

REGULATORY REFORM REVIEW COMMISSION

The Regulatory Reform Review Commission is established by North Dakota Century Code (NDCC) Section 49-21-22.2. The commission is to review the operation and effect of North Dakota telecommunications law on an ongoing basis during the interims between the 1999 and 2003 legislative sessions. Also, the commission may review the effects of federal universal support mechanisms on telecommunications companies and consumers in this state as well as the preservation and advancement of universal service in this state.

Under NDCC Section 49-21-22.2, the commission consists of one member of the Public Service Commission who has responsibility for telecommunications regulation, two members of the Senate appointed by the President of the Senate, and two members of the House of Representatives appointed by the Speaker of the House. Commission members were Representatives Mick Grosz (Chairman) and Eliot Glassheim, and Senators Vern Thompson and Rich Wardner, and Public Service Commissioner Bruce Hagen.

The commission submitted this report to the Legislative Council at the biennial meeting of the Council in November 2000. The Council accepted the report for submission to the 57th Legislative Assembly.

NORTH DAKOTA TELECOMMUNICATIONS LAW

Before 1983 telecommunications companies in North Dakota were regulated by the Public Service Commission as traditional public utilities. In 1983 cooperatives and small telephone companies were removed from the ratemaking jurisdiction of the Public Service Commission. In 1985 the Legislative Assembly revised this exemption to remove local service of cooperatives and small companies from the Public Service Commission's ratemaking jurisdiction. In 1985 the Public Service Commission was given authority to deregulate telecommunications services. The Public Service Commission was required to find that the service, company, or transaction was of limited scope or was subject to effective competition to be deregulated. This authority was removed in 1999 by Senate Bill No. 2420.

There have been several amendments to the telecommunications law since 1989, when major deregulation of the telecommunications industry began.

1989 Senate Bill No. 2320

The Regulatory Reform Review Commission was created in 1989 to review the deregulation of the telecommunications industry resulting from enactment of 1989 Senate Bill No. 2320. The commission originally consisted of the three Public Service Commissioners, two members of the Senate, and two members of the House of Representatives.

Senate Bill No. 2320 exempted telecommunications companies and services from rate or rate-of-return regulation by the Public Service Commission unless a telecommunications company notified the Public Service Commission that it wanted to be regulated in this manner. For telecommunications companies with over 50,000 end users, the election not to be exempt from rate or rate-of-return regulation was a one-time, irrevocable decision. Although the Legislative Assembly exempted essential telecommunications service and nonessential telecommunications service (service that is not included within the definition of essential telecommunications service) from rate or rate-of-return regulation by the Public Service Commission, essential telecommunications service is still subject to a price cap based upon the essential telecommunications price factor. Essential telecommunications service includes service that is necessary for switched access to interexchange telecommunications companies and necessary for two-way switched communications for both residential and business service within a local exchange area.

1989-90 Interim and 52nd Legislative Assembly

During the 1989-90 interim, the commission reviewed the Public Service Commission's determination of the essential telecommunications price factor, Minnesota's incentive regulations, and recommendations of interested parties. Even though the commission did not recommend any legislation, the 52nd Legislative Assembly enacted three bills that primarily affected NDCC Title 49 (no changes were made to the substantive provisions of 1989 Senate Bill No. 2320).

1991 House Bill No. 1095

This bill required a person who makes telephones available to the public for intrastate telephone calls on that person's premises to ensure that the telephones allow the consumer to use access code numbers ("800," "950," or "10XXX 0+") to obtain access to the provider of operator services desired by the consumer at a charge no greater than that charged for calls placed using the presubscribed provider of operator services.

1991 House Bill No. 1556

This bill required telecommunications companies and rural telephone cooperatives offering telephone call identification services to allow a caller to withhold display of the caller's telephone number from the person receiving the telephone call placed by the caller.

1991 House Bill No. 1557

This bill required mutual aid telecommunications cooperatives and telecommunications cooperative associations to have the approval of two-thirds of the membership of the cooperative or association to sell a physical plant if the value of the plant is more than five percent of the value of the cooperative or association. In addition, the enabling statute for the commission was amended to transfer responsibility for providing staff services for the commission from the Legislative Council to the Public Service Commission.

1991-92 Interim and 53rd Legislative Assembly

The study of telecommunications law by the commission during the 1991-92 interim resulted in two main recommendations incorporated into 1993 Senate Bill No. 2440. The first related to the banking of essential telecommunications price factor changes and the second related to uniform long-distance rates. These recommendations came after the commission reviewed the Public Service Commission's determination of the essential telecommunications price factor and the Public Service Commission's decision that ordered equal access (intraLATA) and unbundling for the purpose of offering service on an equal and open nondiscriminatory basis. The 53rd Legislative Assembly enacted four bills that primarily affected NDCC Title 49.

1993 Senate Bill No. 2317

This bill exempted a public utility operated as a nonprofit, cooperative, or mutual telecommunications company or a telecommunications company having fewer than 3,000 local exchange subscribers from regulation under NDCC Chapters 49-02 and 49-21. However, these public utilities were still subject to Sections 49-02-02(7), 49-21-01.2, 49-21-01.3, 49-21-01.4, 49-21-06, 49-21-07, 49-21-08, 49-21-09, and 49-21-10 regarding rates, terms, and conditions of access services or connection between facilities and transfer of telecommunications between two or more telecommunications companies.

1993 Senate Bill No. 2385

This bill, effective through July 31, 1999, provided that dialing parity on an intraLATA basis, otherwise known as 1+ intraLATA equal access, may not be required to be provided by any company providing local exchange service. This bill reversed a Public Service Commission ruling that forced U S West (now known as Qwest) to open its "short-haul" long-distance markets to other telephone companies.

1993 Senate Bill No. 2393

This bill reduced to one the number of Public Service Commissioners on the commission and required the Legislative Council to provide staff services rather than the Public Service Commission.

1993 Senate Bill No. 2440

This bill changed the definition of "essential telecommunications price factor" for purposes of telecommunications regulation from the annual change in a company's input cost index reduced by 50 percent of that company's productivity incentive adjustment to a factor determined annually which is the lower of 41.6667 percent of the percentage change of the average annual gross national product price index or the percentage change of the average annual gross national product price index minus 2.75 percentage points for group I telecommunications companies or a factor determined annually which is the lower of 52.0834 percent of the percentage change of the average annual gross national product price index or the percentage change of the average annual gross national product price index minus 2.0625 percentage points for group II telecommunications companies. Group I telecommunications companies are those companies with over 50,000 subscribers, and group II telecommunications companies are companies with 50,000 or fewer subscribers. The bill also revised the distinction between essential telecommunications services that are regulated or subject to the essential telecommunications price factor cap and nonessential services that are not subject to the essential telecommunications price factor cap. The bill also revised the definition of telecommunications services that are not subject to the telecommunications deregulation law, such as coinless or coin-operated public or semipublic telephone terminal equipment and the use of such equipment, inside wire and premise cable installation and maintenance, and directory services that are not essential, such as "yellow pages" advertising and boldface or color listings in "white pages."

1993-94 Interim and 54th Legislative Assembly

The study of telecommunications law by the commission during the 1993-94 interim resulted in the recommendation of Senate Bill Nos. 2078 and 2079. The commission made these recommendations after reviewing federal legislation and the North Dakota Supreme Court decision *MCI Telecommunications Corp. v. Heitkamp*, 523 N.W.2d 548 (1994). This case related to a challenge of 1993 Senate Bill No. 2385, which provided that dialing parity on an intraLATA basis may not be required to be provided by any company providing local exchange service. The statute withstood challenge on special law and unlawful delegation of legislative authority grounds. The 54th Legislative Assembly enacted five bills relating to telecommunications law.

1995 Senate Bill No. 2008

This bill deleted the requirement that the Public Service Commission consider proposed rates and proposed design in determining whether to grant a certificate of public convenience and necessity and provided that the Public Service Commission must consider the technical, financial, and managerial ability of an applicant for the certificate.

1995 Senate Bill No. 2078

This bill included pay phones within regulation for the purpose of requiring access code numbers to the operator services desired by the consumer.

1995 Senate Bill No. 2079

This bill reestablished the commission until 1999.

1995 House Bill No. 1274

This bill required telecommunications companies to allow callers on a per line basis to withhold display of a caller's telephone number from the telephone instrument of the individual receiving the telephone call placed by the caller. The bill required telecommunications companies to provide this option without charge on a per call basis and without charge on a per line basis to residential customers and business customers with special needs.

1995 House Bill No. 1459

This bill increased the size of a telecommunications company not subject to regulation by the Public Service Commission from a company having fewer than 3,000 local exchange subscribers to a company having fewer than 8,000 local exchange subscribers. As a result of this bill, only the three largest telephone companies in this state were subject to price regulation.

1995-96 Interim and 55th Legislative Assembly

The study of telecommunications law by the commission during the 1995-96 interim resulted in the recommendation of 1997 House Bill No. 1067. The commission made this recommendation after reviewing the federal Telecommunications Act of 1996 [Pub. L. 104-104; 110 Stat. 5] and meeting with the Taxation Committee and reviewing the effect of taxation laws on North Dakota telecommunications law. The Act was the first major change to the federal telecommunications law since 1934 (the major change provided by the Act is the opening of local exchange markets to competition). House Bill No. 1067, which failed to pass, was meant to implement the federal Telecommunications Act of 1996. A portion of the bill would have created a state universal service fund. The 55th Legislative Assembly did not enact any bill that primarily affected telecommunications law found in NDCC Title 49.

1997-98 Interim and 56th Legislative Assembly

The study of telecommunications law by the commission during the 1997-98 interim resulted in the recommendation of 1999 House Bill No. 1050, which was a request for further study. The commission was assigned one study, Senate Concurrent Resolution No. 4055. The study directed the Legislative Council to study the potential for expansion of extended area telecommunications service. Extended area service is a service by which a subscriber of one exchange may call a subscriber in another exchange without paying a toll fee or separate charge for the call. Usually the costs of extended area service are spread over the rates paid by all the subscribers in the involved exchange. In addition, once extended area service is implemented, it is typically mandated for all subscribers within an exchange. After studying extended area service and its alternatives, the commission made no recommendation.

In its review of this state's telecommunications law, the commission reviewed the federal Telecommunications Act of 1996 and its effect on universal service, access rates, competition, and this state's price cap. The 56th Legislative Assembly enacted seven

bills that affected telecommunications law found in NDCC Title 49.

1999 House Bill No. 1050

This bill extended the commission through 2002 and encouraged the study of universal service support mechanisms.

1999 House Bill No. 1169

This bill prohibited a change in telecommunications services without authorization from the customer, commonly referred to as "slamming" and "cramming." The bill stated that slamming and cramming are unlawful practices.

1999 House Bill No. 1450

This bill provided that a telecommunications company may not be an eligible telecommunications carrier unless the company offers all services supported by federal universal service mechanisms throughout the study area.

1999 House Bill No. 1451

This bill prohibited any political subdivision from imposing a fee on a telecommunications company for the use of the political subdivision's right of way other than a fee for management costs. This bill applied retroactively to January 1, 1999.

1999 Senate Bill No. 2094

This bill made technical changes in the law that requires a person who makes telephones available to the public or to transient users of that person's premises to provide operator services through access code numbers to the services desired by the consumer at a charge no greater than the charge for using the prescribed provider of operator services.

1999 Senate Bill No. 2234

This bill prohibited the Public Service Commission from setting aside any telecommunications price in effect on January 1, 1999, for intrastate switched-access service provided by any rural telephone company upon complaint by an interexchange telecommunications company that the price is unreasonably high, except a price for intrastate switched-access service in an exchange may be set aside to the extent it is unreasonably high as a consequence of recovery of costs of intrastate switched-access service in that exchange from any explicit federal or state mechanisms to preserve and advance universal service; a sale, assignment, or other transfer of ownership or control of that exchange after January 1, 1999; or reduction of prices after January 1, 1999, for any other services provided in that exchange. This bill expires July 31, 2001.

1999 Senate Bill No. 2420

This bill rebalanced rates among local, toll, and access, in a revenue neutral manner, with access charges and toll rates to be reduced by similar percentages and in a competitively neutral manner as a result of an increase in local rates. The bill allowed a telecommunications company with more than 50,000 subscribers to increase the monthly price of residential service up to \$15.50 after July 31, 1999, and up to \$18 after June 30, 2000. A telecommunications company increasing prices must submit a report to the Public Service Commission reasonably demonstrating that it reduced the prices of its intrastate intraLATA message toll service and intrastate switched access by an annual amount not less than the annual revenue increase resulting from the service price increases.

The Public Service Commission has authority to investigate the increased prices and can set aside an unfair or unreasonable price increase. An unfair or unreasonable price must be above the price in effect on January 1, 1999, and the average cost for providing residential service must exceed the price resulting from the increase using embedded or forward-looking economic cost methodologies. The bill provided that a local exchange carrier can set residential exchange service prices below the maximum price cap provided it also lowers its interconnection prices at the same time.

The bill deregulated private line transport service and specifically identified those provisions of the federal Telecommunications Act of 1996 that the Public Service Commission is authorized to implement and granted the Public Service Commission authority to adopt rules regarding the Act.

The bill imposed uniform service quality standards among all providers. The bill provided that the Public Service Commission may not adopt a rule or order regarding the quality of service provided by telecommunications companies unless the rule is applicable to all telecommunications companies providing similar service in the same market area.

The bill prohibited certain acts to promote or regulate competition. The bill provided that a telecommunications company may not be required to construct facilities at the request or for the use of another telecommunications company except to the extent required by the federal Act. The bill clarified that if a telecommunications company is required to incur nonrecurring costs in excess of the normal course of business and for the benefit of another company or a customer, the Public Service Commission generally must allow the burdened company to recover the cost in advance. The bill prohibited a telecommunications company from discriminating against another company by refusing to provide or delaying access to the company's services or essential facilities, providing access on terms that are less favorable than those the company provides to itself, or by degrading the quality of access or service provided to another company. The bill identified those sections of law which competitive local exchange carriers are required to meet and established the Public Service Commission's jurisdiction over those telecommunications companies regardless of size. The bill repealed the Public Service Commission's authority to exempt a company, transaction, or service from regulation if there is sufficient competition.

Although the bill extended the prohibition against requiring 1+ dialing parity from July 31, 1999, to January 1, 2000, this section of the bill was superseded by a Federal Communications Commission ruling that 1+ dialing parity must be offered by July 22, 1999. This ruling was in accordance with *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 119 S. Ct. 721, 142 L. Ed. 2d 835 (1999), in which the United States Supreme Court held that the Federal Communications Commission has general jurisdiction to implement the federal Act's local competition provisions.

Testimony on North Dakota Telecommunications Law

The commission received information and heard testimony on various aspects of North Dakota telecommunications law.

1999 Senate Bill No. 2420

The Federal Communications Commission has allowed suspensions of its rule that 1+ dialing parity must be offered by July 22, 1999, to rural companies to the extent that is allowed by state law, which was until January 1, 2000. Most rural telecommunications companies, approximately 20, asked for and received a suspension.

Senate Bill No. 2420 included a provision allowing the Public Service Commission to set aside some or all of the increase allowed by the bill if an investigation finds the resulting rates to be in excess of the cost of providing residential local exchange service. On June 6, 2000, the Public Service Commission opened an investigation to determine Qwest's cost of providing local exchange service in North Dakota. Immediately following the hearing, the Public Service Commission reviewed Qwest's access and toll price reductions taken in response to the local price increase to determine if these reductions were revenue and competitively neutral.

The commission heard testimony before the hearings were held before the Public Service Commission. According to a representative from Qwest, the rebalancing allowed by the bill for the allowed increase to \$15.50 per month caused a 24 percent (approximately \$6.7 million) decrease in intrastate long-distance and switched-access prices. All customers received some benefit from the toll and access reductions; however, some received more than others by taking advantage of promotional rates. A representative from AT&T doubted the revenue neutrality of the proposals by Qwest.

AT&T argued that Qwest's access rates are too high. North Dakota has the highest access rates in Qwest's 14-state territory. The commission was informed that high access rates make it difficult for competition. For example, according to Qwest's figures interexchange carriers are charged six cents a minute on each end of a conversation for access. A high estimate of the cost of access for originating and terminating a telephone call is two cents per minute. Under the example, AT&T needs to charge 16 cents per minute to make four cents per minute on carrying intrastate telephone calls between Qwest customers. If Qwest charges 16 cents, it makes 14 cents per minute. Qwest charges under 10 cents per minute to some of its own customers. Competition at that price would cost the competitor more money than it would receive from customers and would enrich Qwest at the same time.

The commission heard testimony after the hearing by the Public Service Commission that AT&T's questions and concerns about the latest round of access charge reductions by Qwest had been answered and addressed to AT&T's satisfaction. The hearing determined that Qwest had lowered access charges as required by the bill.

1999 Senate Bill No. 2234

Senate Bill No. 2234 sets a floor for the price of access charged by rural telephone companies at the price on January 1, 1999. This floor expires on July 31, 2001. The commission was informed that the rates charged for access by rural companies are high in relation to cost.

Aggregator Exception

A representative of the University of North Dakota requested that universities and colleges that provide telecommunications services be designated as aggregators rather than as resellers or facilities-based carriers. The University of North Dakota is a reseller and a facility-based provider and has to follow certain state and federal rules that foster competition. These rules generally require resellers to provide dialing number parity, local number portability, and enhanced-911 enhancements. As a result, the university will need to make costly changes to its telephone system.

If universities and colleges were aggregators, they would be exempt from these laws. The university provides telecommunications services to Barnes and Noble, which is located on university property, to private vendors in the Memorial Union food court, to the credit union located on campus, and to the fraternity houses not located on university property. Although these telecommunications services are operated for a profit, the services are on state-owned or leased properties and are provided to educational-related entities, and the income is generally used for reinvestment to provide better telecommunications services.

Commission discussion concluded that drawing the boundary line of where a state-run telecommunications company may operate would be difficult.

FEDERAL TELECOMMUNICATIONS ACT OF 1996

Competition With Regional Bell Operating Companies

The federal Telecommunications Act of 1996, enacted on February 8, 1996, represented the first major revision of federal telecommunications law in more than 60 years. The primary intent of the law was to open all telecommunications markets to competition by developing fair rules for all participants. The Act was to bring to the long-distance market the benefits competition had brought to the local exchange market. The Act allows competition in local exchange markets and, when there is competition, allows the regional Bell operating companies to enter the interLATA long-distance market.

The Act provides for the development of competitive local exchange markets. There are three avenues for competition with the local exchange carrier--resale, lease or purchase of network elements, or overbuilding. The main rule is that each telecommunications carrier has a duty to allow interconnection. In addition, all local exchange carriers have a duty to offer resale. Each incumbent local exchange carrier has five main duties, which include the duty to negotiate, to provide for interconnection at any technically feasible point and of at least equal quality, to provide for unbundled access to network elements, to provide for resale at wholesale rates, and to provide for collocation for the physical location of equipment necessary for interconnection or access to unbundled network elements at the premises of the local exchange carrier. The Act allows states to authorize their public utilities commissions to establish the access and interconnection obligations of local exchange carriers.

The particulars of interconnection between an incumbent local exchange carrier and a competitor may be determined one of three ways--negotiation, mediation, or arbitration. Any interconnection agreement adopted by negotiation must be submitted for approval to the state public utilities commission.

The state public utilities commission may mediate or arbitrate an agreement. The Act provides for arbitration standards and procedures. The standard for arbitrating just and reasonable rates for interconnection and just and reasonable rates for network elements for unbundled access must be based upon the cost of providing the interconnection or network element and may include a reasonable profit.

One of the ironies of the Act is that it establishes cooperation as the essential prerequisite to competition. It requires federal and state regulators to cooperate in matters of policy. It requires incumbents to negotiate interconnection agreements, thereby cooperating with their competitors.

Under the Act, a Bell operating company may provide interLATA services if the company has filed an approved statement of generally available terms and has met a 14-point competitive checklist. A Bell operating company may file a statement of generally available terms with the state public utilities commission. The state public utilities commission may not approve the statement unless the statement complies with the pricing standards for interconnection and network element charges and the duties of interconnection. The Bell operating company may enter the interLATA market if the company is providing access and interconnection pursuant to an agreement with a facilities-based carrier and meets the 14-point competitive checklist.

During the 1997-98 interim, the commission reviewed competition faced by Qwest--the Bell operating company in this state. The commission received testimony on a report from Ostrander Consulting on the level of competition faced by Qwest and on what would be sufficient competition for deregulation. The Ostrander report concluded that in this state resale is not competition and facilities-based competitors are competition. At the time of the report, there were no significant facilities-based local exchange competitors in this state.

Rural Protections From Competition

The Act allows special protections for rural telephone companies. All local exchange carriers in this state are rural telephone companies, except Qwest. The duties of an incumbent local exchange carrier do not apply to a rural telephone company until the company has received a bona fide request for interconnection, services, or network elements, and the state public utilities commission determines the request is not unduly economically burdensome, is technically feasible, and is consistent with federal universal service. In addition, a rural telephone company may petition the state public utilities commission for a suspension or modification of the duties of a local exchange carrier or an incumbent local exchange carrier. The state public utilities commission must grant the petition if the public utilities commission determines it is necessary to avoid significant adverse economic impact on users of telecommunications services, to avoid imposing a requirement that is unduly economically burdensome, or to avoid imposing a requirement that is technically infeasible and is inconsistent with the public interest, convenience, and necessity. Senate Bill No. 2420 (1999) authorized the Public Service Commission to exercise this authority.

Traditional competition may not work in rural cooperative areas. For there to be resale competition in rural cooperative areas, the customers who own a cooperative would have to lease services to another company so the other company could sell them back to the same customer. Competition would most likely come from facilities-based competitors taking the most profitable large business accounts (cherry picking). A natural monopoly may be the most efficient way to serve rural areas while ensuring that all customers have affordable service. A natural monopoly normally requires some controls on price so that service is affordable. This may come from customers if they run the company or if there is some other force that makes the monopoly benevolent.

Universal Service

The Act provides for a federal universal service fund. Universal service is the concept that every person should have a telephone. Under the Act, the term "universal service" is an evolving term that takes into account the access every American should have, and that term could include broadband in the future.

The Act creates a joint board that determines federal universal service support. Under the Act, only eligible telecommunications carriers may receive high-cost area federal universal service funds. An eligible telecommunications carrier is required to offer services that are supported by the federal universal service fund. In addition, the Act provides for discounts for educational providers and libraries.

Historically, the goals of universal service have been advanced through a federal universal service fund and through implicit subsidies. Under the Act, the goal of competition is aided by the replacement of implicit subsidies with explicit federal universal service funding. For there to be fair competition, implicit subsidies must be replaced with explicit subsidies.

Under the Act, each state public utilities commission is required to designate a common carrier as an eligible telecommunications carrier for a service area designated by the public utilities commission. Senate Bill No. 2420 (1999) authorized the Public Service Commission to exercise this authority. The Public Service Commission may, in the case of an area served by a rural telephone company, and must, in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier for a service area. Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the Public Service Commission is required to find that the designation is in the public interest.

If no common carrier will provide the universal services, the Public Service Commission with respect to intrastate service must determine which common carrier or carriers are best able to provide the services and is required to order the carrier or carriers to provide the service. The Public Service Commission is required to permit an eligible telecommunications carrier to relinquish its designation if there is more than one eligible telecommunications carrier in the service area.

Nonrural Companies

During the 1997-98 interim, the Federal Communications Commission decided the percentage of universal service support provided by the federal mechanism was to be 25 percent of the cost for providing universal service to high-cost nonrural areas; however, this decision was not made final.

The 75/25 percent split has been dropped in favor of a new mechanism that consists of a two-part methodology that considers both costs of providing support services and a state's ability to support those costs using the state's own resources. Specifically, the Federal Communications Commission completed development of the cost model that will be used to estimate the large telephone company's forward-looking cost of providing service. The federal cost model is for the purposes of determining federal universal service support and is not appropriate for other purposes, such as determining prices for unbundled network elements. In addition, the Federal Communications Commission adopted a methodology that uses the costs generated by the cost model to calculate the appropriate level of support for nonrural carriers serving high-cost areas. The new forward-looking mechanisms use a single national cost benchmark of 135 percent against which all carrier's forward-looking costs of providing supported services are compared to determine their need for support. If a carrier's forward-looking cost of providing service exceeds 135 percent of the national average cost per line, the new high-cost support mechanism will provide federal support for all intrastate costs that

exceed this benchmark. The Federal Communications Commission also adopted a transitional hold harmless measure. During this period, no large telephone company will receive less support under the new high-cost support mechanism than it receives under the existing mechanism. Nonrural carriers in North Dakota do not receive a subsidy nor will they receive a subsidy under the new rules.

The commission received testimony from rural cooperatives concerning the Federal Communications Commission decision and application of that decision to rural cooperatives. The rural cooperatives were concerned that the Federal Communications Commission will cap universal service funding at present levels; that the Federal Communications Commission will adopt a forward-looking cost model instead of one based on actual or historical costs because a forward-looking cost model does not take into account the difficulty and expense of providing telephone service in rough terrain with great expanses; and that the benchmark will be set at a single national cost benchmark of 135 percent. A 135 percent standard of high cost for nonrurals, instead of the previous 115 percent, eliminated some companies, customers, and states from the receipt of federal universal service funds.

Rural Companies

The federal universal service support that exists for rural carriers will not be changed before 2001. The first step is for the Rural Task Force to make recommendations to the Federal-State Joint Board on Universal Service. After the board receives the recommendations, it will make its recommendations to the Federal Communications Commission, which will make the final decisions relating to a rural universal service fund.

The Federal-State Joint Board on Universal Service formed the Rural Task Force from a broad cross-section of the telecommunications industry to provide recommendations on appropriate high-cost universal service mechanisms and policies for areas served by the nation's more than 1,000 rural telephone carriers and those carriers that serve in insular areas. The Rural Task Force released its report on September 29, 2000. In the report, the Rural Task Force made the following recommendations:

1. The recommendations should be implemented immediately and remain in place for a five-year period.
2. The modified embedded cost mechanism should be adopted for sizing the rural carrier federal universal service fund.
3. The synthesis model should not be used for determining the forward-looking costs of rural carriers.
4. A flexible system for disaggregating support should be used to establish the portable per line support available to all eligible telecommunications carriers with timely distributions.
5. States should be delegated responsibility for overview of the use of universal service support in a manner similar to that used for nonrural local exchange carriers.
6. The services included within universal service should be reviewed and a "no barriers to advanced services" policy should be adopted.
7. Modifications to the caps and limitations on universal service funding which currently exist should be enacted, including:
 - a. The high-cost loop fund should be rebased by increasing it to \$118.5 million, grown by an annual factor, and including a safety net;
 - b. The corporate operations expense limitation should be adjusted for growth; and
 - c. A safety valve mechanism should be added to the limitation on support for acquired or transferred exchanges.
8. A set of principles should be used in addressing implicit support in interstate access charges, and high-cost fund III should be created to take the place of any implicit support removed from interstate access.

Eligible Telecommunications Carriers - Wireless Services

The commission heard testimony on the status of wireless service companies as eligible telecommunications carriers. Wireless service has the technical capability to provide competition in rural portions of this state as an eligible telecommunications carrier. Even though technologically possible, however, wireless service does not provide high rates of speed. It is argued that wireless service could reduce the subsidies needed for universal service because wireless service has a lower cost of service in some areas of the state.

The Public Service Commission hearing on whether to give eligible telecommunications carrier status to Western Wireless began on October 29, 1998, and may have been the first hearing of its kind in the nation. The Public Service Commission determined that Western Wireless cannot be an eligible telecommunications carrier. The decision was based on whether the market can handle two competitors and if consumers will benefit from competition. This decision was contrary to a wireless service decision made in Minnesota.

State Universal Service Funds

Section 254(f) of the federal Telecommunications Act of 1996 provides:

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. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

Many states have enacted legislation on universal service after the passage of the Act. The commission received information on the universal service funds in other states, in particular Montana's.

Montana Universal Service Fund

In 1997 Montana enacted temporary legislation that expires on December 31, 2001. The legislation requires that state's public utilities commission to establish and administer a universal service fund that provides affordable services in high-cost areas. The fund must complement the federal fund; be competitively and technologically neutral in funding and distribution; provide specific, predictable, and sufficient mechanisms of support for high-cost areas; and allow for a federal support system for schools, libraries, and health care providers.

The universal service fund must support the following services:

1. Voice grade access to the public-switched network.
2. Dual-tone multifrequency signaling or its equivalent.
3. Single-party service.
4. Access to emergency services.
5. Access to operator services.
6. Access to interexchange services.
7. Access to directory assistance.

Contributions to the Montana universal service fund are collected by the daily administrator on a monthly basis. The amount is calculated by determining the total revenue for all telecommunications carriers from the preceding year and determining the funds needed for distribution for universal service for the upcoming year and then computing the uniform percentage amount of revenue that will produce the desired distribution. The amount is adjusted for the previous year's shortfalls and excesses.

Distributions under the universal service fund are paid to eligible telecommunications carriers that offer the services supported by the fund. The public utilities commission is to calculate the distribution for designated support areas. A designated support area for a rural telephone company is its service areas unless the rural telephone company voluntarily adopts the proxy model adopted by the public utilities commission. A designated support area for all other telecommunications carriers means a geographic area determined by the public utilities commission which must be smaller than a wire center. The amount of support an eligible telecommunications carrier receives is the amount of costs in its designated support area minus the benchmark amount. The public utilities commission determines the benchmark.

If there is an additional eligible telecommunications carrier in a designated support area, the additional carrier has access to the universal service fund on the same basis as the rural telephone company. Both carriers must receive distribution based on the rural telephone company's average cost for each line disaggregated to geographic areas smaller than a wire center. Support for each line is based on the rural telephone company's cost as determined in the equation for the situation when there is only one eligible telecommunications company and distributed to each of the geographic areas on the basis of relative distribution factors established by a cost proxy model adopted by the public utilities commission.

Based on a competitive bidding process, the public utilities commission is to choose a daily administrator for the universal service fund. The daily administrator may not be a telecommunications carrier. The daily administrator has the duties of providing monthly reports and annual audit reports to the public utilities commission. In addition, the daily administrator must make available financial accounts for viewing by telecommunications companies and the public. The public utilities commission may investigate and make orders concerning the accounts and practices of the daily administrator. The administration costs must be paid from the fund.

North Dakota Universal Service Fund

The need for a state high-cost fund is supported by three assumptions. First, it is assumed penetration decreases when the cost of dial tone increases. Second, competition will cause rates to move toward costs. As a result, there will be rate restructuring in which more revenue is received from residential customers. In addition, there will be more revenue from rural areas due to geographic deaveraging. Third, it is assumed that federal support for rural services will not be adequate. The third assumption is the reason the commission reviewed the development of the federal nonrural and rural universal service funds.

There are four reasons why a high-cost fund may not be needed. First, the elasticity of demand for telephone service may not be great. In other words, people may keep their telephones even if prices rise significantly. Second, other programs may be adequate, including Lifeline and Linkup. Third, rate restructuring and deaveraging may not happen. Finally, technology may provide a more cost-effective way to keep a customer connected within a level of affordability.

Although many questions arise concerning the creation of a high-cost fund, there are four basic questions:

1. Are prices for certain services unaffordable for the average customer?
2. Who should contribute to the universal service fund?
3. How will it be determined how much each eligible company will receive in universal service funds?
4. How will the fund be administered?

The Basics

The commission reviewed programs most frequently supported by state universal service funds. Programs supported by state universal service funds include high-cost support; revenue recovery or rate rebalancing; enhanced-911; telecommunications relay service; the Lifeline program; the Linkup program; state support for schools, libraries, and health care facilities; and the provision of special telecommunications equipment for physically challenged individuals. Commission discussion indicated the focus of a state universal service fund should be on a high-cost rural fund, although it was discussed that the universal service fund should help schools and businesses. The commission focused on the creation of a high-cost fund because of the potential need if the federal fund left a revenue shortfall for the companies in the rural areas of this state.

Another reason for creating a state universal fund is to remove implicit subsidies in access rates. The cost of providing local service in rural areas is in excess of what rural cooperatives are charging for the service. The federal universal service fund and access charges provide for profitability and universal service within rural areas. The committee was informed making rural access rates comparable with urban access rates is important to economic development in rural areas; however, rural companies need high access rates if there is not any universal service funding to fill the gap left by lower-access rates.

The commission was informed that on average it takes between 12 to 24 months from legislation until operation of a state universal service fund. Nine months has been the shortest duration of time from legislation to operation. An option provided to the commission was for a statutory mechanism that would allow for the creation of a universal service fund based upon conditions that necessitate the need for a fund, such as an underfunded federal fund.

The commission received testimony on the principles that should guide the commission in creating a state universal service fund. According to a representative from Western Wireless, the core principles of a universal service fund should be as included within the federal Telecommunications Act of 1996:

1. A universal service fund must be competitively and technologically neutral. Universal service support mechanisms should not unfairly advantage or disadvantage any technology or company over another technology or company.
2. Any kind of carrier should be able to be an eligible telecommunications carrier.
3. Subsidies must be portable.

The commission was informed by a representative from MidContinent Communications that nontraditional telecommunications companies should be included when creating a state universal service fund. Legislation creating a state universal service fund should allow for the inclusion of areas of technology that are not traditionally thought of as telecommunication carriers.

The commission was informed by a representative from AT&T that AT&T has five positions in relation to a state universal service fund. These positions are:

1. North Dakota should not create a state universal service fund until there is sufficient evidence of need.
2. If there is a state universal service fund, it should be narrowly targeted to the need.
3. The fund should prohibit double recovery.
4. Access charges should be reduced and based on cost.
5. State universal service funds should be portable.

Contributions

The commission received testimony on contributions to a state fund. Vermont and Texas assess interstate and international revenues as well as intrastate revenues. It appears Vermont assesses these revenues because they were the first universal service fund and have a relatively small area to assess. It appears Texas assesses these revenues because of the need for a large funding amount. In addition, Texas has a history of assessing these sources. Before the universal service fund, Texas had an infrastructure fund that required contributions from the same sources of revenue.

Telecommunications service providers that would have to pay into the fund and not receive moneys from the fund, e.g., cable companies, expressed concern about what percentage of revenues would be required as a contribution. The size of the fund would depend upon the need created by federal action on universal service. Until the Federal Communications Commission makes decisions concerning federal universal service, it will be difficult to determine the percentage of revenues required to produce the amount of income needed for a state universal service fund. Commission discussion included consideration of having a cap placed on the fund to limit the percentage of contribution.

Distributions

Without a formula or benchmark of affordability to determine which telephone lines would receive funding, it is impossible to say how many people would benefit from a state universal service fund; however, even if this information were available, it would be difficult to determine because the concept of the fund is that the funding goes to each line and not to subscribers.

The commission was informed by a representative from Western Wireless that the idea of competition includes the idea of rewarding efficiency and that a state universal service fund should not penalize efficiency or reward inefficiency because it is in the best interest of rural customers to have competition.

Commission discussion indicated that taxpayers should not have to pay the same amount of money to a company that is able through technology to provide lower-cost services as it has to pay to more costly service providers. The amount should be based on cost, and a lower cost to provide a service should result in lower payments under the fund because the purpose of a state universal fund is not to benefit the telecommunications companies but to benefit the high-cost consumers and citizens of this state.

Administration

The commission received testimony on the administration of universal service programs in Arizona, Arkansas, Kansas, Nevada, Oklahoma, Texas, and Vermont by the National Exchange Carrier Association, Inc. (a private not-for-profit corporation). In addition, information was provided on Nebraska and Wyoming.

The commission was informed as to the lessons learned by the National Exchange Carrier Association, Inc., relating to fund implementation and design. The key to good administration of a universal service fund is to have a good working relationship between commission staff and the administrator. In addition, precise definitions make it easy to administer a fund. In particular, the association made the following recommendations.

1. Broad industry participation during fund rulemaking and establishment phases lessens confusion and resistance during implementation.
2. A single collection mechanism for various universal service and other programs (e.g., enhanced-911, telecommunications relay service) simplifies processes and creates cost-efficiencies. Enhanced-911 collections are often incorporated into a state universal service fund. The combination of enhanced-911 funding with universal service funding provides for ease of administration by having one collection system.
3. An assessment based on percentage of revenues, applied to all service providers, ensures contributions are collected in a nondiscriminatory, competitively neutral manner.
4. An assessment of "retail" intrastate-only revenues avoids double assessing. Precise definitions of assessable and exempt revenue categories (pay phone, wireless, vertical services, etc.) clarifies requirements and reduces confusion.
5. A payment-after-collection methodology reduces cash flow fluctuations and decreases the possibility of fund shortfall.
6. Monthly billings and collections of service providers and the establishment of a de minimus threshold to exempt small contributors from assessments or require less frequent payments offer administrative simplicity and reduce costs.
7. Documentation clearly delineating roles of the state regulatory agency staff and the fund administrator streamlines processes and reduces overlaps.
8. The Legislative Assembly or Public Service Commission should define explicit criteria for determining support payments disbursed from the fund.
9. A "contingency factor" should be built into at least the initial funding requirements to offset cash flow fluctuations, cover initial delinquencies, and help account for revenue seasonality during fund startup.
10. The Legislative Assembly should consider developing a fund shortfall payment prioritization plan, which provides the administrator with specific guidelines for prioritizing or prorating payments, if fund requirements exceed collections for a period.
11. Service providers' payments into the fund should not be treated as tax collections and should be held separate from the state's general fund.
12. Public benefit funds are "self-sustaining" so appropriations to "fund the fund" or a legislative-mandated cap on fund size is not required.

State Universal Service Fund Bill Draft

The commission considered a bill draft that would have created a state universal service fund based on Montana's law. The bill draft created a state universal service fund for the purpose of providing funding in case of an underfunded federal universal service fund. In addition, the state universal service fund included an advanced services fund that supports access in high-cost areas to 128,000 baud at rates comparable to urban areas. Any eligible telecommunications carrier, including Qwest, could receive funding; however, nonrural companies would receive funding for high-cost areas without a competitive alternative. The advanced services fund was in addition to and not in conflict with the statewide network under development by the Information Technology Department. The advanced services fund in the bill draft addresses the issue of providing reasonable low-cost service to private businesses, which the Information Technology Department's plan did not address. As such, the fund would encourage economic development.

Interested persons recommended substantive changes to the bill draft. The bill draft went through three drafts. During commission consideration, some of the following recommendations were added to the bill draft, as noted after the recommendation.

The recommendations of the North Dakota Association of Telephone Cooperatives were:

1. The concept of an affordability benchmark should be expanded to give the Public Service Commission some parameters for determining the benchmark. The commission was urged to create a statement or definition that provides for a philosophy in determining the affordability benchmark.
2. The determination of cost should not be limited so as to exclude extended area service.

The recommendations of Western Wireless were:

1. Portability of support should be specifically required.
2. The requirement of providing data service of at least 128,000 baud should be removed because the baud requirement is not technologically neutral. The concept of having a universal service fund is for that fund to support basic service in high-cost areas, and 128,000 baud is a luxury although future changes in technology may make 128,000 baud basic service. The federal fund does not support 128,000 baud, and all urban areas do not have 128,000 baud.
3. The requirement of some usage to the public-switched network should be defined to mean local usage. The bill draft was revised to include this suggestion.
4. The requirement of customer's choice in access to interexchange services should be removed because it is inconsistent with the federal scheme. The commission discussion regarding a customer's choice of interexchange services as a service supported by the fund pointed out that allowing customers to choose their interexchange carriers keeps customers from becoming captive to the local exchange's interexchange carrier of choice. In addition, the state can have requirements different from what the federal government has for the federal universal service fund.
5. Lifeline and toll limitations for lifeline should be added to the list for services supported by the fund.

The recommendations of the National Exchange Carrier Association were:

1. The commission should consider whether to assess retail interstate revenues, which include international revenues.
2. The general policy provisions should be clarified. The bill draft was revised to remove the general policy provisions.
3. The requirement of all funds being transferred to the State Treasurer should be removed for administrative convenience. The committee was informed that the transfer was required by the Constitution of North Dakota.
4. The benchmark should be set on a statewide basis.
5. The calculations for the fund should not be set in statute and should parallel the federal mechanism. The bill draft was revised to include this suggestion.
6. The issue of passthrough of contributions should be specifically addressed in the bill draft.

The recommendations of the Public Service Commission were:

1. The definitions should be reviewed to ensure that those who pay into the fund and collect from the fund are within the purpose of the bill draft. In particular, should the bill draft address private line service as a telecommunications service?
2. The general policy provisions should be reviewed because the provisions are ambiguous and can be interpreted to be contradictory to the specific provisions in the bill draft. The bill draft was revised to remove the general policy provisions.
3. There should be a definition of the need that is required for the Public Service Commission to create a fund. The bill draft was revised to include this suggestion.
4. Access to the supported service of 128,000 baud should be clarified to say whether it is a one-time support for network improvements or an ongoing monthly support of advanced services. The bill draft was revised to include this suggestion.
5. Timeframes should be set in light of the recommendations of the Rural Task Force. The bill draft was revised to include this suggestion; however, it was recommended that the commission consider including a start date for distributions and collections.
6. The costs of administration should be specifically listed, and the draft should include a time for the payment of costs. The

bill draft was revised to include this suggestion.

7. The cost methodology, including processes and timeframes, should be consistent with the federal fund if the state fund is meant to complement the federal fund. The bill draft was revised to include this suggestion. In addition, the commission should consider addressing the problem of referencing the federal methodology in that the methodology may change after the adoption of the Act.
8. The commission should consider including an upper limit to the size of the fund.
9. The commission should consider specific provisions for passthrough of charges to customers.
10. The commission should consider giving the Public Service Commission more jurisdiction over the bill draft, especially regarding the billing for, payment, and collection of contributions.

The commission was informed there are two different ways in which the state could provide provisions different from federal law. First, the state could provide a different administrative procedure. The committee was informed it is very important to use the same administrative procedure as federal law because of administrative convenience; the Public Service Commission would be unable to manage the fund unless it copied the federal fund; and telephone companies could do exactly what they do for the federal fund and send a copy of that paperwork to the state, thereby providing administrative convenience to telephone companies. Second, the state could have a policy decision different from the federal law. The bill draft differs from federal law in providing advanced services and by having the distribution based upon each carrier's cost. The bill draft provides for two different ways to determine subsidies when there is competition in a rural area. The commission was informed that this conflicts with Section 254(f) of the federal Act and with the concept of portability. Under the federal Act, if you win a customer, you get the subsidy.

According to a representative of AT&T, in light of the Rural Task Force recommendations, no fund is needed to complement the federal fund. If the recommendations are adopted by the Federal Communications Commission, there will be more money, more services covered, and more state control of that money. The representative argued that the provision of 128,000 baud is an economic development policy and should be supported by a general tax, not a tax on telecommunications service providers. In addition, the advanced services fund should not refer to 128,000 baud because it is suggestive of supporting integrated services digital networks and therefore is not technologically neutral. Other advanced services include variations of digital subscribers, cable, satellite, and wireless.

Arguments regarding the inclusion of 128,000 baud as a service funded by the state universal service fund pointed out that the requirement of 128,000 baud is meant to encourage high-speed Internet access to the rural areas of this state because access to the Internet is no longer a luxury. In two years, 128,000 baud will be an inadequate advanced service. It was said a baud rate of 128,000 would provide a minimum standard for fairness between urban and rural areas and is intended to be technologically neutral. The argument was made that this state can and should be more progressive than the federal universal service fund.

Arguments also pointed out that the residents of cities have to pay for high-speed data services, and it would be unfair for city residents to have to pay for high-speed data services for rural areas through the fund. It was countered that the subsidy for the 128,000 baud in the bill draft is intended for the line, not for the service. The intent under the bill draft was for people to pay for the service at a rate comparable to urban rates.

The commission considered and adopted an amendment to clarify that the advanced services fund operates independently from the existence of the basic universal service fund.

The commission considered but did not adopt an amendment to the bill draft that would have required rates of at least 115 percent of urban rates for those in rural areas before there is eligibility for universal service funding. The amendment was intended to require customers in rural areas to pay a little more than what urban customers pay to be able to take advantage of a subsidy. It was agreed that requiring rurals to raise their rates to 115 percent of those rates charged in urban areas would only be symbolic because the extra revenue would be passed back to cooperative members in most rural areas. In addition, the commission considered setting a minimum benchmark at 115 percent of urban rates. Discussion pointed out that finding a benchmark is part of creating a universal service fund; however, setting price is traditionally not part of a universal service fund.

The commission considered but did not adopt an amendment that would have limited local rates to a maximum of a 10 percent increase for universal service funding. Whether a limit would need to be placed on the fund is unclear because the Federal Communications Commission has not made a decision based upon the Rural Task Force recommendations. Commission members pointed out that the Legislative Assembly would be able to put a cap on the fund and would have better information when it meets than is available at present.

The commission considered and adopted an amendment to base, in part, a company's claim from the fund on excluding costs equivalent to 115 percent of rates charged in urban areas. The amendment would not require rural customers to pay more than urban customers.

Conclusion

The commission makes no recommendation regarding a North Dakota universal service fund. Although commission discussion indicated support for the philosophy in the bill draft that was considered, and some members supported the bill draft as a tool for dialogue and debate in the next legislative session, others were not satisfied with the bill draft because they believed it was too complex or unfair to urban customers.