability of modern technology to these customers. Citizens and says that the need for any further market positioning of these institutions is ultimately a social policy question, which should be implemented through legislative initiative, not by the Commission.

C. Discussion

In D.94-09-065, the implementation rate design phase of the new regulatory framework (NRF) for Pacific and GTEC, the Commission recognized that Pacific and GTEC needed to "significantly improve their customer outreach and educational programs to achieve a 95% penetration rate for phone service among low income, nonwhite, and non-English speaking households.¹⁰ The Commission ordered that Pacific and GTEC file monitoring plans regarding penetration rates.

This 95% goal is a Commission commitment to ensure that all populations in California are afforded universal service and that technological advancements benefit all segments of the population. Having already addressed this issue in the NRF proceeding, we do not need to address it further, except to state that in a competitive environment, the same requirements should apply to all carriers. We therefore will apply the monitoring requirement to the other providers of local exchange service, such as the competitive local carriers (CLCs) and the other incumbent LECs.¹¹ These providers should include in their annual reports

Citizens believe that the competitive market will

¹⁰ D.94-09-065, pp. 6-7.

¹¹ Our reference to CLC has the same meaning as that defined in the local competition OIR/OII (dated April 26, 1995). We are aware that some parties have suggested in that proceeding that the term CLC be renamed.

their efforts and achievements to improve telephone penetration rates in their service territories, especially among nonwhite, non-English speaking and low income households. As discussed later, their performance may be a consideration in determining whether the provider should be allowed to become a designated carrier of last resort.

We solicit input from parties and suggest for the Legislature's consideration whether the standard by which the 95% penetration rate is measured should be modified to use income as the only variable against which penetration is measured. We would like parties' thoughts and data if available on whether middle and higher income households, regardless of race, have higher penetration rates than low income households.

We believe that education, health care, community, and government institutions should be in a position to benefit from the information age. Absent suggestions to the contrary, we believe this objective can best be achieved by creating and fostering the development of a competitive market. Potential providers for this market must realize that making certain kinds of telecommunications services widely available to these institutions will increase demand, thereby encouraging the development of a market for these products and services.

Another way to position these kinds of institutions to benefit from the information age is to provide for special rates. However, providing special rates to certain classes of customers to the exclusion of others for the same type of services may be contrary to PU Code § 453 and its prohibition against discriminatory rates and charges.

B. Basic Service Definition

1. Introduction

The first step in our analysis of the redesign of universal service is to derive a definition of basic service which

notations and other information. **Basic Service** refers to the services that are provided to all customers, regardless of their location or the type of service they receive. **A. Introduction** The definition of basic service is important for universal service because it forms the building block for what services customers will receive, and how the subsidies are derived. Although the terms basic service and basic exchange service have been freely used throughout many Commission decisions, no one decision has defined what that means. In this section, we focus our attention on the definition of basic service, and whether the definition needs to be periodically reviewed to reflect new technology and markets. Before doing so, we need to point out that the fourth stated objective of AB 3643 was to "Develop a process to periodically review and revise the definition of universal service to reflect new technology and markets." (Statutes 1994, Chapter 278, Section 2(a)(4)). We believe that the reference to a process to review and revise the "definition of universal service" was meant to refer to the definition of basic service. This is apparent by looking at Section 2(b)(2) of AB 3643, which states, in part, that "there must be an ongoing evaluation of which services are deemed essential and therefore a part of universal service." The reference to the "ongoing evaluation of which services are deemed essential" suggests that the periodic review contemplated in the fourth objective was for the definition of basic service, and not for the definition of universal service. As AB 3643 notes, those services which are deemed essential are part of universal service. It is those essential services which make up the definition of basic service.

B. Basic Service Definition

1. Introduction

The first step in our analysis of the redesign of universal service is to derive a definition of basic service which

can accommodate technological innovations. Currently, basic service represents a set of telecommunications capabilities which consumers receive when they order service from a monopoly local exchange carrier. Those capabilities have developed over time, and are expressed in various Commission decisions. The basic service definition also serves as the basis for deciding how much low and income customers should be subsidized under the ULTS program, and what services should be subsidized in high cost areas. The limited importance of basic service is that it serves as the gateway, or the connection to, the telephone network. Without that connection, a person's ability to participate in society is limited.

In defining basic service, we are not saying that all basic service throughout the state should be subsidized. Instead, we are defining a level of service which all local exchange carriers must provide in California if they want to avail themselves of the subsidies. The definition of basic service should be thought of in terms of what is a minimum level of service that consumers have come to expect, or what services are essential to all residential telephone customers. A provider can always offer more than what the basic service definition provides.

2.51 Positions of the Parties

Pacific and GTEC propose a similar definition of basic service. Pacific advocates a definition developed by the United States Telephone Association which includes: voice grade access to the public switched telephone network; the ability to place and receive calls; touch tone dialing; single party service; directory listing; access to operator services; access to directory assistance; and access to emergency services. GTEC's definition would add equal access to interexchange carriers and access to telephone relay services to Pacific's list.

Although GTEC does not include local usage in its definition of basic service as part of its strategy for the FCC universal service proceeding, GTEC states that the issue of usage

is an issue the Commission may want to adopt for California. GTEC, however, points out that to implement a support program for usage will require addressing the problem of how to compare different areas within the state which have different calling scopes and expand Pacific questions whether local usage should be included as part of basic service, and states that rates for usage should cover costs.

DCA, DRA, UCAN and the Coalition propose similar definitions of basic service, but include certain California specific items such as the ULTS rate, access to customer service, access to information and 800 services, and information service blocking.

Public Advocates, on behalf of its clients, state that the importance of bringing universal service and full and equal access to information services to poor, minority, and non-English speaking communities cannot be understated. Public Advocates believes that there should be a goal of incorporating advanced technologies into the definition of basic service. Public Advocates says enhanced services should be incorporated into basic services when those services become available to 51% of customers in the service area. Public Advocates also contends that basic service must include guaranteed capacity to handle data transfer.

The California Alarm Association suggests that the basic service definition include the ability of the network to send voice simple data.

Discussion The public switched telephone network, the DCA, DRA, UCAN and the Coalition's definitions of basic service generally reflect the level of basic service Californians currently enjoy. DCA, DRA, UCAN and GTEC's definitions tend to ignore some of the consumer protections Californians have come to expect, such as information service blocking. The larger LECs advocate a minimal nationwide definition which in many respects represents a retreat from established Commission policy. GTEC states that the issue of

- We propose that basic services should include the following elements (see proposed Rule 4, App. A):
- o Access to single party local exchange service;
 - o Access to interexchange carriers;
 - o Ability to place and receive calls;
 - o Touch tone dialing;
 - o Free access to emergency services, 911/811;
 - o Lifeline rate for eligible customers;
 - o Customer choice of flat or measured rate service;
 - o Access to directory assistance;
 - o Access to a directory listing;
 - o Access to operator services;
 - o Voice grade connection to public switched telephone network;
 - o Access to information services and 800 services;
 - o One-time free blocking for information services and one-time billing adjustment for charges incurred inadvertently, mistakenly, or that were unauthorized;
 - o Access to telephone relay service provided for in PU Code § 2881;
 - o Access to public pay telephones;
 - o Free access to customer service for information about ULTS, service activation, service termination, service repair, and bill inquiries.

We believe that the proposed definition of what the basic service package must include at a minimum is a reasonable and a definition of what are essential telecommunications services. The basic service package also reflects what telephone customers have come to expect.

We also believe that the definition of basic service minimums should be the same for all local exchange providers. If different definitions were adopted for different providers, certain groups of customers might not have access to certain essential basic services. Different levels of basic service based on demographic factors could adversely impact economic growth and consumer welfare. A uniform definition allows customers who move from one part of the state to another, to obtain the same type of telephone service regardless of location. Having the same definition of basic service is also technology neutral, and promotes fair competition because a provider cannot provide reduced levels of basic service. In addition, a uniform definition prevents customers from having to purchase services that they do not need. Having a single statewide definition also makes universal service less burdensome to administer.

The Greenlining Institute, which has participated in the local competition OIR/OII, suggested at the June 9, 1995 full panel hearing on local competition that consideration should be given to free telephone service. At some point in the future, carriers may try to bundle basic service with other services and products, so that the basic service is free or set at a very low rate. For the time being, we believe that the idea of free service is best left to the marketplace to decide.

C. Review of the Basic Service Definition

1. Introduction
One of the objectives of the current proceeding is to create a mechanism to evaluate which services are essential and therefore should be part of basic service. This objective anticipates that as technology advances new services may become essential. This proceeding will adopt a process for initiating review and criteria for evaluating whether a service should be included in basic service.

2. Positions of the Parties

The parties have widely varying views on how evaluation of the definition of basic services should occur. Pacific supports formal periodic review every three to five years. Pacific believes that a service should be included in basic service when it becomes essential and accepted. Pacific proposes that a service be considered essential when not having the service would create a significant impairment to participation in mainstream society. Pacific also states that market penetration of the service should be in the 80% to 90% range. In addition to the participation aspect and the penetration criteria described above, Pacific advocates a benefit/cost test before the service is incorporated into the basic service definition.

CTEG proposes a minimum and maximum period between reviews of universal service. Once a review has been completed a new review should not commence for two years. After this two-year period has passed parties can petition for a review of the definition of basic service. If no petition for review has been received within five years, then a new review is initiated.

CTEG advocates market acceptance and public interest criteria. CTEG argues that the Commission would have to determine that a new feature had been widely accepted and that the market would not, without intervention, meet all of the Commission's universal service expectations.

DRA believes that the definition of basic service should not be revisited until the year 2000. DRA recommends three criteria for examining whether the service should be included in the basic service definition: (1) that the service element is necessary for full participation in society; (2) to promote more widespread subscription to the service; and (3) to prevent stratification between the information rich and information poor. DRA further suggests that penetration rates may be necessary to evaluate whether new services should be included in the basic service definition.

The Coalition argues against periodic review of the definition of basic service in favor of a review triggered by penetration rates. The Coalition suggests that widespread subscription, for example, over 65% of residential customers, or a decline in penetration among low income, non-white or non-English speaking customers, should trigger formal review of the definition of basic service. The Coalition argues that high subscription alone should not result in the broadening of basic service. Instead, the Coalition suggests that the Commission determine whether the service is essential and whether the benefits of inclusion in the definition of basic service outweigh the costs. The Coalition argues that a service should be considered essential when it is necessary to enable a person to participate fully in society or to promote more widespread subscription to local service. The benefit/cost test should include a consideration of whether the inclusion of the service will raise basic rates to such an extent that penetration will decline as a result.

UCAN suggests that review of the definition of basic service be triggered when 51% of local customers subscribe to a service or if penetration levels in low income, non-white or non-English speaking communities decline significantly over a two month period.

Public Advocates contends that enhanced telecommunications services should become part of basic service when the service is available to 51% of customers.

Discussion
The parties identify two issues that the Commission needs to resolve in reevaluating basic services: the establishment of a review procedure and the criteria for evaluating when a service should be included in the definition of basic service. The review procedure can either be a periodic formal review or the procedure can be triggered by a measure such as service penetration rates monitored by the Commission. A drawback to the periodic formal review option is that it may initiate proceedings when there is no need to because no service meets the criteria for inclusion in the basic service package. A negative aspect of the trigger approach is that it would require an ongoing, extensive monitoring role on the part of the Commission of new and emerging technologies.

We propose adopting a periodic formal review of the definition of the basic service package. Such a review would determine if services should be added or deleted from the package. The effective date of the Commission's initial adoption of the definition of basic service in this proceeding will start the calculation of the periodic review date. Interested parties may file a petition for modification to reopen this proceeding to reevaluate the definition at the end of three years. If no party requests such a review at the end of that period, then the next opportunity for review will take place three years hence. If a review is requested and this proceeding is reopened, then the next opportunity for review will come at the end of three years. Underserved communities believe that the market will not diffuse advanced technologies to

¹² The petition for modification shall be filed on or before the 180th day before the periodic review date.

from the effective date of the adoption of the revised definition of basic service. (See proposed Rule 4.C.(App. A))

Relevant and precise criteria are necessary for an efficient reevaluation of the basic service package. We propose that the Commission consider including a service in the definition of basic service if a substantial majority of residential viewers of subscribers use the service, and access to the service is found to be essential for participation in society. For the purpose of determining whether a service should be included as part of basic service, a minimum of 65% of residential customers must subscribe to the service. The 65% figure indicates that it has gained wide acceptance among consumers. In addition, the quantitative and qualitative benefits of adding the service to the basic service definition must outweigh the costs. The Commission should also consider as criteria whether intervention is necessary or if continued subscriber growth and availability would occur in the absence of regulatory action. (See proposed Rule 4.C., App. A.)

D. Promoting Access to and the Deployment of Advanced Technology

Introduction
The universal service OII/OIR recognized that one of the goals of universal service is to provide incentives to promote the deployment of advanced telecommunication technology to all customer segments.

2. Positions of the Parties
Some parties assert that it is necessary for the Commission to take an active role in expanding the use of enhanced services among historically underserved low income, non-white and non-English speaking Californians. UCAN and Public Advocates believe that the market will not diffuse advanced technologies to underserved communities. They argue that as long as the definition of universal service depends on penetration rates, underserved communities will lag behind in receiving the benefits of advanced

telecommunications services. To address this problem, UCAN advocates a market building grant program, and Public Advocates non suggests measures to prevent utility redlining of customer classes.

UCAN contends that in the absence of intervention, competing carriers will offer enhanced services to niche markets whose customers can afford them, rather than offer the services to a broad spectrum of consumers. Instead of reducing the overall subsidy, UCAN believes that a larger subsidy will result because niche markets will develop while applications that appeal to a broad spectrum of the public will fail, which will keep subsidies high.

UCAN suggests as a possible solution to this problem that the Commission create a mechanism that will work to reduce subsidies and promote broad-based, affordable, and useful applications. This could be achieved by the assessment of universal applications incentive fee, which would be distributed under Commission guidelines through partnership arrangements. UCAN envisions grants distributed to state/local/business partnerships which will in turn develop applications designed to meet the needs of a broad range of customers. This could then lead to the offering of this service on a broader basis, which would then reduce the amount of the subsidy required to maintain universal service.

In their comments in our local competition proceeding, the Universal Service Alliance (USA) advocates a market building strategy similar to that proposed by UCAN. USA fears that without intervention the market will serve high end customers. USA advocates a foundation which might fund community technology centers that would facilitate products developments relationships between vendors and those consumers or institutions at risk of being bypassed by market forces. This foundation would be funded by telecommunications providers and participating companies and their

not only telecommunications providers and their

Public Advocates warns that low-income, non-white and non-English speaking Californians may become victims of redlining, the refusal of advanced telecommunications providers to serve certain neighborhoods unless the Commission intervenes. Public Advocates suggests that each carrier be held responsible to build facilities and offer programming to underserved communities without discrimination on the basis of income, race, ethnicity, or geography. Public Advocates also contends that the idea of a second tier of universally available services, as proposed in the Infrastructure Report, will exacerbate this problem rather than reduce it.

The Telecommunications Education Trust (TET) believes that in the future there is going to be a distinct class of customers who have access to the digital, broadband, interactive network. TET supports the idea that the people who cannot afford the hardware to connect or the money to give them access should be given access through schools, libraries, and clinics, or through some sort of public kiosks or pay phone approach.

Discussion

The proposals of UCAN and USA may serve to provide a greater access to new technologies by bringing providers and underserved consumers together to develop new services, products, and applications. However, it is unclear if introduction of these services to underserved consumers will stimulate sufficient interest in and demand for these new services, products and applications, thus resulting in lower costs.

The narrow source of funding that UCAN proposes raises some concerns. The type of applications UCAN speaks of involve not only telecommunications, but also software, hardware and perhaps certain types of multi-media production. Consequently, if such a program were to be implemented, then it might be appropriate for all participating companies and their product end users to contribute, not only telecommunications providers and their

customers. However, this type of broad funding base is currently beyond the Commission's jurisdiction. Instead of proposing a rule at this time regarding a grant program for advanced technology, we invite further comment on the grant proposals. Comments should cover the following:

- o What recommended amount of funding is necessary for such a grant program?
- o What effect will the proposal have in increasing access to advanced services?
- o Have similar types of market building grant programs been effective?
- o Should development of new and emerging products and services be left to market forces?

Regarding the two-tiered approach to basic service, that is the general fund is more appropriate for this type of program?

Should non-regulated entities or persons contribute to this market building fund?

What additional Commission and/or other resources would be needed to effectively administer such a program?

Who should receive the grants in order to maximize access to advanced telecommunications technology?

How should we evaluate whether such a grant program has been successful?

Redlining in telecommunications could be viewed as the practice of denying access to generally available advanced telecommunications services or adversely varying the terms of such access because of the conditions, characteristics or trends in particular communities. We are concerned that this possibility may lead to the development of information poor communities.

One way to solve this potential problem is to require each LEC and CLC to offer all services to anyone within their

defined service area. Carriers, however, might then try to narrowly define their service areas. The problem that redlining raises is that a determination must be drawn between the economics of certain services, and when the deployment does not occur because of discrimination.

We invite comment by the parties on the following:

- o Will an explicit prohibition against redlining be effective?
- o What economic or market factors should be considered to determine whether lack of service availability is due to redlining or some other cause?
- o If redlining is detected, what should be the consequences?

Regarding the two-tiered approach to basic service, that proposal was contained in our Infrastructure Report at p. 19. The Infrastructure Report stated that a two-tiered approach would be designed to manage the transition toward a redefinition of basic service. The first tier would consist of conventional voice telephone service. In the second tier, it was proposed that basic digital access be added to the basic service definition. When a majority of individuals and businesses use the second tier service as a common method of conducting daily activities, it was proposed that the Commission would consider expanding ULTS support to this service.

Based on DRA's comments, it appears that the telecommunications market is already moving toward digital access. As DRA notes, all services, including voice services, will soon be carried by digital signals. Pacific and GTE, which serve a combined 97% of the access lines in California, have announced plans for 100% deployment of digital switching by 1997.

At the present time the definition of basic service for purposes of this proceeding, should not be expanded to include basic digital access. This may change in the near future as

digital technology becomes more commonplace. For purposes of this universal service proceeding, unless comments on these rules can convince us otherwise, the only tier of basic service is the list of elements that we listed earlier.

With the introduction of telecommunications competition into all areas of service, we are revisiting our existing ULTS and CHCF mechanisms. Based on the comments, parties

A. Introduction
The Commission is committed to guaranteeing that high quality basic telecommunications services remain available and affordable to all Californians. In the universal service OIR/OII, the Commission asked parties to comment on how the Commission could ensure reasonable rates for basic telecommunications services. The OIR/OII also asked parties to recommend a mechanism which would ensure universal service in a competitive environment.

We have given these two issues some thought. Reasonable rates are intertwined with the current universal service programs. In order to keep rates at reasonable levels, the ULTS and CHCF were developed. In addition, rates have been geographically averaged so that high cost areas are offset by lower cost areas. A balance must be achieved between the size of the subsidies, and the rate. One way to reduce the size of the subsidies is to allow rates to move toward the cost of providing service by deaveraging rates by geographic areas. However, such a move may result in very high and unaffordable rates if a rate ceiling is not imposed.

We invite comment on whether we should consider geographic deaveraging of rates in this or other related proceedings. Specifically, we invite comment on the idea of whether rates in high cost areas should be geographically deaveraged, subject to a cap that is limited to the lower of the cost to serve or 150% of the weighted average rate in low cost areas. First, competitive local exchange markets for three reasons. First, as long as internal subsidies of the incumbent LEC are used to support

Instead of focusing on how rates should be structured in a competitive environment, we turn our attention to what kind of mechanism will ensure universal service in a competitive environment.

With the introduction of telecommunications competition into all areas of California, the Commission needs to reexamine the existing ULTS and CHCF mechanisms. Based on the comments, parties generally agree that the ULTS mechanism needs only minor reform in a competitive environment. A revised ULTS program can possibly be implemented before a revised high cost fund is adopted. However, many parties suggest that the subsidy mechanism for high cost areas requires more thought and planning. But Is There a Need to Revise the Existing Universal Service Mechanisms?

1. Introduction
The commenting parties agree that some type of funding mechanism should remain in place for income eligible telecommunication subscribers. The commenting parties also agree that many areas of the state are high cost areas which may require a funding mechanism. However, there appears to be some disagreement as to whether basic services are subsidized in high cost areas are not restricted solely to areas within the territories of California's 20 small and mid-size LECs, but also include certain exchanges of Pacific and GTE as well. These areas are high cost for various reasons, such as a small population, and difficult terrain. With the introduction of local exchange competition, the Commission needs to develop a funding mechanism which specifically targets high cost areas throughout California.

2. Positions of the Parties
The Coalition says that the present system for preserving universal service is inconsistent with the development of a competitive local exchange market for three reasons. First, as long as internal subsidies of the incumbent LEC are used to support

universal service, potential competitive providers, no matter how efficient, will face competitive disadvantage against services which are subsidized. Second, as long as competitors contribute to a universal service funding mechanism which also subsidizes the incumbent carriers' basic exchange service, in addition to having universal service goals, potential competitors may be forced to fund their dominant competitor. Third, the current system of que internal subsidies can be maintained over the long run because competition will drive the prices for services from which contributions currently may be derived closer to the actual cost of providing those services.

The Coalition proposes that before a new universal service plan is implemented, the LECs first demonstrate the need for subsidized basic exchange services through appropriate total service long run incremental cost (TSLRIC) studies.¹³ Second, the LECs must demonstrate that if the need for a basic service subsidy does exist, the level of competition for basic service must pose a significant threat to the LEC's ability to fund the identified subsidy requirements. If after such a demonstration it is determined that a significant need for a basic exchange subsidy does exist, the Coalition believes that a competitively neutral universal service funding mechanism is required for the development of effective local exchange competition.

GTEC contends that to ensure that universal service is maintained in a competitive environment, a policy and program needs to be put in place. The cornerstone of a smooth transition to full

universal service is that whatever method is chosen to subsidize universal service, it is critical that any funding mechanism must be

13 The Coalition defines TSLRIC as follows: "TSLRIC means the forward-looking (economic) incremental cost to the LEC caused by providing the entire quantity of the service, network building block/component or group) of network building blocks/components in question, using the most efficient technology deployed most efficiently. The long run means a period long enough so that the cost estimates are based on the assumption that all inputs are variable." (Coalition's Comments, p. 3, fn. 4.)

local exchange competition is the comprehensive redesign of universal
 existing universal service funding mechanisms to ensure competitive
 neutrality. GTEC says that this can be accomplished by moving
 universal service contributions from other incumbent LEC services
 priced above reported costs to a mechanism that is explicit in
 nature. The redesign of the existing universal service internal
 support mechanisms ensures that the benefits of local exchange
 competition can be realized without jeopardizing the goal of
 affordable and ubiquitously available service. GTEC asserts that
 the continuation of current universal service policies will not
 interfere with the development of effective local competition.
 Under the current system, GTEC asserts, the LECs face asymmetric
 obligations to serve, pricing constraints, and regulatory burdens.
 MCI states that the Coalition's plan permits the development of
 effective local exchange competition and promotes the economic
 efficiencies that local exchange competition can bring. MCI
 contends that the Coalition's mechanism is neutral and does not
 compensate the LECs for alleged competitive losses or lost
 revenue contribution. In a competitive environment, MCI states
 that the LECs may lose customers and revenue as a result of local
 exchange competition. Citizens agrees that the universal service
 funding mechanism must be competitively neutral and points out that
 a competitively neutral mechanism is one that creates the least
 possible market distortions. The Cellular Carriers Association of
 California (CCAG) states that whatever method is chosen to subsidize
 universal service, it is critical that any funding mechanism must be
 competitively neutral among service providers and that all
 providers should bear an equitable share of any such obligation.
 MFS Communications Corporation (MFS) states that any
 system of universal service should be (1) quantified and
 efficiently targeted to help those deserving of assistance;

(2) funded by a mechanism that removes funding from the LEC rate structure; and (3) neutrally administered by a disinterested party, such as an accounting, financial services, or information management firm. Public Advocates also agrees that

McCaw Cellular Communications, Inc. (McCaw) states that the Commission should establish a goal of eliminating intercarrier subsidy programs. This can be accomplished by providing subsidy payments directly to customers, and not to carriers, and by removing subsidy rate elements in interconnection charges paid to incumbent LECs. McCaw believes that once these incentives to report higher costs are eliminated, and competition is introduced, the incumbent LECs will be forced to achieve lower costs. As a result, rates should decrease. To reach this point, McCaw states that the Commission must (1) design a collection mechanism for customer subsidies; (2) create a competitively neutral and equitable efficient scheme for distributing subsidies; and (3) calculate the amount of the required subsidy. During the June 9, 1995 full panel hearing in the Local Competition proceeding, Pacific urged that local competition be delayed until a complete set of universal service rules are put in place. In Pacific's comments to this proceeding, Pacific recommends that the Commission adopt an interim universal service rate element for Pacific's interconnection service. This would remain in place until a permanent universal service funding mechanism is implemented. Pacific argues that local exchange competitors will enter the market and take away the high call volume business and residential customers. Due to the potential loss of those customers, the revenues available for internal service cross subsidies will shrink and the remaining customers and the LECs will have to bear the additional costs of serving unprofitable customers. Public Advocates states that in order to fund universal service, there must be an identified funding source in order to

maintain the long-term viability of the program. Also, all (S) providers of telecommunications services must contribute to the fund.

Public Advocates contends that central to the issue of a subsidy is ensuring that there are adequate cost studies to accurately determine the cost of providing universal service. Any incentives for efficiency must not impose a barrier on a company's effort to ensure that special populations are provided with payphone affordable and accessible telephone service.

The Smaller LECs contend that the best method of ensuring the reasonableness of rates for basic telecommunications services and for ensuring the availability and affordability of universal service, is to retain the CHCR. Since the small LECs have to make rate case filings by the end of 1995, they feel it would be imprudent to make changes to the CHCR program at this time. The Smaller Independent LECs believe that there is little practical experience as to how competition will impact low density, high cost exchanges. The Smaller Independent LECs state that for the areas in which they are located, markets are extremely limited and cannot support multiple carriers. Because of these unknown effects, the Smaller Independent LECs point out that an increasing number of other states have exempted small LECs from competition until more data is available. Since the smaller LECs serve less than one percent of the access lines in California, they recommend that the Commission follow the lead of the other states and defer the introduction of competition for local exchange services in low density, rural areas until such time as the Commission has had an opportunity to review the impact and effect of competition in high density, low cost sections of the state.

AirTouch says that the Commission is not authorized to implement rules for universal service under AB 3643. Instead, AB 3643 says that the Commission is to institute and complete an

investigation on universal service and report its findings to the Legislature.

3. Discussion We agree with the parties which state that there is a need to quantify the basic service subsidy, that the subsidy needs to be explicit, and separate from the LECs' existing rate structure, and that the mechanism must be competitively neutral. It is apparent that changes will be needed to the existing universal service programs funded by the ULTS and CHCF mechanisms because competition will allow competing providers to enter all markets in California. Instead of a single provider, the customer may have the choice of multiple providers. The funding mechanisms need to be redesigned to allow new market entrants access to universal service funds if they provide basic service to low income customers or to high cost areas. In addition, the mechanisms need to be changed to reflect the downward pressures on costs that competition should bring. Over time, competition and technological advancements should reduce the total amount of basic service subsidies. The revisions to the high cost fund should also reflect the change from a company subsidy to a subsidy that benefits residential customers who live in high cost areas or who are eligible for the ULTS program.

Although we do not agree with Pacific's position that local exchange competition should be postponed before final universal service rules are in place, or that an interim funding mechanism should be established, we acknowledge that competition will take some time. Potential competitors will have to establish their local exchange networks, or enter into agreements with the LECs for access to the local exchange network, both of which are complex issues to resolve. In addition, no studies have been completed that confirm that the LECs' residential basic exchange services are being subsidized by other LEC services. By the time competitors are able to make market inroads, and cost studies are

completed, redesigned universal service rules will have been adopted.

In the universal service OIR/OII, the Commission asked parties to comment on whether a new mechanism should cover both low income customers and high cost areas. The Commission asked parties specifically to comment on the voucher and auction approach, or on other universal service funding methods. Based on the comments we have received, we believe that our proposed universal service mechanisms will be easier to administer and implement if the areas supporting low income customers and the program for high cost areas remain separate. Once the universal service support systems are in place and the Commission has identified the actual cost of providing basic exchange service by geographic areas, we may consider combining the funding mechanisms for low income customers and high cost areas. We will discuss the funding mechanisms for high cost areas, and for low income customers, separately in the sections that follow.

As for the comments of the Small LECs and Smaller Independent LECs that the Commission should refrain from introducing local competition and preserve the existing CHCF in their service territories, we conclude that PU Code § 709.5(b) controls. PU Code § 709.5(a) provides in part that "It is the intent of the Legislature that all telecommunications markets subject to Commission jurisdiction be opened to competition no later than January 1, 1997." (Emphasis added.) Unless PU Code § 709.5 is amended to exempt the smaller LECs from local exchange competition, it is our belief that our redesign of universal service must apply statewide to their local exchange networks.

Another reason why the small and medium size LECs should not be treated differently than Pacific and GTEC is because most of the small LECs are dependent on the CHCF to fund their Commission authorized rates of return. However, if Pacific and GTEC become eligible to draw from a high cost fund, the funding needs for these

CHCF could rise dramatically. In addition, the CHCF may be discontinued upon completion of the small LECs' general rate cases ordered in D194-09-065.

We do not find AirTouch's comment that we are not authorized to institute new universal service rules as a result of AB 3643 compelling. Such an argument overlooks the fact that other legislation, specifically AB 3606 (1994 Statutes, Chapter 1260) added PU Code § 709.5 to state that all telecommunications markets be opened to competition no later than January 1, 1997, and that the Commission take the necessary steps to put into place whatever additional rules and regulations that may be necessary. (PU Code § 709.5 (c))

The Mechanism for Funding High Cost Areas

1. Proposals for Funding High Cost Areas

a. Introduction

In deciding how high cost areas will be funded in a competitive environment, several issues are raised.

The first issue that needs to be addressed is whether the mechanism for funding a high cost area should only be for residential customers. The CHCF currently focuses on subsidies for the smaller LECs, and does not make a distinction as to whether the subsidy is for the smaller LECs' residential or business customers.

The second issue, which is not limited just to high cost areas, is which provider undertakes the franchise obligation of being the carrier of last resort (COLR) for a particular area.

The COLR is the regulatory concept that there must always be a provider that is obligated to serve all customers in a particular service area. The 22 LECs have been the COLR in California's 500 plus local exchanges. With the introduction of competition, the COLR concept changes because certain competitors may choose to serve a smaller service area or group of customers than the incumbent LEC is now obligated to serve. In certain circumstances, the cost of serving the customer would be determined through cost

areas, within existing LEC service territories, that may result in more than one COLR, and in other areas there may only be one COLR.

In order to gain insight on why changes to the existing CHCF are necessary, a brief description of the CHCF is in order. Traditionally, the funding for high cost areas has come from pooling of local exchange carrier revenues. When switched access rates were reduced in 1985, a large reduction in access pool revenues resulted. This led to the creation of the present mechanism, the CHCF. (See D.85-06-115 (18 CPUC2d 133).) The CHCF was established so that drastic increases in the smaller LECs' local exchange rates could be avoided. Because the reduction in switched access rates and access pool revenues was (not) due to any decrease in LECs' costs, the smaller LECs' revenue requirements had to be subsidized if their basic exchange rates were to remain reasonable. The CHCF subsidizes reasonable basic exchange rates for customers of the smaller LECs that concur in statewide average toll, private line, and access rates. Pacific and GTEC fund their high cost exchanges with internal cross subsidies, and revenues from directory advertising. The Commission, in anticipation of having to change the funding mechanism for high cost areas, requested in the universal service OIR/OII that parties comment on two particular methods of funding high cost areas, the voucher method, and the auction method. Both methods are beneficial from the standpoint that the subsidy for funding high cost areas is directly paid to identified, and each method allows multiple competitors in the local exchange market.

In brief, the two methods are as follows. The voucher system for high cost areas would work by giving the customer a credit voucher for a set amount of money which represents the difference between the actual cost of serving a customer and a rate that is deemed affordable by the Commission. The cost of serving the customer would be determined through cost

studies. A variation of the voucher is the virtual voucher. With a virtual voucher, the customer chooses a provider. The carrier is that the customer selects would then draw a subsidy from the funds on behalf of the customer, and would credit that customer's bill with the amount of the subsidy. The customer then pays the balance of the bill. From the customer's perspective, a virtual voucher is easier to administer than a voucher.

The auction or bidding mechanism would allow qualified providers to bid a fixed amount of basic service subsidy necessary to serve a high cost area. The bidder with the lowest bid would become the subsidized COLR for that area for a set period of time.

Positions of the Parties

Several parties commented in favor of the virtual voucher proposal. One of the biggest proponents of the voucher is the Coalition. The Coalition thinks that the voucher method provides significant advantages over an auction approach. The Coalition states that under the voucher method, the customer doesn't have to do anything except to choose a provider and pay a monthly bill, some of which will be subsidized. In addition, the voucher method is easier to administer.

The Coalition believes that the auction approach would give an advantage to the incumbent LECs because a carrier would be required to be ready to serve an entire area as a COLR. Under the voucher method, carriers could come into the market when they are prepared to do so. Instead of serving an entire area, under the voucher method, the carrier could select the area that it wants to serve.

The Coalition also claims that GTE's bidding mechanism proposal relies on LEC resale. The Coalition fears that winning bidders will be faced with price squeezes or lack of unbundling which will preclude competition from developing. The Coalition states that the incumbent LEC should retain the COLR obligation until procedures are in place to select another COLR.

Thus, for a period of time between the authorization of a competition and the implementation of a new funding mechanism for high cost areas, the incumbent LECs would continue to have the obligation to serve. The Coalition recommends the auction method as a supplemental COLR mechanism in the event no provider is willing to come forward and assume the COLR responsibility. Such a mechanism would serve as a safety net to ensure the availability of basic exchange service. The Commission or any provider could initiate an auction whereby service providers would bid to be the COLR for the area. The bid could be in the form of a lump-sum amount, over and above the per line subsidy that would be provided for that particular area, which the bidder would receive for committing to be the COLR in the geographic area. The service provider requiring the smallest subsidy would become the COLR for a specified number of years with competitive entry allowed. If the winning bidder were not the incumbent LEC, then the LEC would be required to offer its facilities for that geographic area to the winning bidder at the net book value of the facilities. Citizens favors a voucher approach as well. However, Citizens believes that prior to instituting a voucher system, the first step is to allow the rates of the LECs to move upwards toward their actual costs. Once rates move toward cost, the Commission could determine the level of subsidy that would be appropriate for providers in qualifying high cost areas. Contribution credits could then be attributed to the LEC or any other provider that they offer service in a high cost area. Citizens says that a virtual voucher would be a relatively easy for customers to understand and use, but some education would be necessary beforehand. The provider would find the systems relatively simple to administer because the net contribution credits would be allocated to it by an independent fund administrator. The provider would have to establish a billing

system that reflects the contribution credits and bill only, the difference between the market price and the subsidy amount to eligible targeted customers. If the fund were administered by an independent trust, all the Commission would have to do is to monitor the system and reexamine the level of the subsidy as needed.

Citizens believes that the voucher system will encourage competition and the entry of additional providers because the disbursements are available for qualifying high cost areas to any carriers willing to provide services to those areas. As rates move toward cost, Citizens expects that all areas will become more attractive to competitors.

Citizens suggests that under a virtual voucher mechanism, the designation of a COLR is a moot issue because there will be funding for high cost areas, and the eligible customer can choose from multiple providers. Citizens says that in a market of multiple providers of service, all providers should serve all customers requesting service. Citizens says that a COLR designation needs to be made in only two instances: (1) when no carrier has entered the market and the incumbent must continue to serve all potential customers; and (2) when, after competitors have entered the market, all but one decide to exit, the remaining carrier must be designated as the COLR. If all the carriers decide to exit an area, the Commission could then hold an auction to select the carrier willing to serve with the lowest level of high cost support.

Pacific and GTEC favor the bidding mechanism proposal that GTEC submitted in connection with the FCC proceeding on universal service. The GTEC bidding mechanism would support carriers who plan to undertake a COLR obligation. Their method would initially be based on the LEC's incremental costs, using a proxy cost approach to estimate the cost for each newly defined market area. The proxy cost study would then be tried up, if

necessary, to recover the full LEO book costs. This cost-based approach would be replaced by a competitive bidding process when new firms are willing to enter a geographic area to be carriers of last resort in a given geographic area. This auction or bidding process would result in an amount determined by the lowest bid of a qualified firm. That amount represents the support required by the winning bidder to serve that area. The winning bidder would then be committed to serve as the COLR in the given area. Any other qualified carrier would then be allowed to opt in or opt out of being a COLR in that area at the support level determined by the lowest bid amount for the defined package of local service. COLRs would disclose to all consumers that they stand ready to serve any customer within their market area. The proposal favored by GTEC would allow multiple firms to assume COLR obligations, while not allowing replacement of an incumbent's LEO as the COLR. In addition, GTEC contends that the bidding process will provide an objective means for determining when the auction mechanism is no longer needed to assure supply at affordable rates in a given area. When the submission of subsidy bids converges to zero, this will indicate that the Commission's required rate is close to the market rate where firms will provide service without support. Pacific believes that a voucher system would require customers to be highly knowledgeable about their choices and how to compare them. In addition, Pacific contends that the voucher and virtual voucher mechanisms would require significant regulatory oversight to determine appropriate presubscriber subsidy levels in a way which is objective and competitively neutral. It would also require that a system be set up to carry out the voucher transfers between the customer and the company. For the auction method, Pacific proposes that funding for each high cost area be determined at the wire center level. Pacific claims that ignoring customer differences will result in cream skimming, if the competitors will target the more densely populated areas.

profitable high volume business and residential users. Pacific states that the Commission should supervise the bidding process, and that the actual auction process should be delegated to a third party with the costs borne by the bidding parties. Pacific believes that there could be multiple COLRS. If that were the case, the Commission would have to ascertain and monitor the financial integrity of more firms than if only one COLR was in place. Pacific believes that multiple COLRS could also lead to gaming by referring unattractive customers to high cost or low revenue customers to other COLRS. Also, multiple COLRS raise the issue of whether this would lead to efficient infrastructure investment because a fixed amount of subsidy would be spread between two infrastructures. One way of overcoming this problem is through resale of another carrier's services. Even though Pacific favors an auction mechanism, Pacific argues that other regulatory changes and attitudes need to change in order to sustain universal service. In particular, Pacific contends that the NRF sharing and price indexing mechanisms need to be eliminated. In addition, Pacific believes that LECs should be encouraged to enter new markets by eliminating rules which restrain LECs from investing. Pacific believes that after further regulatory reform, the only service that will require subsidy support will be residential basic exchange service. Pacific believes that all other services should be priced at or above their costs on a geographically deaveraged basis. If any business rates remain geographically averaged, then subsidy fundings of these businesses in high cost areas would also be required. Pacific believes that the Commission needs to evaluate the circumstances of the small LECs independently, and design appropriate plans for their service territories. Although the goal of universal service is to provide uniform service at

affordable rates statewide; Pacific states that the regulatory program schemes need not be uniform among all the California exchanges and that it should be. McCaw also supports a bidding process to select the COLR for high cost areas. Although the Smaller Independent LECs do not believe that the current CHCF should be changed, they did comment on the voucher and auction methods. They believe that the voucher system would be difficult and costly to administer. The cost of the administration would have to be recovered through additional charges on carriers or end users. The Smaller Independent LECs also contend that the voucher system does not address incentives for infrastructure development in rural areas. With respect to the auction method, they state that auctions may be a feasible alternative for bidding for previously unserved territories but it would not be suited for territories already being served. They argue that an auction mechanism raises serious legal issues regarding a regulatory taking and just compensation. Roseville does not believe that the auction process promotes the goal of providing high quality universal telephone service. Roseville contends that the auction process provides little incentive to encourage long run infrastructure development. In addition, the auction process does not eliminate the need to provide recovery for the embedded costs of plant put in place to meet the COLR obligations.

Roseville suggests that in order to ensure the maintenance of universal service, there is a need to designate a facilities-based COLR for all telephone subscribers in each geographic area. Roseville recommends that the existing LEC be designated as the COLR for basic exchange services in their territories. Allowing the incumbent LEC to remain in place as the COLR acts as a safeguard to ensure that service continues in that particular area and minimizes service disruptions. For those

customers who don't want an alternate provider, they retain the existing LEC to which the customer is accustomed. The CCAC proposes that the Commission should consider whether the COLR obligation should be borne by providers other than the LEC. With the growing use of wireless telecommunications, a wireless provider might be able to assume the COLR obligation in a more limited geographical area at a lower cost. CCAC also suggests that resale be allowed to avoid duplication of facilities.

DRA does not believe that either a voucher system or an auction is necessary at this time. Instead, DRA proposes a two-stage transitional period before full local exchange competition is reached. In the first transitional period, basic services would be recategorized from Category I to Category III. LECs would maintain their existing rates for basic services, and CLCs would have pricing flexibility for their basic services. The transition to the second stage would occur if the following conditions are met: (1) the LECs are authorized to enter the interLATA markets; (2) cost study requirements per D.94-09-065 are met; and (3) equal access is authorized and implemented for all carriers. During this period LECs would be authorized to establish a cost-based rate for basic services based on the cost studies performed in response to D.94-09-065. Upon a finding that effective competition exists, then full competition would be allowed. At that time, all LECs and CLCs would have full pricing flexibility for basic universal service, and the LEC's basic services would be recategorized to Category III, above the line services.

Under DRA's proposal, no additional funding for universal service, other than the existing ULTS program, the Bear Gulch program, and the existing ULTS program, is needed. Areas likely to remain high cost areas are likely to remain high cost areas and are likely to remain high cost areas. In contrast to GTEC's proposal, we were

14 The three categories of service are described in D.89-10-031. (33xCPUC2d at p 125-126) (62125126)

and Disabled Telecommunications Programs and the CHCF, would be needed. In the future, when the market is found by the Commission to be effectively competitive, then DRA proposes an auction for the ULTS program. DRA states, however, that this will not happen for a while and need not be addressed at this point. With respect to possible changes to the CHCF, DRA says that this issue should be revisited when the smaller LECs file their general rate cases and/or elect to be regulated under the new regulatory framework and structure.

Discussion
In the redesign of both the CHCF and the ULTS program, the Commission must fashion mechanisms which ensure competitive neutrality and at the same time ensure that the benefits of competition can be realized without affecting the goals of affordable and ubiquitously available service.

Both the auction method and the voucher method require the development of extensive administrative procedures. Both programs also require periodic review: either to conduct the auctions, or to review costs to determine if the subsidy for high cost areas should be reduced.

Our proposed rules do not put recommend an auction as the primary mechanism for distributing high cost subsidies. The reason for this is that auction proposals would appear to result in one of two outcomes: (1) there are multiple winners so bidders have little incentive to bid down the subsidy or (2) there is a single winner and subsequently little consumer choice. Under GTEC's multiple winner proposal there does not appear to be any incentive for bidders to bid down the subsidy required to serve a particular area. By failing to generate low bids, the required subsidies for high cost areas are likely to remain high rather than be reduced over time. If, in contrast to GTEC's proposal, we were to adopt an auction which identified a clear winner with exclusive access to subsidy funds, then we may be forcing customers to take

service from a particular carrier, the one who wins the auction. By reducing consumer choice, this may conflict with our objective of bringing the benefits of competition to all Californians.

In addition, we believe that auctions for all high cost areas would be administratively difficult. The Commission or its designee may have to become involved with numerous ongoing auctions, interests, and an unbounded network as such. While we are not proposing an auction as the primary mechanism for distributing high cost subsidies, we recognize some of the potential advantages of an auction. First, auctions rely or less on controversial cost studies than the voucher system. Even though cost studies may be used to establish a basis or benchmark in an auction system, the bidding process should correct any errors carriers detect in cost studies. Second, an auction encourages bidders to focus on the overall business opportunity of high cost areas, rather than narrowly on the cost of basic services. If bidders view a subsidy as a means of gaining access to profitable toll or other ancillary markets, they may be willing to bid lower. By contrast, a voucher system does not allow for viewing basic service as access to more lucrative markets. Parties that advocate an auction as the primary mechanism for distributing subsidies for high cost areas should file comments regarding the following: (1) what incentives are there to bid low; (2) how consumer choice would be accommodated with an auction; and (3) is the auction mechanism administratively feasible. DRA's phased approach has some merit in that no significant alterations are required to the existing universal service programs. Instead, DRA's proposal relies on competitive forces to ensure that basic service remains affordable and ubiquitously available. One drawback to DRA's approach is that no proactive steps are taken to determine the subsidies in high cost

areas and for low income customers, and to develop a plan to reduce those subsidy amounts. By reducing consumer choice, this may reduce

We agree with DRA's general premise that any new explicit subsidy for large LECs should only be implemented when (1) there is reliable evidence based on sound cost studies that a subsidy is necessary and (2) the minimum conditions for competition, such as unbundled network components, interconnection arrangements, intraLATA presubscription and interLATA relief, are in place. However, we feel it is important to have a mechanism ready to put in place when full competition occurs.

We have considered the comments of the parties regarding the various kinds of funding mechanisms that can be utilized to further promote the universal availability of telecommunications services in a competitive environment. We have also compared the CHCF to the different proposals. We propose that the current CHCF be replaced with a virtual voucher system of funding, which we shall refer to as the high cost voucher fund. We also propose that an auction mechanism be used as a safety net in the event no single carrier is willing to undertake the COLR obligation. With a properly constructed funding mechanism for ensuring universal access, the combination of a high cost voucher fund and the backup auction mechanism will guarantee that no service territory is at risk of losing telephone service.

The purpose of the high cost voucher fund is to provide subsidies in high cost areas of the state. This fund differs from the CHCF in that all areas of the state with high cost areas can be subsidized. In addition, this fund will allow all providers in high cost areas to draw from the fund, while allowing the customer to select among a choice of providers. The high cost voucher fund also differs from the CHCF because under our proposal the smaller LECs will no longer be funded so as to meet their individual revenue requirements. The steps are taken to determine the

We propose that the high cost voucher fund be available to all carriers of residential basic service. This is a departure from the current CHCF which provides funding for the overall company costs of the small and medium sized LECs. Our proposed redesign of the high cost fund will subsidize high cost residential customers explicitly, rather than adhere to the current system of implicitly funding both business and residential customers to the extent that high cost LECs have recovered their costs through the CHCF, rather than through higher business rates. The high cost LECs may need to raise business rates to recover their costs of serving the business community.

In the event there are no carriers willing to undertake the COLR obligation, we propose that an auction method be used. This auction mechanism would be used in a situation where no provider is willing to assume the COLR obligation, unless that carrier is guaranteed an additional payment. If no party is willing to come forward and assume the COLR responsibility at the predetermined subsidy level, then the Commission or any qualified provider can propose to initiate an auction whereby service providers can bid to take over the COLR obligation, for an amount over and above the established per line subsidy that would be provided for each geographic area.

In order to implement this high cost voucher fund mechanism, several other details need to be addressed. The first is to determine how much it costs to serve particular areas of the state. In order to accomplish that, the areas of study need to be defined, and cost studies need to be submitted. Once the costs are known, the second detail is to determine which areas of the state are high cost areas that the fund should subsidize. Once that is known, then the total subsidy for the high cost areas can be determined. The third detail is determining who the COLR should be, and whether criteria need to be developed as to which carrier is qualified to be a designated COLR. The fourth detail is to set

up a mechanism to collect the subsidy. Inherent in this fourth detail is determining who should be responsible for the surcharge. These issues are described below.

2. Cost Studies to Determine the Subsidy Amount

a. Introduction

The commenting parties, whether they favor a voucher approach or an auction approach, appear to be in agreement that before either method is adopted, some sort of cost studies are necessary. Before a voucher system is instituted, the parties in favor of such a mechanism assert that the amount of the subsidy needs to be determined. Under GTEC's proposal, the incumbent LECs would continue as the COLR until an auction is held. During that initial startup, GTEC proposes that COLR funding be based on a cost based approach.

We recognize that cost studies are likely to be very contentious, and that cost studies may vary somewhat from actual costs. However, requiring cost studies is a good starting point for determining whether a subsidy is needed, how large the subsidy needs to be, and how the subsidy should be targeted. The cost studies are a useful tool for analyzing where rates should be in comparison to costs. Without cost studies, we would have to rely on the outcome of the auctions to determine how large the subsidies should be.

The methodology for these cost studies is nearly as contentious as the mechanism in which they are used. One idea is to base cost studies on recorded costs. The small and medium size LECs favor this approach. They assert that actual costs can be easily determined because their service areas are so small. Another idea is to how costs are derived is based on using proxy factors to estimate the costs of certain areas. Under the proxy factor method, the Commission would examine a sample of actual costs from areas of different population density and terrain around the state. From this sample proxy factors could be

developed which estimate the loop cost based on loop length, a house population density and possibly terrain. The Commission would then apply these proxy factors to areas of the state where actual costs have not been used.

As we understand it, actual cost information is not developed for the FCC on a study area basis. For most of the LECs in California, this typically means all of the LEC's territory within the state. Thus, the accounting data for costs is generally representative of a wide area. The problem with using such a large study area in the design of a funding mechanism for high cost areas of a state is that the cost of serving customers is likely to vary dramatically from one part of the study area to another. Typical reasons for such variance are because of density, terrain, and environmental conditions. As a result of such variances, high cost areas within a study area are averaged together with the low cost areas within the study area.

Under the current system of implicit subsidies, low cost areas help to subsidize high cost areas.¹⁵ Such a system works in a monopoly environment. However, with the introduction of competitive forces, this system is no longer viable.

b. Geographic Study Areas

In order to design a funding mechanism which targets California's high cost areas, study areas that are smaller than the single statewide study area are needed. We shall refer to these as smaller study areas as geographic study areas (GSAs). The GSAs will serve as reference points from which cost data can be derived, and from which the subsidies for the designated COLR or COLRs can be derived. (See proposed Rule 6.A.5 App. X.A.1) We also propose that the designated COLR be required to serve areas based on GSAs.

¹⁵ Implicit subsidies also occur between services, exchanges, and among high and low revenue customers.

Such a requirement will allow the funding mechanism to easily match up the designated COLR with the subsidy amount to which the COLR is entitled to. (See proposed Rule 6(D)(5), App. A.)

In determining the size of a GSA, a small region avoids cost averaging between customers, and prevents barriers to entry. Smaller GSAs should also be better able to determine the total amount of subsidy required statewide. We tentatively conclude that census block groups should serve as the GSAs. (See proposed Rule 6(A)(2), App. A.) Census block groups have the advantage of being compact enough that the cost to serve residential customers within them should be relatively homogeneous. Our selection of this compact geographical area seeks to avoid the cost averaging disparity between the cost of serving a town center and the less dense outskirts of town. The census block groups also have readily available demographic data such as population density.

We recognize that there are some disadvantages with the census block group approach as well. For instance, there are a lot of census block groups, and the census block group is not a unit by which telephone data is traditionally kept. However, if costs are going to be developed on a proxy basis, the only disadvantage is that the calculations for all the different GSAs will take some time.

We are also open to other alternative sized GSAs such as the LEC wire centers, zip codes, or larger census bureau designations. Although larger geographic units may be easier to administer, they are likely to mask differences in the cost of service because of cost averaging. In addition, a large GSA may act as a barrier to entry if each COLR receiving a subsidy is required to serve on a GSA basis.

We welcome comment on whether census block groups can be used effectively as GSAs to develop costs and the total subsidy amount. If an alternate type of GSA is recommended, please comment on how that geographic unit can accomplish the following:

(1) promote the ease of administration; (2) provide access to demographic and other data; (3) provide access to telephone cost data; and (4) whether the size of the GSA will act as a barrier to those providers who want to become a designated COLR or who want to offer services in that GSA.

Formulation of the Cost Studies

The next step is to decide how the costs should be developed for the GSAs. Except for the small and medium sized LECs, it appears that cost data has typically been for the statewide study areas of Pacific or GTEC. GTEC contends that because there is limited data on actual costs below the statewide study area level, a proxy approach should be used to develop incremental cost estimates. GTEC believes that a proxy approach provides a means of capturing the differences in costs across small geographic areas through the use of variables. However, GTEC says that proxy costs are still imperfect and need to be reconciled with actual cost data at the statewide study area level. According to GTEC, actual costs should include the markup over incremental cost needed to recover the joint and common cost of the firm.

Pacific favors a proxy method using wire centers as the GSAs. The costs for each of the wire centers in the state would be based on cost templates of six to eight kinds of typical wire centers.¹⁶ Pacific states that the proxy cost could then be adjusted, if necessary, to take into account the special

circumstances of particular wire centers, such as unusual terrain, climate characteristics, or atypical levels of service.

¹⁶ Pacific's proxy formula would estimate cost as a function of certain observable variables. The primary variables are population density by itself or together with loop length

The Coalition says that the cost studies may serve as the basis for calculation of a universal service subsidy if they are conducted according to the following principles: (1) the cost studies must identify the TSLRIC of local exchange service and (2) the costs of basic service must be determined for different cost areas or cost zones defined strictly with respect to the cost characteristics of geographic areas.

We propose that costs for all the GSAs be developed by way of proxies. For the small and medium sized LECs, if actual cost data is available, that information should be used in determining the high cost GSAs. If the small and medium sized LECs do not have any verifiable cost data, then the cost studies should be done by way of proxies. (See proposed Rule 6.A.75 App. A)

We request comment on the following: (1) can costed proxies be developed for different types of cost categories and if so, how many categories would be needed? (2) can the GSAs be categorized into the different types of cost categories? (3) how should the proxy formulas be developed, and are workshops or hearings necessary to develop these formulas, and (4) can the relative accuracy of the proxies be verified by comparing them to actual costs incurred by the small, medium, and large LECs?

The costs for each of the wire centers in the state would be based on cost estimates of six to eight kinds of typical wire centers. Pacific states that the proxy cost could then be

adjusted, if necessary, to take into account the special 17 The need for subsidies in high cost areas depends on the revenue generated by consumers in those areas. At a minimum revenue consists of the rate charged for flat rate or measured rate residential service and the End User Common Line (EUCL) charge. However, other revenues may need to be considered. For example, PU Code § 728.2 directs the Commission to consider the net commercial directory revenues for the purpose of establishing rates for other services. In addition, a portion of the interstate per line cost is currently recovered through the carrier common line charge. We invite comment as to what revenues beyond the tariffed rate and EUCL should be considered in determining the appropriate per line subsidy for high cost areas at the outset of competition

We propose that the cost studies for determining the existence and amount of cross-subsidies supporting rates for basic services that are below cost be handled in the ongoing OANAD v Jacob OIR/OIL. We believe that concentration of cost issues in a single proceeding will result in the most efficient use of Commission and party resources. We recognize that this adds a new dimension to the OANAD cost process. However, the OANAD proceeding is examining the costs associated with unbundling basic network functions and basic service is intimately associated with those network functions, and some of the work product for determining basic network functions may overlap with what is needed for the cost studies of high cost areas. Upon the completion of the cost studies relating to high cost areas in the OANAD proceeding, the total subsidy for high cost areas can then be derived and used in this proceeding to put the high cost voucher fund into effect.

Due to the proposed schedule in the OANAD proceeding (see Assigned Commissioner's Ruling in OANAD, June 22, 1995), a decision as to whether the cost studies for high cost areas should be handled in the OANAD proceeding needs to be resolved quickly. We may issue an interim decision shortly after the initial round of comments are filed in this proceeding if we decide that the cost studies for high cost areas should be done in the OANAD proceeding. We request comment on whether the cost studies for high cost areas should be done in the OANAD proceeding. Commenting parties should explain: (1) whether such a procedure is appropriate given the focus of each proceeding and the resources needed for cost studies; (2) whether the cost studies in connection with high cost areas are likely to overlap with the cost issues associated with unbundling; and (3) whether the cost studies for high cost areas can be completed within the proposed OANAD schedule for cost studies.

18 One method is to compare the subsidy per customer with a weighted average of carrier rates. The Commission could reduce the subsidy amount available as basic rates are reduced.

Determining High Cost GSAs
The next problem to address in designing the high cost voucher fund mechanism is to decide how high cost GSAs should be determined. That is, the Commission needs to establish a reference or benchmark as a point of comparison. In theory, if the costs (in a GSA) exceed this reference or benchmark price, the GSA would be considered a high cost GSA and would receive funding from the high cost voucher fund.

GTEC advocates that the Commission determine the initial benchmark price that a customer is willing to pay for a defined basic service package. The benchmark price would be the total monthly price which includes all rate elements of that service. The Coalition suggests that the net subsidy amount available should be based on the differential between the of basic service and the incumbent LEC's existing rates as approved by the Commission for each particular GSA.

We propose that the reference or benchmark for calculating the subsidy for each GSA be based on the revenues generated by the LEC offering basic service in that particular GSA. If the proxy cost of serving that GSA is above the benchmark, then that GSA should be considered a high cost GSA, and the carrier or the carriers of last resort serving that particular GSA are eligible to receive funding. (See proposed Rule 61A.67 App A)

We also propose to periodically review the subsidy amounts to see if the subsidies for high cost areas should be reduced.¹⁸ In such a review, the Commission should consider whether the cost studies, the proxy costs of the benchmarks should be revised. Also, the

likely to overlap with the cost issues associated with unbundling and (3) whether the cost studies for high cost areas can be completed within the proposed OMB schedule for cost studies.

¹⁸ One method is to compare the subsidy per customer with a weighted average of carrier rates. The Commission could reduce the subsidy amount available as basic rates are reduced.

Commission should consider during that review the effects of both competition and advances in technology. (See proposed Rule 61A.71, App. A.) If over time the rates charged fall below the initial reference or benchmark that would indicate that a reduction in the subsidy amount would be required. We welcome comments on (1) whether our proposal achieves a proper balance between the amount of subsidy required and whether such subsidy will attract other carriers to serve the high cost GSAs; (2) should the initial subsidy amount be determined by using some other benchmark, such as a statewide average of the proxy costs of all the GSAs; and (3) is the periodic review of the subsidy amounts necessary, and if so, how often should such reviews take place and what items would require review or adjustments. Once the Commission determines the cost of serving the GSAs, and reference or benchmark prices have been established, the amount of subsidy can then be calculated for each high cost GSA. From the total amount of subsidy for each high cost GSA, the Commission can then set the amount of subsidy that is available on a per customer basis. The subsidy would then be collected and distributed based on the number of customers that each designated COLR serves in a high cost GSA.

3. Determining Who the COLR Should Be

As part of our proposal, we will initially require the incumbent LECs to serve and be designated the COLR in all their service areas until such time that another carrier or carriers are designated as the COLR.¹⁹ In the event the incumbent LEC decides to remain as a COLR, it may do so. Other qualified providers may also seek to become a designated COLR in a particular GSA, or to compete in a GSA without being designated as a COLR. However, only

¹⁹ This proposed requirement is consistent with Local Competition Rule 5.A.

the designated carrier or carriers of last resort will be entitled to draw from the high-cost voucher funds. (See proposed notice of proposed Rule 6.D.3. (App. A)) If a carrier wants to be designated a COLR, it shall file a Notice Of Intent To Be Designated A COLR (NOI) in this proceeding.²⁰ The NOI signifies that the carrier is willing to undertake the COLR obligation at the established per-line subsidy for the cost zone in which the GSA is located.²¹ The assigned Administrative Law Judge (ALJ) in conjunction with the assigned Commissioner shall conduct hearings, if necessary, on the qualifications of the carrier filing the NOI.²² The Commission will then issue a decision designating which carriers shall be designated the COLR.²³ (See proposed Rule 6.D.4. (App. A))

Anytime after the initial designation of the carrier or carriers willing to undertake the COLR obligation, any carrier who is designated a COLR may opt out of the COLR obligation by filing the appropriate advice letter so long as there is at least one other COLR operating in the same service area. If the carrier opts out as a designated COLR, that carrier is no longer eligible

²⁰ The NOI must comply with Rules 2, 3, 4, 5, and 7, contain information regarding the service areas in which it currently operates in, and a balance sheet and income statement as specified in Rule 17(h). Interested parties may file protests and responses to the NOI in accordance with Article 12 of the Commission's Rules.

²¹ The per line subsidy would be determined after the cost studies have been completed.

²² In situations where the carrier is clearly qualified, but a protesting party is seeking to delay the carrier's entry, no hearings need be held.

²³ We solicit comment on whether an advice letter and Commission resolution process, or some other method, might be a more appropriate way of handling the designation of carrier or carriers of last resort.

to draw from the high cost voucher fund²⁴ (See proposed Rule 6.D App A.)

If there is only one COLR left in an area, and that COLR wants to be relieved of the COLR obligation,²⁵ then the Commission, or its designee, will conduct an auction with qualified bidders to determine who should become the new COLR so as to ensure the continued availability of basic exchange service. The bid will involve the obligation to be the designated COLR for a period of three years. The bidding will start at the established per line of subsidy for that GSA. The COLR obligation will be awarded to the bidder whose bid price is the lowest. The winning bid represents the "premium" which we believe will act as an incentive for encouraging a carrier to undertake the COLR obligation.²⁶ Any other carrier entering this market after the bid has been awarded may compete as a designated COLR entitled to draw 1/2 of the winning bid from the high cost voucher fund.²⁷ A carrier who

²⁴ In the event a designated COLR no longer wants to undertake the obligation, CACD shall prepare a notice informing the fund administrator that the carrier is no longer eligible for high cost voucher funds in the particular service area. A copy of such notice shall also be placed in the correspondence section of the formal files in this proceeding.

²⁵ If a GSA has only one COLR, and that carrier wants to be relieved of its COLR obligation, the carrier must file an application to do so. (See Local Competition Rule 4.F.(8).)

²⁶ The premium that is awarded should be recovered as part of the high cost voucher fund. This could either be calculated as part of the total subsidy required before the high cost voucher fund is established, or included in the adjustment of the total subsidy during a periodic review of the fund.

²⁷ By permitting another designated COLR to enter, we hope to prevent a situation where the last designated COLR wants to exit the service area so that through the auction mechanism the premium alternative that may fix this potential problem is to put a ceiling price on how much of a premium can be bid.
(Footnote continues on next page)

wants to provide service, but does not want to become a designated COLR will not be able to draw from the fund. (See proposed Rule 6(D), App A) If there is only one COLR left in the

Due to the circumstance that there may be a sole designated COLR, we must have a mechanism in place to decide whether other carriers can be designated a COLR after the three year term expires. Before or on the 180th day before the expiration of the three year COLR obligation, all carriers who are interested in serving as a designated COLR upon expiration of their term shall file an NOI as described earlier, in this proceeding for that service area. The Commission will then issue a decision to determine whether the same designated COLR will be retained, or if another auction will be held in accordance with proposed Rule 6(B) (See proposed Rule 6(B)(3), App A) other carrier entering

We invite comments on our proposal as to how the high cost voucher fund and safety net auction mechanism should work. We are particularly interested in how feasible our proposal is, as compared to an all auction mechanism or other alternatives. We are also interested in comments on whether the designated COLR's service territory should be based on GSAs, and whether the carriers who do not want to be designated COLRs should be entitled to select a service territory on a less than GSA basis.

We recognize that the Local Competition proceeding is in the process of issuing interim rules as to entry and application to do so. (See Local Competition Rule 4.4.(8).)

The premium that is awarded should be recovered as part of the high cost voucher fund. This could either be calculated as part of the total subsidy required before the high cost voucher fund is established, or included in the adjustment of the total subsidy during a periodic review of the fund.

By permitting another designated COLR to enter, we hope to prevent a situation where the service area is increased. Another alternative that may fix this potential problem is to put a ceiling price on how much a premium can be bid.

(Footnote continues on next page)

certification rules. However, when a carrier undertakes the COLR obligation, the Commission needs to ensure that the GSA in which the COLR is serving will have a carrier who is capable of fulfilling that obligation. If the COLR were to go out of business and leave a community without telephone service, public health and safety could be endangered, as well as disruption of the local economy. We need to consider whether a COLR should be required to meet criteria beyond the qualifications required of CLCs. This criteria can be used to determine which carriers should be designated a COLR, and which carriers can participate in the safety net auction. Some of the criteria under consideration are the following: (1) the facilities that the carrier has in place or the arrangements that the carrier plans to enter into so that it can provide local exchange service; (2) the financial ability of the carrier to undertake the COLR obligation; and (3) the commitment of the carrier to promote the goals of universal service in low income and non-English speaking communities. (See proposed Rule 6.D.4 of App. A.) We invite comment on whether a COLR should meet specified criteria, or if sufficient safeguards are contained in the Local Competition rules.

4. How the Surcharge Should Be Collected

Introduction The funding source for universal service is extremely important. The Commission stated in its Infrastructure Report that the funding mechanism must be neutral to all carriers and compatible with a competitive market structure. Currently, the Commission uses all end user surcharges (AEUS) to fund both the ULTS program and the CHCR program. These surcharges appear as line items on customers' bills and represent a percentage of customers' expenditures on telecommunications services. All end users of telecommunications services, with the exception of one-way paging company customers, pay the surcharge amount. The AEUS is effective under the current

system because it distributes the burden of funding the universal service subsidy across an extremely broad base of telecommunications users. It has also proven extremely easy to administer. Those customers receiving benefit from the network provide the revenue stream for the subsidy.

Currently, the CHCF funds mostly the small LECs that serve high cost areas. Other high cost areas are funded through implicit subsidies in local exchange carrier rates. Pacific and GTEC have a number of exchanges which may be considered high cost once the implicit subsidies are made explicit. Although the Commission will not know the size of the subsidy needed to support universal service until cost studies for the OSAs are analyzed, the funding needs for high cost areas could certainly be larger than the current size of the CHCF.

Positions of the Parties
GTEC, Pacific and the small LECs support an ABUS. The Coalition believes that it is premature for the Commission to determine a funding mechanism because it is not known whether residential basic exchange service is in fact subsidized and if so, by how much.

McCaw believes that a general tax to support universal service would be the most efficient and broad-based source of universal service funding. In the absence of such a tax, McCaw contends that a surcharge based on an equal charge per access line, customers or minutes of use would be more competitively neutral than a surcharge based on billings.

TET suggests that the current funding mechanism be updated and expanded to include revenue streams from end users as well as all providers.

The City of Los Angeles believes that there must be a fair and reasonable apportionment of costs between telecommunication providers and users. All telecommunication providers should contribute in order to promote fair competition in the marketplace.

AirTouch argues that cellular carriers should not be required to support universal service funds. AirTouch maintains that since wireless service is not an essential service it should not fund universal service.

TURN believes that a high cost fund should be funded from carrier contributions, and not from an AEUS. TURN argues that the new funding mechanism for high cost areas be based on net common carrier revenues. A carrier's net common carrier revenues equals its common carrier revenues reduced by payments made for telecommunications services that have already been subjected to the fund assessment. TURN's proposal is based on the net trans account idea developed by Eli Noam of Columbia University.

Under Noam's system, an independent administrator sets up a universal service account for each carrier. Under the net trans account, all carriers that provide transmission paths to services to third parties for compensation are included in the system. This includes all facilities based two-way transmission carriers: the LECs, interexchange carriers (IECs), cellular carriers, competitive access providers, and private microwave and satellite carriers.

The administrator debits carriers a flat percentage of their transmission path revenues, net of transmission charges paid to other carriers. The administrator calculates the transmission path revenues by summing revenues from local service, intraLATA toll, interLATA toll, mobile telephone calls, access, interconnection and collocation payments received, reseller payments, private lines and high capacity business services, transmission services for information providers, packet switched transmission services, transmission parts of integrated systems packages, basic Centrex services, and central office switching functions. From this total, the administrator subtracts the net transmission charges that carriers have paid to other carriers. For example if an IEC has paid an LEC access charges, the total of

those charges is subtracted from the IEO's transmission path revenues. The administrator then credits carriers for their universal service contributions and for subsidized users choosing the carriers' service.

Noam points out that some carriers, with the exception of the large LECs, are not currently required to keep accounting records which will identify specific transmission path revenues. Noam also points out that the system may be subverted if the net trans account is only implemented in a few states. TURN contends that this type of funding mechanism has the following advantages: (1) unnecessary transfers of monies will result because carriers can offset their contributions to the fund with expected monies from the fund; (2) it eliminates the incentives to price discriminate because the raising and lowering of rates to reflect payments of and receipts of monies from the fund, respectively, is eliminated; (3) it provides incentives for carriers to serve areas of the state where subsidies are available because it will reduce the monies the carrier needs to contribute to the fund; (4) it allows the funding to be spread over a number of providers subject to the mechanism, which minimizes the net cost impacts on customers; (5) if an AEUS is used, an incorrect price signal may be sent to consumers if the AEUS is increased; and (6) all telecommunication providers should contribute to this fund because their networks are enhanced when all customers have the ability to make and receive telephone calls from their homes.

Discussion

The AEUS system has advantages and disadvantages. One advantage is that the basis of an AEUS system is already in place, and is easy to administer. Once the Commission knows the subsidy amount needed it will not be difficult to calculate the AEUS percentage for funding high cost areas. Carriers simply charge end users based on a percentage of the amount of telecommunications services they use. Another advantage is that the AEUS is effective

in showing the explicit amount of subsidy necessary to fund universal service. End users would see that they are paying a certain percentage of their bills to keep basic service rates affordable in high cost areas. The ABUS also has its disadvantages. With the ABUS, the entire cost of the subsidy is shifted to end users. Another disadvantage is that the ABUS may be viewed as a tax on telecommunications services to support basic service in high cost areas. If the funding needs for high cost areas increase dramatically, customers may see a large jump in this surcharge.

The net trans concept has several advantages. It bills carriers, not end users, and therefore may not be perceived as a tax by consumers. The system also considers universal service contributions before billing carriers so that money transfers are minimized.

The net trans account also has some potential disadvantages. New accounting systems would have to be put into place to track transmission path revenues. It might also lead to some gaming as to what kinds of services are considered to be transmission. Such a charge might also affect a provider's choice of how information should be transmitted. The net trans account might also lead to problems in deciding what kind of technology providers should be subject to the net trans charge.

The Commission is undecided at the moment whether a funding mechanism based on the net trans account system is preferable over the ABUS. Although proposed Rule 6 sets forth a net trans account, we emphasize that we are still undecided whether the net trans account or the ABUS should be used.

We are inclined at the moment to have the Commission itself administer the high cost voucher fund mechanism. Such a proposal will eliminate the need to pay an administrative fee to the administrator. It also allows for easier enforcement of the fund in the event carrier revenues need to be audited, or if a

We request that parties comment on the possible problems noted by Noam: (1) whether the net trans account will result in a burden on some carriers because they will have to track their transmission path revenues; and (2) whether the system will work if it is implemented in California, but not in other states. We also solicit additional comment on our concerns about the net trans concept, and what can be done to address those concerns.

If the net trans account is adopted, we propose that all telecommunication service providers subject to our jurisdiction be required to contribute.

Any universal service funding plan requires a funding administrator, who is responsible for collecting and depositing contributions into the fund and for disbursing the money to the appropriate carriers. These duties are similar to those currently required to administer the ULTS fund and the CHCF.

Some of the commenting parties suggest that a neutral fund administrator be selected. Others suggest that the Commission act as the fund administrator.

If the funding administrator is a neutral third party, the Commission would have to select the administrator, and monitor the activities of the administrator and the carriers paying into the fund and receiving monies from the fund. In addition, administrative fees to the administrator would have to be paid, which would result in an additional charge. If necessary, the neutral third party might have to request the Commission to conduct audits or engage in other investigative activities to ensure the following: that the carriers are paying their share; and that carrier fraud can be detected.

We are inclined at the moment to have the Commission itself administer the high cost voucher fund mechanism. Such a proposal will eliminate the need to pay an administrative fee to the administrator. It also allows for easier enforcement of the fund in the event carrier revenues need to be audited, or if a

carrier's certificate of public convenience and necessity needs to be revoked for failure to pay its share into the fund (See with proposed Rule 6(F)4, App. (A.)) We invite further comment on whether the Commission should administer the fund or if a third party with fund management experience should administer the fund. We are particularly interested in receiving comments about the resulting delays and administrative difficulties the Commission might encounter in conducting audits and investigations, or in revocations if the administration of the fund was left up to a third party. However, the ULTS program is a multiple market program. The Mechanism for Funding Low Income Customers

The current mechanism for funding low income customers is the ULTS program. Under the ULTS program all LECs throughout the state charge residential low income customers an installation charge of \$10.00,²⁸ and a monthly fee of \$5.62 for flat rate service or \$3.00 for measured service. Each LEC is then allowed to draw money from the ULTS fund which covers the difference between the statewide ULTS rate and the carrier's rate for residential basic service, as well as for certain expenses associated with the program. However, the residential basic service rates differ depending on the LEC and consequently so does the subsidy amount. For example Pacific, which serves 79% of the access lines in the state, has a residential flat rate of \$11.25. Pacific draws \$5.63 per ULTS customer on a flat rate. GTEC, the state's second largest LEC, has a residential flat rate of \$17.25. GTEC draws \$11.63 per ULTS customer on a flat rate. The rest of the LECs draw rates that vary but they cannot exceed 150% of the rate which would be paid by a customer to a competitive provider. To ensure the competitive neutrality of this

program, the ULTS should not be allowed to collect a subsidy in excess of what the incumbent LEC receives on a

²⁸ The ULTS installation charge for some of the smaller LECs is less than \$10 because of the restrictions contained within PU Code § 874(c).

All of the parties commenting on this issue agree that with the advent of local exchange competition, the Commission needs to revise the ULTS program so that all carriers providing basic exchange service to low income customers can avail themselves of the ULTS funds or a variant of that fund. In contrast to the likelihood that funding needs for high cost areas are likely to increase, it is not expected that the funding level for ULTS will increase significantly. We propose that the existing ULTS program remain in place as we move toward markets with multiple providers. However, the ULTS program needs to be modified so that the subsidy will be available to those local exchange providers who serve low income customers with basic exchange services. (See proposed Rule 5A.1 of App. A.) It may be necessary to reopen the ULTS proceedings to make some necessary changes to the existing ULTS program. With competition in the local exchange, we believe that a virtual voucher system for ULTS customers, similar to the virtual voucher for high cost areas, will help to eliminate customer confusion. Under the virtual voucher approach, the ULTS customer only needs to choose a provider of local exchange service. The local exchange provider may not charge a ULTS customer any more than the statewide ULTS rate as determined by the Commission pursuant to PUC Code § 879. The provider of the service must then manage the customer's account to access subsidy funds with the ULTS voucher. Customers will see the subsidy from the ULTS program on their monthly bills. With a ULTS virtual voucher, income eligible customers will benefit by having greater choice over their local exchange provider. To ensure the competitive neutrality of this low income customer subsidy, the CLC should not be allowed to collect a subsidy in excess of what the incumbent LEC receives on a per customer basis. (See proposed Rule 5A.1 of App. A.) To ensure that the universal service goal of providing affordable service is continued in an era of local exchange

competition, we propose that all local exchange providers be required to inform prospective customers upon the initiation of the service that a ULTS rate is available if the customer meets the ULTS income qualifications. They will also be required to keep track of the number of customers who sign up each month for the ULTS program. Such information shall be submitted to CACD's Office of Telecommunications Branch on a monthly basis. (See proposed program Rule 5, App. A.)

During this transition to open competition, the Commission plans to follow the state mandated ULTS rates provided for in PU Code § 874. If competition drives the price of basic exchange service down, the Legislature may wish to revisit, whether the rates provided for in PU Code § 874 need revision. In the long run, competition and technological advancements may eliminate the need for a ULTS program altogether. The Legislature and the Commission may want to review in a few years how effective and, if necessary, the mandates contained in the Universal Telephone Service Act (PU Code § 871 et seq.) are in a competitive environment.

The Commission believes that the current ABUS for funding the ULTS program has worked and will continue to work once we open the local exchange to competition. We propose to maintain the ABUS for the ULTS program. All providers of local exchange service will be required to charge the appropriate surcharge on all end users of telecommunications services except for ULTS customers.

DCA states that the current self-certification process for the ULTS program should be changed to meet the federal verification standards. By changing the current certification process, DCA contends that the Commission could reduce the amount of the ULTS subsidy because California would be eligible to double its level of federal lifeline funding. The potential offset could be used to help fund telecommunications and information

infrastructures for public schools and libraries.

With competition, there will soon be more providers offering basic service under the ULTS program. It may be beneficial to change the self-certification program to an income verification program that meets federal guidelines so that uniform eligibility requirements are followed and potential fraud is eliminated. By doing so, more monies from the federal lifeline program should be available. A potential disadvantage is that additional ULTS program costs may be incurred by the providers to verify that the customer is indeed eligible for the ULTS program. Parties are invited to comment on whether the Commission should change from a self-certification program to an income verification program, and whether these additional funds could be used for public schools and libraries. We welcome comment as to whether our proposed changes to the ULTS program are responsive to the changes taking place in the local exchange markets. We also request comment on whether the Commission or a third party should act as the fund administrator for the ULTS program. Also, we request comment on whether the revised ULTS program should be adopted and implemented before the high cost voucher fund is adopted and the local exchange to competition. We propose to maintain the ULTS program as worked and we propose to maintain the ULTS program as worked and we propose to maintain the ULTS program as worked.

VII. Consumer Information
A. Introduction

In the universal service OIR/OII, the Commission requested comment on consumer information issues that arise in connection with universal service. The Commission wants to ensure that consumers have a sufficient amount of information to make informed choices. The potential effect could be used to help fund telecommunications and information.

²⁹ Consumer information issues need to be distinguished from consumer protection issues. The latter are being addressed in the Local Competition OIR/OII.

available to them so that consumers can make informed choices about their telecommunications provider and available services.

At the current time, PU Code § 786 requires that on or before March 1st of every year, every telephone corporation operating in the state provide to each residential customer a list of the residential telephone services that it provides, the rates or charges for those services, and the state or federal agencies responsible for regulation of those services.

Positions of the Parties

The parties who commented on what type of consumer information should be made available, and who should prepare and make the information available, represent three different points of view. The first view is that the Commission should take a hands-off approach and allow the marketplace to dictate what sort of consumer information is needed. This view also recognizes that some minimum level of required information may be necessary.

The smaller LECs are of the view that no requirements other than compliance with PU Code § 786 are required. Their service territories are small enough in size that communicating with their customers is not a problem.

The third view, which is supported by Citizens Coalition, DCA, DRA, Public Advocates, TURN, and UCAN, believes that the Commission may need to prepare and distribute some consumer information. Citizens states that the Commission should work with other public service agencies to provide information on the availability of subsidy programs to eligible customers, and that the Commission needs to respond to complaints regarding the dissemination of inaccurate or misleading information. UCAN says that the Commission believes that carriers should be required to provide specific information about residential services, and that a chart of the services and rates offered by carriers offering basic exchange service should be developed.

DRA believes that with open competition, the Commission will not have the resources to police all the information that will be provided to the public. DRA states that the information disseminated to the public must conform with the filed and effective tariffs. DRA also recommends that the Commission prepare an annual comparison, available upon request by consumers, of comparing and describing the basic universal service rates and charges of LECs and large LECs. Information regarding service complaints that the Commission has received should also be included in the comparison.

Public Advocates believes that the Commission needs to be in a position to respond promptly to complaints about marketing abuses and misinformation and that complaints be rapidly investigated and resolved. They also believe that consumers need more information on special services and programs, and on billing disputes.

TURN supports the Coalition's proposal for rate information about basic exchange services being presented in a standardized format. In addition, TURN suggests that the Commission explore the possibility of requiring a similar matrix for toll services.

UCAN states that in order for universal service goals to be met, and for an effective competitive market to evolve, consumers must have access to price and service information which is relevant and presented in an easily understood format. Such a requirement will enable consumers to understand and effectively compare the new services and rates which will be available to them. UCAN says that the carriers should also be required to inform customers about how customer information is handled, and under what circumstances such information might be disclosed. This type of information should be made available to all consumers, regardless of income level, geographic location or language.

UCAN suggests that the preparation and dissemination of this information be the responsibility of the carriers, but that it be supervised by the Commission and independent consumer groups. UCAN envisions that rate information will be distributed by both the carrier and the Commission. The Commission's rate information would offer rate information relating to all carriers, as well as information on selecting a carrier or how to best shop for business services.

UCAN also proposes that the Commission or a neutral third party compile information relating to complaints, and that this information be made available to consumers upon request. UCAN says that carriers should be required to include a notice about the availability of this information.

Discussion With the opening of the local exchange market to competition, we believe that residential consumers should have information available to them which allows for an easy comparison of rates. Such information will help to make our regulatory changes more understandable to the public, and allow customers to make timely and informed choices without resulting in a burden on the carriers so as to discourage competition.

We propose that the idea of a matrix of certain required information regarding basic exchange services be available to consumers in any marketing information that targets residential customers and explains the telecommunication service offerings available. Proposed Rule 17 reflects the kind of information that is required. This matrix may be contained within other marketing information. However, the matrix of required information shall be set apart from the other marketing information with the following statement: "The following information is required by the

California Public Utilities Commission to allow comparisons with rates charged by other providers for the same type of service.

No review or approval of the matrix is required. Commission review and approval of consumer information could delay provision of timely and accurate information while creating an additional burden for regulators. However, if abuses or omissions or misinformation occur with respect to the matrix information, the Commission will investigate as is necessary, and impose substantial penalties.³⁰

We do not believe that it is necessary for the Commission to mandate the provision of other consumer-related information at this time. With respect to potential barriers which may prevent certain segments of the population from obtaining consumer information, both Pacific and GTEC are undertaking efforts to have target non-English speakers with information about their services. We expect that trend to continue. (See D.94-09-065, pp. 272-279.) As rates move toward costs, and subsidies become more targeted, competitive pressures should force all carriers to actively compete for business from all segments of the population. The requirements imposed on GTEC and Pacific in D.94-09-065 should continue to apply so long as they retain market power.

Although we do not propose to impose the same sort of reports and marketing plans on the GLCs and the other incumbent LECs at this time, we believe that all carriers providing local exchange service should strive to achieve our universal service goal of at least 95% for every segment of the population in California. As part of the required annual reports, we propose to adopt the DCA suggestion that the GLCs and the incumbent LECs, except for Pacific and GTEC who have their own reporting information set apart from the other marketing information is required by the

³⁰ The Legislature should consider amending PU Code § 2107 to increase the penalty amounts. The present penalty schedule may not act as a sufficient deterrent when sums much greater than the penalty amount are at stake.

requirements, report on their efforts to attain this goal for non-English speaking and low income people in the communities that these local exchange providers serve. (See proposed Rule 3.83(a), App. A.) As noted earlier, the penetration rates could reflect the carrier's ability to become a designated COLR in high cost areas. This reporting requirement is transitional in nature, and may be eliminated after the markets become competitive.

to recover the embedded costs of facilities required to extend service in the VIII Recovery of LEC's Investment as well as the

ongoing costs of providing universal network access to all subscribers in their territories in the future. A. Introduction

Most of the incumbent LECs contend that they must be compensated for their unrecovered network investments. The LECs assert that those investments were made under the existing regulatory structure with the expectation that they could recover those costs, an expectation not guaranteed by the competitive marketplace. Competition will mean there will be no embedded investments.

B. Position of the Parties The Coalition of incumbent LECs

GTEC contends that as part of the new universal service policy, there should be a transitional program to amortize embedded investments placed by the LECs to meet past COLR obligations. According to GTEC, the LECs have been required to make those investments in the past to meet their service obligations. To the extent that the LEC's embedded investment has not been amortized over time at rates matching their economic lives, some portion of the LEC's current cost levels represents the cost of past obligations that were required by policymakers to provide universal service. GTEC proposes a transitional program that is separate from the funding for ongoing COLR obligations.

Pacific also contends that incumbent LECs must be compensated for their unrecovered network investment if they are displaced as the existing COLR. According to Pacific, this investment was part of a regulatory compact made before competition

was allowed, and that such investment was dictated by the Commission to ensure reliable, high quality telephone service by a single provider. Pacific proposes that it be allowed to amortize the amount of under-recovered capital over a period of five years. Pacific recommends that a broad billing surcharge on all providers is an appropriate recovery mechanism.

Roseville also believes that the LECs should be permitted to recover the embedded costs of facilities required to extend service in the past to all in their territories as well as the ongoing costs of providing universal network access to all subscribers in their territories in the future. Roseville contends that the situation is analogous to the electric industry where the Commission has recognized the need to compensate utilities for investments made in the past that may be uneconomic in a more competitive environment.

The Coalition argues that the gradual growth of competition will mean there will be no stranded investment for incumbent LECs. The Coalition notes that substantial barriers exist which will prevent new entrants from obtaining a large share of the market soon. The Coalition further contends that increases in demand may compensate for loss of market share as has occurred in the long distance market. The Coalition also argues that some degree of stranded investment is a natural consequence of new competition and that the LECs' shareholders should bear some of those costs.

C. Discussion
We do not believe that the LECs should be granted any additional recovery for stranded investments. Rate of return recovery is based on traditional rate of return rate making. We have been moving away from that concept since 1989.

The NRE decision in 1989 transformed the regulatory compact for Pacific and GTEC. The incentive-based regulatory framework was intended to expose shareholders to the risk

associated with investments in order to provide an incentive for more efficient investment. In D.89-10-031 the Commission determined that it would not entertain applications by GTEC or Pacific seeking ratemaking adjustments to account for changes in depreciation practices. (33 CPUC2d at p.217, FOF 53) In the order D.89-10-031 (33 CPUC2d 43) explicitly sought to disassociate rates from depreciation schedules and force utilities to treat (extra) depreciation rates as firms in competitive markets would.

The problem that GTEC and Pacific raise of excessive amortization periods has been diminishing as the expected life for depreciation purposes has been steadily reduced. Moreover, investments made in anticipation of competition should not be regarded as stranded investments. The Commission will hold a full hearing on September 1, 1995.

There are also substantial differences between the electric and telephone industries which justify differing treatment of stranded investments. Electric generation is characterized by large capital investments. In the electric industry, stranded investments are those generating assets that are demonstrably uneconomic, i.e., the cost of procuring energy from these sources is higher than others in the electricity market. The telecommunications industry, on the other hand, is characterized by smaller investments, and more frequent replacements as technology changes.

Finally, there is no reason to believe that the incumbent LECs will have substantial stranded investments due to their past obligation to serve. According to their own representations, LECs' obligations are primarily due to serving high cost areas where competitors will be reluctant to enter. The assets associated with serving the high cost areas will not be stranded if the incumbent LEC continues to serve the high cost area or if it resells its facilities to other providers.

Procedural Process

As indicated earlier, it may be necessary for the Commission to issue one or more interim decisions regarding the issues surrounding universal service before a final set of universal service rules are adopted. This is necessitated by the interrelationship of issues such as cost studies with other Commission proceedings, the overall scheduling of other Commission proceedings and our intent to open all markets to competition by January 1, 1997. To achieve that goal, the following schedule will be followed for this proceeding:

Interested parties will be allowed to file opening comments to the proposed universal service rules on or before September 1, 1995.³¹ The Commission will hold a full panel hearing in connection with this proceeding on September 29, 1995 beginning at 9:00 a.m. in San Francisco.

Public participation hearings (PPHs) will be held at different locations throughout the state in the September and October timeframe regarding the proposed rules. The tentative locations and dates are listed below. These dates and locations may be changed if needed by the Assigned Commissioner. A ruling will be issued by the Assigned Commissioner in the near future confirming the locations and dates of the PPHs.

Finally, there is no reason to believe that the incumbent LECs will have substantial stranded investments due to their past obligation to serve. According to their own representations, LEC obligations are primarily due to serving high cost areas where competitors will be reluctant to enter. The assets associated with

³¹ In the ALJ ruling of May 11, 1995 in this proceeding, the official service list inadvertently failed to include Sprint Communications Company L.P. (Sprint). Sprint and DCA, as well as the others on the service list should be served with the opening and reply comments.

| <u>Location</u> | <u>Date</u> |
|-----------------|-------------------------------|
| Los Angeles | September 20, 1995, Wednesday |
| San Bernardino | September 26, 1995, Tuesday |
| Barstow | September 27, 1995, Wednesday |
| San Diego | October 2, 1995, Monday |
| Fresno | October 5, 1995, Thursday |
| San Jose | October 10, 1995, Tuesday |
| Sacramento | October 11, 1995, Wednesday |
| Volcano | October 12, 1995, Thursday |
| Redding | October 19, 1995, Thursday |
| Eureka | October 24, 1995, Tuesday |

Comments that reply to the opening comments or to issues raised at the PPH, and PPHs, may be filed on or before December 1, 1995. The reply comments shall not exceed 25 pages. After receipt of the opening comments, the Commission may issue an interim decision regarding where cost studies for the purpose of determining high cost GSA will be addressed, and the format of those studies. Additional interim decisions or rulings may be needed to lay the groundwork for the universal service rules, and to adopt the final rules. At this time, it is envisioned that once the cost studies determine the subsidy needed for the high cost voucher mechanism, a final decision will be issued around June 1996 implementing the universal service rules.

Findings of Fact

1. On January 24, 1995, the Commission opened this universal service OIR/OII to develop rules to pursue universal service goals in a competitive telecommunications environment.
2. Comments to the universal service OIR/OII were filed by commenting parties in March 1995.
3. On or about June 23, 1995, DCA filed a motion to accept the late filing of its comments and recommendations to the universal service OIR/OII.
4. AB 3643 states that participation by the State and

Consumer Services Agency should be encouraged.

5. Universal service means essentially two things: (1) that a minimum level of telecommunication services are available to virtually everyone in the state; and (2) that the rates for such services remain reasonable.

6. The universal service concept that rates remain reasonable has resulted in the development of the CHCF and the ULTS programs.

7. The CHCF ensures that both residential and business customers in high cost service areas of the small and medium sized LECs have access to telephone services at reasonable prices.

8. The CHCF allows the small and medium size LECs to receive funds to recover the relatively high network costs of providing exchange services in less profitable and high cost areas of the state.

9. Pacific and GTEC do not draw funds from the CHCF because their higher cost areas are internally subsidized by the more profitable exchanges, subsidies between product lines, and other sources of revenues.

10. The statewide ULTS program ensures that low income households have access to basic telephone services at a fixed and affordable price.

11. In D.94-09-065, the Commission recognized that Pacific and GTEC needed to significantly improve their customer outreach and educational programs to achieve a 95% penetration rate for phone service among low income, nonwhite, and non-English speaking households, and ordered Pacific and GTEC to file monitoring plans regarding penetration rates.

12. The 95% goal represents a Commission commitment to ensure that all populations in California are afforded universal service, and that technological advancements benefit all segments of the population.

13. CLCs, and incumbent LECs other than Pacific and GTEC, should be required to submit in their annual reports, their efforts

and achievements to improve telephone penetration rates in their service territories, especially among nonwhite, non-English speaking, and low income households.

14. The Commission can position education, health care, community, and government institutions to benefit from the information age by creating and fostering the development of a competitive market.

15. The fourth stated objective of AB 3643 refers to the development of a process to periodically review and revise the definition of universal service to reflect new technology and markets.

16. AB 3643 states that there must be an ongoing evaluation of which services are deemed essential and therefore a part of universal service.

17. Basic service represents a set of telecommunications capabilities which consumers receive when they order service from a LEC.

18. The basic service definition serves as the basis for deciding how much low income customers should be subsidized under the ULTS program, and what services should be subsidized in high cost areas.

19. DRA, UCAN, and the Coalition's definitions of basic service generally reflect the level of basic service that Californians currently enjoy.

20. Pacific and GTB's definitions of basic service advocates a minimal nationwide definition which retreats from established Commission policy.

21. In establishing a procedure to reevaluate basic services, the Commission needs to adopt a process for initiating review, and to select criteria for evaluating whether a service should be included in basic service.

22. UCAN and USA have proposed grant or funding programs to help in the development of new products and services.

23. The Commission is concerned about the possible redlining of information poor communities, especially in rural areas.

24. It appears that the telecommunications market is already moving toward digital access.

25. The Commission is committed to guaranteeing that high quality, basic telecommunications services remain available and affordable to all Californians.

26. The mechanism for universal service in a competitive environment must ensure that low income customers have access to affordable service and that high cost areas of the state receive support so that telecommunications services will remain affordable throughout the state.

27. With the introduction of competition into all areas of California, the Commission needs to reexamine both the ULTS and CHCF programs.

28. High cost areas are not restricted solely to areas within the territories of the small and medium size LECs, but include certain service areas of Pacific and GTEC as well.

29. Local exchange competition should be permitted before final universal service rules are adopted.

30. The current universal service funding mechanisms should remain in place during the transition to local exchange competition.

31. Competition will take time to develop.

32. Cost studies are needed to confirm the extent to which the LECs' residential basic exchange services are being subsidized.

33. Based on the comments, the low income and high cost universal service programs should remain separate.

34. PU Code § 709.5(a) states the intent of the Legislature that all telecommunications markets subject to the Commission's jurisdiction should be opened to competition no later than January 1, 1997.

UCAN and USA have proposed grant or funding programs to help in the development of new products and services.

35. N.P.U. Code S 709.5(c) provides that the Commission should take the necessary steps to put into place whatever additional rules and regulations that may be necessary to achieve the January 1, 1997 date.

36. The focus of the CHCF is on subsidies for the smaller LECs, rather than a subsidy of the smaller LECs' residential or business customers.

37. The COLR is the regulatory concept that there must always be a provider that is obligated to serve all customers in a particular service area.

38. With the introduction of competition, certain providers may choose to serve a smaller service area than what the incumbent LEC is obligated to serve.

39. The voucher system for high cost areas would work by giving the customer a credit voucher for a set amount of money which represents the difference between the actual cost of serving a customer and a rate that is deemed affordable by the Commission.

40. With a virtual voucher, the carrier selected by the customer would credit the customer's bill with the subsidy amount and receive payment from the fund.

41. The auction or bidding mechanism allows qualified providers to bid a fixed amount of subsidy necessary to serve a high cost area.

42. Under the auction mechanism, there does not appear to be any incentives for bidders to bid down the subsidy required to serve a particular area.

43. If an auction mechanism is chosen, it is likely that the Commission or its designee would have to become involved in numerous service territory auctions.

44. The high cost voucher fund differs from the CHCF in that all areas of the state with high cost areas can be subsidized, all providers in high cost areas can draw from the fund, and the single

56. The Commission wants to ensure that residential consumers have a sufficient amount of information available to them so that consumers can make informed choices about their telecommunications provider and available services.

57. Residential consumers should have information available to them which allows for an easy comparison of rates.

58. DCA sought to disassociate rates from depreciation practices.

59. The excessive amortization period that GTEC and Pacific complain of has been diminishing as the expected life for depreciation purposes has been steadily reduced.

60. Investments made in anticipation of competition should not be regarded as stranded investments.

61. The assets associated with serving high cost areas will not be stranded if the incumbent LEC continues to serve the service area, or if it resells to other providers.

Conclusions of Law

1. DCA's motion to accept the late filing of its comments and recommendations should be granted.

2. Providing special rates to certain classes of customers to the exclusion of others for the same type of services may be contrary to PU Code § 453 and its prohibition against discriminatory rates and charges.

3. The reference in AB 3643 to a review process of the definition of universal service was meant to refer to a review process of the definition of basic service, because the reference in AB 3643 to an ongoing evaluation of which services are deemed essential suggests that essential services make up the definition of basic service.

4. Basic service defines a level of basic service which all local exchange providers must adhere to in California.

5. The definition of basic service should include the elements contained in proposed Rule 4.B.

The proposed definition of basic service is a reasonable definition of what are essential telecommunications services and reflects what telephone customers have come to expect.

7. The definition of basic service should be the same for all local exchange providers.

8. The Commission should adopt a periodic formal review of the definition of basic service as set forth in proposed Rule 4.C.

9. The Commission should adopt the criteria set forth in proposed Rule 4.C.2 as the criteria for reevaluating the definition of basic service.

10. The Commission should not propose a rule at this time to fund the types of programs proposed by UCAN and USA.

11. The universal service mechanisms need to be redesigned to allow new market entrants access to those funds, and to reflect the downward pressures on costs that competition should bring.

12. In accordance with PU Code §709.5, the redesign of universal service should apply to all service areas within the state.

13. The Commission proposes to replace the current CHCF with the high cost voucher fund, and that an auction mechanism be used as a safety net in the event no single provider is willing to undertake the COLR obligation in any area of California.

14. The high cost voucher fund should subsidize residential customers rather than implicitly subsidizing both business and residential customers through service revenue cross-subsidies as is true of current carrier rate designs.

15. A designated COLR should be required to serve areas based on GSAs.

16. The Commission should adopt census block groups as the GSAs which define a level of basic service.

17. The cost studies should be developed by way of proxies for all the GSAs in accordance with proposed Rule 6.A.

elements contained in proposed Rule 4.B.

18. The cost studies for determining the existence and amount of cross-subsidies supporting rates for basic service should be handled in the OANAD proceeding.

19. An interim decision may be needed in this proceeding as to where the cost studies for high cost areas should be handled.

20. The Commission should adopt as the reference or benchmark the LECs' existing basic service revenues for calculating the high cost GSAs.

21. The Commission should periodically review the subsidy amounts to determine if the subsidies for high cost areas should be reduced.

22. The incumbent LECs should be required to serve and be designated the COLRs in all their service areas until such time that another carrier or carriers are designated as the COLR.

23. Other qualified providers may seek to become a designated COLR in a particular GSA, or to compete in a GSA without being designated as a COLR.

24. Only the designated COLR or COLRs will be entitled to draw from the high cost voucher fund.

25. A carrier who wants to become a designated COLR shall file a NOI as set forth in proposed Rule 6.D.

26. A designated COLR may opt out as the designated carrier as set forth in proposed Rule 6.D.6.

27. In the event the last designated COLR wants to be relieved of its COLR obligation, then the Commission or its designee will conduct an auction in accordance with proposed Rule 6.B. to determine who the new designated COLR should be.

28. If a COLR has been designated through the auction mechanism, all carriers who are interested in serving as a designated COLR upon expiration of the term shall file an NOI in accordance with proposed Rule 6.B.3.

29. Criteria, such as that contained in proposed Rule 6.D.4., should be adopted as to which carrier is qualified to be designated COLR.

30. The Commission proposes to adopt the net trans account system as the funding mechanism for high cost areas.

31. All telecommunication services providers subject to our jurisdiction should be required to contribute to this net trans account.

32. The Commission should administer the high cost voucher mechanism.

33. The Commission should modify the existing ULTS program so that the subsidy is available to those local exchange providers who serve low income customers with basic exchange services.

34. To ensure the competitive neutrality of the ULTS customer subsidy, the CLC should not be allowed to collect a subsidy in excess of what the incumbent LEC receives on a per customer basis.

35. All local exchange providers who offer basic service to low income customers should be required to abide by proposed Rule 5.

36. The AEUS for the ULTS program should be continued at least as an interim measure to assure that income eligible customers have access to affordable basic service.

37. The Commission should require all local exchange providers offering residential basic service to abide by proposed Rule 7.

38. The requirements imposed on GTEC and Pacific in D.94-09-065 should continue to apply so long as they retain market power.

39. The CLCs should be required to include in their annual reports their efforts to attain universal service for non English speaking and low income people in the communities that the CLCs serve, similar to what the Commission directed Pacific and GTEC to do in D.94-09-065.

40. The LECs should not be granted any additional recovery for stranded investments. In connection with the proposed universal service rules, the Commission is holding a public hearing on September 29, 1995 beginning at 9:00 a.m. in San Francisco. Parties interested in appearing at the hearing should contact either Brian Roberts or Cory Texeira of the Commission's Regulatory and Compliance Division (DCAO) at (415) 773-3000. **INTERIM ORDER**
IT IS ORDERED that:

1. The June 23, 1995 motion of the California Department of Consumer Affairs (DCA) is granted. DCA's comments and recommendations regarding the universal service OIR/OII shall be filed by the Docket Office as of the date DCA's motion was filed.

2. Parties are directed to file opening comments on the proposed rules with the Commission's Docket Office, and to concurrently serve a copy of their filed comments on the service list for this proceeding as set forth in the ALJ Ruling of May 11, 1995. The comments shall be limited to no more than 50 pages, including attachments, and indicate in a clear and focused manner any additions, deletions, clarifications or modifications they believe are appropriate in the proposed universal service rules. Opening comments shall be filed on or before September 1, 1995.

3. Parties shall state in their opening comments whether other issues pertaining to universal service need to be addressed, and whether they believe evidentiary hearings will be required to resolve any of the issues associated with the proposed rules. Any party which believes that changes or additions to the proposed rules are appropriate, but that no evidentiary hearings are required, should clearly set forth in its comments any additional information they believe the Commission should consider before adopting rules.

4. Parties which believe evidentiary hearings are warranted are directed to present in their opening comments a proposed schedule for conducting discovery, preparing written testimony, holding hearings, and filing briefs to resolve the disputed issues.

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PROPOSED UNIVERSAL SERVICE RULES

1. DEFINITIONS

A. All End User Surcharge (AEUS): A funding mechanism used to collect money for Commission mandated programs. The AEUS is applicable to all telecommunications providers with the exception of one way paging companies. The surcharge is a percentage of the customer's total expenditures on telecommunications services. The surcharge is visible on customers' bills as a line item charge.

B. Basic Service: A certain defined minimum level of telecommunications service available to virtually everyone in each telephone exchange. Sometimes referred to as basic exchange service.

C. California High Cost Fund (CHCF): A fund established by the Commission to ensure that customers in areas served by small and mid-size LECs have access to telephone services at reasonable rates. The Commission collects money for the fund through an AEUS and distributes it to the small and mid-size LECs based on the individual need of the companies as authorized by a Commission resolution.

D. Carrier of Last Resort (COLR): A local exchange service provider that stands ready to provide basic service to any customer requesting such service within a specified area. To be a COLR, the provider must meet Commission approved qualifications.

E. Census Block Group: An area defined by the United States Census Bureau which serves as the geographic service area.

F. Common Carriage: Provision of telecommunications services available to the public on a non-discriminatory basis.

G. Competitive Local Carrier (CLC): A common carrier which has been issued a Certificate of Public Convenience and Necessity to provide wireline local exchange telecommunications service for a geographic area specified by such carrier.

H. Proxy Factor: The idea that all telecommunications service providers should be required to contribute to and be allowed to receive subsidies from the universal service programs on an equitable basis.

I. Total Service Long Run Incremental Costs (TSRIC): The definition of TSRIC that is developed in the OAND CIR\011.

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I. Geographic Study Area (GSA): A Commission designated geographic area that will serve as a reference point from which cost data and high cost subsidies can be derived for the designated carrier or carriers of last resort.

J. High Cost Voucher Fund: The fund developed in this proceeding to subsidize high cost areas of the state. The fund includes a collection mechanism, a distribution mechanism, and a method for calculating the amount of the required subsidy.

K. Local Exchange: A telecommunications system providing service within a specified area within which communications are considered exchange messages except for those messages between toll points.

L. Local Exchange Carrier (LEC): The incumbent carrier or carriers whose names appear on Attachment A of these rules.

M. Loop: A transmission path capable of delivering analog voice grade signals or digital signals at less than 1.544 Mbps between the network interface at a customer's premises and the main distribution frame or any other point of interconnection to the LEC network. Also known as the basic level network access channel.

N. Net Trans Account: A funding mechanism which may be used to collect money for the Commission's high cost voucher fund. Under this mechanism, the Commission bills carriers a percentage of their transmission path revenues after netting out the carrier's access charges and contributions to universal service.

O. Open Access Network Architecture Development (OANAD): Order Instituting Rulemaking and Order Instituting Investigation (R/93-04-003 and I/93-04-002) to govern access to bottleneck services and establish a framework for network architecture development of dominant carrier networks.

P. Proxy Costs: Geographically specific costs developed using proxy factors rather than direct measurement of costs.

Q. Proxy Factor: Factor associated with costs, such as loop length or population density, which can be used to estimate costs when direct measurement is unavailable or impractical.

R. Rate Cap: Upper limit or ceiling level on prices.

S. Total Service Long Run Incremental Costs (TSLRIC): The definition of TSLRIC that is developed in the OANAD OIR/OII.

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T. Transmission path revenues; A carrier's revenues from local service, intra-LATA toll, inter-LATA toll, mobile telephone long distance calls, access, interconnection and collocation payments received, reseller payments, private lines and high capacity business services, transmission services for information providers, packet switched transmission services, transmission parts of integrated systems packages, basic Centrex services and central office switching functions.

U. Universal Lifeline Telephone Service (ULTS): The ULTS program is a statewide explicit customer subsidy that ensures low income households have access to basic telephone services at a fixed and affordable rate. The ULTS program was created in response to the Moore Universal Telephone Service Act which became law in September, 1983. The ULTS program is sometimes referred to as Lifeline.

V. Universal Service: The provision of basic service to virtually everyone in California at reasonable rates.

W. Voucher: A mechanism used to distribute a credit to a single customer or customers in connection with the Commission's universal service funding programs. The credit to the service customer is based on the difference between the cost of serving the customer and the rate deemed affordable by the Commission.

2. SCOPE OF RULES

These rules govern universal service to California telecommunications users. For the purposes of funding universal service, these rules apply to all California telecommunications carriers. For the purpose of providing universal service, these rules apply to all California telecommunications carriers providing basic service.

3. UNIVERSAL SERVICE PRINCIPLES AND OBJECTIVES

A. Principles: It is the objective of the Commission to ensure that high-quality basic telecommunications services remain available and affordable to all Californians regardless of linguistic, cultural, ethnic, physical, geographic, or income considerations. It is the objective of the Commission to provide for the progressive expansion of the definition of basic service as service capabilities advance and the need for advanced services ubiquity becomes prevalent, in order to avoid information rich and information poor stratification.

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It is the policy of the Commission to ensure that consumers have access to information needed to make timely and informed choices about basic service and universal service providers.

4. It is the policy of the Commission to provide consumers with the ability to choose among competing basic universal service providers regardless of the technologies employed by competing firms.

5. It is the policy of the Commission to ensure that universal service providers adhere to interconnectivity, interoperability, common carriage, reliability, privacy and security guidelines.

6. It is the policy of the Commission to provide incentives for efficient provisioning of universal services, and which will reduce the aggregate subsidy required for universal service over time.

7. It is the policy of the Commission to provide a competitively neutral universal service mechanism which will minimize market distortions. The mechanism must provide for competitive provisioning of basic service, access to universal service funds, and a funding source which is broad-based and sustainable.

B. Objectives:

1. It is the objective of the Commission to develop a fully operable, competitively neutral universal service financing source and distribution mechanism no later than January 1, 1997. The funding mechanism must provide efficiency incentives to significantly reduce the aggregate subsidy required for universal service over time.

2. It is the objective of the Commission to adopt universal service policies which allow education, health care, community and government institutions to be in a position that allows them to be early recipients of the benefits of the information age.

3. It is the objective of the Commission to improve the penetration rate of basic service to non-English speaking and low income households by means of the following mechanisms: expanding the knowledge of basic service as service capabilities advance and the need for advanced services becomes prevalent, in order to avoid information rich and information poor stratification.

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All LECs and CLCs shall be responsible for pursuing the objective of achieving a 95% penetration rate among low income and non-English speaking households in their service territories;

LECs and CLCs shall have the flexibility to develop innovative strategies to contribute to the attainment of this objective;

LECs and CLCs shall submit the required annual reports describing their efforts to attain this objective.

d. In service territories where there is a substantial population of non-English speakers, a carrier's efforts to communicate with such customers in their native languages shall be a factor that the Commission considers in assessing each local carrier's contribution to pursuit of universal service targets.

Parties may petition for a new review of the composition of basic service three years after the adoption of final review of basic service. The adoption of final review of basic service shall, at a minimum, provide all elements of basic service and I.95-01-020-10-A7. Carriers providing residential service shall provide basic service. The petition for modification shall be filed by the date of the review. Basic service includes the following services:

- 1. access to single party local exchange service;
- 2. access to interexchange carriers;
- 3. ability to place and receive calls;
- 4. touch tone dialing;
- 5. free access to emergency services 911/E911;
- 6. access to directory assistance;
- 7. lifeline rate for eligible customers;
- 8. flat or measured rate service;
- 9. access to directory assistance;
- 10. directory listing;
- 11. access to operator services;

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12. voice grade connection to public switched telephone network;

13. access to information services and 800 services;

14. one-time free blocking for information services and one-time billing adjustments for charges incurred inadvertently, mistakenly, or that were unauthorized;

15. access to telephone relay service as provided for in PU Code § 2881;

16. access to public policy pay telephones;

17. free access to customer service for information about ULTS, service activation, service termination, service repair and billing inquiries;

18. Periodic Review of Basic Service

1. Parties may petition for a new review of the composition of basic service three years after the conclusion of a review of basic service. The adoption of final universal service rules in this proceeding (R.95-01-020 and I.95-01-021) will constitute the first review of basic service. The petition for modification shall be filed on or before the 180th day before the review date.

19. In evaluating whether services should be added to or deleted from basic service the Commission will consider the following criteria:

a. the service is essential for participation in society;

b. a substantial majority, 65%, of residential customers subscribe to the service;

c. the benefits of adding the service outweigh the costs;

d. availability of the service, or subscription rates would not increase without intervention;

3. Providers will maintain and make available to the Commission upon request sufficient information for the Commission to determine whether the above criteria have been satisfied.

ii. access to operator services

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UNIVERSAL LIFELINE TELEPHONE SERVICE (ULTS)

Costs for providing basic service to customers with basic service in which carriers are required to inform customers of the option for ULTS service when customers first inquire or sign up for basic exchange service. The methodology for determining and average loop length. The methodology for determining carriers must charge no more than the statewide ULTS rate as set by the Commission to qualifying low income customers.

1. All carriers providing basic service will have access to the ULTS fund.

Carriers may collect the difference between their tariffed rate for other residential customers and the Lifeline rate from the ULTS fund, but they may not collect more on a per customer basis than the incumbent LEC.

Carriers must serve each eligible customer requesting lifeline service within the carriers' specified serving area above the average basic service in that particular GSA.

B. ULTS Funding Source

All telecommunications carriers are required to charge the appropriate surcharge, as set by the Commission, on all end users of telecommunications services.

2. End users of one-way paging companies are excluded from the collection of the surcharge.

Carriers shall submit the number of customers who sign up for the ULTS program to CACD's Telecommunications Branch on a monthly basis. The number being served by the carrier in each GSA.

6. THE HIGH COST VOUCHER FUND

The rate for basic exchange service the carrier is to serve high cost areas will vary according to the cost of providing service within a GSA.

A. Identifying The Cost To Serve High Cost Areas

High cost voucher fund subsidies will vary according to the cost of providing service within a GSA. The GSA is used for the purposes of identifying the cost of providing universal service to a particular area. A census block group shall serve as the GSA.

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3. Total (Service) Long Run Incremental Cost (TSLRIC) will serve as the measure of costs for providing basic service to residential customers. The methodology for determining the TSLRIC will be developed as part of this proceeding and the OANAD proceeding.

4. Costs for providing customers with basic service in individual GSAs will be determined by factors which serve as proxies for the characteristics associated with costs, including, but not limited to, population density and average loop length. The methodology for determining proxy costs and the initial proxy factors will be developed in this proceeding and the OANAD proceeding.

5. Small and medium sized LECs can: develop TSLRIC studies of their own; or select the proxy costs developed by one of the large LECs.

6. A GSA will be considered a high cost GSA if the average cost of serving residential customers in that GSA is above the average revenue generated by the LEC offering basic service in that particular GSA.

7. Subsidy amounts will be reviewed periodically. This review will consider the amount which subsidies should be reduced due to efficiencies gained through technological advances and competitive pressures.

B. Carrier Responsibilities

1. Carriers shall report the following information to CACD's Telecommunications Branch on a monthly basis:

a. The number of residential basic exchange customers being served by the carrier in each GSA.

b. The rate for basic exchange service the carrier is charging in each GSA.

A calculation of the subsidy amount that the carrier should receive for providing basic exchange service to the high cost areas.

The GSA is used for the purposes of identifying the cost of providing universal service to a particular area. A census block group shall serve as the GSA.

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C. Subsidy Applicability

The high cost voucher fund will apply only to residential basic services priced at the tariffed rate and on other provisions on the GSA and on the responsibility of the current subsidy level.

2. The Commission will periodically review the subsidy in each GSA. The Commission will initiate a service providers bid to be the COLR.

D. Carrier of Last Resort

All incumbent LECs will be designated as the COLR in all their service areas at least until such time that another carrier or carriers are designated as the COLR. Competitive entry would be allowed but only if the

2. Other qualified providers may seek to become a designated COLR, or to compete in a GSA without being designated as a COLR. A COLR who loses the bid to any interested party in the area to any interested party as

3. Only designated COLRs will have access to the high cost voucher fund subsidy.

Those carriers seeking to be designated a COLR shall file a Notice of Intent to be Designated a COLR (Designated COLR NOI). The Commission will consider the following factors when evaluating whether COLR status should be granted:

a. the facilities the carrier has in place or the arrangements that the carrier plans to enter into in order to provide local service;

b. the financial capability of the carrier to undertake the COLR obligation;

the ability of the carrier to promote the goals of universal service in low income and non-English speaking communities.

3. Carriers will be required to submit records to the Commission. A designated COLR will be required to serve the entire GSA.

6. A designated COLR may opt of its obligations in a GSA by advice letter unless it is the only carrier remaining in the GSA, in which case it must file an application to withdraw as the COLR, and continue to act as the COLR until the application is granted or a new COLR has been designated as a result of an auction.

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E. Competitive Bidding To Serve As The COLR

1. If there is only one carrier in a GSA and that carrier has filed an application to withdraw as the COLR in that GSA, and no other provider is willing to assume the COLR responsibility at the current subsidy level:

a. The Commission will initiate an auction whereby service providers bid to be the COLR.

b. Providers will bid for an amount, over and above the previously established per line subsidy. The lowest bidder would become the subsidized COLR prepared to provide service to all customers for three years. Competitive entry would be allowed, but only 1/2 the

subsidy would be available. Other designated COLR, or to compete in a GSA without being

2. A COLR who loses the bid shall have the option to sell its facilities in the area to any interested party at its book value.

3. 180 days prior to the expiration of the three-year COLR obligation, other carriers desiring to become a

designated COLR in the GSA shall file a Designated COLR application. The Commission will then determine whether the same designated COLR should be retained, whether multiple carriers of last resort should be permitted, or if another auction should be held.

1. The Commission will require all telecommunications service providers to contribute to the high cost voucher fund.

2. The Commission will collect and distribute money for this fund through the net-trans account method.

3. Carriers will be required to submit records to the Commission regarding:

a. all transmission path revenues, and

b. A designated COLR may opt out of its obligations in a GSA by advancing payments to other carriers remaining in the GSA, in which case it must file an application to the Commission. The Commission will be the administrator of the high cost voucher fund mechanism until the designated COLR has been designated as a result of an auction.

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The Commission will calculate each carrier's payment (or receipt) from the fund and will bill (or distribute) the appropriate amount to carriers.

Distributing The High Cost Area Subsidy In A Resale Environment

- 1. If resale of basic exchange service or loops is allowed, the subsidy for residential basic exchange service for that customer shall be treated as follows:
 - a. If the price of the service or facility resold is below its cost, the underlying facilities based provider receives the subsidy for the services sold.
 - b. If the price of the service or facility resold is market based or based upon actual or averaged costs, then the carrier who sells basic exchange service to the end-user residential customer shall receive the subsidy provided that the basic residential service is priced at the affordable (but below cost) price set by the Commission.

7. CONSUMER INFORMATION RULE

- A. All providers of basic exchange services must provide the following information to consumers in any marketing information that targets residential customers and which explains the telecommunication service offerings available. The required information will be set apart from other marketing information with the following statement: "The following information is required by the California Public Utilities Commission to allow comparisons with rates charged by other providers for the same type of service."

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The required information shall consist of the following:

BASIC SERVICES

ONE TIME

CHARGE TO INSTALL **COST PER MONTH**

Flat Rate Service: A set monthly rate of \$_____ for unlimited local calling within a minimum of 12 minutes. If the price of the service or facility is below the price of the service or facility, the carrier shall be treated as if the price of the service or facility is \$_____.

Measured Rate Service: A reduced to price of \$_____ monthly rate plus per minute charges of _____ for each local call above a minimum provider receive a minimum of \$3.00 allowance.

Universal Lifeline Telephone Service: A subsidized low-priced service for the end-user, limited income customers, provided that the basic residential service is provided at the price of \$_____ Unlimited local calling is provided at the price of \$_____.

Measured Rate Universal Lifeline: Provides, at a minimum, 60 untimed local calls over 60 cents each.

Price information is current as of (month, date, and year). The required information will be set apart from other marketing information with the following statement: "The following information is required by the California Public Utilities Commission to allow comparisons with rates charged by other providers for the same type of service."

(END OF APPENDIX A)

ATTACHMENT A

Calaveras Telephone Company
California-Oregon Telephone Co.,
Citizens Utilities Company of California
Contel of California, Inc.
CP National
Ducor Telephone Company,
Evans Telephone Company
Foresthill Telephone Co.
GTE California Incorporated
GTE West Coast Incorporated
Happy Valley Telephone Company
Hornitos Telephone Company
Kerman Telephone Company
Pacific Bell
Pinnacles Telephone Company
The Ponderosa Telephone Co.
Roseville Telephone Company
Sierra Telephone Company, Inc.
Siskiyou Telephone Company
Tuolumne Telephone Company
The Volcano Telephone Company
Winterhaven Telephone Co.

(END OF ATTACHMENT A)