

The offsets are incorporated in Rule 6.C.2. of Appendix B. Our estimate of what offsets there should be are shown in Appendix D.

Until such time the CLCs are authorized to receive monies from the EUCL charge, the CCLC, and the interstate USF, the offsets described above shall only apply to the five large and mid-size LECs. Also, should the the FCC revise these various charges or adopt new charges, we shall revisit the offsets issue.

## I. Funding Mechanism Issues

### 1. Introduction

In our proposed rules, we discussed how the CHCF-B fund should be collected. (D.95-07-050, pp. 60-66) We compared two options: (1) using an AEUS; or (2) a net trans account method.<sup>48</sup>

With an AEUS, a surcharge is imposed on all customers' expenditures for telecommunications services. The surcharge appears as a line item on each customer's bill. The carriers pay the monies that they have collected from their customers into the fund. The fund administrator then issues a check when the carrier submits a claim.

Under a net trans account, the surcharge is collected from carrier contributions. The carrier is assessed a percentage charge on its revenues, net of payments made to other carriers for telecommunications access. Carriers may seek reimbursement for the charge from their customers, to the extent the carriers are able to pass along the charge. Under the net trans account, monetary transactions are reduced. The fund administrator accounts for the amount of money a carrier owes, and subtracts the amount it is

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<sup>48</sup> AT&T/MCI witness Cornell refers to the net trans account method as a "value-added charge." Like the net trans method, the value-added charge is based on the total revenues received for a service, net of any payments for inputs that will also be subject to the charge. (Ex. 1, pp. 35-36.)

entitled to draw. Hence the name, net trans account. For example, if a LEC owes the fund \$50 million and is allowed to draw \$100 million from the subsidy fund, the administrator simply disburses a check for \$50 million to the carrier.

Although proposed rule 6.F. set forth the net trans account as the proposed funding mechanism, we stated in D.95-07-050 at page 64 that the Commission was still undecided as to whether the net trans account system is preferable over an AEUS. We requested parties to provide additional comment on the net trans account system.

In addition to choosing a funding method, we must also make some choices regarding the following: which customers or carriers should pay into the fund; which services should be included in the surcharge calculation; the surcharge for the CHCF-B; and should the CHCF-A be combined with the CHCF-B for purposes of administration.

## 2. What Type of Funding Mechanism Should be Adopted?

### a. Positions of the Parties

AT&T/MCI support the adoption of a net trans account method. They state that the net trans method is easier to administer than an AEUS because it eliminates the need to collect and then disburse the monies. Instead, under the net trans approach, only the net amounts would change hands. AT&T/MCI acknowledge that with an AEUS, end users would know how much they are paying to support universal service. However, the net trans method could also accomplish this if the charge appears as a separate line item on the customer's bills.

DCA supports the use of an AEUS. DCA contends that an AEUS is already in place, and that it is easy to administer. In addition, an AEUS informs customers about the amount of the subsidy, who pays it, and who benefits from it.

DRA recommends that the net trans account method be adopted. DRA states that with the exception of GTEC and ICG, all

of the other active parties support the use of a net trans account. DRA believes that the net trans is consistent with the Telco Act, and that it has distinct public policy advantages over the AEUS. For example, under the net trans approach, the carriers are required to make payments into the fund. As a result, the carriers have a much stronger incentive to keep the size of the fund reasonable.

GTEC favors the adoption of the AEUS as the preferred mechanism for funding the CHCF-B fund. GTEC comments that an AEUS is easy to administer, simple to collect, and is competitively neutral. GTEC also states that the AEUS is preferable because it is a clear and explicit charge that customers can see as to how much they are contributing to universal service. GTEC asserts that under a net trans approach, the subsidy would not be explicit, but would be buried in the rates that customers pay for service.

GTEC also asserts that an AEUS maximizes competitive neutrality because the surcharge is applied uniformly across all providers and services. That is, under the AEUS, every time a customer spends a dollar on telecommunications, a given percentage of that dollar will go to support universal service. GTEC argues that with a net trans method, recovery of the surcharge amount is unlikely to be uniform across all services rates. This may influence customers to select different services in different amounts. GTEC also argues that the AEUS is a proven method of collection, since it has been used in California to collect the ULTS funds.

ICG recommends that the Commission adopt the AEUS because customers will be able to see on their bills how much they are paying to support universal service. ICG states that the AEUS is competitively neutral because all the services of all carriers would be affected in exactly the same way. ICG points out that a net trans account is not competitively neutral because it requires carriers to pay into the fund directly. As a result, smaller

carriers are more likely to be impacted because they will have to absorb the contribution to the fund, or they will have to attempt to pass the contribution onto their customers.

Pacific favors the use of the net trans account. Pacific witness Mitchell testified that the net trans approach simplifies implementation, reduces billing costs, and minimizes the potential for significant customer confusion.

The Small LECs support the use of an AEUS. They believe that it is the fairest and most neutral method of distributing the subsidy burden. The Small LECs point out that the AEUS is a simple and proven mechanism, whereas the net trans account exists only in theory. Given all the other complex changes associated with the transition to competition, the Small LECs believe that an AEUS should be adopted.

TURN recommends that the net trans account method be adopted. TURN states that the carrier contribution approach of the net trans is consistent with the requirements of the Telco Act. According to TURN, Section 254(f) of the Telco Act directs state commissions to require telecommunications carriers to contribute to preserve and advance universal service. Under the net trans method, the carriers would pay a percentage of their common carrier revenues net of payments made to other carriers. Although the carriers may attempt to pass this charge onto its customers, market conditions may prevent this from occurring, and carriers may end up contributing some of their own funds. The AEUS, on the other hand, makes customers the sole funding source of the fund.

TURN also argues that with a net trans account method, carriers have a stronger incentive to keep the fund size reasonable. TURN also comments that carriers would have every incentive to keep their customers informed by noting on their bills that customers are paying a certain percentage surcharge to support universal service.

b. Discussion

Both the AEUS and the net trans account method have advantages and disadvantages. In making a decision as to which funding mechanism should be adopted, we are mindful that our selection should be consistent with the following principles contained in AB 3643:

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

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"(5) Consumers should be able to have access to all the information needed in order for them to make timely and informed choices about telecommunications products and services, and how to best use them."  
(Stats. 1994, Ch. 278, Sec. 2(b).)

The two principles described above make clear that the funding mechanism should meet the following criteria: that it is competitively neutral, that it clearly identifies the source of the subsidy, and that consumers have the information they need to make informed choices.

In addition, as pointed out by the parties, Section 254(f) of the Telco Act also provides some guidance. Section 254(f) states in pertinent part:

"(f) State Authority.--A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State."

An AEUS would appear as a surcharge on each customer's bill. The imposition of such a surcharge is in conformance with AB 3643 because it clearly identifies the source of the subsidy. Customers can see how much they are paying into the fund which supports universal service, and which allows residential customers in high cost areas to pay affordable rates. Customers are also informed as to the amount of the surcharge. If after seeing the surcharge amount, customers believe the surcharge is too high, they can make their opinion known by contacting the Commission or their state legislators. In this way, customers provide a check and balance to ensure that the surcharge for the fund is not oversized.

The net trans account method would impose the funding obligation directly on carriers, rather than on customers. The carriers have requested that if a net trans account method is adopted, that they be permitted to state on their customers' bills that part of the customer's bill includes a payment to support the fund. However, as testified to by several witnesses, the carrier could conceivably absorb some or all of the fund charge. If the carrier decided to absorb some or all of the charge, then a net trans method would not be consistent with the principle expressed in AB 3643 that the subsidy "be imposed in a manner that clearly identifies the source of the subsidy" because the customer would not know if such a charge was being imposed on them.<sup>49</sup> Under such

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<sup>49</sup> We recognize that an argument could be made that AB 3643 did not intend that the customers of telecommunications carriers be obligated to fund the subsidy to support universal service, and therefore the language in Section 2.(b)(3) of AB 3643 was meant to apply to only carriers. Thus, if the charge was imposed on the carriers only, then it would be consistent with this principle because the carriers would know that the charge was imposed on them to fund universal service. We believe, however, that such an

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a scenario, customers would not have access to "all the information needed" to know whether the carrier was in fact passing the carrier based charge onto the customer.

The structure for an AEUS is already in place as well. An AEUS method is used to collect both the ULTS and the CHCF-A. In contrast, in order to establish the net trans account method, all the carriers and the fund administrator would have to design new accounting procedures and systems. As everyone interested in this issue acknowledges, the net trans account method is a new concept and untested in the real world. Also, in order to ensure that carriers are correctly netting out payments paid to other carriers for services subject to the charge, auditing of the carriers is likely to be needed initially.

We believe that the AEUS is a more competitively neutral method of funding than the net trans account method. With an AEUS, the charge is imposed on all telecommunications services and customers. Thus, an AEUS is broad based because everyone who uses telecommunications services in California is affected by the surcharge. It is also competitively neutral because all telecommunications services are subject to the surcharge. The net trans method, on the other hand, may not be competitively neutral because the carrier could pass on the charge to less elastic

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interpretation of AB 3643 would be mistaken. Clearly, when AB 3643 was enacted, the Legislature knew that the longstanding practice of funding universal service came from the ULTS AEUS, and other implicit rate subsidies supported by ratepayers, and not by the carriers. (See Stats. 1994, Ch. 278, Section 1(a), Section 2(a)(2) and (3).)

services such as residential basic service, and relieve the more competitive services of the charge.

The net trans account method could also cause implicit subsidies to continue. Since carriers would be obligated to pay the charge under a net trans approach, carriers may have to raise the money to fund universal service. Some of these carriers will undoubtedly try to raise some of the same rates that currently support below cost rates in high cost areas.

TURN contends that the language of Section 254(k) of the Telco Act requires that telecommunications carriers, and not customers, pay into the fund to preserve and advance universal service. We are not persuaded by TURN's argument that the Telco Act was intended to prevent us from setting up an AEUS to fund the CHCF-B. Despite the language in Section 254(k), we agree with ICG that it is highly unlikely that Congress intended that carriers, and not their customers, should contribute to the national fund. Especially since carriers are likely to pass that charge onto its customers. Moreover, the carriers who collect the AEUS do "contribute" to the fund in the sense that they incur administrative expenses to assess, collect, and remit the monies to the fund. In addition, Section 254(f) of the Telco Act permits the states to adopt regulations pertaining to universal service that are not inconsistent with the FCC's rules to preserve and advance universal service.

We adopt the use of the AEUS to collect the surcharge for the CHCF-B. This is reflected in Rule 6.F.2. of Appendix B.

### 3. Who Should be Obligated to Pay Into the Fund

#### a. Introduction

Having adopted an AEUS funding mechanism, the next issue to address is whether any customer groups should be excluded from having to pay the AEUS. This issue was raised during this proceeding in the context of both an AEUS, and the net trans account.

b. Positions of the Parties

AT&T/MCI recommend the exclusion of residential primary service and local coin revenues from public policy payphones. They further recommend that the fund should be supported by:

"All other common carrier services, whether provided under tariff or under contract; whether provided by an incumbent local exchange carrier, an interexchange carrier, an alternative access provider, an entering competitive local exchange provider, a satellite carrier, a cellular company, a payphone provider, or an alternative operator services provider; and whether involving switched services or dedicated services should be considered part of the base for provision of support." (Ex. 1, pp. 34-35.)

AT&T/MCI assert that the revenues from residential primary access service should be excluded because it is the service eligible for support. AT&T/MCI witness Cornell stated that these lines should be excluded from the charge on the theory that if they are part of the taxing base, more lines will probably need support, thereby making the fund even larger. According to Cornell, a primary service should be viewed as a residential customer's first line, and does not include toll or long distance charges that the customer may make. Coin revenue from public policy payphones should be excluded because it is a subsidized service.

CCTA's witness Kahn, recommends subtracting out basic service revenues from the funding base to remove the service being supported from the source of the support.

DRA's witness, Angela Young, agreed that residential basic service revenue should be excluded from the calculation.

GTEC contends that primary basic exchange revenues should be excluded from the funding base. GTEC asserts that by including them, basic service will become more costly, and increase the number of customers who need support. As for TCG's claim that excluding residential revenues will result in a competitive

disadvantage to carriers who only serve business customers, GTEC contends that no such advantages will result.

Pacific argues that basic residential revenues should not be included in the funding base. Pacific states that applying the surcharge to the subsidized revenues will increase the cost of basic service, which in turn increases the size of the subsidy.

Paul Cain, the witness for TCG and MFS Intelenet (MFS), testified that residential customers should not be excluded from the calculation of the surcharge. If basic residential revenues are excluded, a large portion of Pacific's and GTEC's revenues would not be included in the calculation of their net transmission revenues. According to Cain, this would dramatically increase the percentage share of the universal service obligation that would be borne by carriers serving business customers, which would defeat the goal of a broad based, competitively neutral mechanism. That is, a carrier who only provides service to business customers would end up transferring revenues to a carrier providing both residential and business services, thereby giving a competitive advantage to the carrier receiving the transfer.

TURN supports excluding residential primary basic exchange service from the funding base. TURN states that inclusion of primary basic exchange service in the revenue base would have the effect of increasing the costs and enlarging the fund, and add to the complexity of administering the USF.

This proceeding also heard testimony on whether cellular customers should be excluded from the funding base calculation. The Cellular Carriers Association of California (CCAC) state that cellular carriers should not have to contribute to state universal service programs. CCAC argues that the Omnibus Reconciliation Act of 1993 (Omnibus Act) exempts cellular carriers from state universal service obligations. (Omnibus Budget Reconciliation Act of 1993, Pub. Law No. 103-66, Title VI, Section 6002(b), 107 Stat. 312 (1993).) CCAC argues that the Omnibus Act

preempted states from any rate and entry regulations. Although CCAC recognizes that the Omnibus Act acknowledged the importance of the state maintenance of universal service, and specifically provided that commercial mobile radio service (CMRS) are not exempt from such surcharges when the CMRS are a substitute for landline telephone service, CCAC contends that it is exempt from a universal service surcharge because cellular service is not a substitute for landline service.<sup>50</sup> CCAC also argues that if the Commission does not exclude cellular service from the funding base, the surcharge must be restructured in the way that it is calculated. They state that the current way the surcharge is calculated unfairly discriminates against cellular customers because the charge is paid based on a percentage of total revenue.

DCA contends that cellular customers should contribute to the high cost area subsidy fund. DCA agrees with DRA's position that the Telco Act provides that every telecommunications carrier should contribute to a state based universal service program, and that cellular customers benefit from universal service in the same way that landline customers benefit. DCA also points out that cellular customers generate increased usage on both the landline and wireless networks, and therefore it is appropriate for cellular carriers to share in the funding of the CHCF-B fund.

DRA argues that applying the universal service surcharge to wireless carriers is equitable and non-discriminatory.

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<sup>50</sup> Section 332(c)(3)(A) of Title 47 of the United States Code reads in pertinent part: "Nothing in this subparagraph shall exempt providers of commercial mobile services (where such services are a substitute for landline telephone exchange service for a substantial portion of the communications within such state) from requirements imposed by a State commission on all providers of telecommunications services necessary to ensure the universal availability of telecommunications services at affordable rates."

DRA contends that cellular subscribers receive the societal benefits of universal service, and that it is only fair that they contribute. Broadening the funding base to include cellular customers widens the pool of contributors. DRA also argues that CCAC's suggestion that the universal service surcharge be transformed into a flat uniform dollar amount imposed on a per line or per call basis would simply shift the burden of universal service onto wireline customers.

DRA points out that cellular customers pay the same surcharge that wireline customers pay. Although this may result in cellular customers paying a greater surcharge per phone call, that is because the cellular carriers receive much more in revenue per phone call.

GTEC disagrees with CCAC's interpretation of the Omnibus Reconciliation Act. GTEC contends that the legislation exempts CMRS providers from state imposed rate regulation except with regard to universal service. GTEC further argues that even if that legislation exempted CMRS providers, the Telco Act explicitly stated that all carriers should contribute to universal service.

TURN states that it is entirely appropriate to impose the surcharge on wireless services. TURN argues that CCAC presents no valid distinction that warrants treating cellular services differently from expensive enhanced services that use the wireline network. TURN asserts that customers who choose wireless services, or wireline enhanced services, voluntarily do so to gain a special benefit, such as increased convenience. TURN further argues that wireless carriers benefit from the universal service policies that increase the ubiquity of telecommunication services.

c. Discussion

As previously stated, we have adopted an AEUS for collection of the subsidy funds. With this mechanism, we see no reason to exclude residential local exchange service from the surcharge amount. A broad based support mechanism should include

residential basic service in the funding base so as to reduce the overall surcharge percentage rate. All residential customers should support the fund because they benefit from the comprehensive and far-flung network as well. Additionally, with our modifications to the proxy model, we have targeted the subsidy to a minority of access lines in the state, areas of the state which are truly high cost. The majority of access lines will not be subsidized and should help contribute to the universal service fund. The only customer group that will be excluded from the charge are ULTS customers. ULTS customers have certified their need based on specific income levels.

Regarding the issue of excluding cellular carriers, we reaffirm the position which we took in D.94-09-065 at page 292. In that decision, we held that all end users of every LEC, IEC, cellular, and paging company in the state, receive value from the interconnection to the switched network, and that all users should be included in the billing base for the ULTS program and the Deaf and Disabled Telecommunications program.

As noted in CCAC's opening brief at page 2, when the draft decision which led to the adoption of D.94-09-065 was issued, CCAC commented that "cellular subscribers should not be required to subsidize the landline network in any manner, but, if required to do so, subsidization should be subject to an equitable universal service funding mechanism." Despite CCAC's comments, D.94-09-065 left unchanged the imposition of a ULTS surcharge on cellular customers.

Since the Omnibus Act preceded the issuance of the draft decision which became D.94-09-065, CCAC's argument that the 1993 act exempts cellular customers from having to pay for universal service had been considered in D.94-09-065 and rejected. There is no need to revisit that issue again. Accordingly, we reject the arguments of CCAC to exclude cellular carriers from paying into the fund, or that the fund should be modified to a flat

uniform rate instead of a percentage of revenues. We would note that inclusion of cellular customers in the funding base is consistent with AB 3643's principle that the funding mechanism be broad based.

**4. The Surcharge for the CHCF-B**

The surcharge that we adopt today was derived from the adjusted CPM estimate of the cost to serve high cost CBGs using the \$18.39 benchmark. The annual subsidy was divided by the total number of end user customers to arrive at the gross surcharge. The gross surcharge was then offset by the EUCL, the CCLC, and interstate USF support, if any. This results in a net surcharge, or what end users will see on their bills as the surcharge for the CHCF-B. The net surcharge for the CHCF-B amounts to 1.24%. The steps leading up to this surcharge of 1.24% are shown in Appendix E.

**5. Combining the CHCF-A and CHCF-B**

For purposes of collecting the funds for the CHCF-B, we will require the CHCF-B and the CHCF-A surcharges to appear as two separate line items on the end user's bill. Since the two funds are for two different funding mechanisms, and for the smaller LECs and the large and mid-size LECs, the carriers shall be responsible for remitting the CHCF-A and the CHCF-B monies to separate bank accounts, and shall account for these two funds separately.

Placing the two surcharges together as two separate line items should result in less customer confusion, and a more efficient manner of administering and collecting two different surcharge amounts. Customers will be able to see on their bills that they are contributing to two funds which support universal service in high cost areas. The combined CHCF surcharges shall appear on end users' bills beginning January 1, 1997. This will give the carriers time to implement this change to their billing systems. In addition, it will also give carriers the time needed

to prepare and mail a bill insert informing customers of the change.

The bill insert shall be mailed concurrently with the first bill that reflects this new billing format. The bill insert language shall be developed in a workshop to be convened by the Telecommunications Division as soon as possible.

At the present time, the CHCF-A is administered by Pacific. The Commission, as discussed later, will initially administer the CHCF-B. The Commission should also take over the administration of the CHCF-A. This transition should take place over the next six months. Pacific shall be directed to provide for an orderly transfer of the CHCF-A responsibilities, and all the books, accounts, monies, and related paperwork to the Telecommunications Division. In the interim, Pacific shall continue to administer the CHCF-A.

The testimony in this proceeding indicates that draws on the CHCF-A are likely to be minimal in the future. If that remains the case, once the Joint Board and the FCC decide on the federal funding mechanisms for universal service, the Commission should revisit the CHCF-A fund to determine whether the fund is still required, or if the subsidy amount should be reduced.

## **J. Carrier of Last Resort**

### **1. Introduction**

The COLR is a regulatory concept rooted in the idea that by accepting the franchise obligation from the state to serve a particular area, the public utility is obligated to serve all the customers in that service area who request service. (D.95-07-050, p. 36; 3 C.R.C. 948, 956-957.) The COLR concept is important to universal service policy because it ensures that customers receive service. Prior to the opening of the local exchange markets to competition, the 22 incumbent LECs served as the COLR in California's 500 plus local telephone exchanges.

As we noted in D.95-07-050 at pages 36 to 37, with the introduction of competition, the COLR may no longer be the single monopolist serving the territory. Instead, certain competitors may choose to serve the same service area, a smaller service area, or group of customers. That may result in more than one COLR in certain service areas, and only one COLR in other areas.

In the proposed COLR rules, the incumbent LECs would continue to serve and be designated the COLR in all of their respective service areas. The incumbent LEC would retain that obligation until another carrier or carriers are designated as the COLR. The incumbent LEC could also decide to remain as a COLR. The proposed rules also provide for a procedure to replace the last remaining COLR who wants to be relieved of its COLR obligation.

Under the proposed rules, only designated COLRs would be able to receive a subsidy for providing service to residential customers in high cost areas. The subsidy, which is derived from the proxy model, will vary according to the cost of providing basic service within a GSA.

## **2. Positions of the Parties**

AT&T Wireless commented that proposed rule 6.D.5, which requires a designated COLR in a given GSA to serve the entire GSA, may be discriminatory to wireless carriers because the boundaries of a particular GSA may not fit within the territory covered by that carrier's FCC licenses. AT&T Wireless also points out that incumbent LECs may also experience the same problem if they are required to cover GSA boundaries that are outside their existing exchange territories. AT&T Wireless recommends that the proposed rules be modified to permit any carrier to apply for designation as a COLR in an area that may not cover an entire GSA.

Citizens commented that proposed rule 6.E.2. may be legally deficient because it forces the owner of the facilities to sell its facilities at book value. Citizens also believes that the Commission already has procedures in place to protect against

abandonment of a particular service area, and that the auction mechanism provided for in proposed rule 6.E.1.a. is unnecessary.

The Coalition commented that there is no need to require new CLC entrants, who seek to be a COLR in a particular area, to comply with any extra criteria than that which is required as part of the local entry certification process. Accordingly, the Coalition believes that proposed rule 6.D.4. is not required. The Coalition also feels that the NOI process could be streamlined by permitting the CLCs to seek COLR authority by advice letter.

The Coalition commented that in order to eliminate barriers to entry, access to subsidy funds should be allowed to all new entrants, whether or not they are willing to undertake the COLR obligations. The Coalition argues that new entrants in many cases will be required to construct entirely new networks from the ground up. If new entrants are required to serve an entire GSA, the new entrants are likely to refrain from entering the market at all.

If the Commission insists on requiring that a carrier undertake the COLR obligations in order to draw from the CHCF-B, the Coalition recommends that the geographic area be sized in a manner which makes meeting the obligation possible. The Coalition believes that GSAs which are sized by census blocks would best meet this requirement.

Regarding the safety net auction mechanism, the Coalition cautions that the incumbent LECs may try to use the mechanism as a means of ratcheting up the subsidy amount. The Coalition recommends that in order to prevent this from occurring, the incumbent LECs be prohibited from participating in the bidding if they initiate the auction.

The Coalition agrees that the winner of the safety net auction should be allowed a premium as an incentive to serve a particular area. However, after three years, the Coalition recommends that all the other COLRs serving the same area should be entitled to the entire subsidy premium.

DRA suggests that some minor revisions be made to proposed rules 6.D.4.a., 6.D.4.b., 6.D.4.c. DRA also recommends that proposed rule 6.G.1., regarding resale, be revised. DRA believes that the Commission should not be directly involved in deciding whether a service or facility that is resold should be priced below its cost. Also, DRA asserts that the high cost subsidy should apply only to the offering of basic service as a whole, and should not apply to the offering of any unbundled part of basic service, such as the loop. Therefore, DRA recommends that rule 6.G.1. be revised as follows:

If resale of basic service is permitted, the carrier who sells basic service to the end-user residential customer shall receive the subsidy provided that the basic residential service is priced at the affordable price set by the Commission.

GTEC commented that it is reasonable to impose a COLR obligation only on those carriers who are willing to serve any customer in a market, and that all the carriers seeking to undertake the COLR responsibility should be required to meet Commission established fitness requirements. GTEC believes that the financial qualifications should be more stringent as well, and proposes that in order to become a COLR, that the carrier must possess a minimum of \$500,000 of cash or cash equivalent.

Pacific agrees with the Commission's proposed rule that only providers acting as a COLR throughout the GSA should be eligible to receive the high cost subsidy. Pacific states that the eligibility requirement acts as an incentive for carriers to offer service to all subscribers within the GSA. If the subsidy was offered without a carrier having to undertake the COLR obligation, Pacific contends that such a method would simply subsidize entrants for cream skimming.

Pacific supports the use of an auction in the event no single carrier is willing to undertake the COLR obligation, as well

as allowing a COLR to opt out of its obligation. However, it disagrees with the Coalition's proposal that if an auction is triggered by the withdrawal of the sole COLR, the withdrawing COLR should be disqualified from bidding in the auction. Pacific argues that such a restriction may actually increase the size of the fund because the incumbent COLR will not be participating. Pacific also points out that proposed rule 6.E. should be clarified regarding when the auction will be held. Pacific recommends that the auction be noticed and held within 180 days after the COLR files its application to withdraw.

Regarding the issue as to whether a COLR should have to meet specified criteria beyond the safeguards contained in the local competition rules, Pacific believes that the local competition rules are sufficient, and that no additional criteria are necessary.

Pacific commented that this proceeding needs to address the issue of resale of residential service, and whether the reseller is entitled to participate in the CHCF-B fund. Pacific points out that the reseller should not be able to qualify as a COLR because it is not standing ready to serve any customers in the same sense that a facilities based carrier is. Pacific suggests two ways of dealing with this issue. The first is to have the facilities based carrier or COLR receive all the funding. The COLR whose services are resold has no control over whether the reseller is providing all the basic service elements. The second method is to allow a reseller to draw from the fund if the reseller can demonstrate that the service provided meets the COLR requirements.

The Smaller Independent LECs state that they have made significant investments to develop modern, state-of-the-art digital networks, and that they are in the best position to deploy new technologies in their service areas at reasonable rates. Due to this large embedded plant investment, they argue that they should be designated the exclusive carrier for a period of at least seven

years.<sup>51</sup> They argue that this designation will allow them the opportunity to recover their capital investment while providing a transition period to determine their future investment in a new competitive environment. Competing carriers could still offer service in these areas, but only the incumbent LECs could draw from the high cost fund.

Both Roseville and the Smaller Independent LECs agree with the discussion in D.95-07-050 that only highly qualified carriers should receive a COLR designation. They believe that the Commission's first criteria should be that only facilities based providers may become a COLR.

As part of the process for qualifying as a COLR, USA proposes that the carrier seeking to become a COLR explicitly state what efforts it intends to make to communicate with non-English speakers in their native language. USA also believes that there should be an ongoing review of all providers to determine if they are meeting their obligations in this area.

### 3. Discussion

As noted earlier, the purpose of the COLR idea is to ensure that there is a public utility which is obligated to serve all the customers in its service area who request service. In D.95-07-050, we proposed that the incumbent LECs be designated the COLR in all their service areas until such time that another carrier or carriers are designated to be a COLR. (D.95-07-050, App. A, 6.D.1.) The process for becoming a designated COLR was explained in D.95-07-050 at page 57, and in proposed rule 6.D.4. The proposed rules also provide that "A designated COLR will be required to serve the GSA." (D.95-07-050, App. A, 6.D.5.)

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<sup>51</sup> Roseville suggested in its comments that due to this plant investment, it should be designated as the exclusive COLR for a period of no less than five years.

We wish to make clear that the COLR obligation applies to both residential and business customers, and in all areas of the state, regardless of whether it is a high cost area or a low cost area. Although our CHCF-B fund does not subsidize business customers in high cost areas, a carrier who wants to draw on the fund must provide service to all residential and business customers in that area who request service.

In response to some of the comments that we received about requiring the COLR to serve the entire CBG, we want to clarify the area in which the COLR is obligated to serve. The GSAs, or geographic study areas, serve as the reference point in the proxy models from which cost data and high cost area subsidies can be derived. (D.95-07-050, p. 50.)<sup>52</sup> We did not intend to suggest that the GSA serve as the geographic service area for all CLCs. This would be contrary to our local competition rule which allows the CLCs to designate the service territory that they intend to serve. (D.95-07-054, p. 28; D.95-12-056, App. C, Rule 4.F.)

What we did intend is that any designated COLR, in order to avail itself of the subsidy for a high cost area, must serve the GSA upon which the subsidy is based. This enables the Commission to match the subsidy in a high cost GSA to the number of residential customers the COLR serves in that particular GSA. This is consistent with the Telco Act's requirement that an "eligible telecommunications carrier" shall offer the services supported by the federal universal service support mechanisms throughout the service area designated by the state. (Telco Act, § 102, amending 47 U.S.C. § 214(e).)

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<sup>52</sup> CBGs were selected as the unit sizes from which the GSAs were to derive the cost of providing basic service. (D.95-12-021, pp. 10-11.)

Due to the existing exchange area boundaries, and the service area boundaries imposed on a carrier by the FCC that AT&T Wireless mentioned, we will modify our proposed requirement that a designated COLR be required to serve the entire GSA to the following:

- a. Until such time as provided for in rule 6.D.1., all incumbent LECs, in order to avail themselves of the subsidy for a high cost GSA, shall be required to serve all the high cost GSAs that are within the incumbent LEC's existing exchange area boundaries;
- b. All CLCs who are designated COLRs, in order to avail themselves of the subsidy for a particular high cost GSA, shall be required to serve all of the GSAs that are within the CLC's designated service territory.  
(Rule 6.D.6., App. B.)

The Coalition argues that every carrier serving an area, whether or not the carrier has undertaken the COLR obligation, should be eligible for the subsidy. We disagree. The purpose of allowing only the designated COLRs to draw from the funding mechanism for high cost areas is to attract competition into these high cost areas. In order to draw on the funds, the carrier must be willing to serve all customers in the Rule 6.C.2. designated area. This will allow consumers to choose from more than one carrier.

Nor do we believe that the requirement that you must be a designated COLR in order to receive CHCF-B funding acts as a barrier to entry. The CBGs, which serve as the GSAs, tend to be smaller in geographic area than exchanges. Thus, the smaller size will tend to encourage a carrier to serve the entire GSA and receive a subsidy, rather than serving a smaller portion of the GSA and remaining ineligible to receive the subsidy.

We have received several comments with respect to the issue of who gets to receive the high cost area subsidy in a resale

situation. We will adopt Pacific's suggestion that the reseller should be able to draw from the CHCF-B fund so long as the reseller is designated COLR and can demonstrate that its bundled basic service offering provides all the required service elements of basic service. Rule 6.G. of Appendix B has been modified to reflect this change.

The sale of unbundled BNFs may pose problems for the way in which subsidies should be distributed. If a CLC purchases some BNFs from the underlying facilities based carrier in a high cost area, the issue arises as to whether the subsidy should be apportioned between the CLC and the seller of the BNFs. We plan to examine this issue after the OANAD proceeding has determined what the prices of these unbundled components should be.

We also need to clarify proposed rule 6.D.3. to make clear that a designated COLR in a high cost GSA will be entitled to a subsidy on a per residential customer basis. The subsidy will reflect the difference between the adopted CPM cost estimate of serving the CBG(s) that are within the COLR's serving area, and the adopted benchmark price, less the offsets for the EUCL charge, CCLC, and the interstate USF and CHCF-A, if any. (See Rule 6.C.2.) The expected amounts that the five large and mid-size LECs might expect are shown in Appendix D.

In order to receive the subsidy for serving the high cost areas, the designated COLR shall report on a monthly basis, the number of residential basic service customers that it served during the prior month to the Commission. The Telecommunications Division shall conduct a workshop within 90 days to develop the type of information that needs to be reported. The Commission retains its right to inspect the books and records of the COLRs to ensure compliance with the CHCF-B.

In D.95-07-050, we described the designated COLR NOI process in the text of the decision, but only referred to the process in proposed rule 6.D.4. We will incorporate the NOI

process into the adopted rules as Rule 6.D.4. We will also adopt the Coalition's suggestion that the NOI process be handled by way of an advice letter, instead of the NOI application process that we described in D.95-07-050. The advice letter process seeking to be a designated COLR shall become effective on forty days' notice to the Commission unless a protest in accordance with the protest procedures set forth in GO 96-A is received. The incumbent LECs are not required to submit advice letters seeking to be a designated COLR since that obligation has already been imposed upon them in our adopted rule 6.D.1. in Appendix B, and in rule 5.A. of the local competition rules. (See D.95-12-056, App. C, 5.A.) As CLCs start to file advice letters to seek designated COLR status, the Telecommunications Division staff will need to develop a mapping and tracking system to keep track of the COLRs, and the areas that they are obligated to serve.

Proposed rule 6.D.4. also listed the factors we stated the Commission should consider in determining whether COLR status should be granted. A number of comments responded to our invitation to comment on whether a COLR should be required to meet criteria beyond what is required of the CLCs.

We have considered those comments, and will delete the financial ability criterion. We will retain the criteria regarding a description of the facilities that the carrier has in place or the arrangements the carrier plans to enter into in order to provide local service, as well as the carrier's commitment to promoting universal service to all residential customer groups within the carrier's service territory.<sup>53</sup> We believe that these two criteria should be used to ensure that a carrier desiring to be

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<sup>53</sup> We will modify proposed rule 6.D.4.c. to delete the reference to low income and non-English speaking communities. Instead, we will broaden the rule to include the promotion of universal service among all customer segments.

designated a COLR has a stake in the outcome, that it is unlikely to abandon its customers, and that the carrier is committed to promoting universal service. Under the Telco Act, it appears that the federal equivalent of a COLR, an eligible telecommunications carrier, will have to advertise the availability and charges for such services through the media in order to be eligible for universal service support. (Telco Act, § 102, amending 47 U.S.C. 214.)

We will not adopt the suggestions by Roseville and the Smaller Independent LECs that because of their size and investments, that these LECs should be designated the exclusive COLR for a period of no less than five years. It is clear under the Telco Act that rural telephone companies may soon be faced with requests for interconnection, and that the state will allow such arrangements if the request is not unduly economically burdensome, is technically feasible, and consistent with the federal universal service provision. In addition, PU Code § 709.5(a) clearly provides that

"it is the intent of the Legislature that all telecommunications subject to commission jurisdiction be opened to competition no later than January 1, 1997." (Emphasis added.)

A number of comments addressed the competitive bidding mechanism that we proposed in the event no carrier wanted to retain the COLR obligation. We will clarify proposed rule 6.E.1.a. to reflect that an auction will be held within 180 days from the date of filing of an application to withdraw as the COLR in a GSA. We will also adopt Citizens' suggestion that proposed rule 6.E.2. be changed to delete the reference to a sale at book value.

The Coalition suggested that after three years, the other competitors who entered after the auction was awarded should be entitled to the full subsidy rather than one-half the subsidy. That suggestion will not be adopted. We intend that the length of the award in such a situation should be limited to three years.