

Otherwise, the premium that is paid to the winning COLR will continue indefinitely, rather than possibly being bid down. Some changes have been made to proposed rule 6.E.3. to make this intent clearer.

## **K. Recognition of the Explicit Subsidy**

### **1. Introduction**

In order to avoid a situation where the incumbent LEC receives a subsidy from both the CHCF-B fund, and monies from the implicit subsidies contained in rates for services which are priced to help offset the costs of universal service, an adjustment is needed. Most of the parties refer to this problem as the "windfall" issue.

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

AT&T/MCI contend that the Commission should order the incumbent LECs at the creation of the fund to lower prices on a dollar for dollar basis to prevent the LECs from realizing a windfall due to the creation of an explicit fund to subsidize high cost areas. If the Commission does not reduce prices by the operative date of the fund, AT&T/MCI recommend that the relevant prices of the incumbent LECs be subject to refund.

AT&T/MCI contend that the prices of two essential monopoly input functions, namely the switching component of switched access, and collocation, should be reduced to their direct economic cost or TSLRIC as soon as possible so as to encourage rapid development of competition and provide the greatest benefits to consumers. AT&T/MCI also state that the other essential monopoly input functions should be priced at TSLRIC as well, but the unbundling of those elements and their pricing should be done in OANAD.

AT&T/MCI assert that CCTA's proposal for an across the board reduction is arbitrary and economically inefficient. Such a proposal would reduce the different services by an equal percentage regardless of each service's contribution above cost. The equal

percentage reduction is not revenue neutral because it would reduce the differentials between the rates for essential monopoly input functions, and the rates for end user services that use those functions. AT&T/MCI contend that this will only exacerbate the prospect of an anticompetitive price squeeze and discriminatory pricing.

CCTA contends that Pacific's proposal to selectively reduce toll prices rather than the prices of intrastate switched access or other products is self serving because it only affects those services which Pacific claims to have high margins, and in which it faces greater competition. CCTA believes that fairness requires that there be an equal proportionate reduction to all above cost rates, excluding those which apply to services included in the basic service package, or those that are covered by contract.

The Coalition recommends that the Commission order each LEC to implement rate adjustments that fully offset each LEC's receipts from the fund. To prevent the LECs from serving their own anticompetitive interests, they should not be permitted to unilaterally choose the offsetting rate adjustments. The Coalition also recommends that the fund should not begin to operate until: the Commission determines and implements the appropriate offsetting rate adjustments; or, the Commission has made the rates that might be adjusted, subject to refund, including interest, and eligible for cumulative refunds when the appropriate rate adjustments have been determined and implemented. The Coalition asserts that there should be no other rate rebalancing other than downward adjustments to offset the windfall problem.

DRA agrees with AT&T/MCI that the LECs should reduce rates for essential monopoly input functions, i.e., local switching and collocation services, that are currently in Category I. Such a reduction will most likely foster competitive entry into the local exchange markets. DRA recommends that the Commission reject

Pacific's proposal to reduce rates for end user services such as toll. DRA believes that no offsets are needed for toll and other competitive services because the competitive marketplace will force the LECs to reduce rates. DRA believes that it makes more regulatory sense to flow the rate reductions through the LECs' least competitive services in Category I. DRA contends that this will help to achieve the Commission's goal of having prices move closer to costs.

GTEC states that offsetting reductions should be made in rates so as to remove the distortion that is caused by the existing implicit support in rates. However, none of the parties' proposals dealing with this issue should be adopted because different rates are at different starting points. GTEC suggests that the only practical way to deal with this issue is to allow each LEC to propose a package of rate reductions which exactly offset its anticipated gross receipts from the fund. GTEC recommends that this process occur in another proceeding designed to address these kinds of rate issues.

ICG recommends that the Commission hold further hearings before deciding how the LECs' rates should be adjusted to prevent them from receiving a windfall. In the event the Commission decides not to hold further hearings on this issue, ICG recommends that the Commission adopt CCTA's proposal.

Pacific commented that any universal service funding will generate new revenue sources for the incumbent COLRs, and that offsetting revenue reductions are appropriate. Pacific proposes to make the following reductions: (1) change the peak and off peak price structure for residential customers; (2) change to a subminute billing methodology for both residential and business customers; and (3) reduce the monthly prices for custom calling features for residential customers. If more reductions are needed, Pacific contemplates as an option a possible reduction in business toll rates.

TCG argues that Pacific's plan for rate reductions gives Pacific a competitive advantage because its proposed rate reductions are tied to those services where competitive pressures are going to require reductions in prices. Also, Pacific's plan to use the advice letter process to effectuate the reductions is harmful to competition because of the difficulty of responding to advice letter filings in a timely manner, and because of the potential that the rate changes proposed in an advice letter could become effective while the resolution of a protest is pending. TCG favors CCTA witness Kahn's proposal that any carrier making a net positive draw from the fund must evenly spread its offsetting rate reductions across all services.<sup>54</sup>

### 3. Discussion

We first note that AT&T/MCI's suggestion that essential monopoly input functions be reduced to their direct economic costs or TSLRIC, is an issue that the OANAD proceeding should be concerned with, rather than this proceeding. It is in the OANAD proceeding that the costs and pricing of essential monopoly input functions are being examined.

The assigned ALJ properly excluded testimony regarding rate rebalancing and deaveraging from this proceeding. (See 14 RT 1387.) The focus of this proceeding is to establish a universal

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<sup>54</sup> In DCA's reply brief at pages 30 to 31, DCA stated that TCG's proposal, that rates should be reduced across the board over all LEC services, was the most fair. TCG had stated in its opening brief that "rate reductions be spread evenly across all of the LECs' services." In TCG's reply brief, TCG recommended that "any carrier making a net positive draw from the USF must evenly spread its offsetting rate reductions across all services, as proposed by Dr. Kahn." Since TCG's proposal appears to be based on CCTA witness Kahn's proposal, it is unclear whether DCA favors an across the board reduction of all services, including residential basic service, or whether it would exclude residential basic service from such rate reductions.

service fund. It was not intended to be an exercise in pricing of services in a competitive marketplace. (D.95-12-021, p. 3.) However, in order to make subsidies for high cost areas explicit, there must be a correlating downward adjustment of rates through a surcredit or reduction in tariffed rates so as to prevent the LECs from recovering implicit subsidy support as well. It is only to that extent, that we engage in the rebalancing of rates.

In resolving this windfall issue, we must be cognizant of the motives of the incumbent LECs, and the other parties. By adopting the proposal of AT&T/MCI, the essential monopoly inputs become cheaper for the CLCs. If, however, Pacific's proposal to reduce only the prices for certain competitive Category II services is adopted, that allows Pacific to reduce the prices of services for which it faces more competition, and thereby possibly preserving its share of the market.

We do not believe that ICG's suggestion to hold additional hearings into this issue, or that GTEC's proposal, are the most efficient ways to resolve the windfall issue in the short term. What we need to do in this proceeding is to establish a fund to provide explicit support to high cost areas of the state. In order to implement such a fund, and to transition from implicit subsidies to explicit subsidies, we must take immediate action to resolve this problem.

Contrary to AT&T/MCI's assertion that CCTA's proposal is arbitrary and not economically efficient, we believe that CCTA's proposal of ordering an equal percentage reduction for all rates, except for residential basic service, and rates covered by contracts, results in the most competitively neutral outcome in the short term. Neither the CLCs or the incumbent LECs gain an advantage as a result of the adoption of an across the board reduction. Although some of the services provide greater contribution toward universal service than other services, an

across the board reduction will result in an immediate offset without much controversy.

By excluding rate reductions for residential basic exchange services, we help ensure that the implicit universal service support that is contained in other rates, is reduced. The exclusion of residential basic service from the rate reductions is appropriate given the purpose of the fund. If we were to reduce rates for basic service as well, this would widen, rather than narrow, the gap between residential rates and their costs.

Concurrent with the effective date of the fund, the five large and mid-size LECs affected by the CHCF-B shall reduce all of their rates, except for residential basic service and existing contracts, by an equal percentage. This overall reduction shall equal the anticipated monthly draw the incumbent LECs anticipate receiving from the fund. The rate reduction shall be accomplished by a monthly surcredit to each customer's bill through an advice letter filing. In order to ensure that the total reductions equal the total amount the LECs receive from the fund, the large and mid-size LECs shall establish memorandum accounts to track the rate reductions, so that a true up with the actual monies received from the CHCF-B, can occur if necessary.

Since this surcredit will only offset the first year's anticipated explicit subsidy support, we shall afford the five large and mid-size LECs the opportunity to decide what rates should be rebalanced downwards to permanently offset the explicit subsidy support. This should take place in a subsequent phase of this proceeding to begin in about six months.<sup>55</sup> That will give everyone an opportunity to study in detail what rate reductions need to be permanently made to avoid the windfall at the start of

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<sup>55</sup> This could also take place in a proceeding addressing the overall rebalancing of rates.

the second year of the fund. Such a procedure will also allow parties time to digest how the pricing decision in OANAD may affect any proposed rate reductions. A review of the true up memorandum accounts could also take place in this phase if necessary.

#### L. Who Should Administer the Fund

##### 1. Introduction

In D.95-07-050 at page 65, we discussed whether the Commission, or a neutral third party, should administer the CHCF-B fund. We proposed that the Commission should administer the fund because of two reasons. First, by having the Commission administer the fund, it would eliminate the need to pay an administrative fee to an outside administrator. Second, it would allow for easier enforcement of the fund in the event auditing of the carriers were required, or if a carrier's authority needed to be revoked.

D.95-07-050 invited further comment on who should administer the fund. We were particularly interested in receiving comments about the possible delays and administrative difficulties the Commission might face with doing audits, investigations, and revocations, if the administration of the fund was left up to a third party.

##### 2. Positions of the Parties

Citizens does not believe that the Commission should be the administrator of the CHCF-B fund. Instead, Citizens recommends that an independent third party, such as the National Exchange Carriers Association (NECA), administer the funds. Once the fund structure is established, Citizens recommends that third parties be allowed to bid on administering the program.

The Coalition commented that the administration of the CHCF-B fund should be administered by a third party with fund management experience. This would separate the fund's workings from other resource demands or resource constraints that the Commission staff might face. The budget to administer the fund would be included as part of the funding requirement. The

Coalition suggests that the third party administrator be overseen by a committee of Commission, industry, and consumer representatives, similar to the ULTS Trust Administrative Committee. The third party administrator should also have sufficient auditing and legal resources. The Coalition states that if improper behavior on the part of a carrier is detected, the administrator could file a complaint against the carrier with the Commission.

DRA believes that the Commission should appoint itself to administer the high cost fund. DRA states that only the Commission staff has the appropriate expertise to monitor such a program.

GTEC commented that the Commission has the expertise to administer both the high cost fund, and the ULTS fund. GTEC suggests that the Commission must weigh whether the staff has the time and people to undertake administration of both funds, or whether a neutral third party administrator should administer the funds.

### 3. Discussion

The CHCF-B fund is a new program that will undoubtedly require some adjustments and fine tuning as the fund is implemented. In order for the Commission to make timely adjustments to the operations of the fund, the Commission should be the initial administrator of the fund. Administration of the fund will be handled by the head of the Commission's Telecommunications Division or his/her designee.<sup>56</sup> As the details and the workings of the fund's operations become better known, the staff of the Commission can quickly incorporate changes to the fund which will make it operate more smoothly and efficiently. Also, if problems

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<sup>56</sup> The Commission staff shall provide quarterly updates to the full Commission at its meetings concerning the administration and operation of both the CHCF-A and the CHCF-B.

are detected with the carriers in conjunction with the fund, the Commission can take prompt action to resolve any such problems. In addition, incorporating the CHCF-A into the CHCF-B may require resolution of some operational details. The Commission is in the best position to quickly resolve any possible problems.

The comments correctly observe that resource constraints may impact the Commission's long term administration of the combined CHCF-A and CHCF-B. At the end of one year's time, we will evaluate the operations of the two funds, and its impact on our resources, to determine if we should request proposals from neutral third parties to take over the administration of the funds. The Telecommunications Division shall prepare a report for the Commission regarding the operations and administration of the two funds, and whether the Commission should continue to administer the two programs. That report shall be forwarded by the Commission to the Legislature for their information.

In order to make the CHCF-B operational, the Executive Director shall coordinate the details of administering the CHCF-B fund on a day to day basis with the Telecommunications Division and the Fiscal and Administrative Services Branch of the Management Services Division. Such details include, but are not limited to, the following: development of monthly reports for remitting amounts to the fund and claims from the fund; establishing the necessary accounting systems; opening appropriate bank accounts; establishment of claim procedures and issuance of checks; and auditing and investigatory procedures for remittances to the fund and claims on the fund.

The administrative details of day to day operations of the CHCF-B fund shall be resolved as quickly as possible, and before the effective date of the CHCF-B.

## M. Review of the Fund Size

### 1. Introduction

D.95-07-050 proposed that the subsidy amounts derived by the proxy model be reviewed periodically. (D.95-07-050, pp. 55-56, App. B, rule 6.A.7.) The Commission stated that such a review would give us the opportunity to review the effects of competition, advances in technology, and whether the subsidy amounts need to be reduced. We invited further comment on whether a periodic review was necessary, and if so, how often such reviews should take place, and what items would need review or adjustments.

### 2. Positions of the Parties

The Coalition favors a three year periodic review where the market rates for basic service would be reviewed to determine the new subsidy requirement. The Coalition suggests that the new subsidy requirement reflect the weighted average of the cost of basic service as reflected in the rates charged by all the carriers serving a GSA.

DRA supports a periodic review of the subsidy amount. DRA believes that a review would ensure that technological advances and competitive pressures are reflected in the subsidy amount. Without a review procedure, DRA cautions that the subsidy has the potential for subsidizing providers, rather than promoting universal service.

GTEC commented that the Commission should not attempt to update the proxy costs over time to keep up with changes in cost levels, technology, or with the definition of basic service. Instead, if two or more carriers are willing to be a COLR in a specified area, an auction approach should be used to determine the level of support needed. Instead of the Commission having to decide whose cost studies are more accurate, the bidding would represent what a firm is willing to commit itself to in exchange for undertaking the COLR responsibility. GTEC recommends that the Commission adopt GTEC's proposed auction method.

In its comments to D.95-07-050, Pacific stated that a periodic review of the high cost funding program should not take place for at least seven years. Pacific contends that more frequent reviews will interrupt modernization efforts in high cost areas, and discourage competitive entry. Since the proxy model is to be based on forward looking technologies, Pacific argues that the subsidy fund will automatically reflect the major cost saving advances. In addition, if the fund is sized correctly, Pacific asserts that competition will emerge and efficient enhanced technologies will benefit consumers.

After the evidentiary hearings concluded, Pacific's reply brief agreed with GTEC that the Commission should investigate the feasibility of establishing an auction mechanism for providing universal service.

### 3. Discussion

The parties who commented agree that a review of the CHCF-B fund should take place. However, they disagree as to how often the review should be, and the type of review mechanism that should be used.

We believe that a review of the subsidies generated by the CHCF-B fund should take place. The review of the CHCF-B funding mechanism will ensure that the overall size of the fund is within reason, and that it will be adjusted as competition and technology evolve. By conducting such a review, the need for ongoing high cost area support may be reduced over time.

Due to the entry of new competitors, and the use of this untested CHCF-B fund mechanism, a review of the fund should take place in three years. Three years should give us sufficient time to determine whether new entrants are willing to serve high cost areas of the state with the subsidies provided. This initial review will give us the opportunity to adjust the CHCF-B fund. Subsequent reviews will take place every three years thereafter.

The next issue to decide is the format of such a review. Suggestions have been made to use an auction mechanism, an indexing mechanism, a weighted average of the prices charged for basic service in a GSA, or to conduct a reexamination of the inputs and assumptions used in the proxy model.

An indexing mechanism, or a weighted average, could be useful for readjusting the subsidies derived from the proxy model. However, a drawback to these two forms of adjustment is that they are somewhat dependent upon the numbers derived in the initial proxy model. For example, the indexing mechanism allows the subsidy amount to be increased or decreased by the indexed amount. This does not encourage carriers to become more efficient. As a result, the subsidy tends to remain near the same level as originally set.

If a reexamination of all the inputs and assumptions in a proxy model is used to review the subsidy amounts, based on our most recent experience, such a reexamination is likely to be time consuming and contentious.

After having undergone the process of examining and reviewing the competing proxy cost models, the inputs, the outputs, and the time and expense associated with such a review, the auction mechanism merits additional thought. There should be no doubt, however, that the proxy model exercise has been beneficial. As we noted in D.95-07-050 at page 49, the cost studies serve as "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."

With a subsidy mechanism in place, the auction mechanism appears to be the most efficient mechanism for reviewing the subsidy amounts in the future. By the time the three year initial review comes up, new entrants may have entered the markets and gained experience regarding the cost of providing residential basic service in high cost areas. A properly structured auction

mechanism could drive down the cost of the subsidy for high cost areas if a more efficient provider exists in a particular GSA.

The auction mechanism also eliminates revisiting whether a particular proxy cost model is better than another, and performing costs studies over again. It also eliminates technology debates as to what type of technology the proxy model should use since the bidder will take that into account when the bid is made. Also, if new service elements are added to the definition of basic service, that will be accounted for in the auction process. Bidders will also have to consider all sources of revenues when they make their bids.

Over the course of the next two years, the Telecommunications Division staff will monitor how competition develops in high cost areas of the state and keep us informed. If there is little or no competition, then we may reconsider the use of an auction mechanism as a way of reviewing the subsidy amounts. If competition develops in high cost areas of the state, then workshops shall be set up to discuss with interested parties how the auction mechanism should be organized.<sup>57</sup> If necessary, a Commission decision regarding the auction mechanism will then follow, with the auctions taking place in about three years from today.

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<sup>57</sup> The following are some of our preliminary thoughts on what an auction mechanism might consider. (1) What qualifications must a carrier meet before being allowed to participate in the auction process; (2) how should the bidding process be structured, and how many rounds of bidding there should be; (3) when does the bid become binding on the carrier; (4) should performance bonds be required to ensure that the winning bidder can carry out its obligations; (5) should CBGs be aggregated for purposes of bidding; and (6) should losing bidders be allowed the same subsidy as the winning bidder.

### VIII. Universal Lifeline Telephone Service Program

#### A. Introduction

The ULTS program is designed to promote the use of affordable, statewide, basic telephone service among low income households. The ULTS program is mandated by the Moore Universal Telephone Service Act (Moore Act) contained in PU Code Section 871 et seq. At the present time, there are approximately 3 million ULTS subscribers in California.

Under the ULTS program, all LECs throughout the state charge qualified residential low income customers a discounted installation charge of \$10.00,<sup>58</sup> and a monthly fee of \$5.62 for flat rate service or \$3.00 for measured rate service.<sup>59</sup> Each LEC is then allowed to draw money from the ULTS fund, which covers the difference between the statewide ULTS rate, and the LEC's rate for residential basic service, as well as for certain expenses associated with the ULTS program. The ULTS program is currently funded by a 3.2% surcharge on all end users' bills.

Under our proposed revisions to the ULTS program, a ULTS customer would be free to select any carrier from those who provide residential local exchange service. By selecting a particular carrier, that serving carrier would then be permitted to submit a claim to the ULTS program for reimbursement.

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<sup>58</sup> Some of the small LECs charge less than \$10 for the ULTS installation charge because of the restrictions contained in PU Code § 874(c). (See D.94-09-065, p. 57.)

<sup>59</sup> Some of the small LECs' basic exchange rates are lower than Pacific's basic exchange rate. In those cases, the small LECs' ULTS rates will be less than the statewide ULTS rates. In addition, in exchanges with extended area service (EAS), the ULTS customer will pay 50% of the EAS charge.

**B. Position of the Parties**

AT&T Wireless believes proposed rule 5.A.1.b., that carriers qualifying for a subsidy from the ULTS program must "charge no more than the statewide ULTS rate, as set by the Commission, to qualifying low income customers," hinders a customer's choice. AT&T Wireless recommends that ULTS customers be allowed to apply the ULTS subsidy to a provider of basic service, whose rate may be priced higher. However, the amount of subsidy that the higher priced carrier would receive, could be no higher than the ULTS subsidy amount received by other carriers for serving other ULTS customers. In effect, the customer who chose the higher priced carrier, would have to pay the ULTS base rate, plus the difference between the higher rate and the ULTS subsidy amount. AT&T Wireless contends that consumers should be permitted to use their virtual voucher to select a higher priced service that reflects the cost of a higher priced technology.

Cal/Neva and Consumer Action are opposed to any change from the current self-certification application process for ULTS, to an income verification process. They argue that an income verification process creates a barrier to enrollment because of the complexity of the process, and the type of information that may be required. They also argue that such a process is expensive. In addition, in a November 1993 study of the ULTS program for the Commission, it was determined that the number of ULTS customers who were ineligible based on income, was too low to justify the administrative costs associated with such an income verification method.<sup>60</sup> They also fear that any monies received as a result of a change to an income verification method could be diverted to

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<sup>60</sup> See A Study to Assess Customer Eligibility and Recommend Outreach Activities for the Universal Lifeline Telephone Service, SRI International, Nov. 1993, pp. 3, 13.)

support libraries and public schools, as suggested by DCA. They contend that such monies should be used to benefit affordable telephone service for low income customers.

Cal/Neva also supports expanding the ULTS program to provide discounted basic service to the "working poor", as suggested by Consumer Action. They believe that the ULTS income ceilings are too low to benefit working poor and lower middle income households. They suggest that a second tier of ULTS with a higher income ceiling, and somewhat lower benefit levels, should be established.

Citizens, as well as Pacific, suggests that proposed rule 5.A.1 be clarified to state that only those carriers who provide basic residential service will have access to the ULTS subsidy.

The Coalition is opposed to an income verification process for the ULTS program. The Coalition believes that this issue should be dealt with in R.94-12-001. The Coalition asserts that an income verification process is expensive, and the cost of verification may exceed the extra monies that would be available from the federal government. The Coalition also points to the November 1993 study which concluded that the incidence of fraud in obtaining ULTS service was not significant.

The Coalition believes that the current administrator should continue to administer the fund. However, the administrator's resources for auditing and enforcement should be increased.

The Coalition also supports Consumer Action's proposal to eliminate the existing subsidy of ULTS marketing by the LECs. As Consumer Action points out below, in a competitive environment, it is unfair for the customers of one company to underwrite the marketing efforts of other firms to attract customers. The Coalition does not oppose Consumer Action's proposal to use ULTS funds that are earmarked for LEC marketing subsidies to fund community and consumer groups, so long as those organizations'

marketing efforts are effective and targeted to all appropriate communities.

Consumer Action agrees that all carriers who provide basic service to low income customers should be able to avail themselves of the ULTS fund. However, they believe that the reimbursement should be limited to the added expenses incurred in providing ULTS service, such as the difference between the ULTS rate and regular service. Consumer Action is opposed to any carrier subsidy to pay for ULTS outreach, advertising, and other marketing efforts. They believe that the existing reimbursement for such efforts must be ended because of the competition that the carriers face, and to avoid multiple subsidies for marketing efforts directed at the same group of customers. Consumer Action favors the use of community and consumer groups to carry out the marketing for increasing telephone subscribership under the ULTS program.

Consumer Action also favors a revision to the once a year discounted installation charge. Consumer Action believes that low income customers tend to move more frequently, and that the current rule limiting the installation discount to once a year serves as a price barrier for households that move twice or more in a given year.

Consumer Action also commented that the Administrative Committee of the ULTS Trust should be maintained as the fund administrator for the ULTS program, rather than moving the responsibilities to the Commission or another third party.

DCA commented that the ULTS program should adopt the federal verification standards for ULTS applicants. DCA's understanding is that because the ULTS program currently employs a self certification process instead of an income verification method, approximately \$50 million per year in potential federal funding for lifeline service is foregone. DCA suggests that an income verification process be adopted, and that the additional

federal monies be used to provide schools and libraries with access to advanced technologies.

DRA commented that the Administrative Committee that is currently mandated to administer the ULTS fund should continue to perform this function. DRA recommends that the membership of the Administrative Committee be diversified to include representatives of the CLCs.

DRA pointed out in its September 1, 1995 comments that the marketing of the ULTS program in a competitive environment may need revision. Under the current practice, the incumbent LECs are reimbursed for their recorded expenses associated with administering the ULTS program, including their ULTS marketing expenses. With the opening of the local exchange to competition, the marketing expenses associated with the ULTS program become an issue.

DRA sets forth two approaches for resolving the marketing expense problem, and states that each approach has its own advantages. The first approach is to allow the LECs and the CLCs to market the ULTS program. DRA states that the advantages of this approach are the following:

- "o there would be continuity between the marketing and the provision of the service;
- "o the LECs and CLCs are in the best position to be knowledgeable about customers and should as a result be able to provide effective marketing;
- "o the LECs, especially the larger ones, already have experience marketing ULTS through outreach programs;
- "o private enterprise would provide the service, diminishing the role of government (although the neutral third party could also be private);

- "o if DRA's proposed modification to Appendix A paragraph 5.A.1.c is implemented (see section E. below), an incentive will be created for low-cost CLCs to market to eligible ULTS customers."

DRA's second approach is to give the responsibility for marketing the ULTS program to a neutral third party, such as the ULTS Trust Administrative Committee. DRA believes that the advantages of having a third party handle the ULTS marketing are as follows:

- "o the possibility of cream-skimming would be diminished, since this agency would be impartial;
- "o the need for Commission oversight of companies' ULTS marketing efforts would be avoided;
- "o coordination of efforts could be improved."

DRA believes that the advantages in favor of the LECs and the CLCs handling the ULTS marketing outweighs the advantages of the neutral third party approach. Consistent with that recommended approach, DRA recommends that a fixed statewide administrative fee per ULTS customer be paid to the LEC or CLC. DRA suggests that the fee be derived from the historical average expenditures by the LECs in administering the ULTS program, including marketing expenses. This fee could be updated from time to time to reflect the effects of inflation and productivity.

On the subject of whether the existing self certification process should be changed, DRA recommends that the Commission should hold workshops on the feasibility of implementing an income verification process for ULTS. DRA recommends that the Commission first determine if the \$50 million of federal funding is available before deciding whether to implement the verification program. DRA points out that an independent verification program may be

necessary if the LECs and the CLCs are allowed to do their own ULTS marketing, because some carriers may be tempted to subscribe customers who are ineligible for the ULTS program.

DRA also recognizes the drawbacks of an income verification process for the ULTS program. Such a process may deter some eligible customers from applying for support. Also, the cost of verification may be prohibitively expensive, in light of the relatively small amount of subsidy per customer that the carrier receives. DRA also does not expect to see significant savings in terms of reduced fraud through such a process because of what the November 1993 study concluded.

DRA also suggests revisions to proposed rule 5.A.1.a., 5.A.1.c., and 5.B.3., and recommends that the revised rules for the ULTS program be implemented as soon as possible. DRA also recommends that the amount of the subsidy should be revisited whenever the definition of basic service is changed.

DRA is opposed to a second tier of ULTS with a higher income ceiling and somewhat lower benefit levels. DRA contends that the size of the fund is already significant, and it is likely that demand for ULTS will continue to increase as the population grows. Instead of a two tiered ULTS program, DRA believes that toll call restriction and bill installment payment plans are ways in which lower income consumers can avoid being disconnected from the network.

GTEC believes that the ULTS program should have an income verification process instead of a self verification process. GTEC contends that such a process would ensure that only those meeting the required eligibility criteria would receive a subsidized rate. Such a process also acts as a deterrent against fraud if a carrier tried to claim a subsidy for a customer who was not eligible for the ULTS program. In addition, the adoption of an income verification program would make available the additional federal monies to help fund the ULTS program.

Pacific recommends that the Commission continue to allow ULTS customers to self certify their eligibility, rather than to adopt an income verification process. Pacific states that an income verification process could have unintended adverse effects on the ULTS program by discouraging eligible customers from applying. In addition, such a process would be costly to administer given the number of ULTS subscribers. Pacific believes that the current self certification process strikes the proper balance of deterring fraud, and ensuring that the universal service goals benefit the greatest number of California customers.

Pacific commented that a neutral third party should oversee the administration of the ULTS fund unless administrative feasibility is better served by having the Commission administer the fund.

Public Advocates recommends that enhanced telecommunications services be made available to qualified ULTS customers at ULTS rates, i.e., no more than 50 percent of the price of the service. Public Advocates also recommends that the ULTS program should retain the self certification process, because of the likelihood that an income verification process will deter many eligible persons from applying.

The Smaller Independent LECs recommend that the self verification process continue. However, they suggest that the Commission investigate how the current self verification process in a substantially similar form, could satisfy federal requirements and make it eligible for the additional \$50 million in federal subsidies.

USA believes that with all the other changes occurring in the telecommunications industry, that the Commission should not change the self certification procedure for ULTS at this time.

### **C. Discussion**

As we noted in D.95-07-050 at page 67, with the introduction of local exchange competition, the Commission needs to

review and revise the ULTS program. These revisions will permit all carriers who provide residential basic service to ULTS customers to avail themselves of the ULTS funds. The changes that we make to the ULTS program are discussed below.

We first address the suggestions to modify some of the proposed rules. We will adopt the suggestion by Citizens and Pacific to clarify rule 5.A.1. by specifying that only those carriers who offer residential basic service will have access to ULTS funds. Such a suggestion is appropriate given that the ULTS program is a residential service. Thus, all that a ULTS customer needs to do is to select a provider of local exchange service. That carrier will then establish the necessary paperwork in order to claim reimbursement from the ULTS program.

We will also adopt DRA's suggestion to modify proposed rule 5.B.3. to make the reporting consistent with the requirements of GO 153, as well as Resolution T-15826. We have also revised this rule to include the requirement that the carrier report the number of ULTS customers that it served that month. Proposed rule 5.B.3. has been renumbered as rule 5.A.1.e. This requirement will enhance the verification process to ensure that the claim for reimbursement per ULTS customer is correct. The Telecommunications Division staff shall revise the ULTS Monthly Report and Claim Statement to reflect this requirement.

We do not adopt DRA's suggestion to modify proposed rule 5.A.1.c. We believe that rule 5.A.1.c., as drafted, is more competitively neutral than DRA's suggestion that the lower cost provider be provided with a larger subsidy. In a competitive market, prices and subsidies should be driven downward. We have revised rule 5.A.1.c. to clarify how much of a subsidy the carrier serving the ULTS customer is entitled to.

We have also revised rule 5.A.1.b. to clarify that a new entrant serving ULTS customers, shall set their ULTS rate in accordance with PU Code § 874, i.e., the ULTS rate shall not be

more than 50% of the new entrant's rates for non-ULTS customers, and that such a rate cannot exceed the ULTS rate set by the Commission.<sup>61</sup> In addition proposed rule 5.B.2. has been revised to reflect the other services that are exempt from the ULTS surcharge as provided for in D.94-09-065 at pages 288 to 293.

As for the recommendation of AT&T Wireless, we believe that PU Code § 874 limits our ability to apply the ULTS subsidy toward the basic service rate of a higher priced carrier. PU Code § 874 states in pertinent part:

"The lifeline telephone service rates and charges shall be as follows:

"(a) In a residential subscriber's service area where measured service is not available, the lifeline telephone service rates shall not be more than 50 percent of the rates for basic flat rate service, exclusive of federally mandated end user access charges, available to the residential subscriber.

"(b) In a residential subscriber's service area where measured service is available, the subscriber may elect either of the following:

"(1) A lifeline telephone service measured rate of not more than 50 percent of the basic rate for measured service, exclusive of federally mandated end user access charges, available to the residential subscriber.

"(2) A lifeline flat rate of not more than 50 percent of the rates for basic flat rate service, exclusive of federally mandated end user

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<sup>61</sup> The statewide ULTS rate was last set in D.94-09-065 at pp. 50 and 57.

access charges, available to the residential subscriber."

- "(c) The lifeline telephone service installation or connection charge, or both, shall not be more than 50 percent of the charge for basic residential service installation and connection charges, or both. The commission may limit the number of installation and connection charges, or both, that may be incurred at the reduced rate in any given period."

The Moore Act was enacted at a time when there was only one monopoly provider of local exchange service. PU Code § 874 did not envision that there would be two or more competing basic service carriers in the same service territory. Due to the specific singular references that the ULTS rate shall not be more than 50% of the rate for basic flat rate service or of the rate for basic measured rate service, and due to our past practice of setting a uniform statewide ULTS rate for GTEC and Pacific that is equal to 50% of Pacific's residential basic exchange rates,<sup>62</sup> we feel compelled to deny AT&T Wireless's request to allow the ULTS subsidy to be applied as a credit to a carrier's higher priced basic service rate. This result is also consistent with the Moore Act's declaration that basic residential telephone service be made affordable to low income citizens, and that the use of the word "residential" means "residential use and excludes industrial, commercial, and every other category of end use." (PU Code §§ 871.5(b), 872.) The Moore Act clearly does not contemplate that ULTS program funds be used to subsidize mobile telephones if these are offered to the public at a higher price than standard telephone service.

<sup>62</sup> See D.94-09-065 at pages 49 to 50.

Despite the conclusion above, we do recognize the importance that mobile telephone technologies, such as cellular and personal communication services, may have for providing basic service in remote rural areas of the state. However, until the Moore Act is amended by the Legislature, the ULTS program funds should not be used to subsidize a service that can be used anywhere.

Our analysis of Public Advocates' recommendation to include enhanced telecommunications services within the ULTS program is similar to our analysis above. The Moore Act contemplates the offering of basic telephone service at affordable rates to the greatest number of citizens. (PU Code § 871.5.) The Moore Act envisions Lifeline service as that class of service necessary to meet minimum residential communication needs. (PU Code § 873(a).) Subdivision (b) of PU Code § 873 states as follows:

"(b) Minimum residential communications needs includes, but is not limited to, the ability to originate and receive calls and the ability to access electronic information services."

We do not believe that "the ability to access electronic information services" was meant to include access to enhanced telecommunications services. Our basic service definition allows the calling party to make outgoing calls to the telephone number of the electronic information service. However, access to that type of service, such as the Internet, is not regulated by us, nor should such access be subsidized by the ULTS program. Nor do we believe that PU Code § 882 creates a ULTS entitlement to advanced telecommunications services. Accordingly, we reject Public Advocates' suggestion to broaden the ULTS program to include lifeline rates for enhanced services. We note that Rule 4.C.1. and 4.B. in Appendix B will incorporate new service elements as support