Agenda Date: June 14, 2002
Item Numbers: Utilities 3 and Utilities 4

Dockets: UT-013058 and UT-023020
Company Name: All Rural Incumbent Local Exchange Carriers
CenturyTel of Washington and Inter-Island

Staff: Bob Shirley, Telecommunications Policy Analyst
Tim Zawislak, Telecommunications Analyst

Recommendation:
Pursuant to the broad authority granted to state commissions by 47 C.F.R. § 54.315, and for the purposes of promoting competition and preserving and advancing universal service, Staff recommends the Commission exercise the authority provided a state commission in 47 C.F.R. 54.315(b)(4) and (c)(5) to require disaggregation and targeting of federal universal service support by rural incumbent local exchange companies and CenturyTel of Washington and Inter-Island at the sub-exchange level not later than June 21, 2002, and when doing so to use the Staff provided multipliers found in Appendix A to this memo.

Background
Designation as an Eligible Telecommunications Carrier (ETC) is the prerequisite for a company to draw funds from the federal universal service fund, including the high-cost fund, administered by Universal Service Administrative Company (USAC). In 1997, the Commission made initial ETC designations pursuant to the federal Telecommunications Act of 1996 (the Act). At that time, the Commission chose to use the method provided in the act to make ETC designations at other than the study area geographic level. Designation at other than the study area level, including designation at the exchange geographic level as chosen by the Commission, required agreement from the Federal Communications Commission (FCC).

In response to the Commission's decision to designate all carriers at the exchange level, incumbent rural local exchange carriers stated a concern that competitors could enter exchanges and seek only those customers that were relatively low cost to serve while taking the exchange average support, thus reaping a windfall of support. To protect against this cream skimming possibility, incumbent rural LECs proposed that support be deaveraged (eventually termed "disaggregated") at the exchange level. The Commission, at the same time it ordered Staff to petition the FCC for agreement with designations of ETCs at the exchange level rather than the study area level, also ordered Staff and the incumbent rural LECs to embark on a process to lead to a deaveraging proposal.

A petition was filed with the FCC in August 1998, seeking agreement with the Commission decision to make exchange-level designations and seeking its approval of the deaveraging proposal that divided each exchange into two zones and apportioned the federal universal service support within each zone.[1] That petition was granted September 9, 1999.[2]

Subsequently, the Rural Task Force established by the FCC recommended that the FCC require all rural incumbent LECs to choose to deaverage or not, and to maintain that choice for at least four years. In May, 2001, the FCC adopted 47 C.F.R. § 54.315 and required rural incumbent LECs to choose one of three disaggregation approaches within 270 days; the rule was subsequently amended to fix the date for the choice as not later than May 15, 2002. Also in the period between 1997 and May 2001, the FCC revised its rules for support on a number of occasions with the ultimate result that support for service in high-cost locations would no longer be a zero sum game that had meant a competitor could reduce the support available to an incumbent. It changed its rules so that all competitors would receive support on a per-line basis equal to the support received on a per-line basis by the incumbent.[3]

Subsequent to FCC adoption of the disaggregation requirements in 47 C.F.R. § 54.315, Commission Staff contacted rural ILECs and United States Cellular Corporation and invited them to discuss the disaggregation requirements. Staff met with representatives of companies on July 10, 2001, less than two months after the FCC released the relevant Report and Order. After the discussions on that date, Staff and company representatives agreed to another meeting on September 10, 2001, to continue discussions. Rural ILECs broke off the discussions with Staff by letter dated September 5, 2001, in which they stated it was too early in the process for development of an industry-wide position and that company-by company decisions were anticipated. Only a few informal contacts were initiated by Companies prior to filing their disaggregation selections in May, 2002. Subsequent to the filings, Staff proposed meeting with company representatives.

On June 7, 2002, Staff met with representatives of rural ILECs and discussed their petitions, the methodology used by the two companies that chose disaggregation below the study area geographic level, and discussed Staff's concerns that their choices could have on present and future competition and the sufficiency of universal service support

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[1] Deaveraged amounts were calculated at the wire center level in 1998, and that is also the case with Staff's calculations provided in the Appendices to this memo. Because 112 exchanges out of 116 involved in the deaveraging contain only one wire center, however, Staff has chosen for the sake of simplicity in this memo to refer to "exchanges" rather than "wire centers." The Commission has maps of exchanges filed by carriers but does not have maps of wire centers and it will be easier for those who do not have access to company wire center maps to understand the process and outcomes if it is expressed with reference to exchanges. The FCC in its rule permits disaggregation at the wire center and sub-wire center level and the detailed technical work has been conducted with respect to wire centers.

[2] See Docket No. UT-970380.

[3] The result of this federal policy is to continue supporting every access line used by customers. In high-cost (low-revenue) locations, all lines are supported. This is the case whether the customer subscribes to the incumbent, a competitor, or to both. For example, there is support for 10 lines for a real estate agent in Kalama whether it subscribes to 10 from the incumbent or six from the incumbent and four from United States Cellular Corporation.

for competitors and would-be competitors. At the end of the meeting, Staff informed companies of the direction it was leaning with respect to a recommendation.

<u>Disaggregation Using a Cost Model to Apportion Study Area Support</u>
In 1998, Staff and Company representatives used the Benchmark Cost Proxy Model (BCPM) to create a method (an equation) to determine the portion of each company's total support that should be associated with each access line in each of two zones in each of the Company's exchanges.

For each Company, each exchange was divided into a zone A and a zone B, with A the geographic area with the relatively lower cost of service and B the zone with the relatively higher cost. These zones were based on population density using census data. For each zone, an amount of support per line, per month was derived that, when multiplied by the number of lines in each zone, would add up to one-twelfth of the annual amount of federal high-cost support collected by that company.

Three elements of the methodology used in determining the amounts used in the petition to the FCC in 1998 are at issue. In 1998, the methodology allocated support (1) between two zones in each exchange; and (2) employed a residential revenue benchmark of $31.00 and a business revenue benchmark of $51.00; and (3) used the "uncapped" version of BCPM.

The result of the work done by Staff and Company representatives in 1998 resulted in assigning percentages of total study-area per-line support amounts that ranged from a low of a 0% multiplier for some Zone A locations to a high of 3,765% for the highest Zone B multiplier. (Note that these multipliers do not increase or decrease the support amount any incumbent company will receive; that amount is determined incumbent-by incumbent under different FCC rules and is based on incumbent's costs.)

<u>The Incumbent Rural LEC Disaggregation Filings</u>
All the rural ILECs in Washington that joined in the disaggregation petition to the FCC in 1998 made filings on or before May 15, 2002, as required by FCC rule. All but two chose the option that permits no disaggregation. Under that option, the per-line amount of support available to a competitor serving in one or more exchanges of a company that has not disaggregated would be a study-area average per line amount.[4]

TDS Asotin chose to disaggregate at the exchange level using a methodology similar to that proposed to and accepted by the FCC in the Joint Petition. The effect of its filed disaggregation methodology in comparison to the existing methodology was to reduce

[4] Note that choosing not to disaggregate below the study area does not result in a requirement that a competitor would have to compete in every exchange of that company's study area in order to be designated as an ETC and receive federal support. The ETC designations remain at the exchange level and the result is a competitor could go to the lowest-cost exchange and receive support that is higher than the cost to serve in that area because the competitor would receive support based on an average that includes the support provided to the rural incumbent to support higher cost exchanges in its study area.

the support multiplier for the Anaotone exchange and increase it for the more densely populated Asotin exchange. The changes were the result of using a $20.00 per-line cost benchmark rather than the original $31.00 residential and $51.00 revenue benchmarks; employing a “wireless capped” version of BCPM rather than the originally used “uncapped” version: and altering the local switching support (LSS) amounts attributed to each of the two exchanges to reflect an identical amount.

CenturyTel, with approximately seventy exchanges in Washington, chose to divide its exchanges into two groups, a lower cost and higher cost group, and determined a per-access line average support amount for each group. The respective group per-line amounts it filed are $1.80 and $22.17. (See Appendix D for examples, including CenturyTel’s Almira exchange where Joint Petition methodology allocates $ 82.78 per line in Zone A and $ 203.54 in Zone B, but CenturyTel’s May, 2002 proposal would allocate only $22.17 per line in the exchange. For Ames Lake, near Northgate in Seattle, the Joint Petition methodology allocates $0.00 per line for zones A and B both, but the May, 2002 proposal would allocate $1.80 for each line in the exchange.)

State Commissions May Direct Incumbent Rural LECs to Change Disaggregation
The FCC requires rural incumbent LECs to select one of three “paths” for disaggregation of federal universal service support. 47 C.F.R. § 54.315. Disaggregation of support means allocating the total study area support available to a rural ILEC into smaller divisions of the study area, using one of three paths prescribed by the FCC, and subject to state commission action to direct disaggregation in a different manner. If a rural LEC chooses Path 1, then a state commission may require the rural LEC to choose Path 2 or Path 3. 47 C.F.R. § 54.315(b)(4). If a rural LEC chooses Path 2, then a state commission may require the disaggregating and targeting of support in a different manner. 47 C.F.R. § 54.315(c)(5). If a rural LEC chooses Path 3, then a state commission may require modification to the disaggregation and targeting of support. 47 C.F.R. § 54.315(d)(5). Regardless of the path chosen, the Commission may direct the company to disaggregate and target support in a different manner.

The FCC did not include in its rules any standard for state commissions to use in determining whether to direct rural ILECs to disaggregate in a manner different than the one chosen by the company. In its Fourteenth Report and Order[5] adopting the disaggregation requirement and describing the role for state commissions, the FCC did refer to the reason for providing state commissions with the authority to direct the disaggregation. It stated the FCC has a goal of encouraging competitive entry.[6] Competitive neutrality and thwarting anti-competitive behavior figure prominently in its decision.[7]

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[5] *In the Matter of Federal-State Board on Universal Service*, CC Docket 96-45, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order, 16 FCC Rcd 11244 (2001) ("Disaggregation Order"). (Hereinafter referred to as the “Fourteenth Report and Order.”)
[6] Fourteenth Report and Order at ¶ 144.
[7] Id. at ¶¶ 148,150, 151,152, and 160.

Purpose for Exercising Commission Authority Over Disaggregation Methods

The purpose for the Commission to exercise its authority would be to continue with the direction it has taken to align costs and support at the sub-exchange level, or at least at the exchange level, which will promote competitive entry by matching costs and support, and preserve and advance universal service by maintaining a well known, documented, understood method of disaggregation, that has been administered successfully for two years by USAC, and that has attracted two competitors to rural Washington.[8] Competition, as noted in previous proceedings concerning ETC designation, results in lower prices, innovation in services, and greater attention to customer needs. By taking action to require disaggregation and targeting similar to that which has been in place in Washington, the Commission will act in a manner consistent with the FCC's suggestion that "support should generally be disaggregated and targeted in a manner that the per-line level of support is more closely aligned with the cost of providing service."[9] This in turn creates the *sufficiency* of support that is required by the Act. 47 U.S.C. § 254(e) and preserves and advances universal service because competitors will receive an amount of support consistent with the underlying cost of each location served.

The choices of the incumbent rural LECs have practical effects. The disaggregation approach filed by CenturyTel would have the effect of reducing support for United States Cellular Corporation (USCC), a competing ETC in many CenturyTel exchanges. If CentyrTel's creation of two groups of exchanges and averaging the support for each group were to stand, the effect on USCC of that type of gross averaging would be $1.3 million reduction in support.

Under the disaggregation paths chosen by all the rural incumbents, a competitor entering a rural market would face considerable disparities between the amount of per-line support and the underlying costs in each company's exchanges that comprise its study area. For example, a competitor serving Ellensburg Telephone's Ellensburg exchange would receive the same per-line support as a competitor serving Ellensburg's Thorpe exchange. Those exchanges have very different cost profiles, and equally important, very different revenue profiles. Under the disaggregation method put in place in 1999, the amount of support for any given exchange more closely reflects the underlying cost variations between exchanges in company study areas than do the results of the choices made by companies in May. This in turn results in upholding the requirement of the Act that support be sufficient, whether it is support for an incumbent or a competitor.

Detailed Recommendation

Staff recommends that disaggregation be ordered at the two-zone geographic level, which is the status quo, or, if Companies request disaggregation at the exchange level because

[8] Staff recommends today that the Commission grant ETC status to RCC Minnesota (d/b/a Cellular One) in 21 exchanges served by incumbent rural LECs.
[9] Fourteenth Report and Order, ¶ 148.

of the administrative cost of creating and filing sub-exchange maps with USAC (and the Commission finds that convincing), then at the exchange level.[10]
Staff is not convinced that the cost of creating maps for two zones is a great administrative burden, and the FCC offered sub-exchange deaveraging as an option with the map requirement included which suggests it was not convinced that any burden would outweigh the benefit. Staff notes that the requirement that an ETC offer its service throughout the exchange makes it difficult for a competitor to engage in cream skimming and therefore concerns about cream skimming may no longer be a sufficient reason to maintain sub-exchange disaggregation.[11] Because of the reduced concern with cream skimming within an exchange, Staff does not believe that disaggregation at the sub-exchange level is essential to maintaining sufficiency of support as required in the Act.

Staff has provided appendices with multipliers[12] for each sub-exchange and each exchange. In the case of the sub-exchange multipliers, they are based on the disaggregation methodology prepared by Staff and Companies and presented to the FCC by the Commission.

The multipliers for exchange-level disaggregation are based on the same methodology; the Zone A and Zone B multipliers are collapsed into one multiplier per exchange. Staff did not alter the benchmark from a revenue benchmark to a cost benchmark as CenturyTel and TDS Asotin did because a revenue benchmark reduces the amount of support directed to a given location as a result of revenue earned by the company in that location, but a cost benchmark reduces the amount of support directed to an exchange based on study area characteristics rather than exchange or sub-exchange characteristics. The cost model adjusts for costs; the benchmark is the only adjustment in the methodology for revenue. [13]

Staff did not alter the version of BCPM used for calculations from the uncapped version to the capped version. Indeed, Staff did not run BCPM at all but used the existing methodology based on the Joint Petition.[14] The capped version does not model wireline

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[10] See fn 1 for the distinction between exchange and wire center as used in the memo and used in the appendices.
[11] The filings of carriers that move to a study area average seem to Staff to be an indication that their concern about possible cream skimming is substantially less than in 1998.
[12] The percentage of the study area average per-line support to be apportioned for each access line in the zone.
[13] The need for support in exchanges is not so much because they are "high-cost," but because they are "high-cost per customer served."
[14] The BCPM is no longer publicly available without charge. It may be appropriate to revise the underlying calculations at some point in the future using the FCC approved model, often referred to as the Hybrid Cost Proxy Model. Now, however, is not the time to pause and engage in that process because to do so would result in making a substantial change from the Commission's well thought efforts at matching ETC designation and with support targeted to exchanges as represented by the Joint Petition to using study area average support amounts for all exchanges while that process is undertaken. Similarly, Staff offered to consider changes if proposed by companies with respect to any anomalous situation. For example, the multipliers in the original Joint Petition for CenturyTel's Snoqualmie Pass exchange seem low in relation to other locations. However, Staff notes that this apparent anomaly has existed since 1998 and believes a

loops that cost in excess of $15,000 because it assumes that customers requiring loops that cost more than that will be served by cellular or other technology. This is at odds with reality because companies have built and continue to build loops that have costs in excess of that amount. It is at odds with Commission precedent on this issue as well; the Commission rejected the use of capped versions of models in UT-980311.

Summary Recommendation

Staff recommends the Commission exercise the authority provided a state commission in 47 C.F.R. 54.315(b)(4) and (c)(5) to require disaggregation and targeting of federal universal service support by rural incumbent local exchange companies and CenturyTel of Washington and Inter-Island at the sub-exchange level not later than June 21, 2002, and when doing so to use the Staff provided multipliers found in Appendix A to this memo.

Attachments

change should only be made based on some specific information so that he changed multiplier would reflect more appropriately the cost and revenue profile of the exchange, not just be a change in response to an apparent anomaly.