

NORTH DAKOTA LEGISLATIVE COUNCIL

Minutes of the

REGULATORY REFORM REVIEW COMMISSION

Thursday, April 9, 1998
Harvest Room, State Capitol
Bismarck, North Dakota

Representative Mick Grosz, Chairman, called the meeting to order at 9:00 a.m.

Members present: Representatives Mick Grosz, Eliot Glassheim; Senators John M. Andrist, Joel C. Heitkamp; Public Service Commissioner Bruce Hagen

Others present: See Appendix A

It was moved by Senator Heitkamp, seconded by Representative Glassheim, and carried that the minutes of the previous meeting be approved as mailed.

UNIVERSAL SERVICE - SCHOOLS AND LIBRARIES

At the request of Chairman Grosz, Mr. Mike Jaugstetter, State Librarian, provided testimony on the universal service fund for schools and libraries. A copy of his testimony is attached as Appendix B. In addition, he distributed a handout on the March 31, 1998, meeting of the United States House Commerce Committee hearing on universal service for schools and libraries. A copy of this handout is on file in the Legislative Council office.

In response to a question from Representative Grosz, Mr. Jaugstetter said the original funding for schools and libraries was set at \$2.5 billion. He said this amount has been reduced to \$625 million for a trial period of six months. He said some members of Congress think the Federal Communications Commission has overstepped its authority by creating the School and Library Corporation and by allowing funding for hardware. He said schools and libraries in North Dakota have applied for several million dollars in funding. He said no funds have been distributed.

Commissioner Hagen said there is an April 15, 1998, deadline for fund applications. He said money will be distributed after that date.

Representative Grosz said some telephone companies are including a charge for the schools and libraries fund as a separate line item on customers' bills. He said this has caused some embarrassment for certain politicians in Washington, D.C. He said some people are calling the

universal service fund for schools and libraries a tax and entitlement program.

UNIVERSAL SERVICE - OTHER STATES' LEGISLATION

At the request of Chairman Grosz, commission counsel presented a memorandum entitled *State Universal Service Funds Created After the Federal Telecommunications Act of 1996*.

In response to a question from Senator Heitkamp, commission counsel said the consistent theme among the states is empowering their public utilities commissions to develop and administer a universal service fund. He said the states vary greatly, however, in the amount of detail the empowering legislation contains.

COMPETITION

At the request of Chairman Grosz, Mr. Charles E. Johnson, Counsel, Public Service Commission, presented testimony on a report from Ostrander Consulting on the level of competition faced by U S West and on what would be sufficient competition for the deregulation of U S West. A copy of his testimony is attached as Appendix C. A copy of the report by Ostrander Consulting is on file in the Legislative Council office. He also provided a handout from the universal service cost study which provides cost information based on all the wire centers in North Dakota using capped numbers. A copy of this handout is on file in the Legislative Council office.

In response to a question from Representative Grosz, Mr. Johnson said all of the universal service funds described in the memorandum presented by commission counsel complement the federal fund. He said it appears the state funds would not be activated until the beginning of operation of the federal fund.

In response to a question from Representative Grosz, Mr. Johnson said the Ostrander report concluded that in this state resale is not competition. He said there are no facilities-based local exchange competitors in this state. He said

competition must be evaluated on a facility-by-facility basis.

Representative Grosz said the report is based on prices going down with competition. He said if prices are artificially low because of subsidies, prices would have to rise for there to be competition.

In response to a question from Representative Grosz, Mr. Johnson said it is unknown if prices are below cost. He said what costs are is the first question to be answered. He said the second question is who should bear which portions of costs.

In response to a question from Representative Grosz, Mr. Johnson said if U S West is deregulated too early, it would be an unregulated monopoly in the local exchange market--prices could be increased and customers would have no recourse. He said there would be no check on pricing by competition or by the Public Service Commission.

Representative Grosz said if U S West is deregulated and if U S West raises its prices, competition would be able to undercut the incumbent and enter the market.

In response to a question from Representative Grosz, Mr. Johnson said competition will come to a market if it is easy to compete. He said facilities-based competition requires a great amount of money. He said the deregulation of the trucking industry worked well because a person could get into the trucking business for \$5,000. He said a person could get out of the trucking business easily because trucks are easily marketable. He said these concepts do not apply to telephone companies. If a company builds a facility and it fails, he said, that company cannot recoup its losses easily through selling its facilities.

Representative Grosz said if prices are artificially low, competition will never come to the local exchange telecommunications industry.

In response to a question from Representative Grosz, Mr. Johnson said the question as to whether prices are artificially low has yet to be answered. He said it is important to break down costs over a sufficiently small enough area because if the area is too large, there are implicit subsidies in that area.

Senator Andrist said it is necessary to have true universality. He said there should not be a rush to competition at the expense of universality.

In response to a question from Senator Heitkamp, Mr. Johnson said state law allows the Public Service Commission to deregulate U S West. If the Legislative Assembly does not make any legislative changes, he said, the Public Service Commission could still function as to the

deregulation of U S West. He said AT&T had to lose one-half of the market share before they were completely deregulated by the federal government. Until AT&T lost a sufficient amount of the market share, i.e., there was competition, he said, the other companies offering long distance tracked the prices that AT&T offered to the public. He said competition was not present until the other companies were strong enough to offer something better than AT&T.

In response to a question from Senator Heitkamp, Mr. Johnson said the federal Telecommunications Act of 1996 allows the commission to protect rural companies from competition. He said there has not been a request to compete through interconnection with a rural company in this state.

In response to a question from Senator Heitkamp, Mr. Johnson said the federal law does not protect U S West from "cherry picking." He said there is protection in state law for U S West because they can increase rates to meet revenue needs through an application to the Public Service Commission.

Commissioner Hagen said if you deregulate a monopoly the price for the services offered by the monopoly will rise. He said the concept of regulating competition is odd and may not result in perfect administration.

In response to a question from Representative Grosz, Mr. Johnson said the Ostrander report does not list wireless as a competitor of U S West. He said the report is limited to the present-day status of competition. He said wireless may be a competitor in the future.

UNIVERSAL SERVICE - COST HEARING

At the request of Chairman Grosz, Mr. Johnson presented testimony on the recent universal service cost hearing held before the Public Service Commission. A copy of his testimony is on file in the Legislative Council office.

In response to a question from Representative Grosz, Mr. Johnson said implicit subsidies are not shown in the dollar amount figures in Appendix 2 of his testimony. He said the dollar amounts are costs and not prices. He said cost includes profit.

In response to a question from Representative Grosz, Mr. Johnson said long-distance access costs are located in the switch and in the rest of the system based upon how costs are allocated. He said the federal separation method allocates 25 percent of the local loop to interstate access. He said local exchange carriers charge between 3 and 18 cents for local access. If the rate charged for access is 18 cents, he said, almost

17.6 cents of the cost of local access would be an implicit subsidy. He said this number is based on the incremental cost of access to the switch.

In response to a question from Representative Grosz, Mr. Johnson said a person must figure out the proper level of allocation to assess access charges for the local loop cost. He said the federal universal service support level benchmark is \$31. He said the Public Service Commission does not need to look at the allocation of costs for the universal service fund because the Federal Communications Commission looked at the total revenues up to \$31.

Representative Grosz said the statement that any cost over incremental cost is a subsidy is incorrect.

In response to a question from Representative Grosz, Mr. Johnson said the universal cost study was not for determining costs in the local exchange market. He said the benchmark is high enough for the allocation of costs not to be an issue.

In response to a question from Representative Grosz, Mr. Johnson said he is not saying that interexchange carriers are not responsible for support of the local loop. For the purposes of universal service, he said, the \$31 level of support set by the Federal Communications Commission does not deal with the issue of allocation.

Representative Grosz said under the current 75/25 percent split for universal service costs, this state will be responsible for 75 percent of the amount of costs over \$31. He said interexchange carriers can be required to pay their fair share of this amount.

In response to a question from Senator Heitkamp, Representative Grosz said interexchange carriers cannot terminate or originate a telephone call without a local exchange carrier. He said an interexchange carrier should pay for a portion of the loop, not incremental costs.

In response to a question from Representative Glassheim, Mr. Johnson said 25 percent is the share of the local loop for which an interstate interexchange carrier is responsible under the federal universal service fund. Before universal service, he said, access was and is relatively high-- between 10 and 15 cents on average. After universal's service, he said, there will be a surcharge that will remove the need for high access prices. He said some customers will pay more under universal service than they did with high access. He said these customers are the ones that did not use long distance very often.

Representative Grosz said if access is 15 cents before universal service and 10 cents after universal service, plus five cents surcharge, the

end result is either there will be a high tax or high rates. He said access at 15 cents under his example includes the reasonable cost of the local exchange carrier to originate and terminate a long-distance toll call.

In response to a question from Representative Grosz, Mr. Johnson said the average collection per line for U S West is approximately \$35 a month. He said this is what a phone bill would be if all the subsidies were taken out. Although \$35 per month seems to be a high cost, he said, this amount includes many extra services including all vertical services, intralata toll, and access termination and origination.

In response to a question from Senator Heitkamp, Mr. Johnson said the 75/25 split is not an absolute and the actual split will be known by the end of the year. He said the federal fund must be in place by the end of the year.

In response to a question from Representative Grosz, Mr. Johnson said eligible telecommunications carriers in this state will receive the 25 percent split for the portion of the local exchange which is used for interstate service from the federal universal service fund regardless of the formation of a state fund.

Mr. Johnson said the deadline for the state to propose a model for universal service for U S West to the Federal Communications Commission is April 24, 1998. He said it would be more sensible for the state to be able to see the Federal Communications Commission's model before adopting a state model. He said the model may be different for rurals from what it is for regional bell-operating companies.

Representative Grosz said it appears that the rules for large telephone companies tend to trickle down to the small companies.

UNIVERSAL SERVICE THROUGH PRESENT ACCESS RATES

At the request of Chairman Grosz, Mr. Jan Sebby, Rural Telephone Group, presented testimony on leaving intrastate access rates at present levels to accomplish a policy of universal service. A copy of his testimony is attached as Appendix D.

In response to a question from Senator Andrist, Mr. Sebby said the federal universal service fund for rurals will not take effect for three years.

UNIVERSAL SERVICE - PUBLIC SERVICE COMMISSION

Ms. Susan Wefald, Public Service Commissioner, said Mr. Johnson's answers to questions

are Mr. Johnson's answers and not necessarily the answers of the Public Service Commission. She said the commission makes decisions based upon the advice of many staff members, including Mr. Johnson.

In response to a question from Senator Andrist, Ms. Wefald said the Public Service Commission has not ruled out the option offered by Mr. Sebby.

Senator Heitkamp said the Public Service Commission has the staff with the expertise in telecommunications and regulatory duties relating to telecommunications, so the commission should be discussing and making recommendations to the Regulatory Reform Review Commission.

Commissioner Hagen said the Public Service Commission needs the funds, staff, and law to do its job. He said the Public Service Commission has very limited funds.

UNIVERSAL SERVICE - U S WEST

At the request of Chairman Grosz, Ms. Barb Allgaier, Staff Manager, Public Policy, U S West Communications, presented testimony on universal service fund issues. A copy of her presentation is attached as Appendix E. She provided a handout of a color-coded map of the United States which shows the 1990 population density by county. She provided handouts of maps of North Dakota, the Bismarck area, the Crosby area, the Fargo area, the Hankinson area, and the Regent area, which color code the monthly cost of service. A copy of each handout is on file in the Legislative Council office.

In response to a question from Representative Grosz, Ms. Allgaier said if the Public Service Commission adopts a state specific interstate model for the universal service fund, then the same model must be used for the intrastate fund. She said U S West is under competitive pressure to lower intrastate access rates.

In response to a question from Representative Grosz, Ms. Allgaier said implicit supports are included in toll calls, business service, access rates, and rate averaging. She said U S West access rates are based on a statewide average. She said U S West needs to be able to deaverage these rates and lower prices to meet competitive pressures in the cities. She said the support for the local loop which is in access would be better provided through an explicit fund.

In response to a question from Senator Heitkamp, Ms. Allgaier said the time for the removal of implicit subsidies must be at the same time as the addition of explicit subsidies. She said the

cost for universal service for U S West is computed by comparing cost to a benchmark. She said the benchmark is a mark of affordability for a new customer.

UNIVERSAL SERVICE - AT&T

At the request of Chairman Grosz, Mr. Gary Witt, Senior Attorney, AT&T Corporation, presented testimony against the creation of a universal service fund for U S West without access reform. A copy of his testimony is attached as Appendix F.

In response to a question from Representative Grosz, Mr. Witt said it appears the payment of incremental cost would cover the cost of providing access. He said any additional payment would be a subsidy. He said incremental costs are the only costs AT&T should pay for access because the cost of the local loop is caused by a customer subscribing to a local exchange carrier for local service. He said the additional service to call outside the exchange area is incremental. He said the more common telephone call is a local call. He said there are quantitative and qualitative differences between local and long-distance calls.

Representative Grosz said incremental costs do not make sense when used to figure out the charge for renting out an extra bedroom in his basement. He said it does not make sense that because the room is there anyway he should only be able to charge incremental costs for the room.

In response to a question from Representative Grosz, Mr. Witt said the bedroom analogy has difficulties because up until the time of the room rental there has not been a monopoly on rooms for the last 70 years. He said a more appropriate analogy would be of a monopolistic landlord that did not allow tenants of upstart landlords on the monopolist's property.

In response to a question from Representative Grosz, Mr. Witt said AT&T would not use incremental costs for a long period of time. He said there would be a shift to overbuilding on the physical plant. When there is competition, he said, AT&T will pay whatever the competitive market is for access. He said AT&T has spent billions of dollars to get into the local exchange market. He said AT&T has not been able to get into the local exchange market for all the money spent.

In response to a question from Representative Grosz, Mr. Witt said the focus should not be on how much AT&T has to pay for access, but on how much customers have to pay for access. He said the issue is at what point should a

long-distance customer be footing the bill for a local exchange customer making local calls. He said the local exchange customer should pay for the local exchange.

Senator Andrist said he should not have to subsidize telemarketers with incremental costs for access.

In response to a question from Senator Andrist, Mr. Witt said telemarketers are paying their fair share of the local exchange costs for the local exchange in which they are situated. He said to the extent the local exchange is being paid beyond incremental costs, the local exchange is being subsidized.

In response to a question from Senator Heitkamp, Mr. Witt said AT&T is exploring the option of using highway right of way to place fiber optics in the ground. He said the right-of-way issue has nothing to do with AT&T getting into the local exchange market. He said the purchase of right of way is done on the open market in a rural area. He said there is more than one way to connect two points and there are many competitive offerings.

Commissioner Hagen said it is his understanding that the Governor and AT&T will meet again to discuss the right-of-way issue. He said the Public Service Commission does not have jurisdiction over right of way.

In response to a question from Representative Glassheim, Mr. Witt said the difference between the benchmark cost proxy model and the Hatfield cost model includes differences in inputs and the way the inputs are processed. He said the Hatfield cost model attempts to pinpoint customer locations and process its figures based on the lowest cost, highest technology telephone service for these customers. He said this model is much better than the benchmark cost proxy model. He said the benchmark cost proxy model has proprietary information that cannot be verified through independent sources.

Chairman Grosz adjourned the meeting at 4:00 p.m.

Timothy J. Dawson
Commission Counsel

ATTACH:6