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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.)REPLY COMMENTS OF THE

)COMMISSION STAFF

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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 reply 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.  On August 8, 1997, initial comments were filed by Commission Staff, Sprint Communications Company, GTE Northwest, Idaho Telephone Association, MCI Telecommunications Corporation, TDS Telecom and Century Telephone, AT&T, and U S WEST Communications.

Taken as a whole, these comments offer little in the way of practical guidance to this Commission in how to deal with its charge from the Legislature.  The comments mostly restate positions already staked out and known to the other parties in this case.  Therefore comments will reply to specific comments offered by others and then focus on a limited number of specific courses of action the Commission may take in complying with the requirements of Idaho

Code § 62-623.

Staff agrees with U S WEST’s comments at page 6 that the legislature intended the Commission to study implicit subsidies and inform the legislature what, if anything needs to be done, rather than with MCI’s suggestion that this section was a mandate for immediate action.

One of the major difficulties in dealing with the implicit subsidy issue is that parties to this case have radically different points of view.  Subsidies, however defined, flow from a source with excess earnings to an end use with excess costs.  Long distance companies see the subsidy problem at what they think is its source:  the excess revenues created by the current access charge regime.  LECs see the subsidy problem at the other end of the flow, at its end use, as a need for revenue to offset the lack of cost coverage offered by low residential rates, for example.

OBSERVATIONS

1.  Cost models.  AT&T seems to assert (page 8) that this Commission has “ordered that the Hatfield Model should be used for determining the cost of [unbundles network elements] UNEs.”  Consequently the Commission must continue to use the Hatfield Model for determination of the forward-looking economic cost of local service and for determination of the size of the universal service fund.  Staff does not believe the Arbitrator’s First Order in the Arbitration case constitutes blanket approval of any model for all cases, or that it represents “formal” Commission approval.  Even in the context of that case, only the RLCAP and Hatfield models were proposed, not the BCPM model that is the other leading contender for use at the national level.  Both Hatfield and BCPM are evolving and will continue to do so through the FCC proceeding on cost models.  There is at least one new edition of the Hatfield model beyond the version used in the Arbitration case.  Further editions should make one or both models more appropriate for cost estimation than is now the case.

Without actually choosing a specific model at this time, Staff believes (contrary to assertions of U S WEST (page 6) that each company requires separate analysis and modeling) that it is possible to discuss and even to identify the level of subsidy in general through statewide analysis using a single model.  Particularly if this proceeding is merely to judge the importance of the subsidy issue and inform the legislature of needed steps, perhaps such general analysis is the appropriate course of action.

2.  Stranded costs.  Staff agrees with the comments of AT&T at page 15 that the concept of “stranded costs” is inappropriate for use in modeling of costs.  That concept was put forth most strongly by GTE (pages 8-9) in arguing that the ability to fully recover undepreciated investments is now jeopardized by use of forward-looking cost models and that any universal service fund proposal must be supplemented by some sort of recovery mechanism for stranded costs.  First of all, the extent of stranded costs (how much will go unrecovered due to future competition) cannot be known beforehand, except to specify a maximum amount possible.  Actual stranded costs, if any exist at all, will almost certainly be less than any amount calculated now.  Second, recovery of putative stranded costs through a surcharge is not the way such costs would be treated in a competitive market.  Such a scheme for cost recovery is rather the last gasp of a vanishing monopolist, operating still in an old mindset whereby a regulated company wishes to be guaranteed both whatever it would have earned under the old regime plus whatever additional earnings are possible in a new competitive environment.  Unless a company loses badly in the new competitive environment, such a scheme assures earning more than it would have in the old monopoly world.  No such assurances exist in a competitive world, where any such unrecovered costs would simply be netted against future revenues.  Staff suggests the Commission advance with caution when examining any claims for recovery of stranded costs (called legacy costs in recent FCC orders) in the move to competition.

3.  Revenue neutrality.  Staff disagrees with the portion of GTE’s proposed universal service plan that insists on revenue neutrality.  It sounds appropriate if it is interpreted to mean that ILECs should pledge to pass on to customers in the form of lower prices all they receive from federal and state USFs.  That principle, however, appears to limit the amount of possible price reduction to the increased amount of explicit USF support, effectively creating a sort of floor below which revenues will not be allowed to fall under any circumstances.  It may be both possible, or competitively necessary, for ILECs to reduce prices by more than the amount of additional USF support.  U S WEST (pages 11-12) also talks about putting all implicit subsidies identified into new and explicit subsidy mechanisms, e.g. compensating specifically for any reduced access charges with another “explicit subsidy mechanism.”

Staff’s primary objection to this emphasis on revenue neutrality is that it suggests that some parties to this case are not really concerned about their customers, but rather with assuring that they continue to earn in the emerging competitive telecommunications market at least as much as they were earning before in a regulated market.  They seem to be looking backward toward safeguarding and stabilizing revenues rather than forward to enhanced revenues that might flow from taking a chance that customers will respond positively to enhanced services and competitive prices.

4.  Pass through of lower costs to customer rates.  MCI makes a formal pledge to pass on to customers any cost savings from lower access charges.  Sprint does not formally offer to pass on to customers through lower rates any cost savings afforded the company through lower access charges, yet it asks the Commission to seek to change Idaho law so that it could force

U S WEST, as a condition of receiving funds from the USF, to cut its rates for Title 62 services that are above cost.  Despite what appears to be an editing mistake in U S WEST comments (Title 62 instead of Title 61 at page 9, line 2), it seems obvious that U S WEST believes the legislature did not intend to bring access charges back under Commission regulation.

5.  The Economides article appended as Exhibit A to the AT&T testimony contains many definitional points about joint and public goods with which Staff agrees, but Staff rejects the final conclusions drawn by the author.  The notion that “no allocation of costs is necessary or appropriate” in calculating local loop costs is not a necessary conclusion associated with the supposedly neutral logic of TSLRIC models.  The theoretical arguments about cost-causation and separability in cost methodology ring hollow in the face of equity demands that toll carriers and their customers be more than free riders on the local loop.  It seems to Staff patently unfair not to have IXCs pay some share of local loop costs.

It is understandable that AT&T wishes to support low costs for UNEs and shift all forms of subsidy into one explicit universal service fund.  Since all costs will ultimately be paid by telephone customers, the real question is whether they will be collected in one lump as a USF surcharge on the local bill or will be collected partly through the toll bill.  This is ultimately a question of neutrality among telecommunications providers and the AT&T suggestion is as favorable to IXCs as the current situation is to ILECs.  Perhaps real neutrality lies somewhere in between.

Staff concedes that telecommunications service does not meet the formal definition of a “public good,” but notes that the economics literature contains another similar concept, called a “merit good.”  Merit goods do not meet the strict technical conditions of non-rivalry and non-excludability.  They meet instead a softer test, whether public opinion as expressed through public officials finds it desirable to have more of a service than the market will provide.  True public goods cannot and will not be provided by firms in a market environment.  Merit goods may be produced, but in smaller quantities than should be available to serve the public interest.  Universal service seems an admirable example of such a good.  We have for a long time deemed it vital to keep phone prices low so that their availability is nearly universal.

The Economides article notes that “for private goods, price discrimination may increase social welfare.”  In defining clearly why phone service is not a public good, the author has logically inferred that it is, by default, a private good.  Simple extension of the quote about price discrimination can actually be used to imply that the very type of “subsidy” that is declared suspect by Idaho Code and is the subject of this case may actually increase welfare.  Price discrimination means charging more to one customer or group of customers than to another, based on their different demand for the same service.  Charging business more than residences, even toll customers more than local customers, can with some validity be claimed to be appropriate price discrimination of a type that may raise total welfare.  This view is in sharp contrast to the general view that subsidy is an evil to be erased.

6.  Staff notes that the ILEC comments in particular seem to generate an enormous universal service burden when one carries out the simple math they suggest.  GTE, for instance, talks of a $45 cost and a $15 rate for monthly residential service and arrives at an obligation of $50 million.  The most recent annual report of the Idaho USF reports annual disbursements of about $1.7 million.  Those static estimates use a variety of assumptions that result in a worst case scenario as if it were fact.  Throwing out such staggering numbers hardly seems a winning strategy for convincing policy makers that all existing implicit subsidies should simply be rolled over into an explicit subsidy mechanism like the USF.  However, the announcement by the FCC that it intended to limit federal support through the USF to 25% of the difference between the benchmark revenue amount and forward-looking loop cost has already created concerns among states about a major increase in their required level of support.

7.  AT&T comments highlight what Staff agrees is perhaps the major reason that implicit subsidies may be a problem, that implicit subsidy ignores need.  If universal service is the goal, then policies designed to keep local rates low in order to achieve it may provide ill-targeted help.  A uniform local rate of $15, regardless of its relationship to cost, may still be too expensive for some while at the same time being far less than others are willing and able to pay.  Making a subsidy explicit often is a way to highlight some of these differences in treatment or inequities, allowing better targeting of policies to reach those clearly in need of assistance.

However, Staff disagrees with U S WEST’s assertion (page 2) that identification and removal of subsidies are necessarily linked.  It is curious that U S WEST chooses (pages 6-7) to blame IXCs for raising the concern over subsidy that resulted in opening of this case.

8.  Carrier Common Line Charge (CCL).  Several comments note that the CCL creates revenue windfalls to ILECs since it is calculated to cover some amount of fixed costs but then assessed on a usage basis.  It appears to be illogical for IXCs to worry about a windfall to ILECs from the CCL, since that windfall can happen only with strong growth in traffic volume.  IXCs main argument for reducing access charges seems to be that the consequent high toll rates are significantly restraining traffic.  One cannot logically argue both positions simultaneously.

RECOMMENDATIONS

1.  Cost models.  Staff believes the Commission should open a docket for consideration of cost models.  The Commission has already informed the FCC of its intention to develop its own cost model, while at the same time following closely the process underway in FCC 97-256 aimed at development of a national cost model.  Such a docket would provide a forum for receiving testimony and/or presentations from any parties wishing to propose a specific model for use in Idaho.  It would reinforce the tentative commitment already made to the FCC regarding development of an Idaho cost model.  It would allow the Commission to learn and benefit from whatever model improvements result from the FCC proceeding underway at the same time.  In addition, it would eventually provide the analytical tool required to more fully identify and quantify implicit subsidies, a task Staff believes is not possible at this time.

2.  Access charges.  Staff observes that no party unequivocally offered a definition of the term implicit subsidy or a method for quantifying it.  Given that continuing lack of specificity, Staff believes the Commission might take steps now that move in what most parties would agree is “the right direction” by attacking what appears to be the largest source of subsidy, namely access charges.  Staff agrees with several commenters that access charges are the place to begin.

Any reduction would begin to cut into the generally large gap between access charges and costs.

Staff likes the idea, expressed in MCI comments, that some sort of reduction in access charges for intrastate calls might be ordered now.  The emerging competitive regime in telecommunications has been hailed, even justified, as offering benefits to customers, and not just in the very long term.  Given the few halting steps toward competition that have resulted since passage of the Telecommunications Act of 1996 and the nearly complete lack of price reduction, some token reduction is both possible and desirable now.  A small reduction (10% or so) in access charges, with a pledge that it be passed on in lower rates by IXCs, could be looked on as a sort of litmus test for both IXCs and ILECs that they are seriously interested in their customers and committed to using competition as a way to improve customers’ welfare.

Possible further changes to access charges would essentially wait on FCC actions for final steps, leaving carrier common line charges and allocations of local loop costs in place.  That would mean accepting them as givens for now, based on the idea that it is fair for toll to make some contribution to the provision of local exchange service, on which its ability to connect calls to ultimate customers depends.

Consideration of the other possible subsidies requires more time than is now available for exhaustive studies.  Some guidance will come from FCC work in the areas of  interconnection and access and universal service.  Further definition of cost models will provide the analytical tools necessary to begin more formal quantification of other subsidies.

3.  USF.  Staff notes that most parties favor an expansion of the base of contributors, in accord with the broadening begun with the Telecommunications Act of 1996.  This is unequivocally a positive step.  It requires contributions from all firms whose business connects with or relies on the presence of the local network.  If the total amount of support needed for USF goes up as some predict, it will seem vital to share the burden over a wider set of contributors.  Even if the total dollars needed should go down, it makes good sense to require some contribution from every company (and hence every customer) who uses the services of the telecommunications network.  Also, the Commission should solicit comments from interested parties with the aim of specifying an affordability benchmark for ultimate use in determining the appropriate amount of support to come from a revamped USF.

Respectfully submitted this                   day of August 1997.

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