

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Nebraska) Application No. NUSF-28
Public Service Commission, on its)
own Motion, Seeking to Conduct an) FINDINGS AND CONCLUSIONS
Investigation of Intrastate Access)
Charges for Rural ILECS.)
) Entered: November 26, 2002

APPEARANCES:

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BY THE COMMISSION:

1. By order dated April 23, 2002, the Nebraska Public Service Commission (Commission) initiated proceedings in the above-captioned docket, on its own motion, seeking to conduct an investigation of intrastate access charges for rural incumbent local exchange carriers (ILECs). Notice of the application was published in The Daily Record, Omaha, Nebraska, on April 29, 2002.

2. Pre-filed direct testimony was filed by AT&T Communications of the Midwest, Inc., (AT&T); Qwest Corporation (Qwest); The Nebraska Rural Independent Companies (the Rural

Independent Companies)¹; Sprint and Western Wireless Corporation (Western Wireless). Rebuttal testimony was filed by each of the aforementioned parties. The NICE-BCS Group (NICE-BCS)² did not file testimony, however, it was represented at the hearing on this matter and filed late-filed comments on November 20, 2002, opposing the elimination of the CCL charge.

3. A prehearing conference was held in the Commission Hearing Room on June 4, 2002. A prehearing conference order was entered by the hearing officer on June 11, 2002. On September 11, 2002, the hearing officer ruled that pre-filed testimony on the intrastate subscriber line charge was beyond the scope of this proceeding. Parties were, however, permitted to discuss basic local rates as set forth in question 4E in the Order initiating this docket. On September 17, 2002, a hearing was held in the Commission Hearing Room in Lincoln, Nebraska with appearances as listed above.

E V I D E N C E

4. Seven witnesses testified for the various parties during the course of the hearing. The pre-filed direct and rebuttal testimony of the seven witnesses was offered and received into evidence as Exhibits 3 through 8, and Exhibits 11 through 17.

Rural Independent Companies:

5. Mr. Steven Watkins, a Consulting Partner in the firm of Kraskin, Lesse, & Cosson, called for the Rural Independent Companies (RIC), testified first. Mr. Watkins provides telecommunications management consulting services and regulatory assistance to smaller local exchange carriers (LECs). His firm filed a petition for reconsideration of the FCC's MAG Order.³ It is

¹ The Rural Independent Companies for the purpose of this proceeding consist of Arlington Telephone Company, Blair Telephone Company, Cambridge Telephone Company, Clarks Telecommunications Co., Consolidated Telephone Inc., Eastern Nebraska Telephone Company, Great Plains Communications, Inc., Hamilton Telephone Company, Hartington Telecommunications Co., Inc., Hershey Cooperative Telephone Company, Inc., Hooper Telephone Company, K & M Telephone Company, Inc., Nebcom, Inc., Nebraska Central Telephone Company, Northeast Nebraska Telephone Company, Pierce Telephone Co., Rock County Telephone Company, Pierce Telephone Co., Rock County Telephone Company, Stanton Telephone Co., Inc., and Three River Telco.

² The NICE-BCS group for the purpose of this proceeding consists of the following rural independent local exchange carriers: Arapahoe Telephone Company, Benkelman Telephone Company, Inc., Cozad Telephone Company, Curtis Telephone Company, Dalton Telephone Company, Diller Telephone Company, Elsie Communications, Glenwood Telephone Membership Corporation, Hartman Telephone Company, Hemingford Cooperative Telephone Company, Keystone-Arthur Telephone Company, Mainstay Communications, Inc., Southeast Telephone Company and Wauneta Telephone Company.

³ See Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166 (released November 8, 2001)(MAG Order). Commonly also referred to as the "MAG Plan" or "MAG decision".

the rural independent companies' view that maintaining reasonable access charge levels with the current intrastate access rates is the prudent plan. Mr. Watkins testified that a simple reliance on the mirrored interstate approach, which would follow the result of the MAG decision adopted by the FCC would not achieve a proper policy balance for rural users in Nebraska. Rather, the MAG decision is an arbitrary approach that attempts to follow the CALLS⁴ proceeding, was a voluntary plan agreed to by the carrier participants. No record was established in the CALLS Order to serve as a basis for conclusions on specific costs of access or whether any particular rate contains a component of subsidy. Following the MAG decision would result in basic monthly rate increases for rural users without any tangible benefits. The rates for long distance service will no longer include any contribution to interstate common line cost recovery under the MAG Plan. Interexchange carriers cannot provide long distance service without local network common lines. Apart from the problems with the MAG plan, mirroring the interstate access rates would be mathematically and conceptually wrong because the interstate rates that most of these companies charged or developed on an average basis. Mr. Watkins stated that the MAG order is contrary to public interest because it could cause an increase in basic rates, it concludes that LECs should be prohibited from recovering any portion of the common line costs from other sources, it shifts common line cost recovery to new and uncertain sources which will result in an unstable cost recovery mechanism, it shifts traffic sensitive costs to non-traffic sensitive recovery sources, and it will force access rates to levels below the rational consideration of the rural LECs actual costs. The CCL charge is a reasonable charge and should be maintained.

6. Upon cross-examination, Mr. Watkins stated that he believes the FCC approach in access charge reform is extreme. His clients are being made-whole by the MAG Order at the present time. He further stated that there may be some middle ground approach.

7. Ms. Sue Vanicek, a senior consultant for Telec Consulting Resources, also testified on behalf of the Rural Independent Companies. Ms. Vanicek provided that the Commission has the discretion to reduce access. Neb. Rev. Stat. § 86-1404(7) contains permissive language and therefore, it is not mandatory for the Commission to reduce access charges. The Commission is also required to keep local rates affordable.

8. Ms. Vanicek testified that the proper method for determining whether implicit subsidies exist in access rates is the stand-alone cost test. This test calculates the sum of all costs

⁴ See Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, its Report and Order in CC Docket No. 99-249 and its Eleventh Report and Order in CC Docket No. 96-45 (released May 2000)(CALLS Order).

associated with the production of a service in a single product firm. Ms. Vanicek testified that common sense indicates that there are no implicit subsidies in the current access charge structure. Therefore, the Commission does not need to shift any current access charge costs to NUSF support.

9. In Ms. Vanicek's opinion, the CCL is not an implicit subsidy. The loop is a joint cost as it is used in the provision of both basic local exchange service and access service.

10. Ms. Vanicek further testified that the long distance market does not meet the economist's definition of a competitive market. There are only a few suppliers that provide a significant proportion of the total supply of long distance services. In her opinion, the data on long distances rates indicates that access reductions are not flowed-through evenly by customer class. It is difficult to determine whether access reductions are being flowed-through to end user subscribers. The data indicates that Nebraska residential customers have not received the same reductions in toll rates as business customers and are already paying local service rates above the national average.

11. Upon cross-examination, Ms. Vanicek admitted that she did not know what her client's average or composite CCL access rates were at this point. However, two cents is the cap according to the ordered transition plan. She did not know what the interstate CCL rate was at this point. At the interstate level, however, the cost recovery for CCL will be moved to support a component called the interstate common line support. There will be no CCL rate charged to carriers. Ms. Vanicek testified that she has never reviewed or analyzed a stand-alone cost study. She has not seen a stand-alone cost study filed anywhere. However, the FCC has a stand-alone cost standard in their UNE pricing. She did not provide a stand-alone cost study for any purpose within this particular docket. Ms. Vanicek stated that she did not need to provide a study because she does not think that the revenues provided by access plus the revenues derived from local exchange service, exceeded the stand-alone cost of providing access.

Western Wireless:

12. Ms. Suzie Rao, Regulatory Counsel for External Affairs for Western Wireless testified next. Ms. Rao testified that Western Wireless favored access reductions which were consistent with the MAG Order. The fact that there is a significant difference between interstate access rates and intrastate access rates, evidences that implicit subsidies do exist. Rural incumbent access rates are not based upon their cost of providing access service. At the present time, rural ILECs are receiving substantial implicit subsidies that competitive eligible telecommunications carriers (ETCs) do not receive. Another way to

identify the implicit subsidies, according to Ms. Rao, is to compare access rate levels with the output of a forward-looking cost model.

13. In her opinion, there is no public policy justification for establishing discriminatory rate levels for interstate and intrastate access charges. By eliminating implicit subsidies, the Commission is taking steps to enable competition in the local market. The reduction in access charges will spur competition in the intrastate toll market to the benefit of consumers. Wireless services are already providing customers with the choice of bypassing the traditional network altogether. Western Wireless argues that the Commission is preempted from setting access for CMRS ETCs.

Sprint:

14. Mr. James Appleby, Senior Manager of Regulatory Policy for Sprint/United Management Company, representing the interests of Sprint Communications Company L.P. and United Telephone Company of the West d/b/a Sprint (Sprint), testified in pertinent part, that the current subsidy system cannot be sustained in a competitive market. Sprint believes that the cost standard for determining whether a service is providing a subsidy is the forward-looking incremental economic cost standard. Sprint further believes the prices for switched access services should approximate the cost of reciprocal compensation since the same network components are provided to the terminating carriers for both types of traffic.

15. The use of the loop and line-card to connect a call from a long distance provider and an end-user are incurred when the customer purchases local exchange service and do not vary based on usage. The FCC has also concluded that the local loop and the line card are non-traffic sensitive costs. Therefore, Sprint believes the non-traffic sensitive costs of the local loop and the line card, allocated to the intrastate access services, should no longer be recovered from minute of use access services billed to interexchange carriers. According to Sprint, these costs should be recovered on a per-line basis from the end-user customer. Sprint argues the Commission should also require ILECs to adjust the rate level of the true access services, transport and switching because these services are also priced much higher than their economic cost.

16. Sprint recommends that the Commission provide that if any ILEC believes its interstate rates are not an appropriate proxy for its intrastate rates, the carrier has the obligation and the opportunity to file economic cost studies for Commission review to prove the true intrastate access service costs.

17. Upon questioning, Mr. Appleby testified that he was not aware of anything that has been established in Nebraska as the cost standard to determine a cross-subsidy. Mr. Appleby could not commit to Sprint's long distance pricing decisions, however, the likelihood that Sprint would need a pricing differential for intrastate toll, in comparison to interstate toll rates, would be greatly reduced if the CCL rate of the rural ILECs was eliminated.

Qwest:

18. Mr. Scott A. McIntyre, Director of Product and Market Issues for Qwest Corporation, testified that Qwest believes the rural ILECs should reduce switched access rates on a revenue neutral basis to mirror interstate rates. Historically, high access charges have been used to keep basic local prices low. Access charges are a public policy subsidy. Qwest believes that a number of benefits would result including reducing the incentive for uneconomic bypass of the switched network, eliminating customer confusion due to varying rate plans, the removal of economic penalties for carriers that rate average their toll plans, eliminating toll usage-rated support for end-user NTS flat-rated costs, and by eliminating the hidden support that all users of the network pay but in various and incalculable ways, providing balanced support for universal service on the interstate and intrastate levels.

19. Qwest asserts that the only rate element that represents pure implicit subsidy is the CCL. Beyond the CCL, there can be a great debate as to whether rural ILEC's current intrastate switched access charges contain implicit subsidies. The Commission should use FCC rates as a benchmark to measure the subsidy.

20. Qwest further asserts that the approach taken by the rural independent companies is unreasonable. Moreover, Qwest argues that rates can contain subsidies even if rates are below stand-alone cost. In addition, stand-alone costs are difficult to calculate since they generally involve optimized stand-alone networks for services that would never be supplied in isolation.

21. Upon questioning, Mr. McIntyre testified that his argument with respect to uneconomic bypass relates to both originating and terminating access. The Commission's job ultimately is to protect consumers and not competitors.

22. Mr. Harry Shooshan III, a principal and co-founder of Strategic Policy Research, Inc., a public policy and economics consulting firm, was presented as a rebuttal witness on behalf of Qwest. Mr. Shooshan III testified that the existing rate price disparities are not cost-based. They are based solely on the jurisdictional nature of traffic transmitted rather than on any differences in the network functions involved in handling that

traffic. If the Commission does not continue to reduce access consistent with federal policy, ultimately the arbitrage activities encouraged by the existing rate structure will cause that rate structure to collapse.

23. The issue for the Commission is not whether it likes or does not like a particular decision of the FCC, but what the Commission needs to do to carry forward in a very progressive path to complete the work that this Commission started. Mr. Shooshan encouraged the Commission to "stay the course", meaning reduce intrastate access charge levels to mirror interstate rates. The FCC has been clear on access charge reform and has not changed its course based on partisan beliefs. The idea that we can have different prices for what is essentially the same network function is no longer sustainable.

AT&T:

24. Mr. Cory Skluzak, Manager for Local Services and Access Management in AT&T's Western Region Network Division took the position that rate elements, without cost basis such as the CCL, should be eliminated. The Commission should set rates at economic cost without reliance on the NUSF as a revenue "make whole" mechanism. Nebraska's intrastate access structure should be aligned with the interstate structure. AT&T believes that the identification and measurement of alleged subsidies is not a necessary step in the process of implementing further access reform. Empirical evidence in Nebraska reveals that consumers view toll services to be as socially valuable as local service. Mr. Skluzak asked why voice customers making calls over certain distances be singled out to pay inflated prices that other calling groups are not singled out to pay. The CCL should be set at zero because it has no economic cost. AT&T's position is that the local loop is not a joint and common cost. Therefore, the rural ILEC should not recover any portion of the joint and common costs of the local loop through access charges.

25. Upon questioning, Mr. Skluzak did not know whether AT&T's access charge reductions are passed-through in an averaged fashion similar to Sprint. He is not part of AT&T's pricing and marketing division.

O P I N I O N A N D F I N D I N G S

26. This Order addresses the testimony and arguments presented through the pre-filed testimony and at the hearing held on September 17, 2002. Six questions were presented for discussion in the Commission's order initiating this proceeding. The six questions and their subparts were as follows:

2. The current federal and state access charge structures and rates for rural ILECs differ significantly. Accordingly, the Commission requests input on the following issues:

a. Should the Commission, for purposes of state access charges, adopt the interstate access rate structure and/or rate levels for rural ILECs?

b. Does the existing state access charge structure and/or rate levels for rural ILECs contain implicit subsidies? If so, how can the implicit subsidies be identified and measured?

3. The Commission believes that when similar services are priced in a significantly different manner and level, perverse incentives are created. To avoid this situation, if the Commission would adopt a state access charge structure or rate levels different from the interstate jurisdiction for rural ILECs, how can the Commission ensure that access usage is reported and billed correctly?

4. The Commission recognizes that significant changes have occurred in the provision of telecommunications services since the creation of access charges. The widespread availability of wireless, paging, internet and other new telecommunications services have, and will continue to have, a significant impact on the telecommunications landscape and therefore must be taken into account in the development of telecommunications policy. Given that the NUSF surcharge is billed and collected by all telecommunications providers, while access charges are only paid by long distance providers, the Commission seeks input on how, on a going forward basis, costs, traditionally assigned to access charges should be recovered. Specifically:

a. Should any portion of loop cost recovery incorporated in the CCL rate element, in the rural ILEC access charge structure, be shifted to an NUSF component?

b. Should any portion of the recovery of the rural ILECs' local switching costs incorporated in the local switching access charge element, in the rural ILEC access charge structure, be shifted to an NUSF component?

c. Should any portion of the recovery of transport costs associated with the TIC rate element, in the rural ILEC access charge structure, be shifted to an NUSF component?

d. Should any portion of any other rural ILEC access charge element be shifted to an NUSF component?

e. Should any reductions in rural ILEC access charges be recovered through increases in basic rates instead of through NUSF support?

5. In Application No. C-1628/NUSF, Progression Order No. 15, the Commission found that section 332 (C)(3) of the Communications Act of 1934 as amended, preempted this Commission's ability to set or prescribe a CMRS provider's state access rates. At that time, no CMRS provider was designated as an ETC by this Commission. However, now that the Commission expects one or more CMRS providers will be seeking NUSF support, there is an open question as to whether the ETC status changes the Commission's ability to review access rates of CMRS providers which are also designated ETCs. Therefore, in the event that a CMRS provider seeks to draw support from the NUSF, can and should the Commission, as a prerequisite to the receipt of NUSF support, require CMRS providers to either charge the access rates of the competing ILEC or demonstrate that its access rates are cost-based on those lines for which they receive support?

6. Given the existing market conditions of measured toll service, is the requirement to flow-through access charge reductions still appropriate? To what extent should an interexchange carrier that demonstrates to the Commission's satisfaction that its MTS retail price is below its cost for access service be required to flow-through any access charge reductions it may receive?

7. What benefits, if any, can the Commission reasonably expect consumers to realize from further reductions in rural ILEC access charges? In this regard, how can the Commission verify that any access charge reductions required of rural ILECs will be flowed through to Nebraska consumers?

27. Three years ago, the Commission began down the path of intrastate access charge reform by permitting companies to recover lost access through increases in rates and through state and

federal universal service funds. In our C-1628 order entered on January 13, 1999, we found that the intrastate access charge structure for non-rural carriers should approximate the interstate access charge structure . . . " and, further provided that "the state access charge structure should approximate the interstate access charge structure as detailed in this Order." Acknowledging that there are some key distinctions between non-rural and rural carriers, we found that non-rural carriers and rural carriers should be subject to some separate considerations and time lines. Non-rural carriers were required to, inter alia, completely eliminate the CCL charge from their access structure. Rural telephone companies were required to reduce their intrastate access rates over a four-year transition period. The CCL rate element was to be reduced to \$.02 per minute maximum and the traffic sensitive rate elements were to be reduced to the interstate levels of July 1, 1998, with a 1.25 factor for interstate settlements for companies participating in the National Exchange Carrier Association (NECA) pool. However, in our Orders entered throughout C-1628, the progression towards lowering access charges and shifting universal service cost recovery mechanisms to explicit sources with respect to all carriers is apparent.

28. As the parties suggested, it is appropriate to look to our statutory framework with respect to the Commission's jurisdiction on access rates found in Neb. Rev. Stat. § 75-609(3) and the Nebraska Universal Service Fund Act at Neb. Rev. Stat. § 86-1401 et seq. Subsection 3 of 75-609 provides in pertinent part,

Reductions made to access charges pursuant to subsection (2) of this section shall be passed on to the customers of interexchange service carriers in Nebraska whose payment of charges have been reduced. The Commission shall have the power and authority to ensure that any access charge reductions made pursuant to subsection (2) of this section are passed on in a manner that is fair and reasonable. The commission shall have the power to review actions taken by any telephone carrier to ensure that this subsection is carried out.

29. Section 86-1404(7) also provides "The implicit support mechanisms in intrastate access rates throughout the state may be replaced while ensuring that local service rates in all areas of the state remain affordable."

30. Both sides made arguments on the issue of whether implicit subsidies exist in the current intrastate access rate structure. All parties presented convincing theories on how to determine and measure implicit subsidies. All parties, with the exception of one, the Rural Independent Companies, recommended that

the Commission mirror the decisions found in the MAG Order. Upon due consideration, we decline to do so at this time. We feel it is more appropriate to be guided by our state public policy concerns. We do find that continued reductions in intrastate access rates and the shifting of these universal service costs to explicit sources are desirable. While we recognize that reductions in intrastate access charges reduces jurisdictional disparities and reduces the opportunities for arbitrage, the Commission is also on record expressing its reservations with respect to the decisions made in the FCC's MAG Order. In our February 8, 2002, letter to Chairman Powell, we stated several concerns with the MAG Order including increasing burdens that the MAG Order places on the NUSF and limitations that will likely result from the MAG Order on investment by Nebraska rural ILECs. Although we have endorsed the FCC's CALLS Order, we find that, at least for the present time, mirroring our findings with those of MAG Order may produce results which would be inconsistent with our universal service goals.

31. We do find sound public policy reasons for eliminating the CCL rate element from the intrastate access structure. The CCL rate element is a per minute charge billed to interexchange carriers for access to the local network loops. The loop is used by local exchange carriers, long distance carriers, wireless carriers and paging carriers and all users of the public switched network should make a contribution to the recovery of costs associated with the loop. However, consistent with our previous determinations in C-1628 and our treatment of the non-rural carriers, we find that the costs associated with the CCL rate element are more appropriately recovered from the NUSF. The rural independent companies argued that the cost of the loop is a joint and common cost which should be recovered on a usage basis. The Commission agrees that this is a joint and common cost, but believes that all telecommunications providers should contribute equitably to the recovery of these universal service costs as set forth in Neb. Rev. Stat. § 86-1404(4). We further find that eliminating the CCL will encourage rational pricing signals and should benefit consumers through lower intrastate toll rates. We conclude that the CCL should be eliminated over a period of two years as follows:

- A. Establish the CCL Element with the following rate cap as of January 2003:
 - Originating Rate Cap = \$.01/min. (Maximum)
 - Terminating Rate Cap = \$.01/min. (Maximum)
- B. Eliminate the CCL Element charge as of January 2004.

32. The rural independent carriers expressed the concern that shifting cost recovery to explicit universal service support may not give them the predictability as required in Neb. Rev. Stat. § 86-1404(5). Their concern is that the NUSF may become an unstable

source of recovery or that support may no longer be available. In the event that the NUSF is not able to meet its funding commitments, companies would in that instance, be permitted to seek approval to increase intrastate access to a reasonable level.

33. The phase down of the CCL element as set forth above, is also based on the premise that revenues of Nebraska rural carriers that result from this phase down will be replaced on a revenue neutral basis with NUSF support consistent with the practices and procedures that are in place to implement the C-1628 order or any future Commission findings with respect to universal service support. The rural ILECs must petition the Commission for any extension of the transitional elimination of the CCL element on or before October 1, 2003, pursuant to the aforementioned situation.

34. With respect to the Commission's question in paragraph 4(b), supra we find that the costs associated with the line cards should, for the present time, continue to be recovered through the rural ILEC's local switching access element. In response to the question and the testimony relating to the TIC cost recovery, we find that the costs that were associated with the TIC have been appropriately moved to other transport rate elements in the C-1628 transition process. To the extent that the MAG Order reassigned the costs associated with the TIC to other cost recovery mechanisms, we find that, for the present time, should not be similarly reassigned in Nebraska. Apart from the CCL access charge element, the Commission finds insufficient evidence of a need to shift or reduce further access charge components at this time.

35. With respect to questions five through seven, we find that no changes in Commission policy or regulatory structure should be made at this time. The Commission may return to these issues at a date later to be determined in this docket.

O R D E R

IT IS THEREFORE ORDERED by the Nebraska Public Service Commission that all rural telecommunications carriers shall comply with all applicable foregoing Findings and Conclusions.

MADE AND ENTERED at Lincoln, Nebraska, this 26th day of November 2002.

NEBRASKA PUBLIC SERVICE COMMISSION
COMMISSIONERS CONCURRING:

Chair

ATTEST:

Executive Director