DONALD L. HOWELL, II

DEPUTY ATTORNEY GENERAL

IDAHO PUBLIC UTILITIES COMMISSION

PO BOX 83720

BOISE, IDAHO  83720-0074

(208) 334-0312

Street Address for Express Mail:

472 W. WASHINGTON

BOISE, IDAHO  83702-5983

Attorney for the Commission Staff

BEFORE  THE  IDAHO  PUBLIC  UTILITIES  COMMISSION

IN THE MATTER OF THE INVESTIGATION)

TO IDENTIFY AND QUANTIFY IMPLICIT)CASE NO.  GNR-T- 97-12

SUBSIDIES CONTAINED WITHIN THE)

RATES OF IDAHO INCUMBENT TELE-)

PHONE CORPORATIONS.)COMMENTS OF THE

)COMMISSION STAFF

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_)

COMES  NOW  the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Donald L. Howell, Deputy Attorney General, and submits the following comments in the above referenced case.

INTRODUCTION

On July 18, 1997, the Commission issued a Notice of Inquiry (NOI) soliciting written comments addressing issues brought to light by the passage of Idaho Code 62-623 in Idaho’s Telecommunications Act of 1997.  This section requires the Commission to:

(1)Identify and quantify implicit subsidies within the rates of incumbent telephone corporations including, but not limited to:

(a)Access charges paid by intrastate interexchange carriers to incumbent telephone corporations including all of the carrier common line charge;

(b)Above cost rates paid by one (1) class of customers to reduce the price paid by another class of customers, and

(c)Imputation of revenue from nonregulated telecommunications services.

(2)Determine a mechanism for removal of the subsidies from the rates of incumbent telephone corporations and the creation of explicit subsidy mechanisms.

(3)Determine revisions that may be necessary to section 62-610, Idaho Code, regarding universal service in order to comply with the telecommunications act of 1996 and regulations promulgated thereunder.

Staff comments will focus on the difficulties of defining subsidies, costs, and of eliminating subsidies and possible courses of action the Commission may take in complying with the requirements of section 62-623.

Staff sees two conflicting viewpoints on the subsidy issue, one characterized by current interexchange carriers that want to compete well in the toll market and enter the local exchange business and the other characterized by incumbent local carriers that want to compete effectively with new local companies and protect their historical investment.  Staff sees no beacon of truth that cuts to the heart of the issue and allows clear choice of one or the other extreme view.  Toll carriers want to determine subsidies based on forward-looking economic costs from the Hatfield model, incremental not embedded costs, and do not want to make any contribution to joint and common costs.  Toll carriers want the entire cost of the loop to be covered only via local rates lacking any fair or economically rational way to apportion fixed costs over minutes of use.  While that may be true, it seems to Staff patently unfair not to have them pay some fair share of local loop costs.

THE MEANING OF SUBSIDY

In its NOI, the Commission has provided guidance on the question of what constitutes a subsidy.  The Commission observes that the term implicit subsidy is not defined in the statute but postures that “the Commission believes that if a telecommunications service is priced above its costs, there is no subsidization of that service.  Conversely, if a telecommunications service is priced below its costs, then subsidization may be present, although the source of the specific subsidy may not be identified.”

Given that guidance, however, even after one has managed to define them, all the practical questions surrounding subsidies, such as how to measure them and even how to eradicate them, are muted by two facts.  First, any definition of subsidy must bear some reference to costs.  In order for quantification of subsidies to occur, there must be agreement on the definition and measurement of some underlying costs.  Consideration of these questions in Idaho is premature, since the argument over costs is just now being carried out at the federal level in the context of a variety of FCC proceedings dealing with interconnection and access and universal service.

Even with a common definition for subsidy, acceptable to all parties to this case, Staff believes that quantification efforts and subsequent policy decisions about the proper disposition of any subsidies must build on the cost model work now being carried out at the federal level.  Idaho costing efforts must be at least consistent, if not identical, with efforts already required at the federal level.

Second, though the extent of subsidy may eventually be quantified based on some cost, the source of that subsidy is more problematic.  Tracing of revenue flows from a myriad of possible sources that could have made a revenue contribution (from earning more than their relevant costs) to a specific destination (a service or element that is priced below its relevant cost) is difficult if not impossible.  Individual revenues within a company are not separable so that one can trace a dollar from earnings on item A to cost coverage on item B.  Staff believes this problem is insoluble, with the market itself being the only safeguard that over a long period of time there will not be sufficient earnings potential on any item to allow a significant and permanent subsidy of some other item to be sustained.

For purposes of U S WEST, Staff believes it can generalize a lack of significant concern about subsidies by its agreement with a statement made by this Commission in Order No. 25826 (USW-S-94-3).  Reviewing five years of revenue sharing, the Commission found itself able to conclude that “the risk is low” that a prohibited subsidy exists.  That effectively dismisses concern with the type of subsidy prohibited by Idaho Code §62-613, from regulated Title 61 service to un-regulated Title 62 service.

The close scrutiny given U S WEST in its rate case (Case No. USW-T-96-5) ensures that the Commission has set rates for Title 61 services that do cover their costs in the aggregate, ensuring that subsidies are not flowing form Title 62 to Title 61.

The Notice of Inquiry seems deliberately to have omitted any mention of 62-623(2), the subsection dealing with determination of a mechanism for removal of subsidies from rates and creation of explicit subsidy mechanisms.  The wording of the code couples “removal” and “creation” in such a way that it seems to imply that the purpose is merely to make explicit what was before hidden.  Staff believes that if and when sufficient further analysis allows actual quantification of various subsidies, it should not be taken for granted that they should merely be changed in form so as to become explicit.  Each one found should seriously be examined for continuing relevance and effectiveness in promoting whatever public interest goals it may have been created or allowed to further.

Staff does not believe the term “subsidy” must necessarily have a negative connotation.  Pricing above cost to varying degrees is a fact of business life, not an evil creation of historical regulation.  As this Commission pointed out in Order No. 22763 (CEN-T-89-1), “... no service offered by any telephone company in Idaho is priced to recover exactly the cost of providing that particular service.”  In deregulated businesses especially, the terminus to which recent state and federal telecommunications legislation is pointed, no one even asks the question seriously.  Pricing and marketing decisions are made without slavish adherence to individual costs or sometimes even in defiance of specific costs.

Staff believes it is important that subsidies, to the extent they exist, should be made explicit where possible.  This simply provides adequate information for both private and public decision-makers on which to base their actions.  Hidden subsidies fail to provide good information on the real costs of goods or services or programs and may thus lead to distorted public decisions.  They are undesirable not so much because they are subsidies as because they are hidden.  Explicit subsidies give all parties a chance to reflect on the relationship between the real cost and the value of service associated with a particular product and decide for themselves whether or not to continue.  For instance, no one expects the explicit subsidies paid through the USF to disappear.  Their magnitude is out in the open where it can be judged for its contribution to the public interest.  In such cases, the real question is not about the existence, but about the proper size, of the subsidy.  The most important question is whether the existing subsidy represents the most cost-effective way of achieving the goal it is expected to further.  Telecommunications pricing policies in the public interest can and should continue, even after  this subsidy investigation and with more competitive markets.

The concern with subsidies represents a sort of red herring, thrown into the deregulatory fray by individual telecommunications companies eager to quickly and effectively compete with the incumbent LECs and by incumbent LECs eager to prepare themselves for a future competitive world.  To potential local exchange competitors like AT&T, subsidies seem to come in the form of above-cost access charges that will prevent them from being price competitive with LECs as they enter toll markets.  To incumbent LECs like U S WEST, subsidies seem to come in the form of relatively high business rates designed to allow basic residential service to be kept at low and affordable levels.

The concern from telecommunications companies is for their own financial integrity in an increasingly competitive environment.  If their real concern were with customers, then the questions about subsidy as a way of keeping final rates lower is well-placed.  Their concern is not primarily with their customers, who are a primary reason that many of these subsidies were created historically and who have been for the most part the beneficiaries of the historical rate structure.  Eradication of subsidies in the name of competition may seem good to individual companies, but it is not likely to be in the interest of most telecommunications customers.

UNIVERSAL SERVICE FUND

Several problems with the Idaho Universal Service Fund (Idaho Code § 62-610) are consequent on implementation of the Federal Telecommunications Act of 1996.  Revisions will most certainly need to be accomplished.  Several were proposed for the 1996 legislative session, but none found its way into the final bill.  Those same questions, plus a few more, will be in the offing for the 1997 legislative session.  Staff reiterates first of all that Code Section 62-615

currently extends to the commission full power and authority to implement the federal act.  Staff believes that necessary changes can be made through administrative procedures as needed, even before the legislature is asked to ratify such changes in formal legislation as are deemed necessary

The most serious question concerns the difference in methodology between the proposed new federal USF and the existing Idaho USF.  The new federal program is based on forward-looking economic costs.  The existing state program is based on historical accounting costs.  The new federal program is designed to provide economic incentives toward efficient operation rather than to merely recover embedded costs.  If the federal program is put into place as currently outlined in the universal service order, both the methodological change and the choice of 25% as the federal contribution to the loop cost are likely to put new financial pressures on at least some Idaho companies.  Idaho must answer for itself the question of whether it is willing and able to pick up the extra burden on state companies and their customers that is likely to result from implementation of the federal changes.  Staff believes that most of all, Idaho must wait on federal efforts in this arena before attempting to supplement cost models for Idaho uses.

The second set of questions concerns bringing the provisions of Idaho law into conformance with the new federal program.  At the federal level there has been a major expansion of the base for federal support.  The definition of telecommunications provider has been broadened considerably to include all businesses that benefit from some connection with the existing telecommunication network.  Staff believes this broadening of responsibility for funding the universal service obligation should extend also to Idaho, most specifically to the definitions of Section 62-613(14) that currently exempt cellular and CMRS, for instance.  Section 62-610(2) levies a surcharge to support universal service on local exchange and MTS services.  Some broadening of this base for the levy may be necessary to accomplish full spreading of the responsibility of support to all who benefit from the Idaho telecommunications network.  These institutional changes to Idaho telecommunications legislation should be recommended to the legislature for the next session.

Next is the question of broadening eligibility for universal support.  Section 62-610(3) defines eligibility for support, and that also should be broadened to include other carriers willing to accept the federal requirements of what constitutes an “eligible telecommunications carrier.”

At some point, beyond the expansion of definitions included in the current Idaho statute, this Commission may need to step in to decide boundary disputes and determine just which companies are eligible for support.

The Universal Service Order also asks individual states to offer the FCC input and assistance in determining what is a reasonable level at which to support telecommunications rates.  Many states will choose to answer that question for themselves, based on individual state demographic and socio-economic indicators and based on individual assessments of the importance of ubiquitous availability of telecommunications services.  Staff believes that serious answers should be provided to the questions, are telephone penetration rates sufficient and what is a reasonable expectation of a monthly bill for regular telecommunications service.  These are items that can and should be formally discussed by parties to this case in order to provide basic information to which some cost model will be later applied as the Idaho USF is reshaped following federal USF changes.

Given the fact that the universal service order (FCC 97-157) is under court challenge and its ultimate future is in doubt, there is little reason to expect that specific answers to all the federal issues will be provided before the next meeting of the Idaho legislature.  Decisions about the size of the additional burden and whether it is bearable can only come after the federal changes are firmly defined.  For now, that means Idaho must wait and see.

CONCLUSION

In so far as the question of identification and quantification of implicit subsidies is concerned, the time is too short and the list of questions too long to adequately find an answer, assuming one existed.  The best hope of addressing the concerns found in 62-623 is to narrow the scope of the process to those areas where the greatest concern lies, access charges.  No one in the business today would deny that access charges are priced above cost and supply a subsidy.  Its is argruably the largest source of implicit subsidy available and may be the least difficult to identify.  Efforts should be concentrated on addressing this area and bringing access charges more in line with the interstate structure.

The other area that could be examined is geographic averaging of local rates.  This area has potentially large pricing problems.  Costs in this area may be much more difficult to quantify, but given the potential pricing problems this is another areas where time may be well spent.

Examination of subsidies and costs in areas such as vertical services and private line and other miscellaneous features is simply not prudent in the short time available and Staff recommends that those are areas that may best be addressed by the marketplace.

In the area of universal service funding, while it sounds easy to set a deadline and make independent changes as needed, Staff believes that the Idaho USF has and must remain complementary to the federal program.  A program that suits Idaho’s specific needs in the present, after passage of the federal act and in anticipation of future competition, should be designed, but only AFTER the federal program has taken shape.  At this juncture we feel we know the broad outlines of the federal program (subject of course to final district court or Supreme Court determination) but we do not know the final dimensions of the actual support.  Until the final federal program is in sight, Staff believes it is premature to make substantive changes to the Idaho USF.

For now, let’s change the few items we know must change to bring consistency with  federal action, attempt to narrow the range of possible subsidy questions, and watch closely the conduct of the FCC cost proceedings to see which putative subsidies disappear and which might actually hinder competition (and therefore require corrective action) as deregulation unfolds.

The following could be valuable towards this goal:

1.Have companies provide a list of their own services and their concepts of costs.

2.Let them identify what they think are subsidies within other companies’ rates.

3.Let them suggest their own working definition of subsidy.

These methodological questions are much more important than the institutional details about who contributes and who can draw from the USF.  Those items can and should be handled now.  Additional suggestion might be to ask parties for recommendations of how to attack the cost question, subject to the following:

1.The cost methodology must be useful for both universal service and for unbundled elements.

2.It must be accessible to all parties (not a hard-wired, black box).

Respectfully submitted this                  day of August 1997.

Don Howell

Deputy Attorney General

Technical Staff:Joe Cusick

Bill Eastlake

DH:JWC:BE:jo\I:\wpfiles\comments\gnrt9712.dh