

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 09-M-0527 - Proceeding to Examine Issues Related to a
Universal Service Fund.

NOTICE ESTABLISHING SCHEDULE FOR FILING EXCEPTIONS,
SEEKING COMMENT ON REASSERTION OF PUBLIC SERVICE COMMISSION
JURISDICTION OVER WIRELESS TELEPHONE COMPANIES FOR STATE
UNIVERSAL SERVICE FUND PURPOSES, AND SEEKING COMMENT ON FURTHER
EXTENSION OF THE TRANSITION FUND

(Issued January 4, 2012)

A Recommended Decision of Administrative Law Judge Howard A. Jack in the above-captioned proceeding is attached and is issued for exceptions. Note that the Recommended Decision was written prior to the issuance by the Federal Communications Commission of its recent Report and Order regarding inter-carrier compensation and the federal Universal Service Fund (USF),¹ but issuance of the Recommended Decision has been delayed until after the FCC Report and Order so that the FCC Report and Order can be considered in the exceptions process. Parties are consequently asked to address the effect of the FCC Report and Order on this matter in their briefs. Briefs on exceptions are due electronically to the Secretary at secretary@dps.ny.gov and to all active parties by 4:30 p.m. on February 14, 2012. Briefs opposing exceptions are due by 4:30 p.m. on March 5, 2012, following the same procedures. The parties' briefs shall adhere

¹ *Connect America Fund*, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, *Developing an Unified Intercarrier Compensation Regime*, CC Docket Nos. 01-92, 96-45, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Universal Service Fund - Mobility Fund*, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (November 18, 2011)(FCC Report and Order).

to Commission Rule of Procedure 4.10 and to the guidelines for filing documents with the Secretary (www.dps.ny.gov).

On November 18, 2011, the FCC released its Report and Order, which implements comprehensive revisions of the federal USF and inter-carrier compensation mechanisms, intended to help ensure that voice and broadband services are available throughout the nation. The contributions formerly made to the federal USF will be allocated to newly established funds, the Connect America Fund and the Mobility Fund. Additionally, the FCC has identified "bill-and keep" as the optimal end state for inter-carrier compensation, including intrastate rates. In order to achieve these revisions, specific transition steps are identified which will affect the cost and revenue structures of the telecommunications market, affecting all participants whether they provide local, long distance, wireless, or VoIP services. Some telecommunications companies will experience revenue loss from inter-carrier compensation or lessened subsidies from the new Connect America Fund, while others may experience enhanced revenue streams. Some or all of these issues (and others) in the FCC Order might affect resolution of the issues in the USF case pending before the Commission.

Among other things, the Recommended Decision, consistent with the record on which it is based, addresses the issue of whether obligations to contribute to a State universal service fund should be extended to wireless telephone companies. Such action, if adopted by the Commission, would require that the Commission terminate, in part, the current suspension of the operation of the Public Service Law with respect to those companies. The opportunity to comment provided by this Notice is intended to fulfill the Commission's obligation to make such a determination after notice and hearing pursuant to Public

Service Law §5(6). It is anticipated that an oral hearing to take public comment will be scheduled and noticed at a later date. To the extent parties believe an evidentiary hearing is necessary for the purpose of terminating suspension of the applicability of the Public Service Law pursuant to Public Service Law §5(6), they should identify any material issues of fact in dispute and demonstrate why an evidentiary hearing is warranted. Comments and reply comments on this issue will be due at the same time as briefs on exceptions and briefs opposing exceptions, respectively, and may be incorporated therein if desired, although they should be clearly designated as comments regarding the applicability of Public Service Law to wireless carriers pursuant to PSL §5(6).

Additionally, the Commission seeks comment on a further interim extension of the Transition Fund. In Phase I of this proceeding, the Commission issued an order approving terms and conditions of a joint proposal intended to temporarily extend the Transition Fund.² The extension provided for additional Transition Fund (TF) moneys of up to \$600,000 (the Temporary Transition Fund Extension, or TTFE), with contributions to that funding ceasing on the earliest of (a) September 30, 2011, (b) the date of completion of steps necessary to put into effect an order, if any, establishing a State universal service high cost fund (SUSF), or (c) the date the additional contributions equaled \$600,000. Under the terms of the Phase I Order, any unexpended amounts remaining in the TTFE at that time were to be returned, *pro rata*, to the carriers who contributed to the TTFE.

² Case 09-M-0527, *Universal Service Fund*, Order Adopting Phase I Joint Proposal (issued July 16, 2010)(Phase I Order).

By order issued September 16, 2011, the Commission extended the Transition Fund to allow additional time to consider Phase II issues.³ The Commission therefore continued the Fund rather than allowing it to terminate, ordering that unexpended amounts would not be returned and that contributions up to the original \$600,000 funding level would remain available for Transition Fund recipients. Current estimates suggest that the original \$600,000 is sufficient to meet Transition Fund demand through May, 2012. With the issuance of this Recommended Decision for exceptions, however, with briefs that will also address the impact of the FCC decision, and with the consideration as well of the PSL §5(6) issue described above, it is anticipated that all Phase II issues may not be fully resolved before the current funding level of \$600,000 is exhausted.

Therefore, the Commission seeks comment on a proposal to further extend the Transition Fund, with *pro rata* contributions from the current contributors. The additional contributions are proposed to be no greater than \$350,000 and are designed to be sufficient to continue current Fund obligations on a monthly basis until such time as the Commission renders a decision on Phase II issues relating to the establishment of a state universal service fund. Persons wishing to submit comments on a further interim extension of the Transition Fund shall do so by sending comments to secretary@dps.ny.gov no later than 4:30 p.m. on January 23, 2012. Reply comments will be due January 31, 2012. Alternatively, those unable to file comments electronically should mail their comments to Hon. Jaclyn A. Brilling,

³ Case 09-M-0527, Order Modifying Temporary Transition Fund Extension (issued September 16, 2011).

CASE 09-M-0527

Secretary, New York State Public Service Commission, Three
Empire State Plaza, Albany, New York 12203-1350, with filings
postmarked by the due date.

JACLYN A. BRILLING
Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 09-M-0527 - Proceeding to Examine Issues Related to a
Universal Service Fund.

RECOMMENDED DECISION ON PHASE II ISSUES

(Issued January 4, 2012)*

By

Howard A. Jack
Administrative Law Judge

* PLEASE NOTE: This recommended decision was completed before the Federal Communications Commission (FCC) issued its decision in *Connect America Fund*, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, *Developing an Unified Intercarrier Compensation Regime*, CC Docket Nos. 01-92, 96-45, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, *Universal Service Fund - Mobility Fund*, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (November 18, 2011). I have reviewed that FCC decision and determined that nothing in it would lead me to change the recommendations contained in this recommended decision or the analyses upon which I have based my recommendations.

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 09-M-0527 - Proceeding to Examine Issues Related to a
Universal Service Fund.

Howard A. Jack, Administrative Law Judge

RECOMMENDED DECISION ON PHASE II ISSUES

(Issued January 4, 2012)

INTRODUCTION

In July of 2010 the Commission issued an order adopting a Joint Proposal in Phase I of this proceeding.¹ That order put in place a temporary extension (Temporary Transition Fund Extension, or TTFE) of the "Transition Fund" (TF) established in 2003 to ease upward pressure on local telephone service rates expected to flow from phasing out the pooling of intrastate access charge revenues among local exchange telephone companies. The Phase I Order also adopted a schedule for considering the remaining issues in the proceeding. Pursuant to the terms adopted by the order, Phase II of this proceeding has focused on issues about whether a longer term successor to the Transition Fund--a "State Universal Service High-Cost Fund" (SUSF)--is warranted to further the Commission's policy of ensuring universal telephone service in New York; and, if so, the characteristics and features of such a fund.

After considering the evidence and the arguments of the parties on the Phase II issues, I recommend that the Commission find it has implicit authority under the Public Service Law (PSL) to establish an SUSF; and that it is

¹ Case 09-M-0527, *Universal Service Fund*, Order Adopting Phase I Joint Proposal (issued July 16, 2010)(Phase I Order).

reasonable and prudent to establish one for a limited duration of four years, subject to continuation until completion of a proceeding to consider whether to continue the fund. That review proceeding should commence within three years of a Commission order establishing an SUSF. I also recommend that small rural incumbent local exchange carriers (ILECs) be eligible to seek funding from the SUSF, but that the benchmark rate for basic residential local exchange service used in determining the extent of any support levels be raised from \$23.00 to \$25.65 per month. I recommend that the Commission require all telecommunications providers in New York, including wireless and interconnected Voice over Internet Protocol (VoIP) providers, to contribute to the SUSF in proportion to their intrastate retail revenues. In addition, I recommend that, in advance of any Commission decision in Phase II of this proceeding, notice and an opportunity for hearing be provided, pursuant to PSL §5(6)(a) on my recommendation that the Commission terminate the suspension of the application of the Public Service Law to cellular telephone services, to the extent of requiring their providers to contribute to the SUSF. I further recommend that the Commission appoint the New York Intrastate Access Settlement Pool, Inc., as administrator of the SUSF. Finally, I recommend that for a limited time the Commission grandfather disbursements, at current levels, to the three companies now receiving support from the TF/TTFE.

PROCEDURAL HISTORY

The Commission's Phase I Order includes a succinct account of the background and context of this proceeding, as well as the procedural history of its initial phase, which I need not repeat here.² In accordance with the terms adopted in

² Phase I Order, pp. 1-7.

the Phase I Order, the parties engaged in collaborative discussions aimed at resolving Phase II issues, under the auspices of Administrative Law Judge Eleanor Stein, through the later part of the summer of 2010. On September 30, 2010, Verizon, on behalf of a substantial number of parties, filed a report on the collaboration. The report expressed the consensus of the parties that further collaborative discussions were unlikely to lead to settlement of the policy and implementation issues in Phase II by December 31, 2010. According to the terms of subparagraph 9(b) of the Joint Proposal adopted in the Phase I Order, collaboration on those issues ended at that point and Phase II shifted to a litigation track. After considering the parties' various proposals for the litigation stage, I issued a ruling on Phase II litigation procedures, schedule, and issues.³ On December 31, 2010, the following parties filed their direct cases: AT&T Communications of New York, Inc., on behalf of itself and its regulated affiliates (AT&T); the Cable Telecommunications Association of New York, Inc. (CTANY); tw telecom of new york l.p./Level 3 Communications LLC/PAETEC Communications, Inc. (Facility CLECs);⁴ the New York State

³ Case 09-M-0527, Ruling on Phase II Procedures (issued November 18, 2010 (Phase II Procedures Ruling)).

⁴ A "CLEC" is a competitive local exchange carrier. "Facility CLECs" are competing local exchange carriers that provide service over at least some network switches, and possibly loops to end-users, that they own, rather than only over facilities owned by and leased from the incumbent local exchange carrier (ILEC).

Consumer Protection Board;⁵ the New York State Telecommunications Association Smaller ILECs (Smaller ILECs);⁶ Sprint Nextel Corporation (Sprint); trial staff of the Department of Public Service (Staff); T-Mobile Northeast LLC, d/b/a T-Mobile (T-Mobile) and Cellco Partnership d/b/a Verizon Wireless (Verizon Wireless)(collectively, Wireless Group); and Verizon New York Inc. (Verizon). The same parties filed rebuttal cases on January 28, 2011. An evidentiary hearing was held on February 14, 2011. On March 15, 2011, AT&T, CTANY, the Facility CLECs, DCP, the Smaller ILECs, Sprint, Staff, the Wireless Group, and Verizon submitted initial trial briefs, followed by reply briefs on March 25, 2011.

Notice of proposals for establishment of a longer term State universal service high-cost fund was published in the State Register.⁷ In June through August 2011, the Chairman of the Commission received letters from New York State Senators John J. Bonacic, Joseph A. Griffo, Elizabeth O'C. Little, Michael F. Nozzolio, Pattie Richie, Stephen M. Saland, James L. Seward, and Catherine M. Young urging the Commission to take action in this proceeding to help several rural telephone

⁵ As a result of legislation in early 2011 after submission of the Consumer Protection Board's briefs, it became part of the Division of Consumer Protection in the New York State Department of State. This recommended decision therefore will now use the acronym "DCP" for the former Consumer Protection Board.

⁶ See Appendix A for the Smaller ILECs' member telephone companies. Previously, Windstream New York, Inc., with its affiliates, participated in this proceeding as a member of the Smaller ILECs, but it has not done so in the evidentiary hearing and briefing in Phase II. Transcript (Tr.) 20-21.

⁷ XXXIII N.Y. State Register, Issue 15 (April 13, 2011), p. 35.

companies operating in their respective districts to continue providing reliable telecommunications and broadband services.⁸

PARTIES' OVERALL POSITIONS

The initial basic issue in Phase II of this proceeding is whether a longer term support fund is advisable to ensure universal availability of affordable basic residential local telephone service throughout New York, to succeed the Transition Fund and the temporary extension of it approved in the Phase I Order. If it is, then a number of subordinate issues require resolution, including: entities generally eligible to receive funding; any specific requirements for eligibility for funding; entities required to contribute to the fund; how to determine contribution levels; who should administer the fund; whether it should be revaluated periodically or sunset at some particular time; what, if any, particular limit or cap on the amount of the fund should apply; and standards that should apply to determine the amount of disbursements from the fund, including whether there should be a benchmark basic residential service rate either required to be charged as a condition of fund support or imputed in determining the level of support.

⁸ The companies are: Berkshire Telephone Corporation, Cassadaga Telephone Company, Champlain Telephone Company, Chatauqua & Erie Telephone Company, Chazy & Westport Telephone Corporation, Citizens Telephone Company of Hammond, NY, Inc., Crown Point Telephone Corporation, Delhi Telephone Company, Dunkirk and Fredonia Telephone Company, Germantown Telephone Company, Inc., Hancock Telephone Company, Margaretville Telephone Company, Middleburgh Telephone Company, Newport Telephone Company, Nicholville Telephone Company, Oneida County Rural Telephone Company, Ontario Telephone Company, Port Byron Telephone Company, State Telephone Company, Taconic Telephone Corporation, Township Telephone Company, Trumansburg Telephone Company, and Vernon Telephone Company. All are members of the Smaller ILECs.

Staff, the Smaller ILECs, and DCP all support the need for an SUSF. Staff proposes a fund mechanism that would entail examination in a general rate case of a requesting carrier's ability to meet its revenue requirement with a basic residential local service rate set at the current \$23 per month statewide benchmark rate,⁹ extent of availability of alternative service providers in the service territory, the carrier's revenues from total regulated operations (interstate and intrastate), and advisability of plant write-downs. Recipients of funding would have to file annual attestations on continued need for and allowed application of funds. All telecommunications providers in New York using telephone numbers would be required to contribute proportionally, on a per-customer-phone-number-used basis. Staff estimates a worst case fund amount of \$5.6 million per year, with contribution levels of less than \$0.01 per month for each phone number. It recommends review after three to five years to determine whether the SUSF should be terminated, continued, or adjusted.¹⁰

The Smaller ILECs propose a longer term SUSF mechanism modeled on the current TF process, which is based on general rate case filings, with eligibility limited to common carriers designated as "eligible telecommunications carriers" (ETCs) for federal universal service fund purposes.¹¹ Disbursements would depend on a carrier's ability to meet its revenue requirement

⁹ See Case 05-C-0616, *Transition to Intermodal Competition in the Provision of Telecommunications Services*, Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings (issued April 11, 2006)(Comp III Order), pp. 62-63; Case 07-C-0349, *Examining a Framework for Regulatory Relief*, Order Adopting Framework (issued March 4, 2008)(Small ILEC Framework Order), p. 2 n. 2.

¹⁰ See generally Staff Initial Brief (IB), pp. 4-5, 10-20.

¹¹ See 47 U.S.C. §§214(e), 254(e).

with a basic residential local service rate set at a new benchmark rate, reduced to \$15.22 per month. All telecommunications providers in New York--including wireless and cable telephone providers--would be required to contribute to the fund proportionally, based on their intrastate regulated revenues. The Smaller ILECs estimate an initial, uncapped maximum fund amount of \$10.3 million, yielding an estimated cost to end users of \$0.02 per month per access line. They propose a review of the SUSF program after five years.¹² DCP essentially supports the Smaller ILECs' proposals for an SUSF.¹³

CTANY, the Facility CLECs, Sprint, the Wireless Group, and Verizon all oppose establishment of any SUSF as beyond the Commission's authority, unneeded, and, in any event less desirable than alternatives. Their respective positions vary somewhat on issues concerning the conditions, characteristics, and features that should shape an SUSF in the event that the Commission determines one should be created. Those positions will be described later in this recommended decision, in discussing the details of the proponents' SUSF proposals and other parties' reactions to them.

AT&T takes a middle position, supporting neither establishment of a new SUSF nor elimination of current support to small rural ILECs. Instead, it proposes further extension of the TF on an interim basis, beyond the current end-of-September-2011 termination date for the TTFE. AT&T recommends that for three years the Commission keep the existing TF support levels in place for current recipients, at current levels, and use the existing rate case based mechanism established under the Small ILEC Framework Order to determine whether any additional

¹² See generally Smaller ILECs IB, pp. 5-7, 37-55; Tr. 103; Ex. 19.

¹³ See DCP IB, pp. 1-2.

companies should receive funding support during the interim period. AT&T proposes a soft cap to limit overall funding to 150 percent of the current fund level in 2011, 175 percent in 2012, and 200 percent in 2013. It projects a current funding level of less than \$1 million, resulting in fund contributions of \$0.03 on an average end user's monthly \$30 intrastate service bill, or \$0.06 if the amount of the Fund doubled under the soft cap. Under AT&T's proposal, the Commission would commence a review of high-cost funding support issues in two years, to allow issuance of a new order in three years.¹⁴

ISSUES

I. COMMISSION AUTHORITY

A. Parties' Positions

As a threshold issue, opponents of an SUSF strongly deny that the Commission has any legal authority to establish an SUSF, regardless of need or advisability of one, while proponents just as adamantly insist it does. Proponents point initially¹⁵ to §254(f) of the federal Communications Act of 1934, as amended (FCA),¹⁶ which provides:

A State may adopt regulations not inconsistent with the [Federal Communications] Commission's [FCC] rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State.

¹⁴ AT&T IB, pp. 1-2.

¹⁵ DCP IB, p. 2 n. 1; Smaller ILECs IB, pp. 2, 10; Staff IB, p. 5.

¹⁶ 47 U.S.C. §254(f).

Opponents maintain that §254(f) does not itself grant or delegate any authority to a state or state agency to create a universal service support fund.¹⁷ The Wireless Group and Verizon add that this subdivision merely disclaims federal preemption of the field of universal service, giving states permission to adopt measures to support universal service, insofar as they do not interfere with federal universal service regulatory requirements.¹⁸

Notwithstanding §254(f), opponents say, any authority for the Commission to establish an SUSF must be grounded in a statutory grant from the New York State Legislature in the Public Service Law.¹⁹ They note the black letter law that the Commission possesses only those powers expressly set forth in statute, or incidental to its express powers, or implied to carry out its purposes.²⁰

The SUSF proponents see numerous provisions of the Public Service Law that serve as authority for the Commission to establish such a fund. Although they identify no section of the law that expressly grants the power to establish a telecommunications universal service support fund, Staff notes that PSL §92(4) expressly identifies “the goal of universal service to residential customers;” and also refers to letters from the primary sponsor of the bill adding the provision to the PSL and from the Commission chairman reciting that goal and

¹⁷ CTANY Reply Brief (RB), p. 7; Sprint RB, p. 5; Wireless Group RB, pp. 16-17; Verizon IB, pp. 15-16.

¹⁸ Verizon RB, p. 7.

¹⁹ See *supra* p. 8 nn. 14 and 15.

²⁰ Citing, e.g., *Crescent Estates Water Co., Inc. v. Public Service Comm’n.*, 77 N.Y.2d 611, 616-17 (1991)(*Crescent Estates*).

recommending that the governor sign the bill.²¹ Proponents of an SUSF also ground Commission authority to establish a fund in:²²

- PSL §5(1), under which Commission jurisdiction, supervision, powers, and duties extend to every telephone line wholly or partially lying within New York State and the persons or corporations owning, leasing, or operating them;
- PSL §91, which requires telephone service to be adequate and just and reasonable and charges for it to be just and reasonable;
- PSL §94(2), which specifies that the Commission has general supervision of all telephone corporations and telephone lines within its jurisdiction;
- PSL §97, which requires, among other things, that telephone corporations' practices and service be just and reasonable, adequate, proper, and sufficient.

SUSF proponents also rely on PSL §4(1), conferring on the Commission, in addition to the powers and duties specifically set forth in the statute, "all powers necessary or proper to carry out the purposes of [the Public Service Law].²³ The proponents further claim PSL §5(2) as a source of authority to create an SUSF to ensure the availability of access to public

²¹ See Staff IB, pp. 6-7.

²² See generally Smaller ILECs IB, p. 9; Smaller ILECs RB, pp. 3-5; DCP IB, p. 8; DCP RB, pp. 4-5; Staff RB, p. 18.

²³ Staff RB, p. 19.

safety services, such as E911.²⁴ In addition, they argue that the Commission has established similar funds over a long period in the past, citing the System Benefits Charge (SBC), Renewable Portfolio Standard (RPS), and Energy Efficiency Portfolio Standard (EEPS) funds in the energy field and the Targeted Accessibility Fund in telecommunications.²⁵

The SUSF opponents observe that nothing in the Public Service Law expressly grants the Commission power to establish a telecommunications SUSF.²⁶ Nor do they see any merit to any of the proponents' theories about implied power to create one. CTANY suggests that in establishing an SUSF the Commission would impermissibly engage in social policy-making and encroach on the legislature's prerogative to determine social policy ends or goals.²⁷ Verizon contends that, even if promoting universal service were a permissible *goal*, an SUSF is not a permissible *means* to achieve that goal, because the Commission may not pursue an end through means the legislature has not authorized, and it has not expressly authorized such a fund.²⁸ The opponents argue that the general jurisdictional and supervisory provisions

²⁴ Smaller ILECs IB, pp 9-10; Staff RB, p. 20. Section 5(2) directs the Commission to "encourage all persons and corporations subject to its jurisdiction to formulate and carry out long-range programs, individually or cooperatively, for the performance of their public service responsibilities with economy, efficiency, and care for the *public safety*, the preservation of environmental values and the conservation of natural resources ... [emphasis added]."

²⁵ Smaller ILECs IB, pp. 10-11; DCP IB, p. 8; DCP RB, pp. 3-5; Staff RB, p. 20.

²⁶ *E.g.*, Sprint RB, p. 5; Verizon IB, pp. 11-12.

²⁷ CTANY IB, pp. 33-34, 38-40, citing *Boreali v. Axelrod*, 71 N.Y.2d 1, 11 (1987)(*Boreali*).

²⁸ Verizon IB, p. 13, citing *City of New York v Public Service Comm'n.*, 84 Misc.2d 1058 (Sup. Ct. Albany Co. 1976), *aff'd* 53 A.D.2d 164 (3d Dept. 1976), *aff'd* 42 N.Y.2d 916 (1977)(*City of New York*).

of PSL §§5(1) and 94 are insufficient to give the Commission *carte blanche* for every action it might conceivably take with respect to telephone lines and telephone corporations. They maintain that the Commission's ratemaking authority under PSL §§91, 92, and 97 allows it to address any revenue inadequacies of rural ILECs only through setting the just and reasonable rates for those ILECs themselves--including temporary rates in exigent circumstances, if necessary--not through any fund that requires contributions from other telecommunications providers.²⁹

SUSF opponents also contend that requiring contributions to such a fund would constitute taxation, a power that cannot be delegated to the Commission without specificity and provisions for review.³⁰ If not a tax, then contributions to the fund would qualify as a fee or assessment, they say, but one without legislative authorization. The opponents note that the Public Service Law includes a number of provisions that grant the Commission explicit authority to impose assessments on or otherwise collect funds from or require payments by utilities, but that a telecommunications universal service fund is not among those provisions. They refer to: PSL §18-a, generally; §18-a(6)(a), specifically, assessments on some regulated

²⁹ CTANY IB, p. 35; Wireless Group IB, pp. 17-19; Wireless Group RB, p. 13; Verizon IB, pp. 12-14; Verizon RB, p. 9.

³⁰ Citing New York Constitution, Article III, §1, and Article XVI, §1.

utilities "to fund energy efficiency programs;"³¹ §25, penalties; §66-k(2), air pollution mitigation fund; §92-c(11), customer-owned currency operated telephone enforcement fund; §113, refunds and reparations; and §135(d)(5), home energy efficiency public awareness campaign (authorization expired in 1996).³² The opponents rely on the rule of statutory construction that explicit mention in a law of a particular thing or power with respect to a particular subject matter negates any implication of unmentioned analogous things or powers with respect to the same subject matter.³³

Opponents assert that PSL §5(2) provides no basis for mandating contributions to an SUSF, because that subdivision is limited to "encouraging" certain programs, not requiring or compelling them; and, in any event, focuses on efficiency, environmental, and resource conservation programs, not a telecommunications universal service fund. Beyond that, they argue that SBC, RPS, and EEPS funds on which proponents rely are not precedent for any Commission power to adopt an SUSF because

³¹ So characterized in CTANY IB, pp. 34-35. CTANY misapprehends the nature of that statutory assessment. It is intended to recover increased costs--beyond those recoverable under the cap on §18-a assessments established in 1972--of the Department of Public Service and other state agencies supported through the assessment in meeting their expanded responsibilities for regulating and overseeing some utilities, in light of the increasingly more complex Commission work involving "development of important environmental and efficiency policies and programs relating to, among other things, energy efficiency and renewable energy." L. 2009, ch. 59, pt. NN, §1.

³² CTANY IB, pp. 34-35, 37; CTANY RB, p. 9; Sprint RB, p. 5; Wireless Group IB, pp. 16-17; Wireless Group RB, p. 14; Verizon IB, pp. 12-15.

³³ Usually set forth in Latin, as: "*expressio unius est exclusio alterius*." See, e.g., CTANY IB, pp. 34-35, relying on *New York City Council v. City of New York*, 4 A.D.3d 85 (1st Dept. 2004). See also Sprint RB, p. 5; Verizon IB, pp. 12-14.

the former were voluntarily adopted or not opposed by the utilities affected.³⁴ Similarly, SUSF opponents maintain that the TAF is no precedent for a universal service high-cost fund because the Commission adopted it as part of a settlement through the efforts of a collaborative working group, and thus it was not challenged. The TF and TTFE are no precedent for an SUSF, either, they contend, because those funds were also the result of settlements the Commission adopted.³⁵

Lastly, the opponents deny that PSL §92(4) provides any authority for the Commission to establish an SUSF. They contend that subdivision is “simply a notice requirement” and-- by requiring only that an application for a major rate change be accompanied by a statement of the proposed change’s effect on universal service and that the Commission consider the statement in its rate decision--reflects legislative policy of promoting universal service exclusively through ratemaking decisions. As they argued with respect to various funds expressly identified in the Public Service Law, SUSF opponents argue that this express legislative mandate negates by implication any claim that the Commission has implied power to establish a fund to further universal service.³⁶

B. Discussion

As SUSF opponents maintain, FCA §254(f) on its own does not grant or delegate any authority to a state telecommunications regulatory commission to create a universal

³⁴ CTANY IB, p.38; CTANY RB, p. 9; Wireless Group RB, p. 14; Verizon RB, p. 9.

³⁵ CTANY RB, pp. 9-10; Wireless Group RB, pp. 14-15; Verizon IB, p. 38 n. 38; Verizon RB, pp. 9-10.

³⁶ CTANY IB, p. 34; CTANY RB, pp. 7-8; Wireless Group IB, pp. 17-19; Wireless Group RB, pp. 15-16; Sprint RB, pp. 5-6; Verizon RB, p. 8.

service support fund. It simply makes clear that Congress did not intend to preempt states and state commissions from establishing universal service funds that do not interfere with the federal universal service regulatory regime. Thus, any Commission authority to establish an SUSF in New York must rest on an explicit or implicit legislative grant in the Public Service Law.

The Wireless Group seems to go farther and suggest that FCA §254(f) requires a "State," acting through its *legislature*, either to adopt a universal support mechanism by law expressly or to authorize a "State commission" expressly to do so, with action by a "State commission" in the absence of express enabling legislation insufficient. It relies on the definitions in 47 U.S.C. §153(40) and (41).³⁷ The definition of "State" in FCA §153(40), however, is sufficiently broad and general to encompass not only a state's legislature, but its executive branch agencies. Moreover, as DCP notes, §254(f) reads: "[a] *State may adopt regulations ... to preserve and enhance universal service [emphasis added].*"³⁸ Congress assuredly knows that state legislatures do not "adopt regulations," they enact or pass "laws," or "statutes" or "enabling legislation;" and that state agencies, including commissions, do "adopt regulations." Thus, even though SUSF opponents correctly observe that the Public Service Law contains no explicit grant of power to establish an SUSF, I find ample authority in it for the Commission to create one.

PSL §4(1), of course, expressly confirms that the Commission's powers are not limited to those explicitly set forth within the four corners of its enabling law. As

³⁷ See Wireless Group IB, pp. 19-20.

³⁸ DCP IB, pp. 5-6.

recognized by even the judicial authorities the SUSF opponents cite, the Commission also possesses all implied "powers necessary or proper to carry out the purposes" of the Public Service Law.³⁹ The question then arises whether establishing an SUSF would further one or more purposes--i.e., ends or goals--of the Public Service Law. Contrary to CTANY's contention, the Commission would not engage in social policy-making or encroach on the legislature's prerogative in establishing an SUSF, because universal service to residential customers is in fact an end or goal of the Public Service Law. PSL §94(2) recites that goal expressly and clearly.⁴⁰

Contrary to the SUSF opponents' argument, I find that the Commission's authority to take steps to meet that goal is not limited to adjusting rates. Their claim that §92(4)'s directive for the Commission to consider residential universal service impact statements in rate setting negatively implies that it has no other means to address the universal service goal conflates the Commission's duties with its powers.⁴¹ Section 92(4) imposes a *duty* on the Commission to require residential universal service impact statements in major telephone rate cases and to consider those statements specifically in its rate determinations. The subdivision thus negatively implies only that the Commission has no other *duties* with respect to universal service than those specifically set forth in it. Section 92(4) suggests nothing about the Commission's *powers* to

³⁹ See *Crescent Estates*, *supra*, at 616-17.

⁴⁰ None of the "number of coalescing factors" that applied in *Boreali* to the Court of Appeals' determination that the Department of Health had usurped the legislature's prerogative applies here. See 71 N.Y.2d at 11-14.

⁴¹ See PSL §4(1), which distinguishes between the Commission's powers--whether as specified in the law or as "necessary or proper to carry out [its] purposes"--and its duties, only as specified in the Public Service Law. See also PSL §5(1).

use means other than adjusting rates to address the goal of residential universal service. Therefore, no negative implication can logically arise from §92(4) with respect to the existence or non-existence of means beyond those the legislature has directed the Commission to employ toward achieving its purpose.⁴²

Verizon's claim that an SUSF is not a permissible *means* of achieving the statute's universal service goal because such a fund is not expressly authorized (see n. 25, *supra*, and accompanying text) also fails, inasmuch as it flies in the face of PSL §4(1), as well as numerous judicial decisions.⁴³ Neither is there merit to Verizon's argument that requiring regulated utilities to contribute to a fund would amount to regulating activities that are not "exclusively 'utility actions,'" thus contravening *City of New York*. In that case, the activities at issue involved individual constitutional rights, which the courts considered particularly and clearly within judicial, rather than regulatory agency, purview.⁴⁴ In contrast, establishment of an SUSF to support universal basic residential

⁴² The legislative findings and declarations underpinning §92(4) reinforce this conclusion. They assume and accept applicability of the FCA's universal telephone service goal, note that New York had been relatively successful in affording universal residential service, but recognize the threat technological and legal developments pose to the goal and require the Commission "at a minimum" to make specific findings on availability of local exchange service in major rate cases. L. 1984, ch. 618, §1 (eff. Jan. 1, 1985).

⁴³ *E.g.*, *Crescent Estates* at 616-17; *Consolidated Edison Co. of New York, Inc. v. Public Service Comm'n.*, 47 N.Y.2d 94, 102-104 (1979); *Niagara Mohawk Power Corp. v. Public Service Comm'n.*, 69 N.Y.2d 365, 368-69 (1987); *Public Service Comm'n. v. Jamaica Water Supply Co.*, 54 A.D.2d 10, 11-12 (3d Dept. 1976), *aff'd* 42 N.Y.2d 880 (1977); *Multiple Intervenors v. Public Service Comm'n.*, 166 A.D.2d 140, 142-44 (3d Dept. 1991).

⁴⁴ 84 Misc.2d at 1062.

service in New York is a goal of telephone regulation expressly set forth in PSL §94(2). As the court observed in *City of New York*:

The Public Service Law ... circumscribes the area over which the PSC can exercise jurisdiction and control. In general, this area is to ensure proper and adequate telephone service at reasonable cost to the public.⁴⁵

That would be precisely the objective of an SUSF, assuming one is needed and desirable.

PSL §§91, 92, and 97 not only establish the Commission's ratemaking authority, but also confer authority over telephone service and telephone corporation practices. Read in conjunction with PSL §§4(1), 92(4), and 94(2), general supervision of all telephone corporations and telephone lines⁴⁶ in New York, PSL §§91 and 97 also support the Commission's broad discretion to establish an SUSF and require telephone corporations to contribute to it, if needed and advisable in order to help ensure adequate, universal residential service and just, reasonable, adequate, efficient, and proper practices by telephone corporations.

Opponents' arguments against mandatory SUSF contributions as an unconstitutional tax are unconvincing. A requirement for contributing to an SUSF would not constitute a tax. "A tax is a charge that a government exacts from a citizen

⁴⁵ *Id.* at 1061.

⁴⁶ The statutory definition of "telephone line" extends not only to wires or cables, but to essentially all physical personal property and real property "used, operated or owned by any telephone corporation to facilitate the business of affording telephonic communication up to and including the demarcation point located on a subscriber's premises." PSL §2(18).

to defray the general costs of government”⁴⁷ An SUSF would not serve to defray the general costs of government. None of the funds collected under any of the SUSF proposals in this proceeding would pay for any costs of the State, the Commission, or any other instrumentality of the State of New York or otherwise be available to defray government costs. Nor, as proposed, would any of the funds collected even pass through the State Treasury, but rather be remitted to an SUSF fund administrator for subsequent disbursement in accordance with any mechanism the Commission establishes, if it determines an SUSF is needed and advisable.

Verizon’s suggestion that a requirement for contribution to an SUSF might constitute an improper regulatory “fee” misses the mark, as well. The case on which it relies refers to the type of “fee” imposed to reimburse the cost of the regulatory program in question or paid to gain access to a government service or benefit, “such as the fees paid to obtain licenses to practice professions in particular jurisdictions.”⁴⁸ The costs of the Commission’s regulatory programs, including telecommunications regulation, are recovered by the State through assessments pursuant to PSL §18-a, and would not be recovered in any way by an SUSF. In any event, the Court of Appeals has made clear that a regulatory agency has implied power to charge fees “reasonably necessary to the accomplishment of the regulatory program.”⁴⁹

⁴⁷ *Walton v. Dept. of Correctional Services*, 13 N.Y.3d 475, 485 (2009), citing *American Ins. Assn. v. Lewis*, 50 N.Y.2d 617, 623 (1980)(*Walton*).

⁴⁸ *Walton*, 13 N.Y.3d at 485.

⁴⁹ *Suffolk Co. Builders Ass’n v. County of Suffolk*, 46 N.Y.2d 613, 619 (1979), cited approvingly in *Walton*, 13 N.Y.3d at 485.

I also find wanting opponents' arguments based upon the existence of express provisions in the Public Service Law for assessments for various purposes other than an SUSF, together with the statutory construction principle of *expressio unius est exclusio alterius*. The existence of the other funds and assessments to which they point cannot logically support a negative implication that the Commission lacks authority to create an SUSF. The general assessment under PSL §18-a (funding the operations of the Department of Public Service and certain other agencies' activities), the former home energy conservation awareness fund under PSL §135-d(5)(moneys collected through the §18-a assessment), the air pollution mitigation fund under PSL §66-k(2), and the customer-owned currency operated telephone enforcement fund under PSL §92-c(11) are all mandatory. They impose duties on the Commission, rather than confer powers. As noted above, the Public Service Law carefully distinguishes between the Commission's duties and its powers. The presence in the statute of certain express duties--which, as PSL §4(1) requires, must be specified--implies nothing about the presence or absence of Commission powers, which may be only implicit.

Verizon relies on supposed negative implication from Public Service Law provisions on penalties (§25) and refunds and reparations (§113) to no avail. Penalties are fines for violations of regulatory requirements, imposed only after judicial proceedings and paid to the general fund of the State Treasury for use for general governmental purposes, not assessments or funds maintained by a non-governmental administrator to serve particular substantive regulatory goals.⁵⁰ Reparations are payments from ratepayers to a utility to make it

⁵⁰ PSL §24.

whole for shortfalls of revenues produced by temporary rates.⁵¹ They have no relevance whatsoever to assessments or funds to serve particular regulatory goals. Refunds are payments by a utility to customers of amounts initially collected in rates, as in the case of temporary rates, and later determined to be unjustified, or amounts found to be customers' just and reasonable share of reimbursements to the utility from other sources,⁵² again entirely irrelevant to the existence or non-existence of implied Commission power to establish assessments or funds to serve particular regulatory goals.

As SUSF proponents maintain, the Commission has relied in the past, over a long period of time, on implied power to create funds as necessary or proper to serve regulatory goals set forth in the Public Service Law, including the SBC, RPS, and EEPS funds for energy-related purposes and the TAF, TF, and TTFE for telecommunications purposes. Establishment of the SBC dates back 15 years,⁵³ as does the Commission's decision to require the

⁵¹ PSL §113(1).

⁵² See PSL §113(1) and (2).

⁵³ Case 94-E-0952, *Competitive Opportunities for Utility Service*, Opinion 96-12 (issued May 20, 1996).

TAF.⁵⁴ The Commission created the TF in 2003,⁵⁵ RPS in 2004,⁵⁶ EEPS in 2008,⁵⁷ and the TTFE in 2010.⁵⁸ As the Smaller ILECs contend, long-standing administrative agency interpretation of its enabling statute is "entitled to great, if not controlling, weight ..., especially when it has been universally acquiesced in by those interested."⁵⁹ In this instance, these funds demonstrate the Commission's long-standing and continual interpretation of the Public Service Law as including the implied power to establish funds specifically designed to further the goals the legislature has charged it with advancing. Moreover, contrary to the arguments of the opponents, that some of these funds might have resulted from settlement agreements adopted by the Commission does not undercut the force of the

⁵⁴ Case 94-C-0095, *Continuing Provision of Universal Service and Regulatory Framework for Transition to Competition*, Opinion 96-13 (issued May 22, 1996)(Comp II Order), pp. 58-62. Moreover, the Commission established the TAF as a means of pursuing the statutory goal of universal service. Comp II Order, p. 36. The Commission later issued another order establishing the TAF mechanism. Case 94-C-0095 *et al.*, Opinion No. 98-10 (issued June 2, 1998)(TAF Order).

⁵⁵ Case 02-C-0595, *New York Intrastate Access Settlement Pool, Inc. - Traffic Sensitive Access Rates*, Order Adopting Comprehensive Plan (issued December 23, 2003)(Transition Fund Order), pp. 4-5.

⁵⁶ Case 03-E-0188, *Retail Renewable Energy Portfolio Standard*, Order Regarding Retail Renewable Portfolio Standard (issued September 24, 2004)(RPS Order), p. 5.

⁵⁷ Case 07-M-0548, *Energy Efficiency Portfolio Standard*, Order Establishing Energy Efficiency Portfolio Standard and Approving Programs (issued June 23, 2008)(EEPS Order).

⁵⁸ Phase I Order, *supra*.

⁵⁹ *Armitage v. Board of Educ. of the City of Auburn*, 122 Misc. 586, 590-91 (Supreme Ct. Cayuga Co. 1924)(citations omitted); see also *Charles v. Regan*, 126 Misc.2d 333, 334 (Supreme Ct. Albany Co. 1984).

Commission's long-standing interpretation of its powers.⁶⁰ The virtually universal acquiescence of interested parties in the establishment of the TAF and other funds noted warrants even greater deference by the courts to the Commission's interpretation of its enabling legislation, as *Armitage* states.⁶¹

In addition, I find the SUSF proponents' position on the implications of PSL §5(2) more convincing than that of the opponents. Notwithstanding opponents' contention that the Commission's powers under that subdivision are limited to "encouraging," rather than requiring certain programs, the Commission has established the SBC, RPS, and EEPS, pursuant to §5(2), as funds for which contributions are mandatory, confirming its long-standing interpretation of that provision as supporting the power to create a fund and to compel

⁶⁰ As SUSF opponents themselves argue, the Commission has only those powers expressly set forth in the Public Service Law, those incidental to its express powers, and those necessary or proper to carry out its statutory purposes. PSL §4(1). Any agreement or acquiescence of parties before it, therefore, cannot diminish the force of the Commission's interpretation of its enabling act as including the implied power to establish the funds in question. To the contrary, as just noted, acquiescence reinforces that interpretation.

⁶¹ 122 Misc. at 591. CTANY suggests that the TAF is not precedent because it was created as a result of a settlement reached in a collaborative. That suggestion is incorrect. The Commission made its decision implementing the TAF after a working group issued a report, an administrative law judge (ALJ) issued a decision generally recommending adoption of the report, and exceptions were taken. The Commission order did not adopt the working group report, but rather modified the ALJ's recommended decision, including rejecting some working group proposals, and adopted it only as modified. TAF Order, pp. 33-38. The parties did acquiesce to the order, but, as *Armitage* makes clear, that fact does not diminish the precedential value of the TAF Order.

contributions to it.⁶² Furthermore, the Court of Appeals has confirmed the Commission's power to *prescribe* reasonable measures under PSL §5(2).⁶³ Section 5(2), as SUSF proponents note, includes the goal of furthering public safety, and access to E911 emergency service universally in New York is an important element in contributing to public safety.

Finally, the legislature added PSL §§5(2) and 92(4) to the Commission's enabling statute in 1970 and 1984, respectively.⁶⁴ The Commission's establishment of the SBC, RPS, EEPS, TAF, TF, and TTFE all have come subsequent to the enactment of those provisions. The State Assembly and the State Senate each has a Committee on Corporations, Authorities and Commissions that oversees the operations and policies of the Commission.⁶⁵ Nonetheless, despite the long history of the Commission's establishing these funds as means within its implied powers to achieve the statutory goals set forth in §§5(2) and 94(2), the legislature has taken no action to suggest that the Commission's interpretation was erroneous. "If the legislature does not show any dissent from the interpretation placed upon a statute by those having its enforcement in charge the court will consider itself warranted in adopting such construction."⁶⁶

⁶² The Commission cited PSL §5(2) in creating the SBC, RPS, and EEPS funds. Case 94-E-0952, Opinion 96-12, *supra*, p. 58 n. 91; RPS Order, *supra*, p.5; Case 07-M-0548, *supra*, Order Instituting Proceeding (issued May 16, 2007), pp. 5-6, EEPS Order, *supra*, pp. 1-5.

⁶³ *Consolidated Edison Co. of New York, Inc.*, *supra*, 47 N.Y.2d at 103.

⁶⁴ L. 1970, ch. 155, §4; L. 1984, ch. 618, §2.

⁶⁵ See, e.g., <http://assembly.state.ny.us/comm/Corp/2010Annual/index.pdf>.

⁶⁶ *Armitage*, *supra*, 122 Misc. at 591-92.

For these reasons, I recommend that the Commission conclude that it possesses the implied statutory power to establish a State universal service high-cost fund. The next question, then, is whether it is reasonable and prudent for the Commission to exercise that power.

II. NEED FOR OR ADVISABILITY OF AN SUSF

Throughout the many years during which the Commission has promoted policies to encourage the spread of competition in telecommunications in New York it has emphasized its commitment to universal service, the preeminent "goal of ensuring that all residents of the State have access to affordable basic telephone service ... [to enhance] the ability of all persons to communicate with one another; to access public safety, health, education, and assistance services; and to participate more fully in society."⁶⁷ Techniques the Commission has employed to keep basic local residential service rates affordable have included pricing some other services, such as intrastate access services, higher above cost than otherwise would have been the case.⁶⁸ As competition has spread more broadly in the State's telecommunications markets, particularly through the expansion of alternative cable and wireless platforms, more and more ILEC customers have opted for alternative providers, resulting in significant contraction of access lines, revenues, and returns

⁶⁷ Comp II Order, *supra*, pp. 8-9; similarly, Comp III Order, *supra*, p. 72.

⁶⁸ Phase I Order, *supra*, pp. 1-2.

on equity in recent years for smaller ILECs in the higher cost of service rural areas of New York.⁶⁹

According to Staff, the revenue losses of the smaller rural ILECs, together with the need to maintain their networks, including outside plant facilities, despite the loss of customers, threatens their financial viability. That threat is exacerbated by the potential for significant losses of intrastate access charge revenues from reduction of access rates in a separate phase of this proceeding. The risk of atrophy in smaller rural ILECs' revenues portends deterioration in new investments, maintenance, and service quality, possibly a "death spiral" leading to bankruptcy and even an ILEC's going out of business. In areas where no alternative providers are available (dubbed "white spots") customers could be left without telephone service, adversely affecting their ability to communicate with other people and businesses, gain access to emergency services, and participate adequately in society.⁷⁰

⁶⁹ Tr. 104-05, 589-90, 597-99; Ex. 19, 31, 32. On the higher costs of rural service territories, see Comp III Order, *supra*, p. 60. Verizon, and presumably the ILEC subsidiaries of Frontier Communications Corporation (Frontier), are facing similar difficulties. Certainly, Verizon has pointed out its circumstances. Verizon IB, p. 36; Tr. 648. The Frontier ILECs' situation is not clear on this record, although their earnings experience on the whole seems significantly better than those of most ILECs in New York in recent years. Ex. 32. In any event, Verizon opposes an SUSF and has not suggested on this record that its financial experience threatens its ability to continue serving its residential customers anywhere in the State. Frontier, although a party to this proceeding that took part in Phase I, has elected not to participate in Phase II. The focus of the parties has been on the difficulties faced by the smaller rural ILECs in New York and their ability to continue to provide universal service.

⁷⁰ Tr. 592-93, 597-600.

In debating the need for an SUSF the parties disagree over the extent to which service on alternative telecommunications platforms is available in smaller rural ILECs' service territories, the extent to which service on other telecommunications platforms is substitutable for ILEC telephone service, implications of the financial deterioration of the smaller rural ILECs, and whether an SUSF or some alternative is the best approach to address the problem of their financial stability and ensure continuation of universal service for residential customers in New York. The following pages address each of those issues in turn.

A. Availability of Alternative Platforms

1. Parties' Positions

Staff and Verizon each introduced studies on the availability of alternatives to ILEC service in New York. Staff's report, prepared in late 2009, included a Geographic Information System (GIS) mapping method using, *inter alia*, data sets from the NYS Office of Real Property Services for household and business locations, American Roamer for wireless coverage, and cable franchising and U.S. Census data for cable coverage; a method based on ILEC-provided information dating from 2003 on access lines and percentages of customers with competitive cable modem or wireless service alternatives, submitted in Case 07-C-0349, the Small ILEC Framework proceeding; and a separate analysis of cable service availability, based primarily on cable franchise areas and U.S. Census data.⁷¹ Verizon's study entailed

⁷¹ Tr. 418-22; Exhibit 39. At the request of some parties, Staff's study also included information on availability of DSL (digital subscriber line), a broadband service. DSL availability, however, is a red herring, since it is not an alternative to ILEC service. It is provided by ILECs over the same lines as their standard wireline telephone service.

a GIS mapping method similar to Staff's, but with data updated to 2010.⁷²

Based on Staff's statewide study, SUSF proponents contend 90 municipalities in New York have no cable network infrastructure deployed. Moreover, they say, many residences in municipalities with cable service lie in locations where the cable networks do not extend, while many more are situated where there are cable franchises and networks, but no cable modem service available. As a result, they argue, a total of tens of thousands of households lack cable modem telephone service availability.⁷³ They say wireless coverage may potentially be available to about 90 percent of the State, but coverages of the four largest wireless companies in New York range from 40 percent to 80 percent. The proponents further note that even where wireless companies' coverage maps show availability, service cannot be guaranteed because of factors like signal strength, consumer equipment, traffic volumes, terrain, structures, foliage, weather, and other conditions resulting from "natural, manmade or other connecting carrier issues beyond the control of the wireless companies."⁷⁴ Staff adds that its field inspections in the Town of Crown Point, Essex County, and the Town of Milan, Dutchess County, confirm the findings in its report that neither cable nor wireless networks are deployed extensively enough to provide uninterrupted service to all customers in either of the towns if the ILEC serving it exited the market.⁷⁵

⁷² Tr. 456, 631-32; Ex. 83.

⁷³ Staff IB, p. 8; DCP IB, pp. 8-9; Smaller ILECs IB, pp. 20-21.

⁷⁴ Staff IB, p. 9; DCP IB, pp. 8-9; Smaller ILECs IB, pp. 19-21; citing Tr. 84, 424, 432, 446-48, Ex. 39, p. 17, Ex. 41-44, 59 through 67, and 71.

⁷⁵ Staff IB, pp. 9-10; Tr. 35-54; Ex. 72.

SUSF opponents state generally that telephone service is already universally available in New York and that Staff's and Verizon's analyses show nearly or virtually all New Yorkers have choice of carriers.⁷⁶ More specifically, CTANY says Staff's analysis using the 2003 data from Case 07-C-0349 shows only 1,264 residences in the 38 smaller ILEC service areas (not including Verizon or Frontier-Rochester) without cable or wireless platform options. It adds that only 14 ILECs have any customers without alternative providers and, but for one of those, the customers without an alternative carrier are only a small portion of their revenue bases.⁷⁷

The Wireless Group criticizes Staff's GIS mapping analysis as flawed because it includes Frontier and Windstream ILECs, which are not members of the Smaller ILECs party in Phase II of this proceeding, and also includes a number of non-residential property locations. After adjusting for these factors, the Wireless Group asserts, fewer than 1,400 residential locations in the Smaller ILECs' service territories lack competitive alternatives; and only 13 Smaller ILECs have residential locations without alternatives, of which four serve fewer than 10 such locations, only five serve more than 100 such locations, and the ILEC with the largest number of residential locations without alternatives has only 364. Thus, the Wireless Group maintains, if a Smaller ILEC folds without a successor, the actual number of customers without an available alternative will fall between zero and 364.⁷⁸

⁷⁶ Sprint IB, pp. 4-5; Sprint RB, p. 2; Wireless Group IB, p. 5; Verizon IB, pp. 23-24; citing Tr. 322, 795-96; Ex. 83; Ex. 87, Direct, p. 3; Ex. 98, p. 1.

⁷⁷ CTANY IB, pp. 11, 17, citing Ex. 39, pp. 14-16.

⁷⁸ Wireless Group IB, pp. 6-7; Wireless Group RB, pp. 9-11.

SUSF opponents also emphasize that Staff reported a 4.7 percent increase in wireless coverage areas from late 2009 to late 2010, as well as a drop from 94 to 92 in the number of municipalities without cable networks. In addition, federal stimulus grants have been awarded for proposed broadband network expansion in parts of New York.⁷⁹ These changes, they say, show that: white-spot areas are contracting; availability of alternative providers is growing rapidly; wireless can be deployed quickly; and, if a small rural ILEC does become insolvent and exits the market, alternative providers will speedily fill the gap.⁸⁰

Supporters of an SUSF respond that all analyses confirm and none contradicts--and SUSF opponents essentially admit--the fact that alternative cable and wireless networks are not universally available in the State.⁸¹ Staff points to the Verizon study as showing that 60,000 households in the Smaller ILECs' service territories do not have cable modem service available and more than 2,250 do not have available cellular service.⁸² It clarifies that the seeming decrease in municipalities without cable franchises was the result of an administrative error over-reporting the number in its original list, later corrected.⁸³ Staff also argues that the increase in wireless coverage since 2009 is offset by the wireless carriers' admission that they cannot guarantee service availability in all areas where their maps show coverage, because of the factors

⁷⁹ Citing Tr. 431-34, 441-42, and Ex. 40.

⁸⁰ CTANY IB, pp. 16-17; Sprint IB, p. 7; Wireless Group IB, p. 5; Wireless Group RB, p. 11; Verizon IB, p. 24.

⁸¹ DCP RB, p. 8; Staff RB, p. 8.

⁸² Staff RB, pp. 5-6, citing Ex. 83, p. 174.

⁸³ *Id.*, pp. 7-8, citing Ex. 53, compared to Ex. 39, pp. 19-21.

mentioned earlier that are beyond their control.⁸⁴ SUSF proponents add that the Commission has recently stated that wireless service is not yet an adequate substitute for wireline service for all customers.⁸⁵ DCP stresses that the small percentage of New York residents without a cable alternative is precisely the focus of the inquiry here.⁸⁶

2. Discussion

As noted earlier, the Commission has made clear that universal service is the “goal of ensuring that all residents of the State have access to affordable basic telephone service.”⁸⁷ Thus, in considering the threat to universal service posed by the possibility of a smaller rural ILEC’s financial difficulties resulting in its going out of business, it is critical to determine the extent to which any of its residential customers would be left without alternative telephone service. SUSF opponents’ assurances that “virtually” or “nearly” all, or a very high percentage of, residential customers have alternative platforms available fail to meet that test of universality.

Of the Staff and Verizon analyses of available platforms alternative to ILEC systems, I find the study using 2003 data from Case 07-C-0349, now more than seven years old, stale and unreliable. The approaches used in the Staff and Verizon GIS mapping method analyses are essentially the same, but the Verizon study’s results are more up to date and thus

⁸⁴ *Id.*, citing Tr. 446-48.

⁸⁵ *E.g.*, Staff IB, p. 4, citing Case 10-C-0202, *Verizon Service Quality Improvement Plan*, Order Adopting Verizon New York Inc.’s Revised Service Quality Improvement Plan with Modifications (issued December 17, 2010)(Verizon SQIP Order), pp. 15-16. See also DCP IB, pp. 11-12; Smaller ILECs IB, pp. 19-20; Smaller ILECs RB, p. 34.

⁸⁶ DCP RB, p. 8.

⁸⁷ Comp II Order, *supra*, pp. 8-9 (emphasis added).

more reliable. The results of Staff's separate analysis of cable service availability focus on presence or absence of cable franchises and cable modem service within particular municipalities, unrelated to particular ILEC service areas. Thus, it has little utility for assessing availability of alternative platforms within the individual small rural ILEC service territories. For these reasons, I will concentrate on the Verizon study results in assessing the availability of alternative platforms.

Verizon's study, like Staff's, includes Frontier and Windstream companies' systems, although those companies apparently would not seek SUSF disbursements and their customers presumably are not at risk of losing wireline service. None of the SUSF proponents has attempted to counter the opponents' criticism of including white-spots data for those systems. Although it is not clear to me that information on lack of availability of alternative platforms for Frontier and Windstream systems should not be taken into account, as a conservative approach I have weighed the issue both with and without those data. Including Frontier and Windstream systems, the study shows that at a minimum nearly 5,200 residences in 17 ILEC service territories have no alternative platform

available.^{88 89} Excluding Frontier and Windstream, more than 1,400 residences in 15 service areas lack any alternative platform.⁹⁰

These data do not tell the full story, however. As SUSF proponents maintain, wireless carriers admit that they cannot ensure availability of service in all of the locations where their coverage maps show it to be available. Moreover, the Commission itself has very recently concluded that “the unsatisfactory reliability of wireless signals in certain areas of the state and the infirmities of wireless 911 emergency service ... render the service as still not an adequate substitute for wireline service for all customers at this

⁸⁸ Ex. 83, p. 176. The Verizon study does not break the Frontier and Windstream data down into individual service territories. There are seven Frontier and three Windstream service areas included in the aggregated data. Compare Ex. 39, p. 8.

⁸⁹ In light of some SUSF opponents’ implication that a *de minimis* number of residences without an alternative might be acceptable, I note that in eight of those 17 service areas the number of residential locations without alternatives to the ILEC’s service ranges from one to 36. As explained earlier, however, ensuring universal service requires the availability of service for all.

⁹⁰ Ex. 83, p. 176.

time.”⁹¹ Thus, the Verizon study overstates the true geographic availability of platforms alternative to the ILECs’ wireline service. The numbers of residential locations it shows as having no alternative platforms available constitute only a lower boundary estimate.

The issue here is not simply one of *substitutability*, i.e., whether wireless service is sufficiently close to traditional wireline telephone service to be deemed an acceptable substitute for the latter, but one of *availability*. The Verizon study depends (as does the earlier, similar Staff GIS mapping analysis) upon coverage maps to determine geographic locations where wireless service is, in fact, available. The record evidence, however, leads to the inescapable conclusion that so many factors can affect the availability of wireless at any particular location at any particular time that the coverage maps themselves--on which the assessment of availability relies --must be deemed insufficiently credible to serve as a basis for a finding that service can truly be considered available at that location.

A higher boundary estimate would treat all “Cellular Only” locations identified in the Verizon study as equivalent to

⁹¹ Verizon SQIP Order, *supra*, pp. 15-16. Verizon claims that the Commission’s finding in Case 10-C-0202 was not based on any detailed record, such as that in this proceeding, and was related to a “narrow” issue concerning the definition of “core customers” for a service quality plan. Verizon IB, p. 31 n. 81. In Case 10-C-0202, however, as Staff notes (Staff RB, pp. 4-5), Verizon used the same database of “customers who lack competitive wireline alternatives,” from the New York Office of Cyber Security, as it did in preparing Exhibit 83 here. Verizon SQIP Order, p. 15. Moreover, the focus of the Commission’s inquiry in Case 10-C-0202 was not “narrow,” but broader than here: the Commission included within “core customers” not only residential customers, which are at issue here, but business customers, as well, “without wireline competitive alternatives....” *Id.*, p. 1.

locations with no alternative platform. Appendix 1 attached to this recommended decision illustrates that the number of residential locations in 31 smaller rural ILEC territories (excluding those of Frontier and Windstream affiliates) lacking an available alternative platform totals more than 50,000, as an upper bound estimate, with the "Cellular Only" locations added.⁹²

On the other hand, because of the uncertainty about the availability of cellular wireless signals at particular locations, wireless service might be an available alternative platform in some substantial number of residential locations within those smaller rural ILEC service territories, although the extent to which it might or might not cannot be determined from the data in the record. Appendix 2 attached depicts the number of residential locations in each of the 31 smaller rural ILEC service areas (again excluding Frontier and Windstream affiliates), under the assumption that wireless service would be available at 50 percent and would be unavailable at only the remaining 50 percent of those locations, which totals more than 25,700.⁹³

Accordingly, I find that the number of residential locations in the 31 smaller ILEC service territories (excluding Frontier and Windstream affiliates) without an available alternative to ILEC wireline service ranges from a minimum of 1,400 to as many as 50,000, with a mid-range estimate of 25,700.

⁹² Appendix 1 is derived from Exhibit 83, p. 176. Appendix 1 treats the gross number of "cellular only" locations shown in Exhibit 83 as all undependable and equivalent to locations with no available alternative platforms. Including Frontier and Windstream affiliates, the upper bound total rises to 137,529.

⁹³ Appendix 2 is derived from Exhibit 83, p. 176, and Appendix 1. Including Frontier and Windstream affiliates, the mid-range total of residential locations without an available alternative platform amounts to 69,438.

On the basis of those findings, I recommend that the Commission find that platforms alternative to ILEC wireline service are unavailable for a significant number of residential locations within those service territories.

The SUSF opponents maintain that, in any event, an SUSF is unnecessary because competition is shrinking the white-spot areas that now exist and expanding alternative platform systems swiftly, and will promptly fill the gap if a small ILEC becomes insolvent and exits its market. These and related arguments will be considered later in discussing whether an SUSF is needed or advisable as a means to address the current inadequate availability of alternative platforms.

B. Substitutability of Alternative Services

1. Parties' Positions

Beyond the issue of whether alternative providers are physically available in particular geographic locations within various service areas, SUSF proponents dispute whether wireless and cable modem carriers provide telephone service substitutable for traditional wireline telephone service, for the purpose of ensuring universal availability of basic residential local exchange service. They cite the basic service features listed in the Commission's 1996 Comp II decision: single party line, local/toll calling, local usage, tone dialing, access to emergency services, assistance services, and telecommunications relay service (TRS), directory listing, and privacy protections.⁹⁴ Going further, Staff maintains the Commission deems consumer protections, such as call blocking, complaint procedures, intercept services, and deferred payment agreements, network reliability assurance measures, and service quality

⁹⁴ Comp II Order, *supra*, p. 10; similarly, 16 NYCRR 602.1(b).

related tracking as characteristics of affordable, reliable telephone service.⁹⁵

Although Staff concedes that holding alternative providers to all elements of the Commission's rules and regulations applicable to regulated utilities might not be necessary, it presented a list of 27 "essential components" of the Commission's rules and regulations (a number of which duplicate the basic residential local exchange service elements the Commission identified in the Comp II Order) applicable to regulated telephone companies to which it believes alternative providers should conform for their services to be considered substitutable.⁹⁶ The Smaller ILECs and DCP go even farther than Staff. First, they note that the Smaller ILECs' basic residential local exchange service is fully regulated by the Commission, giving their residential customers a full panoply of regulatory protections. They also insist that the smaller rural ILECs are, in effect, carriers of last resort (COLRs), with an obligation to serve all customers in their respective service areas. Thus, they maintain, for an alternative carrier's service to be considered substitutable in a particular service area, the carrier must also submit to Commission oversight and enforcement and accept an obligation to serve all residential customers in that service area, but none does.⁹⁷ Individual service features that SUSF proponents particularly emphasize as important are directory listing, E911 access, Lifeline

⁹⁵ Staff IB, p. 3, no citation provided.

⁹⁶ Staff IB, pp. 20-22; Tr. 467-492, 499, 596; Ex. 34. The 27 listed items include, among other things: geographic availability, discussed above. Some of those 27 items also duplicate or to some extent overlap each other.

⁹⁷ Smaller ILECs IB, pp. 16 n. 38, 19-22; Smaller ILECs RB, pp. 34-35, 38-39; DCP IB, pp. 9-12; Tr. 68-69, 498-99; Ex. 89, Direct, pp. 17-19, 21, Rebuttal, p. 10.

discounts, network reliability assurance, back-up power to ensure access in electricity outage emergencies, and a stand-alone basic service option rather than “bundled” services.⁹⁸

SUSF opponents cite the Commission’s statement in its Comp III Order that “provision of telephone service is no longer a natural monopoly” as a clear indicator that service provided by non-ILECs is substitutable; as well as its finding in the same order that fixed cable phone service, Voice over Internet Protocol (VoIP) service, and wireless service are “widely available in New York and...from the perspective of customer demand...are sufficiently close substitutes for traditional wireline local service.”⁹⁹ They contend that the marketplace is the proper measure of substitutability; that competition relies on consumer choice and acceptance, which is the only test consistent with Commission policy favoring market discipline through competition; and that the characteristics and regulations upon which proponents would rely as a substitutability measure simply reflect legacy technology and regulators trying to compensate for lack of consumer choice in a monopoly environment no longer extant. Opponents argue that Staff presented no empirical evidence, but just its say-so, that the “core characteristics” of regulation it proposes as the test of substitutability are important to or expected by consumers. To the contrary, they state, the marketplace has demonstrated overwhelming consumer acceptance of wireless and cable modem phone service as substitutes, with more and more people

⁹⁸ See *supra* p. 37 nn. 96-97; DCP IB, p. 5.

⁹⁹ CTANY IB, p. 11; CTANY RB, pp. 11-12; Verizon IB, pp. 25-26; Wireless Group IB, p. 8; citing Comp III Order, *supra*, pp. 4, 33, 34-35.

subscribing to those services and dropping traditional regulated wireline service entirely.¹⁰⁰

The Facility CLECs also attack the proponents' call for compliance with the full panoply of regulations applying to ILECs to determine substitutability as excessive. They note that CLECs provide substitutable service to traditional business telephone service, but have never been subject to full regulation. In addition, the Facility CLECs argue that, with rapidly evolving markets and products, no provider of alternative service is likely to subject itself to full State utility regulation, so that, under proponents' test, New York would never have substitutable alternatives.¹⁰¹ The Wireless Group denies that wireless is unregulated, averring that wireless providers are regulated by competition and market demand; federal regulation under the FCA, including prohibitions against unjust and unreasonable charges and practices, regulations governing public safety, E911, accessibility, truth-in-billing, outage reporting, law enforcement assistance, and consumer privacy; and by New York State's generally applicable consumer protection laws.¹⁰²

Opponents deny that ILECs are COLRs, noting that the Commission has not designated any carriers as COLRs by rule or order.¹⁰³ They also suggest that a particular alternative carrier should not have to commit to providing service throughout a particular ILEC territory for its service to be

¹⁰⁰ CTANY IB, pp. 12-13; CTANY RB, pp. 11-12; Facility CLECs IB, 10; Facility CLECs RB, p. 10; Verizon IB, pp. 25-29; Wireless Group IB, pp. 9-10; Wireless Group RB, p. 12.

¹⁰¹ Facility CLECs RB, pp. 10-11.

¹⁰² Wireless Group IB, p. 10, citing: Ex. 87, Direct, pp. 9-10; 47 U.S.C. §201(b); 47 C.F.R. §§20.18 (E911), 64.601 *et seq.* (TRS), 64.2001 *et seq.* (privacy protections).

¹⁰³ Facility CLECs IB, p. 10, citing Tr. 704; CTANY RB, p. 12.

considered substitutable. Rather, they say, the only question should be the extent to which alternative carriers provide service collectively.¹⁰⁴

With respect to particular service features, Verizon contends that alternative carriers provide all of the basic service elements the Commission listed in the Comp II Order except directory listings and operator assistance services, which it argues should no longer be included. It states that, while alternative providers do not always include directory listing by default, widespread cord-cutting¹⁰⁵ of late demonstrates that consumers no longer believe listing is an important aspect of basic service. Verizon claims customers can get substitutes for operator assistance services in a variety of ways and carriers should be allowed to compete on the basis of the convenience and quality of the alternatives provided.¹⁰⁶

On the question of Lifeline discounts, SUSF opponents maintain that some wireless companies offer Lifeline discount service in New York using federal subsidies; the wide range of price points wireless companies offer allows customers to take service at affordable rates even without Lifeline discounts;¹⁰⁷ and, in any event, Lifeline customer needs should be addressed through TAF modifications, a subject for Phase III of this proceeding.¹⁰⁸ SUSF opponents insist that bundled services

¹⁰⁴ Verizon RB, p. 14. This point has already been addressed above under "Availability."

¹⁰⁵ Abandoning landline telephone service entirely in favor of wireless service only is often called "cord cutting."

¹⁰⁶ Verizon IB, pp. 31-32 n. 18; Tr. 642-43.

¹⁰⁷ They cite studies showing that adults living at or near the poverty level are nearly twice as likely to live in households that have cut the cord than higher income adults are. Tr. 643-44; Ex. 87, Direct, p. 6.

¹⁰⁸ Verizon IB, pp. 30-31; Wireless Group IB, p. 11.

should be considered a substitute for stand-alone, unbundled basic service because consumers are choosing bundled services from alternative carriers that include local calling and offer a variety of inexpensive service plans. They also note the Commission's finding in the Comp III case that ILECs' continuing loss of lines and access minutes strongly implies bundled telecommunications services from cable and wireless service providers are in competition with unbundled wireline service.¹⁰⁹ Opponents argue that the need for a back-up emergency power source should not be considered a deficiency of wireless and cable modem services, because even conventional wireline service over fiber requires a back-up power source and the Commission has approved tariffs recognizing consumer responsibility for providing normal or back-up power as needed for telephone service.¹¹⁰ SUSF opponents contend as a general matter that the claimed deficiencies in wireless and cable telephone services are merely differences from traditional service; that in the new competitive marketplace consumers have the ability and responsibility to choose among services offering different packages of advantages and disadvantages;¹¹¹ and that the Commission has acknowledged that substitutable services may change as technology advances.¹¹²

2. Discussion

Commission statements in the Comp III Order that provision of telephone service is no longer a "natural monopoly"

¹⁰⁹ Verizon IB, p. 14; Wireless Group IB, p. 11; citing: Tr. 713-16; Ex. 87, T-Mobile Rebuttal, pp. 9-10; Comp III Order, *supra*, p. 40.

¹¹⁰ Verizon IB, pp. 27-28, citing as an example Verizon Tariff No. 1, §1(A)(5).

¹¹¹ *E.g., id.*

¹¹² CTANY IB, pp. 12-13, citing Comp III Order, *supra*, pp. 75-76. No such Commission comment appears at the cited pages.

and that intermodal services are sufficiently close substitutes for traditional wireline service from the perspective of customer demand do not, *per se*, resolve the issue of substitutability. Staff contends “natural monopoly” is an economic concept addressing whether a single provider can supply a service or product more cheaply than two or more providers in a particular market and is unrelated to the concept of substitutability, which considers whether a particular service is an acceptable replacement for another service.¹¹³ Some commentators, however, have criticized the use and even the very introduction of the phrase.¹¹⁴ In any event the reference to “natural monopoly” and the other Commission comments SUSF opponents cite occurred in the context of the Commission’s analysis of whether alternative services were placing sufficient pressure on ILECs that they could constrain the latter’s ability to exercise market power in setting prices, which requires only a relatively small number of consumers to be willing to switch. From this perspective, the Commission found that the telecommunications market in New York was “adequately competitive.”¹¹⁵ That finding does not settle the question of substitutability here, though.

I also find unconvincing the Smaller ILECs’ argument that because they are, in effect, COLRs, with an obligation to

¹¹³ Staff RB, pp. 3-4. See also JONATHAN E. NUECHTERLEIN & PHILIP J. WEISER, *DIGITAL CROSSROADS* 12 (2007 ed.); William J. Baumol, *On the Proper Cost Tests for Natural Monopoly in a Multiproduct Industry*, 67 AMER. ECON. REV. 809, 810 (1977); PAUL J. GARFIELD & WALLACE F. LOVEJOY, *PUBLIC UTILITY ECONOMICS* 15-19 (1964).

¹¹⁴ See NUECHTERLEIN & WEISER, *supra*, at 14-16; CHARLES F. PHILLIPS, JR., *THE ECONOMICS OF REGULATION* 21 n. 5 (Rev. ed. 1969) and accompanying text.

¹¹⁵ Smaller ILECs RB, pp. 34-36; Comp III Order, *supra*, pp. 32-42.

serve all residential customers in their respective service territories, and must do so under Commission regulation, therefore only an alternative provider that voluntarily commits to serve all residential customers in a particular service territory and to submit to full-scale Commission regulation can be considered to provide basic local exchange service substitutable for that of the ILECs. As the SUSF opponents observe, the Commission has declined to establish COLR responsibilities for telecommunications carriers.¹¹⁶ Although the Commission's common carrier regulations require a telephone corporation to provide service on demand, that obligation is contingent on availability of facilities and capacity.¹¹⁷ Admittedly, by virtue of their designation as ETCs the small rural ILECs of concern here do have some responsibilities under FCA §214(e)(1) similar to those of a COLR and may not readily relinquish them.¹¹⁸ It is also true, however, that the Smaller ILECs undertook those responsibilities voluntarily, in pursuit of access to federal universal service funding support.¹¹⁹ In any event, the obligation to provide certain services supported by federal universal service funding mechanisms cannot logically be considered an element of basic local exchange service itself.

¹¹⁶ Comp II Order, *supra*, p. 10; Small ILEC Framework Order, *supra*, p. 16 n. 23

¹¹⁷ 16 NYCRR 605.2(a).

¹¹⁸ 47 U.S.C. §214(e)(1) and (4). All of the Smaller ILECs participating in this proceeding have been designated as and remain ETCs. See Case 94-C-0095 *et al.*, *Continuing Provision of Universal Service and Regulatory Framework for Transition to Competition*, Order Designating Eligible Telecommunications Carriers and Service Areas, and Granting Waivers (issued December 1, 1997)(ETC Order), Appendix A, p. 1; and, *e.g.*, Case 09-C-0486, *NOC, Inc. Designation as an Eligible Telecommunications Carrier*, Untitled Order (issued July 21, 2009), Appendix A, p. 1.

¹¹⁹ ETC Order, *supra*, p. 6.

The SUSF supporters' proposals that alternative carriers must be subject to the full or nearly full range of regulatory requirements in order that their services be deemed substitutable for small rural ILECs' basic residential exchange service go far beyond what the Commission has defined. The Commission delineated the elements of basic residential service that should be universally available as including only: single-party access line; access to local and toll calling; local usage; tone dialing; access to emergency services; access to assistance services; access to TRS; directory listing; and privacy protections.¹²⁰ In revisiting the issue of universal service more recently, after noting that a Staff "white paper" considered those same elements as remaining appropriate, the Commission made no changes to them.¹²¹ At the same time, the Commission also extensively reviewed the need for service quality standards and reporting, including network reliability, and consumer protection measures. While acknowledging their importance, the Commission did not add them as essential elements of basic residential service.¹²² I find nothing in the record that suggests circumstances have changed in significant ways since the time of the Comp III Order that would warrant a different outcome now, inserting additional elements in defining basic residential exchange service. Accordingly, I will not recommend any expansion of the essential elements of basic residential service.

The concept of substitutability, as Staff argues, considers whether a particular service is an acceptable replacement for another service.¹²³ Yet, as the SUSF opponents

¹²⁰ Comp II Order, *supra*, pp. 9-10.

¹²¹ Comp III Order, *supra*, pp. 71-72, 75-79.

¹²² *Id.*, pp. 80-107.

¹²³ *Supra* p. 42 n. 113.

emphasize, the proper test of acceptability of a replacement is not legacy regulatory judgments of what is necessary in a monopoly context, but consumer judgments reflected in their actual purchases. The long-running and continuing loss of access lines and revenues by the smaller rural ILECs to substantial penetration of alternative platforms for telephone service provides convincing evidence that consumers--not just generally, but within those service areas--consider wireless and cable modem telephone service an acceptable substitute for Commission-regulated ILEC service.¹²⁴ Pretending otherwise ignores the reality of consumer choice.

Looking at the individual basic service elements the Commission has delineated, only directory listings and operator assistance services appear to be questionable for wireless and cable modem service.¹²⁵ At the same time the Commission initially spelled out the basic local exchange service elements, it also cautioned that basic service is a dynamic term for "minimally acceptable" access to and use of the public telecommunications network that should be re-examined from time to time for potential revision in light of evolving technology, markets, and customer demand.¹²⁶ As Verizon maintains, the widespread and continuing adoption of alternative services by consumers in the marketplace, regardless of the availability of directory listings and operator assistance services, accompanied by abandonment of traditional wireline service, supports a finding that consumers generally no longer need or demand these features even as part of more fully featured service, let alone

¹²⁴ See Ex. 19, 31, 32, 39, and 83.

¹²⁵ FCC regulations on E911 and TRS accessibility and privacy protections apply to cable modem service as well as wireless. 47 C.F.R. §§9.5, 20.18, 64.601 *et seq.*, 64.2001 *et seq.*

¹²⁶ Comp II Order, *supra*, pp. 9-10.

service that is "minimally acceptable." Accordingly, I recommend that the Commission no longer include directory listings and operator assistance services as elements of basic service.¹²⁷

I agree with SUSF proponents that the availability of Lifeline discounts is an important consideration in examining the implications of the potential loss of ILEC service. Indeed, in assessing issues related to universal service in the Comp II Order, soon after listing the elements of basic service, the Commission set the parties on a path to develop the mechanics for the TAF, to fund Lifeline, emergency, and TRS services. Unlike emergency and TRS services, however, the Commission did not include Lifeline discounts as elements of basic service.¹²⁸ Consequently, this recommended decision finds that Lifeline discounts are not an element of basic service, but will be considered later in assessing the advantages, disadvantages, and advisability of an SUSF.¹²⁹

Nor do I see that bundling of services renders wireless or cable modem services non-substitutable for traditional wireline basic service. Alternative carriers claim to offer a choice of low-cost service plans and the record

¹²⁷ In granting Verizon a waiver to discontinue distributing telephone directory residential white pages listings, the Commission itself recently found: "Customers today have many options in terms of locating telephone numbers. Statistics suggest that telephone directories are not nearly as valuable as they were even a decade ago." (It did, however, require continued delivery to residential customers on request.) Case 10-C-0215 - *Verizon New York, Inc. - Waiver of Rule Pertaining to Distribution of Telephone Directories*, Order Granting Waiver with Conditions (issued October 15, 2010).

¹²⁸ Comp II Order, *supra*, pp. 9-10, 11-12, 15.

¹²⁹ As Verizon notes, Lifeline and other issues related to the TAF are a subject of the third phase of this proceeding, which is already under way. See Case 09-M-0527, *supra*, Notice Convening Collaborative (issued March 22, 2011).

contains substantial evidence that, despite bundling, even lower income customers are selecting those alternative services over traditional wireline service.¹³⁰

Finally, I reject the proposal that back-up power availability be considered an element of basic service in assessing whether alternative services are substitutable. The Commission itself has already recognized that back-up power is not feasible for service provided over fiber rather than copper wire.¹³¹ The mounting consumer choice, even by lower income customers, of alternative services that lack back-up power over traditional landline service providing back-up power further demonstrates that end users do not consider such a feature essential to telephone service.

In summary, I recommend that the Commission no longer include directory listings or operator assistance service as elements of basic local service and that it find cable modem service and wireless service constitute economic substitutes for traditional wireline basic residential local exchange service.

C. Financial Jeopardy of the Smaller ILECs

1. Parties' Positions

In support of their position that small rural ILECs face serious financial risk, Staff and the Smaller ILECs introduced evidence on loss of access lines and falling returns on equity (ROE). Staff shows that over the 15-year period from 1995 through 2009 the number of New York ILECs' access lines (excluding Verizon's) peaked in 2000, but since then has fallen

¹³⁰ See *supra* p. 41 n. 109. Nonetheless, the lack of a flat rate basic service offering from alternative carriers comparable to that required to be available from ILECs in New York is a factor to consider in weighing the need for or advisability of an SUSF, as discussed below.

¹³¹ Comp III Order, *supra*, p. 64.

steadily, by a total of about 55 percent at the end of the period. Excluding both Verizon and Frontier, Staff's presentation again reflects a 2000 peak year, with continual erosion since then to a level about 40 percent lower by 2009.¹³² With this major loss of revenue-producing lines, from 2005 through 2009 ROEs on intrastate operations for most small rural ILECs fell substantially. By 2009, almost all were suffering from negative intrastate ROEs, of as much as -60 percent.¹³³

As recounted earlier, Staff testified that the small ILECs' continued deteriorating financial circumstances augur a downward spiral that jeopardizes their ability to continue to maintain their networks and provide reliable service, or even survive and provide service at all, to their customers. Intrastate access reform, to be carried out in another phase of this proceeding, can only exacerbate their prospects significantly. In white-spot areas where no alternative platforms are available, Staff asserts, residential and business customers would be left in the lurch without telephone service, the ability to reach emergency services, or crucial communications capability for participation in society and its civil and political affairs.¹³⁴

The Smaller ILECs also argue that they operate pursuant to a "regulatory compact," under which the Commission has a duty to ensure rates charged are just and reasonable and may not deny them a reasonable return on investment. They say they have continued to make investments in reliance on the "regulatory compact," but their ability to persist is now

¹³² Ex. 31.

¹³³ Ex. 19, 32.

¹³⁴ *Supra* pp. 25-26 nn. 69-70 and accompanying text. See also Smaller ILECs IB, pp. 14-18; Tr. 103-05.

seriously at risk, thus requiring external support from an SUSF.¹³⁵

Opponents of an SUSF note that proponents looked at only book ROEs from the Smaller ILECs' annual reports to the Commission. They contend that these data fall short of the type of analysis that should be required for a showing of need; that supporters of an SUSF should have presented detailed *pro forma* financial data, which opponents maintain I required by my Phase II Procedural Ruling, but failed to do so.¹³⁶ Opponents note that most of the Smaller ILECs do not currently need to draw from the existing TF/TTFE and claim the fact that three of them have been granted that support does not require creating a new fund.¹³⁷

The Wireless Group denies that case law supports the existence of any "regulatory compact" that ensures a regulated telephone utility a reasonable return on investment.¹³⁸ Sprint also asserts that SUSF proponents' analysis of financial need fails to consider significant revenue opportunities from retail and wholesale services other than regulated intrastate telephone service, including high-speed Internet access, video-entertainment, bundled service packages, and special access services. It observes that the Smaller ILECs deliver those other services over the same networks as their basic residential

¹³⁵ Smaller ILECs IB, pp. 8-9, citing *Rochester Telephone Corp. v. Public Service Commission*, 87 N.Y.2d. 17 (1995) and *Niagara Mohawk Power Corp.*, *supra*; Tr. 133-35, 219.

¹³⁶ CTANY IB, p. 15; CTANY RB, pp. 3-4; Facility CLECs IB, pp. 4-5.

¹³⁷ *E.g.*, CTANY IB, pp. 15-16; CTANY RB, pp. 3-5; Facility CLECs IB, pp. 4-5.

¹³⁸ Wireless Group RB, pp. 2-5, citing *Energy Ass'n. v. Public Service Commission*, 169 Misc.2d 924, 937-39 (Sup. Ct. Albany County 1996).

local service, even though they allocate 75 percent of the cost of the network loops to regulated intrastate voice service.¹³⁹

The Smaller ILECs and DCP dispute the opponents' claim that rate-case quality *pro forma* financial data are necessary to demonstrate need for a fund. They acknowledge that such detailed data would be appropriate for a rate case where a particular ILEC might seek SUSF support. They contend, however, that detailed rate case financial data are not required for the current phase of this proceeding, which focuses on whether there is sufficient evidence of a general need to establish a funding mechanism as a safety net.¹⁴⁰

The Smaller ILECs also challenge Sprint's argument that their revenues from non-regulated activities or services should be considered in determining need for support from a new fund. They assert that Parts 32 (uniform system of accounts for telecommunications companies), 36 (jurisdictional separations procedures for various revenues, expenses, and other financial categories), and 64, Subpart I (cost allocation between regulated and non-regulated activities) of the FCC's regulations govern and preclude offsetting Commission-jurisdictional intrastate costs with non-jurisdictional, non-regulated revenues.¹⁴¹ The local loop may be shared in part with services beyond the Commission's authority, but allocation of its costs and revenues is dictated by FCC rules, particularly Part 36. In addition, the Smaller ILECs say there are substantial additional costs for non-regulated services that are removed from the

¹³⁹ Sprint IB, pp. 12-14; Tr. 809-10.

¹⁴⁰ Smaller ILECs IB, p. 52; DCP IB, p. 14.

¹⁴¹ Smaller ILECs IB, pp. 58-61; Smaller ILECs RB, pp. 19, 41-43, citing 47 C.F.R Parts 32 and 36 and Part 64, Subpart I.

Commission-regulated intrastate revenue requirement under Part 64 rules.¹⁴²

2. Discussion

I cannot accept the Smaller ILECs' argument that a "regulatory compact" mandates the Commission to provide a subsidy external to the declining revenues they realize from rates as a result of the loss of access lines to competitors, in order to ensure that they earn a reasonable return on investment. The U.S. Supreme Court has made clear that the constitutional safeguard against "takings" "does not assure to public utilities the right under all circumstances to have a return upon the value of the property [used in public service]" or protect them against business hazards "due to competition."¹⁴³ In New York, arguments that there is a "regulatory compact" "are contradicted by the Public Service Law and have repeatedly been rejected by the courts."¹⁴⁴ Rate regulation in New York "[does]

¹⁴² *Id.*, pp. 43-44.

¹⁴³ *Public Service Comm'n. of Montana v. Great Northern Utilities Co.*, 289 U.S. 130, 135 (1933). See also *Market Street Ry. Co. v Railroad Comm'n. of California*, 324 U.S. 548, 567, *reh denied* 324 U.S. 890 (1945) ("The due process clause has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.") The cases on which the Smaller ILECs rely are not apposite and the comments cited are, in context, *dicta*. *Rochester Telephone Corp.*, *supra*, upheld the Commission's imputation to the utility of royalty revenue to compensate ratepayers for improper cost-shifting and uncompensated transfer of intangible assets to affiliated companies. 87 N.Y.2d at 24-25, 27-31. *Niagara Mohawk Power Corp.*, *supra*, upheld a Commission order requiring the utility to refund moneys collected through a fuel adjustment clause for costs that were imprudently incurred. 69 N.Y.2d at 368-376.

¹⁴⁴ *Energy Ass'n.*, *supra*, 169 Misc.2d at 938 (citations omitted), cited in Wireless Group RB, p. 3.

not necessarily guarantee utilities net revenues nor...immunize utilities from the effects of competition."¹⁴⁵

I also find unconvincing Sprint's argument that weighing the financial situation of the small rural ILECs requires considering revenues from non-regulated activities, not subject to Commission intrastate regulation or FCC interstate regulation. As the Smaller ILECs maintain, FCC regulations govern the allocation of costs and revenues associated with intrastate Commission-regulated activities, interstate FCC-regulated activities, and non-regulated activities.¹⁴⁶ That is at least one reason why the Commission has taken the position that from its perspective revenues from non-jurisdictional services "are not available to offset state regulated revenue deficiencies."¹⁴⁷

I find that fund proponents have provided sufficient evidence of threatening financial straits. Contrary to CTANY's suggestion, my Phase II Procedural Ruling did not require submission of detailed *pro forma* financial data of rate case quality to demonstrate need. The ruling acknowledged that individual company financial data *might* be essential in determining the generic question of need for a fund and, in light of that possibility, that I would entertain submission of company-specific *pro forma* data for that purpose.¹⁴⁸ Thus, I invited, but did not require, submission of company-specific *pro*

¹⁴⁵ *Id.*, citing *Market Street Ry. Co.*, *supra*.

¹⁴⁶ See *supra* pp. 49-50 nn. 141-42 and accompanying text.

¹⁴⁷ Comp III Order, *supra*, pp. 55-56 nn. 112 and 114. See also Framework Order, *supra*, p. 9 nn. 11-12 and accompanying text; and *infra* pp. 90-92 nn. 255-62 and accompanying text.

¹⁴⁸ Phase II Procedural Ruling, p. 5.

forma data, if proponents thought it vital for showing need.¹⁴⁹ The Commission has in the past used evidence gleaned from telephone company annual reports as substantial enough to serve as a foundation for authorizing additional revenues and greater pricing flexibility for Verizon and Frontier of Rochester.¹⁵⁰ Similarly, I find information from the Smaller ILECs' annual reports to the Commission, together with the information on access line deterioration, sufficient to support a generic decision on whether or not an SUSF is necessary or advisable.

The record contains substantial evidence presented by SUSF proponents that the small rural ILECs' financial circumstances have been deteriorating as a result of loss of access lines and associated revenues, threatening their viability and, in turn, their ability to continue to provide reliable, quality service throughout their service territories and ensure the universal availability of basic residential local exchange service. That only three of those companies have drawn from the TF so far does not diminish that threat going forward. In fact, the situation promises to get worse with the impending

¹⁴⁹ CTANY presented analysis of particular financial data on several specific members of the Smaller ILECs and whether those companies' individual circumstances warrant subsidy from the TF/TTFE or any SUSF. *E.g.*, CTANY IB, pp. 21-22; CTANY RB, pp. 4-5; generally, Tr. 336-51, 389-406, Ex. 3, 91. As I indicated in the Phase II Procedural Ruling (pp. 4-5), however, this phase of the proceeding is intended to determine the generic need for or desirability of an SUSF, not whether any individual ILEC or its residential customers should receive a particular subsidy from a fund. In any event, CTANY's analysis served primarily as foundation for its arguments that there are substantial disadvantages to an SUSF; that there are better alternatives to a fund; and that, regardless, Staff's estimate of the size of an SUSF is excessive and the current \$23/month benchmark rate Staff proposes to retain is too low. All of these matters are considered below.

¹⁵⁰ Comp III Order, pp. 52-57.

reduction in Phase III of this proceeding of the intrastate access charges that have historically been priced above cost to subsidize local residential service.¹⁵¹ I recommend that the Commission find accordingly.

Still, the threat to small rural ILECs' viability and to universal service does not necessarily demand amelioration through an SUSF. Opponents argue there are practical disadvantages to subsidies provided through an SUSF and better means to address the problem. Supporters strongly disagree. The next section of this recommended decision considers those matters.

D. Advantages and Disadvantages of an SUSF and Alternatives

1. Parties' Positions

Despite the financial stress the small rural ILECs face, fund opponents profess that an SUSF would have significant adverse consequences and that there are better alternatives for addressing the problem. They maintain that subsidies like the TF and an SUSF facilitate and perpetuate carrier inefficiency and create a disincentive to business model reform. Opponents cite as an example the recipient of the greatest amount of TF moneys, Crown Point Telephone Corporation (Crown Point), which has been drawing from that fund since 2004 but has not eliminated dependence on it.¹⁵² CTANY makes similar arguments

¹⁵¹ See, e.g., Phase I Order, pp. 1-2; Cases 09-M-0527 *et al.*, Notice Initiating Collaborative (issued January 11, 2011), pp. 1, 2-3, 5.

¹⁵² Facility CLECs IB, pp. 9-10, citing Tr. 47, 340 and Ex. 88, Direct, p. 5, Rebuttal, p. 7; Verizon IB, pp. 34-35.

and also claims the TF award review process has been too simple and has not involved full rate case review.¹⁵³

Opponents contend that in the absence of an SUSF small rural ILECs would be forced to pursue better options to improve their business models and restructure for greater efficiency, as CTANY says the Commission has warned telephone companies to do in the face of increasing competition.¹⁵⁴ According to the SUSF opponents, those options include: mergers, acquisitions, joint ventures, and other transactions that create economies of scope or scale; diversification and deployment of new profitable services; and various other cost reduction efficiency possibilities. They argue rural ILECs that have consolidated or merged with other companies have been more successful in holding down costs and maintaining financial health.¹⁵⁵ Opponents also propose several other ways the Smaller ILECs might improve their financial condition without resort to subsidy from a fund. The proposed measures include: raising the benchmark rate and requiring companies to raise their basic residential local exchange service rates to the benchmark level; raising other retail rates to the highest just and reasonable level; sale or spin-off of parts of a carrier's business; outsourcing particular functions; allowing carriers to withdraw from providing all or part of their regulated services, including

¹⁵³ CTANY IB, pp. 17-20, citing Tr. 333-46, 352-53, 370-71, 394, 399; Ex. 3, p. 6.

¹⁵⁴ Although I have been unable to find such admonitions in any order that CTANY invokes, without page citation (e.g., CTANY IB, p. 24 n. 34), Exhibit 36, which the Staff Mechanism Panel sponsored, includes Commission comments to that effect dating back as far as the Comp II Order, *supra*, in 1996.

¹⁵⁵ E.g., CTANY IB, pp. 13-14, 17-18, 21-22, 24-25, citing Tr. 303, 334, 343-46, 352-53, 657-59, and Ex. 3, 4, and 91; Verizon IB, pp. 49-50.

reducing service territories; and de-averaging rates to reflect cost characteristics of white-spot areas better.¹⁵⁶

SUSF opponents further assert that a subsidy fund for universal service skews and distorts the competitive market, to the detriment of consumers. They claim that by depressing end user rates artificially an SUSF has potential to chill further competitive network investment and entry into rural areas, as well as New York as a whole, and perhaps even lead existing competitors to exit the market.¹⁵⁷ The mere possibility that a relatively small number of consumers might lose service if one of the Smaller ILECs is no longer viable cannot justify the burden a fund would place on competitors and their customers, they argue, especially since the size of a fund might spiral out of control, as the federal universal service fund has.¹⁵⁸

Rather than an SUSF, opponents maintain, the Commission should rely on competition as the best means to achieve universal service. CTANY claims the Commission has already made this clear.¹⁵⁹ It states that new competitors have been willing to extend their networks farther into rural areas, contributing substantially to meeting universal service goals,

¹⁵⁶ CTANY IB, pp. 26-27, 31; Verizon IB, pp. 42-47, 49-51; citing Tr. 338-40, 382-85, 658-60, 667. Raising the benchmark rate will be discussed later in considering issues related to mechanics of an SUSF.

¹⁵⁷ CTANY IB, p. 18, 23, citing Oneida Rural Order, *supra*, p. 24; Facility CLECs IB, p. 8, Facility CLECs RB, pp. 6-7, citing Ex. 88, Direct, p. 4. Sprint IB, pp. 6-7, citing Tr. 797-98. Verizon IB, pp. 33-34.

¹⁵⁸ CTANY IB, pp. 14, 23; Facility CLECs IB, pp. 8-9, citing Ex. 88, Direct, pp. 4-5, Rebuttal, p. 7; Wireless Group IB, pp. 11, 14; Verizon IB, p. 39.

¹⁵⁹ CTANY IB, p. 9, citing Comp III Order, *supra*, p. 6.

including advances in the period between late 2009 and late 2010.¹⁶⁰

Finally, SUSF opponents proffer that establishing an SUSF now would be premature in light of evolving federal policy reflected in a recent FCC notice of proposed rulemaking (NPRM) aimed at revising federal universal service fund and intercarrier compensation policies to focus on expanding broadband availability in rural areas of the United States.¹⁶¹ They argue that: the proposed federal policies emphasizing broadband have the potential to reduce white-spot areas in this State; New York should match the federal shift and also concentrate on broadband expansion; broadband is already available to all but a small percentage of the Smaller ILECs' customers; and the proposed federal policies favor fiscal responsibility, accountability, and market-driven incentives, to all of which an SUSF is inimical. Thus, opponents say, the Commission should not put in place an SUSF based on traditional circuit-switched networks that might impair, fail to harmonize with, or have to be modified soon after implementation to mesh

¹⁶⁰ *Id.*, pp. 9-10, citing Tr. 334-35, 431-34, Ex. 39. See also Facility CLECs RB, p. 6. The Facility CLECs also suggest that, if the Commission should establish an SUSF mechanism, it should not be funded until a rural ILEC shows that it faces an imminent inability to provide service, perhaps even filing for bankruptcy. Facility CLECs IB, pp. 12-14. This suggestion will be discussed later, in the course of considering mechanism issues.

¹⁶¹ See, e.g., Facility CLECs IB, pp. 5-6, citing *Connect America Fund*, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, *Developing a Unified Intercarrier Compensation Regime*, CC Docket Nos. 01-92, 96-45, *A National Broadband Plan for Our Future*, GN Docket No. 09-51, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13 (February 9, 2011)(FCC CAF NPRM).

with potential new federal universal service policies aimed toward broadband proliferation.¹⁶²

The Smaller ILECs protest that availability of TF support has not perpetuated inefficiency in their operations. They say that, since the Commission's 2003 Transition Fund Order, the three TF recipients--Crown Point, Newport Telephone Company, Inc. (Newport), and Oneida County Rural Telephone Company (Oneida Rural)--have cut operating costs by an inflation-adjusted 44 percent, 11 percent, and 55 percent, respectively.¹⁶³ In addition, they argue that CTANY-sponsored Exhibit 91 shows two of those three companies had 2009 total cost per access line (CPAL) comparing favorably with those of New York rural companies that are subsidiaries of holding companies, with Newport's total CPAL nine percent lower and Oneida Rural's total CPAL only six percent higher than the holding company subsidiaries' average total CPAL, while Newport's is also lower than those of nine of the 11 holding company subsidiaries other than Windstream.¹⁶⁴ The Smaller ILECs also presented testimony that their average operating expense per line in 2009 was 34 percent lower than that of their peers nationwide; and that their high cost loop support payments received under the federal universal service fund, which take into account expenses, operating taxes, and return on

¹⁶² Facility CLECs RB, pp. 7-8; Sprint IB, pp. 7-10; Verizon IB, p. 40.

¹⁶³ Smaller ILECs IB, p. 72, Smaller ILECs RB, pp. 15-16 n. 46, citing Tr. 224-25.

¹⁶⁴ Smaller ILECs RB, p. 16 n. 49. My calculations show Newport's CPAL as 7 percent lower $[(\$862 - \$802)/\$862]$ and Oneida's as 8 percent higher $[(\$931 - \$862)/\$862]$ than the holding company subsidiaries' average, but the differences from what the Smaller ILECs claim seem inconsequential.

investment, are 75 percent lower than those of their rural ILEC peers nationwide.¹⁶⁵

Countering the opponents' arguments that mergers, consolidations, or similar restructuring would reduce smaller rural ILECs' costs and make them more competitive, the Smaller ILECs contend that the Commission has no authority to order mergers or consolidations and cannot do indirectly what it cannot do directly. In any event, SUSF supporters suggest this option is not truly available. They say there is no evidence of an active marketplace in New York for purchase, sale, or merger of ILECs, with the last sale of an ILEC in this State approved about six years ago.¹⁶⁶ The Smaller ILECs add that the premise behind proposals that mergers, acquisitions, or consolidations will solve the financial stress problems they face is that larger size allows a carrier to lower costs, achieve higher returns, and compete more effectively. But Verizon's own experience refutes this presumption, they argue. Verizon, by far the largest ILEC in New York, states that for calendar year 2009 it had a negative 142.96 percent return on equity and total-company net income of negative \$1.16 billion, net operating income of negative \$852.5 million, and negative \$1.02 billion cash flow from operating and investing activities, the latest and worst examples from the trend Verizon has seen in recent years.¹⁶⁷ DCP also maintains that no buyer would be interested in purchasing or merging with a company facing

¹⁶⁵ Tr. 225-26; Ex. 29.

¹⁶⁶ Smaller ILECs IB, pp. 27-29, citing Case 03-C-0972, *Berkshire Telephone Corporation, FairPoint Communications, Inc., MJD Ventures, Inc. and FairPoint Berkshire Corporation - Joint Petition for Merger*, Order Approving Acquisition Subject to Conditions (issued March 18, 2005). See also DCP IB, p. 13, citing Ex. 89, Rebuttal, p. 8.

¹⁶⁷ Smaller ILECs RB, pp. 17-18, citing Verizon IB, p. 36; Tr. 648.

financial uncertainty and lacking a reasonable opportunity to recover its costs. To the contrary, it believes access to an SUSF would make a struggling ILEC more attractive to a merger or acquisition prospect.¹⁶⁸

SUSF proponents deny that a support fund would harm competition or burden other carriers or consumers. They observe that opponents' claims of competitive harm are mere assertions, backed by no supporting evidence of any instance in which a universal service fund prevented or harmed an alternative platform carrier's participation in an area where it chose to provide service. Cable providers have been competitively providing cable modem telephone service in lower cost, higher density portions of Smaller ILECs' service areas for years, despite the Smaller ILECs' receipt of federal universal service support.¹⁶⁹ The Smaller ILECs argue that, at the federal level, in FCA §254, added by the 1996 Telecommunications Act, Congress provided for universal service support subsidies to protect consumers in rural and high cost areas notwithstanding its intent to promote competition. Nonetheless, in the face of federal universal service subsidies, as well as many state level universal service programs, competition has subsequently continued to expand.¹⁷⁰ Similarly, DCP says the SUSF opponents' claims are contradictory. Although the opponents insist an SUSF

¹⁶⁸ DCP IB, p. 13, citing Ex. 89, Rebuttal, p. 8.

¹⁶⁹ Smaller ILECs IB, p. 24; Smaller ILECs RB, pp. 27-28; citing Tr. 82-87, 146-47, Ex. 12, 22, 23. In confidential testimony the Smaller ILECs also cite an example of a small rural ILEC with relatively low rates where cable operators provide telephone service to 100 percent of its service territory; contrasted with an example of a small rural ILEC with relatively high rates, but where cable telephone service is available in little more than half of its service territory. Tr. 146.

¹⁷⁰ Smaller ILECs RB, p. 28, citing Exhibit 8 generally. See also Facility CLECs IB, pp. 8-9.

subsidy would harm competition, they simultaneously argue that the availability of competitive alternatives continues to develop rapidly, despite the availability of TF/TTFE support for the Smaller ILECs.¹⁷¹

Nor would an SUSF constitute a burden on alternative carriers or their customers, according to proponents. Even the Smaller ILECs' estimate of a \$10.3 million fund would amount to only about two cents per month, or 24 cents a year, in average SUSF costs for end users, in an intrastate telecommunications market of about \$11.2 billion annually; while Staff's estimate, based on a higher benchmark rate, would entail SUSF contributions of only half as much. They point to higher levels of System Benefits Charge and Renewable Portfolio Standard surcharges that the Commission has found to be "modest." Unlike the federal universal service fund, proponents say, checks and balances incorporated in the Smaller ILECs' and Staff's proposed SUSF mechanisms here would prevent an SUSF from growing out of control. They note that the record contains no actual evidence to support opponents' declarations that SUSF contributions of two cents a month or less would be a burden for any end users or the New York economy.¹⁷²

SUSF proponents also challenge opponents' optimism that competition itself will guarantee universal service. Proponents state that the record contains no evidence any alternative cable modem or wireless provider seeks to expand its operations to cover a Smaller ILEC service territory fully or has any commitment, desire, or intent to move in and build out to fill the void and sustain universal service if the ILEC succumbs in the future. To the contrary, they argue, the record

¹⁷¹ DCP RB, p. 9.

¹⁷² Smaller ILECs IB, pp. 10-11 n. 22, citing RPS Order, *supra*, p. 9; Smaller ILECs RB, pp. 24-26; DCP IB, pp. 7-8.

demonstrates that alternative platform providers generally choose to compete only in the lower cost, more subscriber dense parts of smaller rural service territories.¹⁷³

With respect to the recent FCC NPRM on federal universal service and intercarrier compensation policies, the Smaller ILECs note that it is only a set of proposals, which might never be adopted. Currently, there is no way to predict what the outcome will be after FCC receipt and analysis of comments. The Smaller ILECs think it unlikely the FCC will address the issues in that proceeding and conclude it before the TTFE is scheduled to terminate at the end of September 2011. They maintain the FCC proposal recognizes that the current federal universal service fund will continue for some time, the transition to a broadband-focused fund will be gradual, and the top-ranked of four specific priorities the FCC set out for a modified universal service high-cost fund is to “preserve and enhance voice service.”¹⁷⁴ In addition, the Smaller ILECs suggest, the issues and objectives in this proceeding are sufficiently consistent with those of the federal NPRM that the SUSF results here could readily address and be adapted to any new federal focus on broadband, especially since they have already deployed broadband extensively in their service territories. They dispute Sprint’s claim that a rate-of-return based fund will be inconsistent with FCC movement toward market-driven, incentive-based policies, saying it is premature to

¹⁷³ Smaller ILECs IB, pp. 5, 24; Smaller ILECs RB, pp. 32-33; DCP IB, p. 13; Staff RB, p. 9. Tr. 67, 82-85; Ex. 16 and 17. Staff notes that municipalities lacking cable networks remain so more than 40 years after cable television deployment in the State began; no franchise agreements are pending in those areas; and there is no sign of any cable company willing to fill the gaps. *Id.*

¹⁷⁴ Smaller ILECs IB, pp. 29-31; Smaller ILECs RB, pp. 44-45, citing FCC CAF NPRM, *supra*, ¶¶21-33, 80.

predict whether or when a return-based fund might be superseded; and that, regardless, their proposal for an SUSF ensures accountability through Commission proceedings on disbursement requests. In any event, they note their own proposal for mandatory SUSF review after five years and offer that, if necessary, the Commission could institute an earlier review proceeding to make sure an SUSF continues to complement federal policy.¹⁷⁵

For their own part, the Smaller ILECs maintain that failure of one of them would adversely affect not only it and its own customers, but alternative carriers and their customers, as well. Alternative carriers' customers would then be unable to terminate calls to or receive calls from the failed Smaller ILEC's customers. In addition, they say, wireless carriers are themselves customers of the Smaller ILECs that depend on availability of the latter's networks for "backhaul" circuits, which connect wireless antenna sites to switches.¹⁷⁶ Staff avers that both wireless and cable companies rely to some extent on the Smaller ILECs to interconnect with the public switched telephone network (PSTN).¹⁷⁷

SUSF opponents offer several responses to the Smaller ILECs' contentions. First, they argue that the Smaller ILECs' networks are only one component of the "network of networks" comprising the PSTN, of which wireless and cable companies' networks are also an integral part. Thus, they say, the Smaller ILECs should not be entitled to a special subsidy any more than other providers whose facilities form part of the seamless PSTN

¹⁷⁵ Smaller ILECs RB, pp. 45-47.

¹⁷⁶ Smaller ILECs IB, p. 17 n. 40 and accompanying text; Tr. 30. See also DCP IB, p. 7.

¹⁷⁷ Staff RB, p. 9.

web.¹⁷⁸ Second, they maintain that ION Hold Co., LLC (ION) owns and, with the aid of federal funding, is adding substantially to a fiber-optic backbone network that both provides redundancy to traditional ILEC networks and in many cases allows competitive carriers to bypass the ILEC networks and backhaul services.¹⁷⁹ Third, opponents aver that intermodal competitors' very opposition to an SUSF undercuts the claim that backhaul services would be lost, demonstrating their confidence that if a small rural ILEC went out of business its backbone network would be bought by some other provider.¹⁸⁰ Verizon also claims that intermodal providers rely on their own "local" facilities-- wireless for wireless companies and coaxial cable for facilities-based cable VoIP.¹⁸¹

2. Discussion

As opponents of an SUSF emphasize, the Commission has long admonished ILECs to take steps to improve efficiency and become more competitive.¹⁸² The record, however, shows that the availability of a subsidy has not deterred small rural ILECs from pursuing greater efficiencies. All three of the smaller rural ILECs that have received payments from the TF have, on an inflation-adjusted basis, reduced expenses since the TF was instituted.¹⁸³ Newport's expenses dropped the least--11 percent --but its total CPAL for 2009 compares favorably with those of

¹⁷⁸ Wireless Group RB, pp. 8-9. The PSTN encompasses all of the mutually interconnected circuit-switched telephone networks.

¹⁷⁹ *Id.*; Verizon IB, pp. 52-53; citing: Ex. 74 generally and in particular pp. 18-19, 21, 25; Ex. 75; Ex. 87, Rebuttal, pp. 1-7, 16.

¹⁸⁰ Verizon IB, pp. 52-53.

¹⁸¹ Verizon RB, pp. 19-20.

¹⁸² *E.g.*, Ex. 36.

¹⁸³ *Supra* pp. 58-59 n. 164 and accompanying text.

the rural ILECs that are subsidiaries of holding companies, which opponents hold out as models of efficiency.¹⁸⁴ Although Crown Point had the highest total CPAL of any ILEC in the State in 2009, it has cut its expenses an inflation-adjusted 44 percent since the 2003 Commission order establishing the TF. Oneida Rural slashed its expenses 55 percent between 2003 and 2009, so that in the latter year its total CPAL fell in the same general range as those of rural holding company subsidiary ILECs.¹⁸⁵ Thus, the weight of the evidence demonstrates that the prospect of receiving TF payments did not induce the small rural ILEC's to disregard the Commission's caution to economize in the face of increasing competition. I find no sufficient basis in

¹⁸⁴ For 2009, Newport's total CPAL was lower than those of nine of 12 rural holding company subsidiaries and seven percent lower than the average total CPAL for those subsidiaries. Ex. 91. In addition, Newport's 2009 total CPAL was well below those of all six Frontier subsidiaries (see Ex. 3, line 24 on each of pp. 4, 7-10, 15) and 21 percent lower than the \$1,011 average total CPAL of the Frontier subsidiaries (derived from the same sources).

¹⁸⁵ In addition to falling below the total CPAL of three of the rural holding company subsidiaries and only eight percent above the average for the 12, Oneida Rural's total CPAL was lower than those of five of the six Frontier subsidiaries and eight percent below the Frontier subsidiaries' average. Ex. 3, line 24 on each of pp. 4, 7-10, 15; Ex. 91.

the record to conclude that an SUSF would suddenly lead companies to cease trying.¹⁸⁶

In addition, the record convinces me that stand-alone rural ILECs generally have performed at least as well as holding company subsidiary ILECs in achieving efficiencies after the TF went into operation. Applying a 10 percent inflation adjustment factor from 2005 to 2009,¹⁸⁷ I calculate that the Frontier subsidiaries' total operating expense changes varied from an increase of one percent to a decrease of 28 percent, with an average 17 percent reduction over that period.¹⁸⁸ For the same period, Crown Point, Newport, and Oneida Rural reduced their total operating expenses by inflation-adjusted amounts of 26 percent, 10 percent, and 42 percent, respectively, or an average of 26 percent.¹⁸⁹ For the same period, the inflation-adjusted change in Frontier subsidiaries' total CPAL ranged from a decrease of seven percent to an increase of 45 percent, with an average *increase* of nine percent.¹⁹⁰ Over the same years, Crown

¹⁸⁶ I also cannot agree with CTANY's suggestion that the TF award process has been too perfunctory and entailed less than full rate case review. That the latter claim is incorrect should be clear from the order CTANY cites, where the Commission made a number of significant adjustments to the company's revenue requirement, even in a minor rate case. Case 08-C-0610, *Oneida County Rural Telephone Co. - Minor Rate Filing*, Order Authorizing Rate Increase (issued January 16, 2009)(Oneida Rural Order). Furthermore, Staff testified that requests for TF payments have received full rate case review, including Staff field visits and review of company books and records. Tr. 597-98.

¹⁸⁷ See U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index - All Urban Consumers (1982-84=100), 2005 Annual to 2009 Annual (<http://data.bls.gov/cgi-bin/surveymost>).

¹⁸⁸ Derived from Ex. 3, line 6 on each of pp. 4, 7-10, and 15.

¹⁸⁹ Derived from Ex. 3, line 6 on each of pp. 5, 11, and 13.

¹⁹⁰ Derived from Ex. 3, line 24 on each of pp. 4, 7-10, and 15.

Point's, Newport's, and Oneida Rural's total CPALs dropped by inflation-adjusted amounts of 21 percent, 11 percent, and 25 percent, respectively, with an average *decrease* of 19 percent.¹⁹¹ Thus, the three stand-alone TF recipient companies performed noticeably better in achieving efficiencies in recent years than the Frontier subsidiaries did.

I do not accept the SUSF opponents' contention that restructuring through mergers or acquisitions will lead to significantly improved efficiency in their operations. Even assuming that small stand-alone rural ILECs could achieve greater efficiency and become more competitive through such measures as mergers or acquisitions, there does not appear to be any active market for that option, as SUSF supporters contend. Nor, as they point out, can one rely on economies of scope or scale to provide a satisfactory solution to the predicament of the traditional wireline ILECs, as Verizon's experience described above demonstrates.¹⁹² I also agree with DCP's opinion that another company is unlikely to pursue purchase of or merger with a small rural ILEC in difficult financial straits.

Most other suggestions of the SUSF opponents for solutions to the smaller rural ILECs' financial dilemma also appear impractical. Raising retail rates will be constrained by existing competition in the more densely settled, non-white-spot areas of their service territories and likely lead to further loss of access lines.¹⁹³ Sale or spin-off of profitable portions of their businesses will make them worse off, while attempts to sell or spin off unprofitable portions are unlikely to find

¹⁹¹ Derived from Ex. 3, line 24 on each of pp. 5, 11, and 13.

¹⁹² *Supra* p. 60.

¹⁹³ Tr. 538-39. As the Commission has recognized, "[O]nly a small proportion of consumers need to react to an incumbent's price increases to render futile the incumbent's efforts to raise revenues." Comp III Order, *supra*, p. 40.

success. Allowing a rural ILEC to withdraw from providing service, including reducing its service territory, will do nothing to ensure universal service in white-spot areas, but, if anything, move the ball away from, rather than toward, the goal. De-averaging rates and increasing them in white-spot areas to reflect higher cost characteristics of those areas would be contrary to the Commission's well-established uniformity rule, intended "to ensure that rates in areas with less competition are constrained by areas where competition is robust."¹⁹⁴ Reducing salaries, modifying pension and benefit plans, and outsourcing all might be possibilities worth exploring when a company applies for relief from an SUSF, if the Commission establishes one. While potentially helpful in minimizing the extent of external funding required, I do not believe it would be prudent to rely on these latter measures themselves to be adequate to help maintain the financial viability of smaller rural ILECs for the purpose of ensuring universal service.

SUSF supporters correctly observe that opponents' position that an SUSF would harm competition rests solely on theoretical declarations and not any factual evidence. To the contrary, as they point out, alternative competitive platforms have entered and expanded within Smaller ILECs' service areas notwithstanding both federal universal service funding and TF payments. Furthermore, Congress did not see federal universal service funding as inimical to competition when it passed the Telecommunications Act of 1996, expressly including §254's provisions for universal service support mechanisms in an act

¹⁹⁴ "[The rule] is a critical element ... to ensure the protection of the public, especially in areas where competition is less robust" *Id.*, pp. 67-68. See also Framework Order, *supra*, p. 15.

intended "[t]o promote competition...and encourage the rapid deployment of new communications technology."¹⁹⁵

I also find that an SUSF as proposed here would not burden alternative carriers, their customers, or the economy of the State. In the future, if an SUSF must grow to maintain universal service in the face of small rural ILECs' loss of intrastate access charge revenues, careful attention to limiting its size to the very minimum necessary will become particularly important. At some point the Commission might well find it advisable to revisit the question of the burden the fund places on those who ultimately shoulder its costs. For the time being, however, the idea that an average penny or two a month per customer--at the most--would impose even a noticeable burden, let alone a significant one, simply is not credible.¹⁹⁶ In any event, I recommend that the Commission and its Staff remain vigilant to make certain that any SUSF does not grow out of control.¹⁹⁷

I cannot recommend that the Commission adopt the SUSF opponents' proposal that it rely on competition alone to ensure universal service. Although in the Comp III Order the Commission expressed the view that competition is the most efficient way to ensure quality telecommunications at reasonable rates, that statement did not imply that competition obviates

¹⁹⁵ Pub. L. 104-104, Preamble (Feb. 8, 1996). Moreover, §254 is included in part II of title II of the FCA, as established by the Telecommunications Act of 1996, entitled "Development of Competitive Markets."

¹⁹⁶ Although Verizon contends a fund would impose an impermissible burden on providers, proponents have proposed that providers have the option of recovering any SUSF assessments through surcharges on end users. See *infra* pp. 121-22, 128.

¹⁹⁷ A cap on fund size that could only be increased with Commission approval would help ensure proper control if access charges are reduced. See *infra* pp. 117-18.

any need for an SUSF. Later in the same order the Commission made clear that it considered a decision on any need for a high cost universal service fund premature at that time.¹⁹⁸ The Commission had also previously noted, when establishing the TF, that it was not prejudging the need for or nature of a universal service fund, pending the approach of TF exhaustion.¹⁹⁹ Again, after the Comp III Order, the Commission observed that discussion of a universal service fund would not occur until the time frame established in the TF Order.²⁰⁰

Moreover, the weight of the evidence here indicates that cable and wireless providers have, as SUSF proponents argue, concentrated their competition in the smaller rural service territories to the lower cost portions with greater subscriber densities. None of the wireless or cable company parties here has argued that it would, in fact, fill the gap if one of the Smaller ILECs fails and is unable to provide service.²⁰¹ Opponents do contend that alternative platforms continued to expand and reduce white-spot areas between late 2009 and 2010, citing that expansion as evidence competition can quickly solve the problem.²⁰² Insofar as the cable platform is concerned, Staff later corrected its testimony to explain that the apparent expansion had not occurred, but was an artifact of an error in its earlier analysis.²⁰³ Any apparent expansion of

¹⁹⁸ Comp III Order, *supra*, pp. 75-76.

¹⁹⁹ Case 02-C-0590, *New York Intrastate Access Settlement Pool, Inc. – Traffic Sensitive and Non-Traffic Sensitive Access Rates*, Order Adopting Comprehensive Plan (December 23, 2003)(TF Order), p. 11 and attached “Comprehensive Plan Phase II,” pp. 5-6.

²⁰⁰ Small ILEC Framework Order, *supra*, pp. 16-17.

²⁰¹ *Supra* p. 62 n. 173 and accompanying text.

²⁰² *Supra* p. 30 nn. 79-80 and accompanying text.

²⁰³ *Supra* p. 30 n. 83 and accompanying text.

wireless during that time period is problematic because of the unreliability of wireless service previously discussed.²⁰⁴ All of the opponents' own declarations about how competition would suffice are in the abstract. I believe it probable that cable modem service and wireless service will gradually expand so that eventually, at some time in the future they will be adequate to ensure universal service availability in the event that a Smaller ILEC folds. From the record here, however, I cannot predict when.

In the meantime, something more is necessary. At the federal level, as noted above, Congress found reliance on competition alone inadequate to ensure universal service when it passed the Telecommunications Act of 1996. I recommend that, similarly, the Commission not attempt to rely on competition alone to ensure universal service in New York. Notwithstanding the economic advantages competition can provide to society, it has its downsides as well. Staff's policy panel very correctly observed that competition produces losers as well as winners.²⁰⁵ The point of a universal service policy is to protect those individuals most vulnerable to harm from the dislocations that accompany the overall benefits competition provides to society more generally. It is not too much to expect society in general, in return for those benefits, to assist in protecting those at risk. Competition alone cannot do that, since it is itself the source of the risk.

I further recommend that the Commission not delay a decision on whether to provide a vehicle for ensuring continued universal service until after the FCC completes its current rulemaking on universal service and intercarrier compensation

²⁰⁴ *Supra* p. 30-31 nn. 84-85 and accompanying text; pp. 33-34 n. 91 and accompanying text.

²⁰⁵ Tr. 591-92.

policies. The termination date for the TTFE under the Phase I Order is approaching quickly. When the FCC will complete its rulemaking proceeding is difficult to say, and what the federal universal service funding regime will look like after the FCC considers the comments of parties cannot be determined now either. Regardless, as the SUSF proponents contend, the FCC's proposed action itself contemplates continuation of the current wireline PSTN-based federal universal service fund for some time, with only a gradual transition to a broadband-based fund.²⁰⁶ So even if the federal fund does shift to a broadband focus, there should be sufficient opportunity for the Commission to consider the FCC's final action on the NPRM and make any advisable revisions to harmonize any State universal service assurance mechanism at that time. Right now, it appears wiser for the Commission to take action to adopt an SUSF or other mechanism to ensure continued universal service after the termination of the TTFE than to let that means of support expire without a successor, pending unpredictable FCC action at an unpredictable time.

The Smaller ILECs' claim that a failure of one of them causing a loss of service would affect more than just its own customers has some merit. Undeniably, customers of other providers, whether ILECs, CLECs, wireless, or fixed or nomadic VoIP, would then be unable to call or be called by the failed ILEC's customers. Furthermore, the ION network and its coming expansion with federal stimulus funding will not obviate all

²⁰⁶ Moreover, it is not even certain that the federal universal service fund will become a broadband-based fund. The FCC is seeking comment on, among other things, "whether ... section 254 [of the FCA] may reasonably be interpreted to authorize [it] to support broadband service." Connect America Fund, Developing a Unified Intercarrier Compensation [sic], 76 Fed. Reg. 11632, 11634 (Mar. 2, 2011).

dependence of alternative providers on the rural ILECs' networks. The ION network as it will be augmented will reach "areas served by *many* of the NYSTA Smaller ILECs," but not all.²⁰⁷ Even the Wireless Group claims only that fiber networks like ION's "in *many* cases...permit competitive providers to bypass the ILEC network entirely."²⁰⁸ Moreover, a recent National Regulatory Research Institute (NRRI) report states:²⁰⁹

Telecommunications networks do not function independently. ILECs still have unique carrier-to-carrier duties that are essential upstream inputs (linchpin services) to other carriers, including special access (point-to-point) services, central office collocation, interoffice transport, tandem switching, and operations support systems.

For these reasons, a business and operational failure by almost any ILEC today would ... likely [in addition to eliminating voice service to its retail customers] cause secondary disruptions in retail services provided by other carriers.

Thus, I find SUSF supporters correctly maintain that other carriers do rely to some extent on the Smaller ILECs' networks to ensure that they can provide service to their own customers.

The Wireless Group's contention that alternative providers' networks are also part of the PSTN has no relevance to whether the Smaller ILECs' traditional wireline networks

²⁰⁷ Ex. 87, Rebuttal, p. 5. Emphasis added.

²⁰⁸ Wireless Group RB, p. 8. Emphasis added. The Smaller ILECs note that ION's backbone network provides connection at only a single point of presence in some ILEC service territories. It does not provide facilities to connect at locations throughout the ILEC service territories. Smaller ILECs IB, p. 17 n. 40, citing Ex. 75.

²⁰⁹ PETER BLUHM *ET AL.*, STATE HIGH COST FUNDS: PURPOSES, DESIGN, AND EVALUATION 8 (NRRI January 19, 2010)(footnote omitted), appearing in the record as Ex. 8, p. 17.

should be eligible for a universal service subsidy. Alternative platform carriers are not now providing universal service, are not essential to the continued provision of universal service, and do not claim to face any financial difficulty that would threaten their continued viability. That they have no need for any SUSF support does not warrant denying support to the Smaller ILECs. The Wireless Group incorrectly argues that, where a customer abandons landline service for wireless or VoIP, the alternative platform network becomes just as essential to universal service as the traditional wireline network of a Smaller ILEC. In such a situation, the Smaller ILEC's network would remain available to provide service in the event of a failure or withdrawal of the alternative provider. The same obviously is not true of wireline or cable modem service in the "white spot" locations within the Smaller ILECs' service territories, where there is no cable modem service and no reliable wireless service upon which to fall back if a Smaller ILEC can no longer provide service.

Finally, in the discussion of substitutability above, I rejected SUSF proponents' proposals to treat several features associated with the Smaller ILECs' wireline service as essential elements of basic residential exchange service. Those features include availability of directory listing, operator assistance services, Lifeline discounts, back-up power, Commission oversight of network reliability, and unbundled basic local exchange service rates.²¹⁰ Although not key to substitutability, these features do provide additional benefits for consumers over wireless and cable modem services, which generally lack them. Consumers in the aggregate make choices that determine substitutability, but their collective preferences are not

²¹⁰ *Supra* pp. 44-48.

necessarily optimal for consumers as individuals. Continued availability of traditional wireline service would preserve greater choice flexibility for consumers in portions of the Smaller ILECs' service territories where alternative services are available, as well as guarantee that residential consumers in white-spot areas would retain these beneficial features in basic local exchange service.²¹¹ An SUSF that helps underwrite continued availability of traditional wireline service thus would have the advantage of also keeping these useful features available to all residential customers in a Smaller ILEC's service area. The availability of that choice will itself contribute to better, more meaningful competition in the portions of the Smaller ILECs' service areas where alternative platforms are reliably available now, as well as in the current white-spot areas when and as alternative platforms do expand into them.

After considering the pros and cons of the several proposed alternatives for addressing the financial distress of the Smaller ILECs and threat to their viability, as reflected in this discussion, I recommend as a reasonable course of action to ensure universal service continuation that the Commission establish an SUSF, unless it decides simply to preserve the *status quo* for several years by extending the TF/TTFE temporarily, as AT&T proposes.²¹²

²¹¹ Compare the value the Commission has ascribed to preserving, rather than restricting, customer choice between flat rate and message rate options as part of basic service offerings. Comp III Order, *supra*, p. 53 n. 109 and accompanying text.

²¹² For consideration of the AT&T proposal, see *infra* pp. 138-39.

III. STRUCTURE OF AN SUSF

A. Eligibility Requirements for SUSF Disbursements

1. Parties' Positions

The Smaller ILECs propose that only entities meeting a long list of requirements be eligible to receive disbursements from an SUSF, including: operating as a common carrier subject to Commission jurisdiction and oversight; providing facilities-based services throughout the Smaller ILECs' service areas; being subject to regulatory requirements and commitments equivalent to those applicable to the Smaller ILECs; designation as an ETC under the federal universal service funding program; providing service that includes the features the Commission identified in the Comp II Order as elements of basic residential local exchange service; and meeting a number of network and operational requirements applicable to regulated common carriers, including consumer protections, back-up powering, and service quality standards. The Smaller ILECs admit that they themselves are the only entities that currently fulfill these requirements. Their proposal to impose these requirements as the test for fund eligibility rests on the same justification as their proposal to impose the same test--regulatory requirements identical to those applicable to their own service--for substitutability. Only through such a test, the Smaller ILECs say, can the Commission be certain residential consumers will receive basic local exchange service equivalent to what they themselves provide.²¹³

On the surface, Staff's proposal for funding eligibility seems somewhat broader. Staff appears to see eligibility as limited in the first instance to rate-of-return regulated ILECs, since an eligibility determination would come

²¹³ Smaller ILECs IB, pp. 38-40; citing Tr. 91-94.

in response to a request in the context of a general rate case filing. But Staff allows that, if a "substitutable provider" of wireless or cable modem service were present in part of a requesting ILEC's service area,²¹⁴ SUSF support of build-out of the substitutable provider's system could somehow be considered as an alternative or complement to supporting the ILEC's operations, depending on the most cost-efficient method of ensuring continued availability of telephone service.²¹⁵ On the other hand, only a carrier whose service met all of Staff's proposed requirements for substitutable service could be considered a "substitutable provider."²¹⁶

SUSF opponents take several positions on eligibility for funding. The Facility CLECs appear merely to assume the Smaller ILECs would be the eligible entities.²¹⁷ CTANY argues that, to be competitively neutral, an SUSF should seek narrowly to support customers and universal service, rather than companies or their current corporate structures.²¹⁸ CTANY also contemplates a process initiated by a requesting rural ILEC, yet maintains that any funding awarded should not go to the ILEC itself but--after comprehensive review of all alternatives and a full rate case--be provided "either directly to the 'White Spot' consumer to subsidize any new above-the-benchmark rate (a direct

²¹⁴ But not all. If one or more "substitutable providers" were available, individually or collectively, throughout a particular ILEC's service territory, there would be no white-spot areas and no justification for SUSF support. Staff IB, pp. 12-13.

²¹⁵ *Id.*; citing Tr. 521-24 and Ex. 35. Although Staff does not say, presumably consideration of build-out by a "substitutable provider" would depend upon its actively intervening in the rate case and requesting SUSF support.

²¹⁶ *Id.*, pp. 12-13, 21-22.

²¹⁷ Facility CLECs IB, pp. 12, 14-16.

²¹⁸ CTANY IB, p. 29.

customer subsidy) or offered to competitors who would be willing to enter these 'White Spot' areas."²¹⁹ Sprint, too, prefers that any support funds go "directly to customers who can exercise competitive choice, rather than handing them out to carriers simply to fill their coffers."²²⁰ It contends that funding should be limited to customers located in white-spot areas who subscribe to stand-alone basic local telephone service, and only if the ILEC makes neither DSL, television, nor other bundled services available to them.²²¹

Verizon, on the other hand, suggests that funding should be given to the most efficient legally authorized provider of telephone service, to be identified through competitive bidding. The bidding process would identify the provider willing, for the least amount of SUSF moneys, to make service available in a particular area "to any customers that do not already have access to the services of other providers." Bids would be solicited only for the services necessary for maintaining universal service in white-spot areas.²²²

2. Discussion

I am not prepared to recommend CTANY's suggestions on SUSF recipients. First, on one hand, CTANY says funds should go directly to *customers*, not to *companies*. On the other hand, it contends that SUSF support should be offered to *companies*, if willing to enter white-spot areas and compete with the ILEC

²¹⁹ CTANY IB, pp. 30-32, 33; citing Tr. 332, 349, 352, 391, 397, 399, 401, 564-65, 657-59.

²²⁰ Sprint IB, p. 12.

²²¹ *Id.*, pp. 14, 15. Sprint seems to propose that SUSF support be unavailable to a residential customer located where DSL or other bundled services are *available*, regardless of whether that customer is taking only stand-alone basic local exchange service.

²²² Verizon IB, p. 53, citing Tr. 669-70.

serving the area. These proposals seem contradictory. Second, I find its suggested option of providing SUSF moneys directly to consumers in only white-spot areas to subsidize basic residential service problematic. That option would entail setting rates for basic residential local exchange service throughout a rural ILEC's service territory at a level above the benchmark rate limit that would apply to the customers in the white-spot areas.²²³ But, as noted earlier, raising retail rates in non-white-spot areas, where competition prevails, will lead to additional loss of access lines and revenues for the ILEC and exacerbate its financial squeeze.²²⁴ Moreover, how the full rate case process that CTANY's proposal contemplates would occur is unclear. CTANY offers no explanation of why any small rural ILEC could reasonably be expected to initiate a request for SUSF disbursements that would go directly to some of its customers or--worse yet from the ILEC's perspective--a competitor, while making its financial circumstances more vulnerable. CTANY offers no perspective on whether it believes ILEC customers, a competitor, or Staff could initiate the process and how.²²⁵

Sprint's suggested approach suffers from the same infirmities as CTANY's with respect to providing support directly to basic residential service customers in white spot areas. Its proposal, too, seems self-contradictory, suggesting

²²³ Presumably CTANY would see subsidy payments going only to basic residential local exchange service customers, rather than all customers (including other residential service customers and any business customers) in the white-spot areas, since it refers to the benchmark rate, which the Commission has established only for basic residential local exchange service.

²²⁴ *Supra* pp. 67-68 n. 193 and accompanying text.

²²⁵ It might assist the Commission in considering available options if CTANY could flesh out in detail in its brief on exceptions just how it sees the process it contemplates would work.

that the recipients could then exercise competitive choice. By definition, the white-spot areas to which Sprint would limit support would have no reliable competitive service available.

Staff and Verizon both raise the possibility of competitive bidding for SUSF disbursements. In Staff's view, only a carrier providing basic residential local exchange service complying with all of Staff's requirements for substitutability would be eligible to compete. Inasmuch as only an ILEC is subject to all of those requirements (or likely to commit to comply with them voluntarily), however, Staff's proposal would effectively limit eligibility for SUSF support to ILECs and thus obviate any chance of competition.²²⁶

Verizon's witness panel laid out no detailed bidding proposal of its own, but testified that the bidding process should follow the process the FCC adopts for the proposed federal "Mobility Fund" for extending third-generation voice and broadband wireless infrastructure to new areas in the United States.²²⁷ There are significant drawbacks to this proposal, however. The proposed federal Mobility Fund bidding process is itself modeled on the reverse auction process the FCC uses in electromagnetic spectrum license auctions. Nonetheless, in proposing to use such a process for Mobility Fund eligibility, the FCC raises many issues on which it seeks comment concerning the design of the process as it would apply in the different context of wireless build-out.²²⁸ More recently, the FCC has also proposed such a reverse auction process for a new "Connect America Fund" (CAF) intended to support build-out and operation

²²⁶ See *supra* pp. 36-37 nn. 94-96 and accompanying text.

²²⁷ Tr. 669-70. See *Universal Service Reform Mobility Fund*, WT Docket No. 10-208, Notice of Proposed Rulemaking, FCC 10-182 (Oct. 14, 2010)(FCC Mobility Fund NPRM).

²²⁸ See, e.g., FCC Mobility Fund NPRM, *supra*, ¶¶16-19, 56-76.

of fixed (wireline or wireless) or mobile wireless broadband in unserved areas of the nation. But, as the Smaller ILECs observe, the notice of proposed rulemaking for the CAF also raises myriad similar issues on which the FCC seeks comment with respect to the proposed reverse auction bidding process as applied in that broadband universal service support context.²²⁹

There is no certainty that the FCC will take final action on either of these rulemakings sufficiently timely for the Commission to use one as a model here before a successor to the TF/TTFE would have to be in place.²³⁰ Nor has any party proffered any analysis in this record of the issues the FCC has identified and how they should be resolved, especially for the purposes of an SUSF rather than the proposed federal universal service funds. The designs of the proposed federal reverse auction processes are fairly complex, in the first place. The NRRI report on state high-cost funds cited earlier discusses the "added complexity of holding an auction for an area already served by an ILEC."²³¹ It also observes that there appears to be no example, "in the United States or elsewhere, of a successful reverse auction that allocated universal service subsidies in an area with an established wireline telecommunications network."²³² In light of the complexity of the process I am also concerned

²²⁹ See FCC CAF NPRM, *supra*, ¶¶324-348.

²³⁰ Recall also that the FCC has asked for comment on its authority to support broadband service. *Supra* p. 71 n. 206. If the FCC concludes that it does not have that authority, there might well be no decision on the details of a federal reverse auction bidding process on which to model one for an SUSF.

²³¹ Ex. 8, pp. 63-65.

²³² *Id.*, p. 63. Moreover, one of the complications the NRRI report mentions is that a state commission might not be able to relieve a losing ILEC of obligations imposed by federal law, citing FCA §251(c), which sets forth "additional obligations" of ILECs. *Id.*, n. 156.

about its potential transaction costs, if used for distributions from an SUSF, on which parties favoring an auction process have provided no information. Those costs might not preclude such a complicated process at the federal level for programs contemplated to distribute \$100 million to \$300 million in the case of the proposed Mobility Fund or \$500 million to more than \$1 billion for the proposed CAF.²³³ For a New York SUSF, however, they might well prove excessive. I do not recommend that New York serve as a guinea pig for this complex, untested, and potentially costly process.

For these reasons, I recommend that the Commission not employ a competitive bidding process or adopt the other proposals of SUSF opponents for designating recipients of SUSF distributions. I find that both the Smaller ILECs' and Staff's proposals essentially come down to limiting the universe of SUSF recipients to the Smaller ILECs. Neither Verizon, the Frontier ILECs, nor the Windstream ILECs are seeking access to any SUSF disbursements.²³⁴ Accordingly, I recommend that the Commission limit eligibility for SUSF disbursements to the Smaller ILECs.

B. Method of Determining the Amounts of SUSF Disbursements

1. Parties' Positions

The Smaller ILECs say the procedure for seeking support from an SUSF should be the same as has applied to requests for disbursements from the TF/TTFE. An ILEC seeking disbursements would be required to file a general rate case²³⁵ and demonstrate that revenues generated by the benchmark rate

²³³ See FCC Mobility Fund NPRM, ¶13; FCC CAF NPRM, ¶24.

²³⁴ See *supra* p. 4 n. 6 and p. 26 n. 69.

²³⁵ See TF Order, *supra*, pp. 4-5 and attached "Comprehensive Plan Phase II," p. 4; Phase I Order, *supra*, Appendix A, pp. 1-2.

for basic residential local exchange service plus all other revenues from its intrastate regulated services were insufficient to recover its intrastate regulated costs, including an opportunity to earn a fair intrastate ROE.²³⁶

Staff and other parties propose to add several requirements on top of the existing TF/TTFE review process and what the Smaller ILECs envision for the SUSF. First, Staff maintains that the requesting company's eligibility for funds should be determined by taking into account its total regulated operations, intrastate and interstate. Staff argues that competitors market inter- and intrastate services as packages with bundled, discounted pricing, but that allocating package revenues between inter- and intrastate jurisdictions is difficult. It also contends that an ILEC employs the same network and personnel to provide both inter- and intrastate services, resulting in common and joint costs that are difficult to allocate, but that allocations under FCC separations rules have long been frozen at now antiquated levels. In fairness, Staff believes, an ILEC seeking SUSF support should use some appropriate amount of total regulated revenues to fund its intrastate operations, particularly when in good financial health on an integrated, total regulated operations basis. Additionally, Staff states, investors consider total company operations when making investment decisions.²³⁷ Sprint, on the other hand, proposes that the Commission take into account revenues from non-regulated video and DSL services of an ILEC requesting SUSF support, because those non-regulated services are delivered over the same network as regulated services.²³⁸

²³⁶ Smaller ILECs IB, pp. 56-58; Tr. 110-13.

²³⁷ Staff IB, pp. 13-14; Tr. 521-22, 524-26. Facility CLECs agree. Facility CLECs IB, p. 15.

²³⁸ Sprint IB, pp. 12-14; Tr. 809-11.

Staff also argues the review process should include an efficiency analysis, using a CPAL²³⁹ benchmark to weigh a requesting ILEC's efficiency compared with other ILECs, with the burden on the former to justify any CPAL above the benchmark. Staff's Mechanism Panel testified that the Commission has used CPAL in other cases, including rate cases, to compare cost efficiencies of different ILECs. Staff maintains the accuracy of the CPAL model used in Case 07-C-0349²⁴⁰ was confirmed by the fact that it explained 99.3 percent of the variation in the data upon which it was estimated. Staff also states that its CPAL model incorporates the wage and benefit level benchmarking (including officer compensation levels) that CTANY argues is necessary and would achieve the same goal.²⁴¹

Next, Staff proposes that a small ILEC seeking SUSF support be required to file an impairment analysis, evaluating the need for plant write-downs in conformance with Generally Accepted Accounting Principles (GAAP) and Financial Accounting Standards Board Accounting Standard Codification Topic 360-10-35. It cites the Commission's warning in the Comp II Order that companies should not expect a regulatory guarantee of full recovery of all stranded revenue requirement.²⁴² Staff explains that the analysis should examine recoverability of long-lived assets, with a write-down required if the carrying

²³⁹ See *supra* p. 58.

²⁴⁰ Case 07-C-0349 resulted in the Framework Order, *supra*.

²⁴¹ Staff IB, p. 14; Tr. 541-42, 551-53. See also Facility CLECs IB, p. 15.

²⁴² Staff IB, pp. 15-19, citing: Comp II Order, *supra*, pp. 27-28, where the Commission explained that "stranded revenue requirement" includes, *inter alia*, stranded investment (plant prematurely retired from service due to competitive losses) and underutilized investment (in-service plant for which use has dropped as a result of customer migration to competitors); Tr. 527-30, 598-99; and Ex. 36.

amount of an asset is not recoverable from the company's undiscounted cash flows.²⁴³

In addition, Staff proposes rate-setting requirements for disbursement of SUSF payments. Currently, TF/TTFE disbursements are calculated on the assumption that the ILEC will charge the benchmark basic residential local service rate of \$23 per month, but the ILEC is not required to raise the rate actually charged to that level. As a condition of SUSF support, Staff would have the Commission require that the benchmark rate actually be charged to basic residential service customers.²⁴⁴

Finally, Staff contends that SUSF recipients should be required to file an annual certification of need, with auditable financial and operational information, and attestation that the

²⁴³ Staff states (Tr. 539-40):

The impairment analysis will assume no state universal service funds are available beyond the benchmark rate, and will also show the level of impairment at varying increments in the company's rate for basic local service until no impairment exists. The impairment analysis will also include information regarding the impact on the company's financial statements, ability to raise capital and potential credit problems, and ability to modernize and maintain its existing network. The Commission will then have the information necessary to make a determination on the appropriate rate for basic service and level of state universal service funds based upon the company's facts and circumstances. The company will subsequently determine whether and to what extent an impairment charge should be taken on its books.

²⁴⁴ Staff IB, pp. 3, 19, citing Tr. 542. Given the wide differences among the various benchmark rates that various parties propose and the revenue and temporal implications of related issues involving how rates actually charged and rates assumed for purposes of calculating SUSF disbursements relate to each other and the benchmark rate, I will address all of those issues as part of the discussion of benchmark rate below.

support funds are being used properly. Staff's Mechanism Panel provided no detail on what information such a certification and attestation might be required to contain.²⁴⁵ The Smaller ILECs say they do not oppose such a requirement conceptually, so long as the existing annual report requirement is sufficient to meet it, with no additional effort or cost imposed on the ILEC receiving support.²⁴⁶

CTANY maintains that an ILEC requesting SUSF payments should be required to file with its rate case information showing the concrete steps it has taken to reduce and control costs and to consider mergers and other corporate restructuring measures, as well as financial forecasts demonstrating its financial viability. CTANY says the requesting company should be subject to full rate case analysis, with more scrutiny to expense levels than in the past; and, that the Commission should impute efficiency savings if the company has not taken sufficient measures on its own. CTANY also recommends that the amount of SUSF support for a requesting ILEC should be determined and awarded for a period of no more than two to three years.²⁴⁷ Like CTANY, Verizon calls for an ILEC that desires SUSF support to file a study of ways to improve its financial stability, including the prospect for merger or other restructuring, but suggests a proceeding on such a study separate from and prior to any rate case seeking that support.²⁴⁸

The Facility CLECs propose that a company seeking SUSF support be required to demonstrate that lightened regulation and

²⁴⁵ *Id.*, pp. 42-43, citing Tr. 542-43.

²⁴⁶ Smaller ILECs IB, pp. 71-72.

²⁴⁷ CTANY IB, pp. 29-32, citing Tr. 332, 349, 352, 391, 397, 399, 401, 538-39, 564-65, 594, 657-59. See also Facility CLECs IB, p. 12.

²⁴⁸ Verizon IB, p. 49, citing Tr. 657-59.

increased pricing flexibility for certain services would not address its financial stability problems.²⁴⁹ They also contend that no money should be collected for an SUSF until a small rural ILEC demonstrates an imminent inability to provide reliable service. No advance funding is necessary, they say, because PSL §97 gives the Commission authority to grant a temporary rate increase, subject to refund, on an emergency basis when a company finds itself in jeopardy of being unable to provide adequate, sufficient service. Even if a rural ILEC went into bankruptcy, the Facility CLECs argue, it would then gain the opportunity to adjust its core business model to improve its ability to provide adequate service going forward, without reliance on an SUSF.²⁵⁰

The Smaller ILECs object to Staff's proposal to use CPAL to analyze the efficiency of an ILEC requesting SUSF support in comparison to the efficiencies of other ILECs. They contend that in the Framework proceeding, which was less than an actual rate case, the Commission used CPAL just as a shortcut estimation tool, as a "surrogate" for actual costs. A request for SUSF support will occur in the context of a general rate case, they say, where actual costs will be available. The Smaller ILECs also protest that Staff seems to suggest that the CPAL analysis would occur and could produce an adjustment after

²⁴⁹ Facility CLECs IB, pp. 11-12, citing Tr. 276-78.

²⁵⁰ Facility CLECs IB, pp. 12-14; see also Verizon IB, p. 42. The Facility CLECs claim FairPoint Communications, Inc. and its operating subsidiaries used bankruptcy to become stronger and were never in danger of failing to provide adequate service, citing Tr. 285. Although counsel for the Facility CLECs attempted to get the Smaller ILECs' witness panel to agree to those allegations, the panel testified that it did not know the circumstances of the FairPoint bankruptcy. No record evidence supports the Facility CLECs' allegations about FairPoint and bankruptcy.

the requesting ILEC's revenue requirement had already been determined.²⁵¹ In addition, they believe Staff's proposal would be based on an analysis of six-year-average historical data, instead of then-current costs, which would fail to reflect adequately the results of recent cost-cutting efficiencies.²⁵²

The Smaller ILECs appear to dispute SUSF opponents' proposal that an ILEC asking for SUSF support submit with its rate case information detailing steps it has implemented to minimize its costs only to the extent that the opponents seek information on steps the ILEC has taken to consider mergers and other restructuring. The Smaller ILECs argue, as discussed above, that the Commission has no power to require any merger, consolidation, joint venture, or other restructuring and cannot do indirectly what it cannot do directly, thus suggesting that such an analysis would be immaterial.²⁵³

2. Discussion

As Staff, the Smaller ILECs, and DCP propose and no party appears to oppose, and consistent with the process that has prevailed for TF/TTFE support, I recommend that an ILEC be required to file a rate case in connection with a request for SUSF disbursements.

I do not accept Staff's proposal that determinations on SUSF disbursements take into account total regulated operations of the requesting ILEC, including interstate as well as intrastate services. First, Staff has offered no explanation of why its claim that *competitors* market inter- and intrastate services as packages, with bundled, discounted pricing, has any relevance to a determination of what, if any, support a rural

²⁵¹ Smaller ILECs IB, pp. 64-65; Tr. 209-12.

²⁵² Smaller ILECs IB, p. 64 n. 221.

²⁵³ Smaller ILECs IB, pp. 27-28.

ILEC should receive from an SUSF, and any answer I might infer would be speculative. In addition, Staff's claim that investors consider total company operations when making decisions is both suspect and of questionable relevance to its proposal. In declining to use non-jurisdictional costs and revenues when considering the trends of Verizon's and Frontier of Rochester's rates of return and ROEs in the Comp III proceeding, the Commission itself stated, "Investors do not typically continue to support one project simply because another unrelated project is profitable."²⁵⁴ Moreover, even assuming Staff's view of investors' decision making is correct, Staff does not propose to use the results of total company operations, but only the results of the subset of total *regulated* operations.

There is at least a serious question of the Commission's authority to use total regulated operations costs and revenues in deciding whether and to what extent a requesting ILEC should receive SUSF support. The Commission's authority extends to intrastate rate-setting only, not to setting rates on telephone company interstate services, which are subject to the preemptive federal authority of the FCC. As noted earlier, the FCC has established regulations governing the separation of regulated from non-regulated costs and revenues, as well as separation of interstate from intrastate costs and revenues.²⁵⁵ The Commission has not necessarily conceded that FCC separations and allocation regulations preempt it from taking telephone

²⁵⁴ Comp III Order, *supra*, p. 55 n. 112.

²⁵⁵ *Supra* pp. 50-51 nn. 141-42 and accompanying text; and pp. 52-53 nn. 146-47 and accompanying text. Staff's complaint that the FCC's separations and allocations regulations are superannuated and no longer appropriate, with frozen category relationships and cost allocation factors, is unavailing. The FCC's regulations remain in effect and therefore relief from them can come only through FCC action.

company revenues from interstate or non-regulated operations into account in its intrastate regulatory decision making. Yet, as the Smaller ILECs emphasize, the Commission has, at least as a matter of long-standing practice, consistently declined to do so when adequate separations data are available.²⁵⁶

To bolster its position, Staff cites the NRRI report on state high-cost funds for the proposition that, although a state commission may not consider revenues from non-regulated operations when setting intrastate telephone rates, "nothing in federal law prevents them from doing so when determining high cost support."²⁵⁷ The cited passage addresses revenues from *non-regulated* activities, not the interstate activities the FCC regulates. The NRRI report makes no such point with regard to revenues from interstate activities. Furthermore, even with respect to revenues from non-regulated activities, the report cites no legal authority.²⁵⁸

Moreover, the same passage shows that the authors of the NRRI report do not believe a state commission may consider revenue from even non-regulated operations in setting intrastate

²⁵⁶ Smaller ILECs IB, pp. 58-60, citing, *inter alia*, *Jamestown Telephone Corp.*, Case 27634, Op. No. 75-20, 11 P.U.R.4th 55, 60-62 (1975), itself citing *New York Telephone Co.*, Case 17352, 11 P.U.R.3^d 320, 329-30 (1955) and Case 28425, *Impact of the Modification of Final Judgment and the Federal Communications Commission's Docket 78-72 on the Provision of Toll Service in New York - ALLTEL et al.*, Untitled Order (issued September 30, 1993), p. 21; Framework Order, *supra*, p. 9; Comp III Order, *supra*, p. 55 n. 112, p. 56 n. 114. See also Smaller ILECs RB, pp. 41-43.

²⁵⁷ BLUHM *ET AL.*, *supra* n. 210, at 49 (Ex. 8, p. 58).

²⁵⁸ Sprint's proposal to take revenues from non-regulated DSL and video services into account in making determinations on SUSF support requests would contradict the Commission's long-standing practice of declining to consider costs and revenues of non-intrastate activities, regardless of whether that Commission practice is viewed as resting on legal or policy grounds.

rates. Under the proposals of either the Smaller ILECs or Staff the determination of any need for SUSF support would occur as an integral part of a general intrastate rate case. Staff sees interstate operation results coming into consideration upon a determination that an ILEC's intrastate revenue requirement "could not be met by setting basic local service rates at the benchmark level."²⁵⁹ Staff's position necessarily implies that in such a situation the Commission could deny SUSF support if it decided that a portion of the company's interstate earnings should be applied to meeting that intrastate revenue requirement. But such a decision would either, as the Smaller ILECs contend, effectively undermine the FCC's allowed interstate revenue requirement and adversely affect the company's opportunity to earn its federally allowed interstate return on equity or leave the company unable to recover its intrastate revenue requirement. Either result appears problematic.

Assuming that the Commission's traditional refusal to consider costs and revenues from non-intrastate operations rests on policy rather than acknowledgement of federal preemption, there then remains Staff's argument that fairness demands consideration of interstate operation results, because the same ILEC network facilities provide both intrastate and interstate services. Staff contends that the cases the Smaller ILECs cite reflecting that refusal are not apposite, because they involve rate relief under traditional rate of return regulation, without subsidies funded by competitors.²⁶⁰ In the *Jamestown Telephone Corp.* and *New York Telephone Co.* cases upon which the Smaller ILECs rely, however, the Commission was concerned about

²⁵⁹ Staff IB, p. 12; Tr. 521-22.

²⁶⁰ Staff RB, pp. 10-11.

fairness, too. It explained that interstate rates should not be expected to subsidize a shortfall in return based on intrastate rates any more than New York intrastate rates should be expected to fix a deficiency in return on an interstate basis.²⁶¹ In any event, Staff's concern over fairness considering that intrastate and interstate services use the same network facilities fails to give any weight to the fact that the FCC's regulations provide for allocation of joint and common costs of shared facilities between intrastate and interstate operations.²⁶²

For these reasons, I do not recommend that the Commission consider costs and revenues other than intrastate when reviewing requests for SUSF support.

Turning to Staff's proposal for a CPAL analysis, there is nothing inherently objectionable in making adjustments to a utility's revenue requirement to recognize and encourage efficiency gains that a company should be expected to achieve. The Commission routinely imposes productivity adjustments to reduce revenue requirements in rate cases, imputing efficiency gains.²⁶³ CPAL is merely one tool available for examining a company's efficiency in comparison with others. As Staff testified, the Commission has used CPAL as a tool to assess telephone company expenses in rate cases previously.²⁶⁴ Whether to use a six-year average historic cost, costs for some other averaging period, or then-current test year costs would be

²⁶¹ See *supra* p. 90 n. 256.

²⁶² See 47 C.F.R. §§36.1 and 36.2; and Part 36 generally. See also *supra* p. 90 n. 255.

²⁶³ *E.g.*, Case 08-E-0539 *et al.*, *Consolidated Edison Co. of New York, Inc. - Electric Rates*, Order Setting Electric Rates (issued April 29, 2009), pp. 36-38.

²⁶⁴ Tr. 541-42, citing, *e.g.*, Case 02-C-1294, *Chazy & Westport Telephone Co. - Minor Rate Increase*, Order Denying Rate Increase (issued August 27, 2003).

premature to determine now, however. If necessary, that question can be considered in the context of an actual rate case with a request for SUSF support.²⁶⁵ In any event, however, any consideration of efficiency of the requesting ILEC's operations in comparison to other ILECs', whether incorporating use of CPAL or not, should occur in the course of determining the company's revenue requirement, not as a *post hoc* reduction of what has already been determined just and reasonable.

The Smaller ILECs' objection to providing information on steps a requesting ILEC has taken to consider potential merger or other restructuring because the Commission has no power to require such actions does not convince me. No telecommunications carrier has any entitlement to receive SUSF support. The Commission can withhold access to an SUSF as a matter of its regulatory discretion if a requesting ILEC has not done all it can to examine potential ways to increase efficiency and reduce costs, including taking a serious look at opportunities for restructuring. Although there is no evidence on this record of a current market for merger or consolidation, requiring study and reporting on the possibilities might well provide a useful test of whether such opportunities exist and better information going forward. I therefore recommend that the Commission require an ILEC to file with its rate case and request for SUSF support a report on all the steps it has taken to reduce costs, including consideration of mergers and other restructuring possibilities. Verizon's proposal that such a study be considered in a separate proceeding prior to any rate

²⁶⁵ It is not clear that Staff has even proposed use of a six-year average. The six-year average the Smaller ILECs cite merely came from a Staff response to a Smaller ILECs' interrogatory request to update a table appended to the Framework Order. See Ex. 94.

case and request for SUSF support strikes me as unnecessarily duplicative and inefficient. I do not recommend that procedure.

I recommend that the Commission adopt Staff's proposed impairment analysis requirement. The Smaller ILECs' argument that GAAP accounting rules do not always track regulatory accounting requirements for utilities misses the point. GAAP provides special rules to accommodate utility accounting if certain criteria are met. One of those criteria is that, given demand for the service and the level of competition, it is reasonable to expect that rates sufficient to recover the utility's costs can be charged and collected from customers. But if competition leads to competitive losses and failure to meet that criterion, then the utility must perform a test for recoverability of long-lived assets and recognize an impairment loss if the carrying charges on a long-lived asset are not recoverable from undiscounted cash flows.²⁶⁶ If, as a result of competition, a utility can no longer fully use plant, the Commission may reasonably deny full recovery for that plant, as it warned in the Comp II Order.²⁶⁷

The Smaller ILECs contend that as COLRs and ETCs they must continue to provide service throughout their service areas and maintain plant ready to serve, even as back-up providers for customers that have already migrated to competitors; and that

²⁶⁶ Staff IB, pp. 17-18; Tr. 530-33.

²⁶⁷ See Comp II Order, *supra*, pp. 14, 27-28. The Smaller ILECs' rejoinder that the Commission failed to repeat that warning in more recent orders approving TF disbursements is unconvincing. The TF payments involve moneys from phasing out intrastate access charge pooling, in accordance with the settlement agreement adopted in the TF Order. The Commission's warning in the Comp II Order specifically related to support from a potential fund to support basic service in high-cost areas, which is the very subject of this proceeding.

pieces of their networks cannot be turned off just because fewer customers are connected to it.²⁶⁸ Some pieces of their networks undoubtedly will have to be maintained to serve existing and potential new customers. Other portions of their networks, however, that have already suffered substantial loss of access lines to competitors may well be highly unlikely ever to see those customers return. An impairment analysis will require an ILEC seeking SUSF support to take a hard look, determine what portions of the network are no longer used to produce revenue that would serve to recover their costs, and write down those assets to minimize its need for external support. I find it more reasonable to impose the cost of unused or under-used assets on the utility stockholders who took the risk of investing in those assets, rather than on an ILEC's customers and non-customers contributing to an SUSF.²⁶⁹

In addition, the Smaller ILECs suggest that writing down assets due to impairment would be unfair, because "Staff-determined" depreciation rates have slowed their recovery of plant investment and have not taken into account the impact of competition.²⁷⁰ Staff, however, does not determine depreciation rates. The Commission does, after a Smaller ILEC has full opportunity to challenge whatever depreciation rates Staff

²⁶⁸ Smaller ILECs IB, pp. 67-68; Tr. 214-16. The Smaller ILECs' arguments that they are COLRs and that there is a "regulatory compact," which would be broken if they are required to write-down any assets, (Smaller ILECs IB, pp. 69-71) have already been rejected. See *supra* pp. 43-44, 51-52.

²⁶⁹ As Staff maintains, taken to its logical extreme, the Smaller ILECs' position would mean that, even if all their customers move to alternative providers, they would never have to write down assets and their stockholders would be fully compensated by customers of other providers, through an SUSF, for the carrying charges on their unused facilities. Staff RB, p. 14.

²⁷⁰ Smaller ILECs IB, p. 70.

advocates. In any event, even if the Smaller ILECs' argument had some merit, their investors have earned returns on higher rate bases than otherwise would have prevailed with higher depreciation rates. Furthermore, if depreciation rates had been higher, their revenue requirements and rates would have been higher, which would have made them even more vulnerable to competitive encroachment than they have been and they would likely have even worse ROEs than they do.

Although it seems reasonable to impose a requirement for some sort of annual certification on need for and proper use of SUSF funding, I have no basis for recommending to the Commission the form or contents of such a certification. In response to the Smaller ILECs' position that the current annual reports to the Commission should suffice, Staff says the current annual report information is incompatible with information in rate filings. As examples, Staff cites calendar year versus fiscal year based information and financial information filed as required by the Uniform System of Accounts, rather than with operating expenses presented by cost component.²⁷¹ These Staff concerns are not reflected in the evidentiary record, nor does Staff, as previously noted, provide any detail on what particular information it thinks should be included in the proposed annual certification or attestation. I recommend that, if the Commission establishes an SUSF, it require parties to the first rate case requesting SUSF support to address this issue in detail and then decide the issue for that and subsequent cases involving requests for SUSF support.

The Smaller ILECs challenge the Facility CLEC and Verizon suggestions that the Commission wait until an ILEC is in imminent danger of being unable to provide reliable service or

²⁷¹ Staff RB, p. 15.

in bankruptcy before taking action in response to that ILEC's circumstances. The Smaller ILECs say such an approach would create an unacceptable risk of uncontrolled harm and service interruptions to consumers, either preceding or created by bankruptcy. They point to the Commission's warning about the risk to consumers from the financial pressure on an ILEC to undertake excessive cost-cutting to preempt bankruptcy, which would endanger safe and reliable service.²⁷² The Smaller ILECs add that in a bankruptcy, the Commission would lose authority over an ILEC's intrastate operations to the federal bankruptcy court, which might not have the same priorities for maintaining service to all customers.²⁷³ I agree with the Smaller ILECs and reject the Facility CLECs' and Verizon's position. Waiting until bankruptcy or an imminent inability to provide service to customers generally before taking prophylactic steps would, rather than ensure universal service, just cavalierly spin the roulette wheel, with the interest of consumers in reliable service at stake.

I see no advantage to setting a limit of two to three years on the length of time before the Commission would have to review and potentially terminate or reset an award of SUSF

²⁷² Citing Case 09-C-0595, *Champlain Telephone Co. and Champlain Telephone Co. Employee Stock Option Plan - Authority to Transfer Controlling Interest*, Order Approving Amendment of Certificate of Incorporation, Issuance of Securities and Transfer of Control with Conditions (issued August 23, 2010), pp. 10-11.

²⁷³ Smaller ILECs IB, pp. 19 n. 56, 25-27; Smaller ILECs RB, pp. 31-32. The Facility CLECs' response that bankruptcy "would not necessarily impact on a carrier's ability to provide reliable voice communication service to its customers" [Facility CLECs RB, p. 9 n. 4 (emphasis added) by implication concedes this point. The Commission's ability to grant temporary rate increases is no answer. See *supra* pp. 67-68 n. 193 and accompanying text.

support to a particular ILEC as CTANY suggests. CTANY itself contends that any SUSF the Commission establishes should sunset after two or three years.²⁷⁴ Other parties recommend that, if the Commission establishes an SUSF, no more than three to five years pass before it sunsets or the Commission conducts a general review of whether or not the fund should continue.²⁷⁵ With general inflation and continued erosion of access lines from competition probable, any ILEC awarded SUSF support is highly unlikely to see its need for support wither within two or three years after the Commission determines that need. Rather, the need is much more likely to increase and the ILEC is just as likely to file a rate case seeking additional SUSF support within that time period. In these circumstances, requiring a review of a particular ILEC's need and level of SUSF support after two or three years is unlikely to provide significant value to the process or to SUSF contributors.

C. Benchmark Rate

1. Parties' Positions

Staff states that in the Comp III Order the Commission established \$23 per month as the benchmark rate for affordable basic residential local exchange service. Staff proposes to continue using that amount as the benchmark rate for purposes of calculating SUSF disbursements. In addition, Staff maintains that, as a condition of SUSF support, the recipient be required to increase its rate actually charged for basic residential local exchange service to the benchmark level. Furthermore, Staff suggests that, to maintain the typical historic relationship between residential and business rates, the

²⁷⁴ CTANY IB, pp. 32.

²⁷⁵ See *infra* pp. 133-35.

recipient ILEC's basic business local exchange service rate should be set no lower than the benchmark residential rate.²⁷⁶

The Smaller ILECs object that the Comp III Order did not set the \$23 rate as a funding benchmark for the current TF, much less an SUSF. They argue that the Commission fixed that level only as a *cap* on Verizon's and other ILECs' charges for basic residential service, with no requirement that rates be raised to that level. Moreover, they contend, the \$23 figure relied on comparison of a limited number of supposedly competitive rates and a cost analysis, but the rates and costs considered applied to services beyond basic local exchange service, including unlimited local calling in much larger local calling areas, as well as unlimited toll calling and even calling features, such as call waiting. They also point to a recent service offering by Verizon for about \$25 a month, but which, they maintain, includes elements well beyond those of basic local exchange service. Adjusting those various rates and costs downward to exclude those extras would yield a benchmark rate cap in the \$11 - \$15 range, they say. According to the Smaller ILECs, the current \$23 benchmark rate exceeds the rates in effect in all but three of 90 cities other than New York in 2008 and \$10 higher than the national average urban rate.²⁷⁷

The Smaller ILECs and DCP insist FCA §254(b)(3) demands use of a nationwide average urban rate to set a benchmark for "reasonably comparable" rates in rural high-cost areas in New York. They add that the FCC has established rules to assess the reasonableness of rural rates by comparison to a nationwide urban average, citing 47 CFR §54.316(a). Instead of the \$23 benchmark Staff urges, the Smaller ILECs propose a

²⁷⁶ Staff IB, pp. 3, 19; Tr. 474, 553-54.

²⁷⁷ Smaller ILECs IB, pp. 75-80; Tr. 116-19; Ex. 21.

benchmark rate cap of \$15.22. They base this figure on a nationwide average urban rate from a 2006 survey the FCC cited in a 2010 opinion, adjusted to reflect inflation to 2009 and then to remove the federal interstate subscriber line charge (SLC) and the federal universal service charge, yielding a rate level of \$13.23. To that result, they add 15 percent to mirror "the 15 percent threshold that is currently used in determining federal [high cost loop] disbursements for rural ETCs."²⁷⁸ The Smaller ILECs contend that the resulting \$15.22 benchmark rate cap they support is consistent with a \$15.81 per month rate applied in setting TF disbursements in 2005; and to the rates and costs of services the Commission discussed in setting the \$23 mark in the Comp III Order, as adjusted to remove the services and features they claim were in excess of basic residential local exchange service.²⁷⁹

The Smaller ILECs propose, in general, that the amount of any SUSF disbursement to an eligible recipient be calculated by imputing the benchmark rate as the applicable basic residential local exchange service rate. Contrary to Staff's recommendation that to receive SUSF support an ILEC must set its basic residential local exchange rate at the benchmark level and actually charge that rate, the Smaller ILECs propose, first, that the current practice of allowing a TF/TTFE recipient

²⁷⁸ Tr. 113-14. The Smaller ILECs cite WC Docket No. 05-337 and CC Docket No. 96-45, *High-Cost Universal Service Support, Federal-State Joint Board on Universal Service, Wyoming Public Service Commission & Wyoming Office of Consumer Advocate - Supplemental Federal Universal Service Funds for Customers of Wyoming's Non-Rural Incumbent Local Exchange Carrier*, Order on Remand and Memorandum Opinion and Order, FCC 10-56 (released April 16, 2010)(FCC Wyoming Order), p. 25.

²⁷⁹ Smaller ILECs IB, pp. 81-82; Smaller ILECs RB, p. 55. See also DCP IB, pp. 14-16; DCP RB, p. 10.

flexibility to charge less than the benchmark rate for basic residential service also apply to recipients of SUSF support. Using the benchmark as a rate cap only, rather than a fixed rate, would allow the recipient carrier pricing flexibility to take into account specific market conditions in its service area and avoid potential loss of customers from higher rates that would only increase need for SUSF support, they maintain. The Smaller ILECs also propose, however, that, for any ILEC seeking support and now charging a rate more than \$2.00 per month lower than the benchmark, the rate be increased only gradually to the benchmark level, in order to avoid rate shock. They propose annual increases of \$2.00 in the actual monthly basic service rate until the benchmark rate is reached. Contrary to their general benchmark "cap" imputation proposal, however, they suggest that in these instances the amount of SUSF support be calculated on the basis of the *actual rate to be charged*, rather than the benchmark level.²⁸⁰

AT&T suggests an increase in the benchmark rate up to what it calls, with no citation, the "federal comparability rate for rural carriers" of 125 percent. Applied to the \$23 rate currently used to calculate TF/TTFE disbursements, that percentage would yield a benchmark of \$28.75 per month. AT&T says an increase is warranted because of inflation since the advent of the \$23 benchmark, and that the benchmark for rural carriers, which have higher costs, should be higher than the statewide benchmark for urban carriers, whose costs are lower. AT&T also notes that a higher benchmark will reduce demands on an SUSF.²⁸¹ CTANY agrees that the Commission should consider raising the \$23 benchmark, suggesting that the current benchmark

²⁸⁰ Smaller ILECs IB, p. 81 n. 279, 82-83; Tr. 50-51, 247-49.

²⁸¹ AT&T IB, p. 11; Tr. 769-70.

was set with reference to urban forward-looking costs that are not only below rural forward-looking costs, but even farther below the historical costs of the rural ILECs.²⁸²

The Facility CLECs maintain that the price and cost components underlying the current \$23 benchmark have risen since it was instituted, so that the benchmark should be increased. They suggest a level 10 percent above the Verizon or Frontier urban rate for comparable local service in the same geographic area, to reflect the higher cost of service in rural areas. The Facility CLECs also say the recipients of SUSF support should be required to justify, in an annual review proceeding, that the benchmark remains reasonable. If that review shows the benchmark no longer reflects a reasonable market rate, then the Commission should raise it.²⁸³ Sprint believes raising the current benchmark would not be unreasonable, to reduce the burden on SUSF contributors, but gives no suggested level other than to note that California has established a benchmark rate of \$36.²⁸⁴

Verizon notes that in the Comp III Order the Commission observed that rural areas are higher cost areas, but rates are below forward-looking or actual costs in many rural areas; and that rates for rural areas more accurately reflecting costs might help extend competition. Verizon adds that the

²⁸² CTANY IB, pp. 26-27, citing Comp III Order, *supra*, pp. 53-54, 58-59.

²⁸³ Facility CLECs IB, pp. 17-19.

²⁸⁴ Sprint IB, pp. 16-17. Sprint also suggests that, if the benchmark is set on the basis of stand-alone basic local service, then only lines *capable* of supporting stand-alone basic service only should receive SUSF support. Since there are no residential lines that are not also *capable* of supporting more than just stand-alone basic local service (e.g., interstate toll service), this suggestion equates to a proposal of no SUSF support for any line.

Smaller ILECs concede their rural service territories are high cost areas. Therefore, Verizon insists Commission policy supports a benchmark for the predominantly rural carriers eligible for SUSF support higher than its own rate. Verizon also contends that inflation since the Comp III Order justifies a higher benchmark now.²⁸⁵ Verizon maintains that the \$23 rate, with addition of the SLC and applicable fees, taxes, and surcharges, yields a total monthly bill of about \$36-\$37, which would be less than 0.88 percent of median monthly household income for non-metropolitan areas of New York in 2010. Since the FCC has found national average household expenditures for the full range of wireline and wireless telephone services amounted to more than two percent of total household expenditures in 2008, Verizon concludes, the Commission has headroom to increase the benchmark reasonably.²⁸⁶ Verizon then calculates a maximum rate it considers would be reasonably comparable to its \$23 per month rate. As a general criterion, it refers to the FCC's federal universal service fund test for "reasonable comparability" of rates in a state's rural areas served by non-rural ILECs to the nationwide average urban rate. That test sets a limit of two standard deviations above the national urban rate average, or 143 percent. Applying that percentage to the current \$23 benchmark would yield a rural benchmark of \$32.89, Verizon contends, which is only a little over a third of the average total household monthly expenditure for telecommunications services.²⁸⁷

²⁸⁵ Verizon IB, pp. 44-45, citing Comp III Order, *supra*, pp. 45, 59, 63; Tr. 33, 37, 41, 47, 257, 762.

²⁸⁶ Verizon IB, pp 45-46.

²⁸⁷ Verizon IB, pp. 46-47; citing 47 CFR §54.316(b).

2. Discussion

I recommend that, for the purpose of determining the amount of SUSF distributions to a requesting ILEC, the Commission establish a benchmark rate cap for basic residential local exchange service of \$25.65. I recommend that the amount of distributions be calculated by imputing to the requesting ILEC revenues from basic residential local exchange service at the benchmark level. To reduce the potential for rate shock and provide some flexibility to deal with competition and demand concerns, however, I recommend that the recipient ILEC be allowed to move the rate actually charged for basic residential service to the benchmark level in steps of no less than \$3.50 each six months until the benchmark level is reached. In addition, I recommend that the Commission adopt Staff's unopposed proposal that an SUSF recipient carrier be required to charge a rate for basic business local exchange service no lower than the rate for basic residential local exchange service. Finally, if the Commission establishes an SUSF, I recommend that it also impose a requirement that annually, on the anniversary date of issuance of the order establishing the fund, the benchmark rate used to calculate SUSF support be increased in proportion with inflation for all new rate case requests for SUSF support filed over the ensuing year.

I do not agree with the Smaller ILECs and DCP that the Commission is somehow bound by FCA §254(b)(3) to set a benchmark for basic residential local exchange service in New York "reasonably comparable" to a national average urban rate. Those parties cite no legal authority for their position. The cited language requires *the FCC and its Joint Board on Universal Service* to look to an average of "rates charged in urban areas" across the nation as a comparability benchmark in setting

federal interstate universal service policies.²⁸⁸ Nothing in §254(b), however, even purports to apply to a state, much less specifies any particular territory or area of reference, much less the nation as a whole, that a state must use when it sets rates applicable in its own rural areas. Given the great variation in residential rates from city to city in the states,²⁸⁹ such a restriction is likely to lead to pricing rural residential rates in some states with state universal service funds far below average urban rates in those states, while requiring urban ratepayers to contribute to support of rural. The Smaller ILECs and DCP cite no legislative history indicating such a Congressional intent, nor do they provide even a theoretical explanation of why Congress would have intended and mandated such an unfair result.²⁹⁰

In fact, as other parties contend, that outcome is precisely what would prevail in New York under the Smaller ILECs' and DCP's benchmark rate proposal. That result would also contravene the Commission's findings and consequent intent in the Comp III Order that: rural rates are below forward-

²⁸⁸ See FCA §254(a) and introductory clause of FCA §254(b).

²⁸⁹ See *FCC 2008 Reference Book of Rates, Price Indices, and Expenditures for Telephone Service* (www.fcc.gov/wcb/iatd/lec.html), Table 1.3.

²⁹⁰ I also note that other states apparently do not believe FCA §254(b)(3) limits the benchmark rates for their state universal service funds to the nationwide urban average residential rate. Of the benchmark rates identified in the NRRI paper on state high-cost funds, a paper the Smaller ILECs introduced in evidence, all but perhaps one exceed the \$15.22 benchmark the Smaller ILECs and DCP propose here and several exceed the \$23 level the Commission has been using for purposes of TF/TTFE distributions. Benchmark rate levels exceed \$23 per month in Arkansas (\$28.70), California (\$36.00), Idaho (\$25.76), Texas (\$38.00), and Wyoming (\$32.57). See *BLUHM ET AL.*, *supra* n. 210, Appendix B (Ex. 8, pp. 99-151).

looking costs and even farther below historic costs; rural service costs more to provide than urban service, despite urban rates being higher than rural; and it is imperative to move rates closer to cost.²⁹¹ Moreover, the Smaller ILECs/DCP proposal would result in significant disparities even among the Smaller ILECs' member companies' various rates for basic residential service, more than a third of which are already above the level those parties recommend as a cap and three of which are already at the current \$23 benchmark level. Therefore, I believe the Smaller ILECs' and DCP's proposed benchmark level would produce rate disparities between urban and rural residential customers, as well as among different rural residential customers, that are neither fair nor reasonable and do not recommend it.

The Commission set the \$23 benchmark in the Comp III Order as reasonable on the basis of rates or costs for three residential rate services: (1) a \$24.95 Verizon package for basic access and unlimited local calls in New York City, set in 2003, which the Commission found competitively determined and just and reasonable; (2) a competitive AT&T offering for basic local service, based on forward-looking costs, of \$22.95 before surcharges; and (3) a \$22.00 competitively based Verizon "Upstate Regional Value Plan," which included basic access and unlimited local calling and intraLATA²⁹² toll calling, and which

²⁹¹ Comp III Order, *supra*, pp. 53-54, 58-60.

²⁹² "LATA" stands for "local access and transport area."
47 U.S.C. §153(25).

was also sufficient to recover forward-looking costs.²⁹³ Looking at the first of these three yardsticks, the Smaller ILECs complain that the \$24.95 Verizon package rate included unlimited local calling to a far larger number (as much as millions) of customers than in a rural area; contend that the Commission has noted that the ability to contact a greater number of phones has greater value, which can be recognized in rate differentials; and then just *assume* that the “value” differential between the Verizon package local unlimited calling area and upstate local calling areas is \$10.00.²⁹⁴ I am not convinced that the mere ability to reach a significantly greater number of other customers in a local calling area *per se* provides a greater value of service. The value of local flat rate calling to the customer depends on the number of calls she needs or wants to make and where those phones she needs or wants to reach are located. Just because a user in a metropolitan area can reach more other phone customers without additional toll charges than could a user in a rural area does not necessarily mean the metropolitan user will realize any additional value compared with the rural user. Any additional value will be realized only if the metropolitan user needs or wants to make more calls to other customers at a greater distance within his local calling area than he could make if that local calling area were only the size of the calling area of a typical rural ILEC. I cannot see how greater value of service could reasonably be determined without a study of comparative calling patterns of metropolitan

²⁹³ Comp III Order, *supra*, pp. 44-45, 58-60. See also Case 05-C-1303, *Petition of Cablevision Systems Corp. - Verizon's Regional Value Plan and Regional Essentials Plan*, Order Denying Petitions Requesting Suspension of and Hearing on Tariff Filings (issued December 6, 2005)(Cablevision - Verizon Order), pp. 1 and 6 and Appendix.

²⁹⁴ Tr. 116-17, citing Comp III Order, *supra*, p. 67 n. 135.

ILEC and rural ILEC customers. The record contains no such study.

In addition, the \$10.00 "value" adjustment the Smaller ILECs make in order to compare the Verizon \$24.99 package favorably to their own \$15.22 proposed benchmark has no basis in fact, but is merely assumed. Moreover, the \$10 adjustment would result in a price of about \$15, far below what the Commission determined to be the forward-looking cost of upstate service. That result would imply that the adjusted price, as well as the Smaller ILECs' proposed benchmark, is inadequate and should be raised substantially to a level back above forward-looking costs.²⁹⁵

Next, the Smaller ILECs attack the \$22 Verizon Upstate "Regional Value" plan rate upon which the Commission relied in part in establishing the \$23 benchmark, because it includes unlimited intraLATA calling. Here, again, the Smaller ILECs ascribe the same \$10 pricing value to the unlimited intraLATA calling included. Again, however, the \$10 value is merely assumed.²⁹⁶ I do not accept that adjustment, for the same reasons I did not accept it with respect to the Verizon \$24.99 package the Commission considered in the Comp III Order.

Third, the Smaller ILECs criticize the consideration of costs of the \$22 Verizon Upstate Regional Value plan in the Comp III Order. They claim the Commission erred in failing to remove from the total forward-looking costs of that service

²⁹⁵ Comp III Order, *supra*, pp. 58-60; Cablevision - Verizon Order, *supra*, Appendix. Even after adjustment to remove interstate costs from the forward-looking costs of upstate service, the adjusted forward-looking costs would be substantially greater than the price of the Verizon \$24.99 package less the Smaller ILECs' \$10 reduction. See *infra* pp. 110.

²⁹⁶ Smaller ILECs IB, pp. 78-79 n. 272 and accompanying text.

\$3.75 for three calling features, \$6.39 for the federal SLC, and \$5.00 for intraLATA usage included in the plan.²⁹⁷ With respect to the \$3.75 for calling features, the Smaller ILECs err. That amount was included in the cost for a different plan, the "Regional Essentials" plan, which included calling features. The forward-looking cost of the \$22 Regional Value plan was \$3.75 less than the forward-looking cost of the Regional Essentials plan, reflecting the proper elimination of the costs of the calling features not included in the Regional Value plan.²⁹⁸ The Smaller ILECs are correct that about \$5 of usage costs are included in the forward-looking cost estimate for the Regional Value plan, consistent with average usage.²⁹⁹ Those usage costs, however, encompass both local calling included within basic service as well as intraLATA calling beyond the local area. The record here provides no way of teasing out any portion that might be attributable to intraLATA calling only and I am unwilling to adjust the forward-looking costs on a speculative basis, especially since those costs fall well below actual historic cost levels and the Commission has emphasized the need to move prices not only to, but above, forward-looking cost levels.³⁰⁰ On the issue of the federal SLC I agree with the Smaller ILECs that the forward-looking costs of the Regional Value plan include interstate costs as part of the TELRIC costs, but the SLC that recovers the interstate cost component is not

²⁹⁷ *Id.*

²⁹⁸ Cablevision – Verizon Order, *supra*, Appendix. Compare the TELRIC costs (total element long-run incremental costs) in line 4 of the column "Upstate" under "Regional Value" with the TELRIC costs in the column "Upstate" under "Regional Essentials."

²⁹⁹ Comp III Order, *supra*, p. 58 n. 119.

³⁰⁰ *Id.*, pp. 58-59.

covered by the \$22 rate for the plan.³⁰¹ The forward-looking total cost associated with that plan--\$26.59 with retail costs included--therefore should have been reduced by the amount of the SLC to determine the proper intrastate forward-looking costs of the plan, yielding \$20.20. But that adjustment still leaves only a \$1.80 margin of the \$22 rate for the plan over its forward-looking costs. The margin over historic cost would be even smaller.

For these reasons, I find no fault with the Commission's overall result in setting the benchmark rate level at \$23 in the Comp III Order.³⁰² Because the Smaller ILECs' benchmark rate proposal not only lacks a sound basis, but would move the benchmark farther away from, rather than closer to, rural forward-looking costs, I recommend that the Commission reject the \$15.22 benchmark level that they and DCP favor.

Turning now to the proposals other parties put forward to raise the benchmark rate level, I am not inclined to recommend the \$28.50 proposal by AT&T based on a "federal comparability rate for rural carriers of 125 percent." It has provided no citation to such a comparability rate and I have not found such a figure myself. Thus, I am unable to confirm whether such a measure exists or, if it does, to evaluate whether it provides an appropriate model in the context of

³⁰¹ Cablevision - Verizon Order, *supra*, Appendix.

³⁰² The Smaller ILECs reliance on deconstructing a recent Verizon \$24.99 offering is misplaced, too. Regardless of the Smaller ILECs' analysis of whether that service offer includes extras beyond basic service, I conclude, contrary to their claim, that offer is a promotional rate, available to "new residential voice customers only" and "not available in all areas" and subject to other restrictions, including "change without notice." Ex. 21. The Smaller ILECs' witness panel appeared to recognize that promotional rates do not serve as proper for comparative purposes. Tr. 70.

setting an SUSF benchmark. Similarly, I will not recommend the 10 percent increase that the Facility CLECs propose, because they provide no rationale for that particular percentage increase rather than any other.

I also find Verizon's suggested approach wanting. Assuming, for the sake of argument, that the FCC's safe harbor percentage limitation for comparing rural rates to a national urban average provides an appropriate model, then rural rates in New York should presumably be compared to an average urban rate for this State. But nothing in the record demonstrates that the current \$23 benchmark level Verizon uses as a base for its calculation represents a New York State average urban rate. In addition, Verizon's proposal assumes that a new benchmark for receipt of SUSF disbursements should be set at the very maximum percentage above the current level that the FCC's two standard deviation range would allow as a safe harbor for "reasonable comparability" at the federal level. Verizon offers no justification for this high a level other than that it would still leave the benchmark rate within what it considers an affordable range. Verizon's approach seems to stand the FCC's approach on its head. The FCC's safe harbor under 47 CFR §54.316(b) liberally *allows* an ETC to receive federal universal service funding even if its rates are as much as two standard deviations above an urban mean, a mean which is itself the federal benchmark. Verizon's approach would narrowly *preclude* an ILEC from receiving state universal service funding unless its rates were at or imputed at a level two standard deviations above the current benchmark, which, as noted, has not even been established as the urban mean in this State. Verizon's proposal would also produce a quite substantial 43 percent increase over the current benchmark level. I do not find Verizon's approach

to have a sound basis and recommend that the Commission not adopt it.

Nonetheless, as several parties argue, the \$23 benchmark dates from five years ago and costs have risen and warrant escalation of the benchmark rate level. The inflationary increase since the Commission set the \$23 rate level in 2006 until now amounts to about 11.5 percent.³⁰³ Accordingly, I recommend that the Commission set the benchmark rate level for SUSF disbursement purposes at \$25.65.

The next issue is whether the benchmark rate level should be viewed as a required rate level or only a rate cap and imputation level, with discretion left to an ILEC granted SUSF disbursements to decide whether to raise its rates to the benchmark level. The Smaller ILECs insist the benchmark should be only a cap, in order to give the recipient ILEC flexibility to respond to competitive market conditions and consumer demand. They say requiring the recipient to charge the benchmark rate level will only increase competitive losses and the subsequent need for SUSF support. In addition, the Smaller ILECs seek a *transitional* "benchmark rate" for any carrier that has a current basic residential local exchange service rate more than \$2.00 below the otherwise applicable benchmark. In order to minimize rate shock, they contend, the SUSF distribution amount should be based on an imputation of revenues from a transitional rate level only \$2.00 greater than the current rate.³⁰⁴

I appreciate the Smaller ILECs' concern over price elasticity of demand and flexibility to address competition, as

³⁰³ U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index - All Urban Consumers (1982-84=100), 2006 Half1 to 2011 Half1 (<http://data.bls.gov/cgi-bin/surveymost>).

³⁰⁴ Smaller ILECs IB, pp. 81 n. 279, 82-83.

well as the potential for rate shock. On the other hand, I recognize that the rates for many of the Smaller ILECs are far below forward-looking costs³⁰⁵ and must, as the Commission has stressed, be brought up to forward-looking cost levels or above. I believe actual rates must, at least, be put on a path toward reaching the benchmark level in a reasonable period of time, particularly for ILECs that depend on SUSF support. Furthermore, imputing revenues based on the full level of the benchmark rate, rather than a reduced transitional level for some ILECs, will produce a greater incentive for carriers to become as efficient as they can as soon as they can. These several opposing concerns require balancing in the public interest, in my view. Accordingly, I recommend that the benchmark level be treated as a cap, but that an ILEC granted SUSF support be required to raise its actual basic residential service rate by a minimum amount on a regular schedule until it achieves the benchmark level.

Implicit in the Smaller ILECs' transitional benchmark rate proposal is a suggestion that actual rates, too, should increase by no more than \$2.00 per iteration. That small an incremental increase, if made on an annual basis, would be inadequate in my view. With annual increments of only that amount, it would, for example, take nine years for the basic residential service rates of Chautauqua & Erie Telephone Corporation, Edwards Telephone Company, Middleburgh Telephone Company, or Port Byron Telephone Company to reach the benchmark level.³⁰⁶ That is simply too long, in my judgment. When the

³⁰⁵ Compare the Smaller ILECs' rates in Exhibit 19 with the forward-looking costs (subject to subtracting the \$6.39 SLC) shown in the Appendix to the Cablevision - Verizon Order, *supra*.

³⁰⁶ See Exhibit 19.

Commission made its initial award of TF support to Crown Point Telephone Corporation in 2004, it required semi-annual increases of \$3.06 in the basic residential rate.³⁰⁷ Given the passage of seven years since then, I find that it would be reasonable to require modestly higher mandatory semi-annual increases of \$3.50 in the basic residential service rate for an ILEC receiving SUSF support, until it reaches the benchmark level. Required rate increases of that amount and frequency would bring all recipient ILECs up to the \$25.65 benchmark level I recommend within two-and-a-half to three years.³⁰⁸ I recommend that the Commission adopt such a requirement.

Finally, I agree with the Facility CLECs' that there should be a mechanism for regular adjustment of the benchmark rate. Their proposal that SUSF recipients be required to justify the continuing reasonability of the benchmark rate level on an annual basis, however, seems excessive and inefficient to me. To minimize transaction costs, I recommend that the Commission require an annual increase in the benchmark rate level, on the anniversary date of the order establishing an SUSF, in proportion with inflation. The increased benchmark rate should then be used in determining SUSF disbursement amounts in any rate case filed over the subsequent year that includes a request for SUSF support.

D. Cap on the Size of an SUSF

1. Parties' Positions

No party to Phase II of this proceeding has proposed an actual, specific hard cap or limit on the size of an SUSF. Staff predicted that as many as 17 rural ILECs would draw from

³⁰⁷ Case 04-C-1002, *Crown Point Telephone Corp. - Multi-Year Rate Plan*, Order Adopting Multi-Year Rate Plan (issued September 29, 2004), p. 7 and Attachment, p. 7.

³⁰⁸ Based on current rate levels shown in Ex. 19.

the fund, and calculated about \$5.6 million as its "worst case estimate" of the total draw.³⁰⁹ The Smaller ILECs estimate the maximum size of the SUSF at about \$10.3 million with all Smaller ILECs receiving funding, based on the imputed \$15.22 benchmark rate they propose. In addition, they say that use of the rate case process to evaluate SUSF support requests will ensure disbursements are necessary and grounded in fact. Given the \$0.01 to \$0.02 per month average end user charges that would flow from the respective Staff and Smaller ILEC maximum funding level estimates, the Smaller ILECs see no reason for concern about the size of an SUSF and thus no need for a cap.³¹⁰ DCP originally felt a fund cap advisable, but later shifted its position to track that of the Smaller ILECs, given the fund size and end-user charge estimates and rate case consideration of funding requests.³¹¹

AT&T has suggested a "soft cap," based on its proposal merely to extend the TF/TTFE for three years. AT&T estimates the current total annual amount of TF/TTFE payouts at about \$1.0 million. To keep the fund size small and consistent with its proposal just to preserve the *status quo*, it suggests cap levels of 150 percent of the current level, or \$1.5 million, for the

³⁰⁹ Staff IB, pp. 10-11; Tr. 547-48, 604, 695.

³¹⁰ Smaller ILECs IB, pp. 54-55. From my review of the way in which the Smaller ILECs calculated the maximum fund size under their benchmark rate proposal, it appears that they did not include the financial consequences on the fund size of their proposal for a transitional benchmark only \$2.00 above the current actual rate level for Smaller ILECs with current basic residential service rate levels more than \$2.00 below their proposed \$15.22 general benchmark level. See Tr. 103-105, Ex. 19, and *supra* pp. 101-02, 113-15. By my calculations, the estimated size of the SUSF, under the Smaller ILECs' \$15.22 standard benchmark level proposal augmented by its transitional benchmark proposal, would grow by about \$2.2 million, to approximately \$12.5 million.

³¹¹ DCP IB, p. 19.

first year, 175 percent of the current level, or \$1.75 million, the second year, and 200 percent of the current level, or \$2.0 million, the third year.³¹² Some other parties indicate a desire for a cap on the size of the fund, but offer no suggestions on a suitable size.³¹³ The Facility CLECs argue that a hard cap would avoid the sort of uncontrollable and explosive growth in an SUSF that has plagued the federal universal service fund, but do not quantify that preference.³¹⁴

The Smaller ILECs insist that the federal universal service fund growth is not a harbinger of the likely growth of an SUSF. They point out that the federal universal service fund allows additional, competitive ETCs, not just the local ILEC, to receive funding, based not on the competitive ETCs' own costs but those of the local ILEC.³¹⁵ The Smaller ILECs contend that federal universal service fund disbursements to New York ILECs actually decreased by 13 percent between 2000 and 2010, with the majority of the overall 15 percent increase in federal universal service funding of New York carriers going to wireless carriers.³¹⁶

2. Discussion

I see little point to imposing a cap on the size of an SUSF at this time. Under current conditions and the SUSF proposals of either Staff or the Smaller ILECs and DCP (or the AT&T proposal to do no more than continue the current TF/TTFE for three years), the maximum amount of funding predicted would entail total charges of no more than \$0.25 per year on average

³¹² AT&T IB, pp. 9, 15; Tr. 766-67, 774-75.

³¹³ *E.g.*, CTANY RB, pp. 15-16; Sprint RB, pp. 6-8.

³¹⁴ Facility CLECs IB, p. 20.

³¹⁵ Smaller ILECs IB, pp. 54-55, citing 47 C.F.R. §54.307.

³¹⁶ *Id.*, citing Tr. 201.

end users of telephone services. If the Commission accepts my recommendation for a higher benchmark rate level than either Staff or the Smaller ILECs propose, the size of the SUSF and the impact on end users will be even smaller. The real potential for SUSF growth lies in the possibility of significant reduction of intrastate access charges, being considered in Phase III of this proceeding, that could cut the Smaller ILECs revenues substantially, as well as in any changes in the federal universal service funding regime that might reduce payments to ETCs in New York. I recommend that for the time being the Commission not set a cap on fund size, but that it consider the issues of impact on SUSF size and whether to impose a cap on the SUSF when it makes its decision on intrastate access charges in Phase III. I also recommend that it consider those issues if and when the FCC adopts any new federal universal service support regime significantly reducing payments that ILECs in New York are eligible to receive.

E. Contributors to an SUSF

1. Parties' Positions

AT&T, DCP, the Facility CLECs, the Smaller ILECs, and Staff all maintain that the broadest possible base of telecommunications providers--including ILECs, CLECs, wireless carriers, interconnected fixed and nomadic VoIP providers, and interexchange carriers--be required to contribute to an SUSF. They state that all providers of intrastate telecommunications service in New York and their customers benefit from universal service policies, which preserve the ability of all end users to make and receive calls to and from all other customers connected to the PSTN at reasonable rates. Fairness and competitive neutrality dictate that all who benefit should contribute, they argue. In addition, requiring contributions from all

telecommunications providers reduces the amount that individual end users who ultimately bear the cost must pay.³¹⁷

CTANY, Sprint, the Wireless Group, and Verizon all oppose forcing alternative service providers to contribute to an SUSF. Several argue that assessing wireless and VoIP service providers to contribute to support of the rural ILECs would be unfair. Those contributions would benefit the ILECs, they say, but punish intermodal service providers' customers for choosing to use a competitive service. They contend that mandating support of legacy technologies and inefficient business plans would produce only higher prices and reduced service options in New York. Verizon adds the suggestion that intermodal services provide the same network benefit as traditional ILEC service in making calls to and from end users possible, but with no financial support from ILECs.³¹⁸

The Wireless Group, Verizon, and CTANY also challenge the Commission's authority to impose an SUSF contribution requirement on wireless or VoIP providers. The Wireless Group contends that the Commission lacks either subject matter or *in personam* jurisdiction over wireless providers, because PSL §5(6)(a) has suspended application of the PSL to cellular service. The Commission may terminate that suspension, it argues, only after notice and hearing, and no adequate notice or hearing on that issue have occurred.³¹⁹ Verizon agrees, and also maintains that the Commission has no regulatory authority over

³¹⁷ AT&T IB, pp. 12-13; DCP IB, pp. 17-18; Facility CLECs IB, pp. 21-22; Facility CLECs RB, 11-12; Smaller ILECs IB, pp. 45-46; Staff IB, p. 11; citing: Tr. 95-98, 188-92, 543, 770-71, Ex. 88, Direct, pp. 7-8; Ex. 89, Direct, p. 23.

³¹⁸ CTANY RB, pp. 14-15; Verizon IB, p. 55; Wireless Group IB, pp. 21-22; Wireless Group RB, pp. 17-18; citing: Tr. 674; Ex. 87, Direct, p. 18.

³¹⁹ Wireless Group IB, pp. 22-23.

VoIP because VoIP is an interstate information service.³²⁰ CTANY simply cites Verizon.³²¹

Verizon also states that it has a lower ROE than the Smaller ILECs that would be eligible for SUSF support. Thus, it argues, taking from it to support companies with better returns would violate the PSL §97(1) requirement that the Commission "give due regard...to a reasonable average return;" and also transgress the due process and takings clauses of the United States and New York State constitutions, by failing to provide it a reasonable opportunity to recover its expenses and a fair rate of return on its capital investments.³²² Sprint goes farther than any other party. It proposes that only those carriers that actually draw from an SUSF, not carriers ineligible to receive or that do not draw from it, be required to contribute to it. Sprint provides no legal or policy arguments in support of its proposal that non-drawers should not have to contribute.³²³

Finally, several parties propose that the Commission give contributors to an SUSF the option of passing their assessments through to end users as explicit surcharges.³²⁴ No party opposes this proposal.

2. Discussion

If the Commission establishes an SUSF, I recommend that it require all providers of telephone service in New York to contribute to the fund, including ILECs, CLECs, intrastate

³²⁰ Verizon IB, pp. 16-18, 55; Verizon RB, pp. 10-11.

³²¹ CTANY RB, p. 15.

³²² Verizon IB, pp. 18-19.

³²³ Sprint IB, p. 18; Tr. 804.

³²⁴ See Smaller ILECs IB, pp. 47-48; Smaller ILECs RB, pp. 47-48; Sprint IB, p. 18; Staff IB, p. 11; Verizon IB, p. 58; Tr. 191, 544, 804-05.

interexchange carriers, wireless carriers, and fixed and nomadic VoIP providers. In order to facilitate that recommendation, I further recommend that, before acting on this recommended decision, the Commission, pursuant to PSL §5(6)(a), issue notice of and provide an opportunity for hearing on my proposal that it terminate the current suspension of the applicability of the Public Service Law to wireless carriers to the extent of requiring them to contribute to an SUSF. I find that there is no other legal barrier to assessing any of the carriers mentioned above and that the public interest favors assessing all. In addition, I recommend that the Commission accept the unopposed proposal that it give contributors to an SUSF the option to pass the assessments on to end use customers through an explicit surcharge.

I cannot agree with Sprint's proposal to assess only those ILECs that draw from an SUSF. Sprint merely observes that those who receive support from the SUSF should have no objection to contributing to it. But Sprint offers no reason whatsoever to exempt all other providers of telephone service. To do as Sprint recommends would highly concentrate the cost of universal service support on precisely those ILECs most at risk of being unable to continue to provide service. Sprint's proposal would implicitly require the drawing companies to increase rates (or total bills under an assessment surcharge option) on service classes other than basic residential local exchange service--in all portions of their service territories, including non-white-spot areas subject to competition--to levels greater than otherwise necessary. The Sprint approach would thus counter-productively accelerate loss of access lines and revenues in non-white-spot areas.³²⁵ While there might be some small net

³²⁵ See *supra* pp. 67-68 n. 193 and accompanying text.

redistribution of costs and revenues among the drawing companies *vis-à-vis* each other under Sprint's proposal, I cannot see how it would do anything to help ensure universal service.

Next, I find Verizon's arguments for exempting itself from SUSF assessments based on its low earnings unconvincing. In the first place, if the Commission accepts the recommendations that all competing service providers be assessed and that contributors have the option of passing assessments through in a surcharge, the assessment on Verizon would be competitively neutral and have no effect on its earnings.³²⁶ If Verizon for some reason were to elect not to use the surcharge option, but pass the assessment through to its customers in its rates, any competitive impact on its earnings would be its own choice. Moreover, in that case assessments currently estimated to amount to an average of no more than \$0.25 per year seem highly unlikely to have any significant competitive effect. In addition, as the Smaller ILECs maintain, Verizon has chosen to operate under an incentive regulation plan, rather than rate of return regulation.³²⁷ Its rate of return, therefore, seems to me to be a reflection of its own choice. I therefore find Verizon's reliance on PSL §97(1) or the due process or takings clauses of the federal and State constitutions to be misplaced.

Verizon also claims that the Commission cannot require VoIP providers or wireless providers to contribute to an SUSF because the Commission has no regulatory authority over them. It bases that claim, with respect to VoIP, solely on its

³²⁶ Promoting competitive neutrality is one reason militating in favor of assessing all competing providers and allowing the surcharge option.

³²⁷ Smaller ILECs IB, p. 48, citing Case 00-C-1945 *et al.*, *Verizon - Cost Recovery and Future Regulatory Framework*, Order Instituting Verizon Incentive Plan (issued February 27, 2002).

position that VoIP is an interstate information service.³²⁸ With respect to wireless, it relies on the suspension of Commission regulatory authority under PSL §5(6)(a). Whether the Commission may exercise regulatory power over these alternative, intermodal providers depends on two questions. The first is whether federal law preempts state regulation of these carriers. The second is whether the Commission's State enabling act confers regulatory power over these entities.

First, I find that nothing in federal law preempts the Commission or the telephone service regulator in any other state from requiring either wireless or VoIP carriers to contribute to a state's universal service fund. Long ago the FCC made clear that nothing in the FCA preempts a state regulatory commission from requiring wireless carriers to contribute to a state universal service fund, on an equitable and non-discriminatory basis.³²⁹ Last fall, the FCC ruled that federal law does not preempt a state commission from requiring interconnected VoIP service providers to contribute to a state universal service fund, so long as the state commission "[allows] those providers to treat as intrastate for state universal service purposes the same revenues that they treat at [sic] intrastate under the

³²⁸ Verizon IB, pp. 16-18; Verizon RB, p. 10-11.

³²⁹ *Pittencrieff Communications, Inc. - Preemption of the Texas Public Utility Regulatory Act of 1995*, Memorandum Opinion and Order, 13 FCC Rcd 1735, 1737-38 (1997)(*Pittencrieff*), *aff'd* *Cellular Communications Industry v. FCC*, 168 F.3d 1332 (D.C. Cir. 1999).

[FCC's] universal service contribution rules."³³⁰ Those FCC rules, designed to avoid duplicative assessments, require, first, that a VoIP provider be allowed three options for separating interstate from intrastate revenues: (1) use a safe harbor under which 64.9 percent of its revenues are deemed interstate and 35.1 percent are deemed intrastate; (2) conduct a traffic study to allocate revenues by jurisdiction; or (3) develop a means of accurately classifying interconnected VoIP communications (and revenues) between federal and state jurisdictions. In addition, the state must have a policy and method of allocating a portion of a VoIP provider's total intrastate revenues to that particular state that avoids duplicative assessments with respect to the same revenues.³³¹

Since federal law does not preempt any state commission's authority to assess VoIP or wireless carriers, the next question is whether the Commission has authority to regulate them, to that extent, under the Public Service Law. Verizon's contention that the Commission lacks authority over VoIP carriers' service because VoIP is "an interstate *information* service [emphasis added]"--suggesting that VoIP

³³⁰ WC Docket No. 06-122, *Nebraska Public Service Commission and Kansas Corporation Commission - State Universal Service Funds and Assessment of Nomadic VoIP Intrastate Revenues*, Declaratory Ruling (released November 5, 2010)(*FCC Nebraska - Kansas Ruling*), ¶¶15-21. Although the ruling specifically spoke primarily in terms of nomadic VoIP, it often refers more generally to "interconnected VoIP" (e.g., *id.*, ¶17) and, *a fortiori*, implicitly finds that fixed VoIP service providers may be required to contribute to a state universal service fund.

³³¹ *Id.*, ¶¶17-21. The FCC noted that "states have successfully resolved allocation of wireless intrastate revenues for purposes of state universal service contributions without the need for [FCC] intervention."

service is not telecommunications service³³²--is not well taken. In the first place, VoIP is not an "information service" under federal law. The FCC has emphasized repeatedly that it has not determined whether interconnected VoIP service should be classified as telecommunications service or an information service under the FCA.³³³ In addition, the very concept of "information service" is a creature solely of the FCA, for the purposes of the FCA, the FCC's powers and duties under various titles of the FCA, and any resulting federal preemption of state law. It is immaterial to the question of Commission authority under State law in the absence of preemption. Nothing in the Public Service Law distinguishes between information service and telecommunications service. The Commission's jurisdiction, supervision, powers, and duties extend to "telephone lines" and persons or corporations owning, leasing, or operating "telephone lines."³³⁴ The initial question under State law, therefore, is whether VoIP service is provided over a "telephone line," as defined in PSL §2(18).

As noted above, the statutory definition of "telephone line" includes essentially all physical personal property and real property "used, operated or owned by any telephone corporation to facilitate the business of affording telephonic communication up to and including the demarcation point located

³³² The FCC clearly recognizes interconnected VoIP service as including both interstate and intrastate elements, or there would be no need to separate interstate from intrastate revenues for purposes of assessments for state universal service funds. Indeed, if the FCC considered VoIP carriers to provide an exclusively interstate service, there would be no basis at all for state universal fund assessments on them and the *FCC Nebraska - Kansas Ruling* never would have issued.

³³³ *E.g., FCC Nebraska - Kansas Ruling, supra*, ¶24 n. 63; FCC CAF NPRM, *supra*, ¶¶73, 618.

³³⁴ PSL §5(1)(d).

on a subscriber's premises."³³⁵ The statute does not define "telephonic communication," but the common meaning of "telephonic" entails conveyance of sound, especially voice, over a distance.³³⁶ By definition, "Voice over Internet Protocol" service provides voice communication. The irrelevance of the medium through which sound is transmitted--whether copper wire, optical-fiber cable, or air--is clear from PSL §5(6)(a)'s suspension, absent further Commission action, of the application of the Public Service Law's provisions to cellular telephone services. If its provisions applied only to traditional telephone service provided over copper wire, PSL §5(6)(a) would be superfluous. Moreover, traditional telephone service provided by ILECs and CLECs travels through networks largely dependent on fiber cable, just as VoIP service does. VoIP service also undeniably entails use of--among other things listed in the statutory definition of "telephone line"-- "cables,...receivers, transmitters, instruments, machines, appliances and...devices." In addition, in VoIP service those various items of property clearly are "used, operated or owned...to facilitate the business of affording telephonic communication."³³⁷

The next question under PSL §2(18), then, is whether those items are used, owned, or operated for that purpose by a "telephone corporation." Under PSL §2(17), the definition of "telephone corporation" includes, *inter alia*, every corporation, company, or person "owning, operating or managing any telephone line or part of a telephone line used in the conduct of the

³³⁵ PSL §2(18).

³³⁶ See, e.g., definitions of "telephonic" and "telephone" in WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE (1971).

³³⁷ PSL §2(18).

business of affording telephonic communication for hire." Providers of VoIP service, whether fixed or nomadic, operate "telephone lines" and do so in conducting the business of affording telephonic communication for hire. Furthermore, VoIP providers "operate the business of affording telephonic communication for profit," and thus cannot rely on the exception from the definition of "telephone corporation" in PSL §2(17). Accordingly, I conclude that under PSL §5(1)(d), the Commission's jurisdiction, supervision, powers, and duties extend to intrastate VoIP service in New York and it has the necessary authority under New York State law to require providers of interconnected VoIP service, whether fixed or nomadic, to contribute to an SUSF.

Turning to wireless service, I do not believe the Commission is yet in a position to determine that the suspension of the Public Service Law's provisions should cease to the extent of requiring wireless carriers to contribute to an SUSF. The notices issued thus far in this proceeding do not mention PSL §5(6)(a) in any way or intimate that termination, even partial termination, of the wireless suspension might be one possible outcome of it. Although wireless carriers might properly have inferred that subsection could be implicated in this proceeding, I believe the issue is significant enough to warrant more explicit notice. Therefore, I recommend that, before deciding the issues in Phase II of this proceeding, the Commission provide additional notice and opportunity for hearing on the proposal that it terminate the suspension of application of the Public Service Law to cellular telephone services to the extent of requiring wireless providers to contribute to an SUSF.

Nonetheless, subject to any new information concerning wireless service that might be developed in response to the additional notice and opportunity for hearing, I find that

requiring VoIP and wireless carriers to contribute to an SUSF is in the public interest. I do not accept the arguments of CTANY, Verizon, and the Wireless Group that, from a public policy perspective, assessing VoIP and wireless carriers would be unfair or punish their customers for choosing an alternative form of telephone service. On the contrary, a requirement for those intermodal providers to contribute to an SUSF would promote greater fairness and competitive neutrality. As the FCC itself reiterated recently in determining that states are not preempted from assessing interconnected VoIP providers to support universal service mechanisms:³³⁸

[I]nterconnected VoIP providers..."benefit from universal service because much of the appeal of their services to consumers derives from the ability to place calls to and receive calls from the PSTN."...[In addition,] requiring interconnected VoIP providers to contribute to universal service would promote the "principle of competitive neutrality" by "reduc[ing] the possibility that carriers with universal service obligations will compete directly with providers without such obligations."

Exactly the same points apply with respect to wireless service. So long as wireless and interconnected VoIP providers are assessed on the same basis as ILECs and other providers,³³⁹ customers of those intermodal providers and customers of ILECs and other providers throughout the State will bear a fair share of SUSF support costs determined in exactly the same manner. In my opinion, refraining from imposing an SUSF contribution on the intermodal providers and their customers--all of whom gain from ensuring universal service--would give those customers an unfair benefit and those providers an unfair competitive advantage. I

³³⁸ *FCC Nebraska - Kansas Ruling, supra*, ¶6 [citations omitted]. See also *id.*, ¶16.

³³⁹ See *infra* pp. 129-30.

recommend that the Commission not exempt them from contributing to an SUSF.

Finally, several parties propose, without opposition, that carriers be given the option of passing their SUSF assessments through to their end-users in a surcharge. I see no reason not to give contributors this flexibility in managing their charges and customer relations in light of whatever competition they might face. I recommend that the Commission adopt this proposal.

F. Basis for Allocating SUSF Contributions

Staff and the Facility CLECs advocate allocating the funding requirements for an SUSF to contributors in proportion to the number of telephone numbers each provider's retail customers are using in New York.³⁴⁰ They favor this approach for ease of administration.³⁴¹ The Facility CLECs also endorse it as a means of avoiding what they consider an inequitable feature of the current system of allocating Targeted Accessibility Fund requirements in proportion to providers' intrastate retail revenues net of intercompany payments. They contend that the TAF's current net-revenue-based approach treats facilities-based carriers unfairly compared with non-facilities-based carriers and discourages investment in new facilities. The former cannot deduct expenses of the facilities they build for their networks from their revenues under the TAF method, while the latter can deduct the intercompany wholesale payments they make for use of facilities-based carriers' networks.³⁴²

The Facility CLECs also suggest a refinement of Staff's proposal to use telephone numbers in service for

³⁴⁰ Staff IB, p. 4; Staff RB, p. 17.

³⁴¹ Tr. 543-44.

³⁴² Facility CLECs IB, pp. 23-24; Facility CLECs RB, p. 12; Ex. 88, Direct, p. 8; Ex. 88, Rebuttal, p. 5.

contribution allocation purposes, however. Under a telephone-numbers-based approach, they argue, the Commission should apply a "reasonable cap" to avoid undue harm to large enterprise businesses that constitute true end-users. The Facility CLECs cite universities as an example, and envision an opportunity for such an end-user to apply to the Commission for approval of a customer-specific cap. The proposed cap opportunity would not be available for carrier-like entities, such as resellers, that are not true end-users. The Facility CLECs provide no additional detail about criteria that should apply to those circumstances or what would constitute a "reasonable cap."³⁴³

Verizon makes the same point about inequity of the TAF allocation method as the Facility CLECs, although Verizon itself, AT&T, DCP, and the Smaller ILECs all support determining individual providers' contributions in proportion to intrastate retail revenues.³⁴⁴ These parties contend that allocation in proportion to revenues would be more equitable, because ultimate recovery of SUSF contributions from end-users would then be proportional to their usage and base charges for telephone service. They also observe that a revenue-based allocation method is consistent with the FCC's method for distributing federal universal service fund contributions, while the use of telephone numbers for that purpose is untested in any jurisdiction. A new method based on telephone numbers would not be worth the time and expense to design and implement it, they say.

It is not clear to me that there is a significant public policy preference between determining SUSF contributions

³⁴³ Facility CLECs IB, pp. 22-23; Ex. 88, Direct, p. 9.

³⁴⁴ Verizon IB, pp. 57-58; AT&T IB, pp. 13-14; DPC IB, p. 18; Smaller ILECs IB, pp. 48-50; Tr. 99-100, 193-94, 675-76, 757, 771-72.

in proportion to intrastate retail revenues or in proportion to telephone numbers. I recommend that the Commission require contributions to an SUSF be calculated in proportion to telephone service providers' intrastate retail revenues for several reasons, however. First, as explained above in considering which providers should contribute to an SUSF, the FCC has found that state universal service contribution requirements do not conflict with federal rules to the extent that a state calculates the amount of its universal service assessments in a manner consistent with the FCC's rules for federal universal service fund purposes. Those rules entail calculation of federal contributions on the basis of interstate revenues. In ruling that a state may assess interconnected VoIP providers for state universal service funds, the FCC made clear that the state must allow the provider to use the revenues treated as intrastate for federal purposes (the complement of the revenues treated as interstate) as intrastate for state universal service fund purposes as well.³⁴⁵ Because federal universal service fund contributions of other providers also are based on revenues, I conclude that consistency with federal universal service fund rules currently demands that contributions to a New York SUSF must also be based on revenues, to avoid treating as intrastate revenues that are treated as interstate under federal requirements.

In addition, use of intrastate retail revenues for determining SUSF contributions appears to have some practical

³⁴⁵ *FCC Nebraska - Kansas Ruling, supra*, ¶17. Because the FCC's rules allow providers three options for establishing a federal revenue base, Staff's apparent suggestion that its telephone-number-based allocation proposal would still leave one of those options available [Staff IB, pp. 11-12, citing Tr. 544-46] does not seem an adequate answer. Consistency with federal rules demands that all three options, not just one, be available to providers.

advantages. It moots the issue with use of telephone numbers for which the Facility CLECs propose a still somewhat nebulous "cap" procedure for large enterprise end-users.³⁴⁶ Moreover, I agree that using the current TAF allocation method, with a minor adjustment, could be more readily implemented, inasmuch as it has been in use by the TAF administrator for well more than a decade. That minor adjustment would be elimination of the netting procedure for intercompany payments. I recommend that the Commission eliminate that procedure because I agree with the Facility CLECs and Verizon that it treats facilities-based providers inequitably compared with non-facilities-based providers. As the Facility CLECs maintain, no party has opposed this improvement.³⁴⁷

G. SUSF Administrator

Most parties that have addressed the issue of the appropriate administrator of an SUSF support the New York State Intrastate Access Settlement Pool, Inc., (Pool) which has administered the TAF since its inception 13 years ago.³⁴⁸ They point out that the TAF is already one form of universal service fund, which the Pool has proven its ability to administer efficiently and effectively over the years. They see no need to duplicate its functions in another administrator, noting that a

³⁴⁶ As Verizon notes, however, it is not clear why any such procedure would be necessary even if the Commission determined that contribution allocations should be based on telephone numbers. "[N]o party has suggested that fund contributions should be made by end-user customers who are not themselves service providers." Verizon RB, p. 22.

³⁴⁷ With respect to the TAF, this issue is among the set of questions that are subjects, together with access charge issues, of Phase III of this proceeding. The Commission, however, might wish to consider taking up the issue and making the recommended correction to the TAF allocation method now, as the Facility CLECs suggest.

³⁴⁸ See TAF Order, *supra*, pp. 33-39.

single administrator for both the TAF and an SUSF would be more efficient.³⁴⁹ Sprint presented testimony in favor of a neutral third-party administrator capable of managing an SUSF with minimal administrative costs, but did not raise the issue in brief.³⁵⁰ Verizon simply stated that an SUSF administer should be a neutral third party, with no financial interest in drawing from or contributing to the fund, selected by competitive bidding.³⁵¹

I recommend that, if the Commission establishes an SUSF, it appoint the Pool as administrator. I agree with the Smaller ILECs that efficiency and minimization of costs can better be achieved by consolidating administration of the TAF and an SUSF under a single entity and taking advantage of the experience and established collection and disbursement processes of the Pool. I see no significant advantage to seeking a new administrator through competitive bidding. The Pool is a neutral third party, which would have no financial stake in SUSF collection or disbursement. No party suggests that the Pool has been inefficient or ineffective or has failed to carry out its duties in conformance with Commission requirements.³⁵² On the basis of this record I see no other reason to incur the delay and additional expense of competitive bidding when a third-party administrator of demonstrated competence is already in place.

H. Review or Sunset

Most parties appear to support setting a sunset, or termination, date for an SUSF, varying from two years to five

³⁴⁹ AT&T IB, p. 14; DCP IB, p. 19; Smaller ILECs IB, pp. 51-52; Staff IB, pp. 19-20; Tr. 101, 196, 546, 772-73; Ex. 88, Direct, p. 10.

³⁵⁰ Tr. 805.

³⁵¹ Verizon IB, p. 59; Tr. 680.

³⁵² Tr. 196-97.

years after the Commission issues an order establishing an SUSF. Verizon insists the fund should cease after no more than two years.³⁵³ CTANY calls for a two- to three-year limit and Sprint no more than a three-year term.³⁵⁴ AT&T and the Facility CLECs propose a three-year cut-off, with AT&T suggesting a prior review proceeding to commence after no more than two years.³⁵⁵ Staff favors a three- to five-year limit; and DCP a five-year term, with a review proceeding commencing one year in advance to consider whether need for a fund remains.³⁵⁶ Provider parties supporting a sunset contend that a fixed term limit for an SUSF would provide discipline linked with opportunity for recipients, creating an incentive and time to adjust business models, explore restructuring and efficiency gains, and shift from reliance on the fund to self-reliance. They argue against an extended term on the ground that telecommunications technologies and markets are rapidly evolving, while relevant federal universal service and access charge regulatory requirements are already in flux. On the other hand, DCP and Staff view a longer term as providing sufficient time to gather experience on and evaluate the operation and effects of an SUSF and to complete review of the results and any continuing need.

Only the Smaller ILECs endorse an open-ended, unlimited life for an SUSF. They propose a review five years after creation of a fund. The Smaller ILECs, like DCP and

³⁵³ Verizon IB, p. 59.

³⁵⁴ CTANY IB, p. 32; Sprint IB, pp. 17-18.

³⁵⁵ AT&T IB, pp. 14-15; Facility CLECs IB, p. 20.

³⁵⁶ Staff IB, p. 10; DCP IB, p. 19. Staff's position is somewhat equivocal. Although Staff's testimony appears to propose a sunset--a fund as but an *interim* solution, with only *potential extension* beyond five years (Tr. 546, 604)--its brief seems to contemplate the opposite--just "an examination for *potentially ending* the fund" when that term expires. [Emphasis added.]

Staff, believe a longer term before review will more reasonably permit gathering information on experience with the operation of an SUSF, while the Commission would still have the option of adjusting the fund during that period if necessary to deal with changes in the industry, FCC action, or the results of the remainder of this proceeding. They consider an automatic sunset ill-advised, arguing that universal service goals and need do not stop at the end of a preset time period and should be presumed to continue, pending completion of review.³⁵⁷

I recommend that, if the Commission establishes an SUSF, it set a sunset date four years from the date of the order creating the fund, subject to: a review proceeding commencing three years from that date to consider whether to continue the fund; and continuation of the fund until completion of the review proceeding. The Commission should also note its continuing ability to commence a proceeding at any time to consider, in light of changing circumstances, whether to terminate or make adjustments to the SUSF. In my view this recommendation reasonably balances the competing interests the parties have identified. It gives the recipients of fund support an incentive to improve their circumstances and move toward self-reliance, faced with a relatively firm deadline; provides a reasonable time for gathering information on experience with the fund; protects against premature cut-off of funding if the review proceeding takes longer than anticipated; and yet allows flexibility to respond to changing circumstances in telecommunications technology, markets (including white-spot areas), and regulatory requirements.

³⁵⁷ Smaller ILECs IB, pp. 52-53.

I. "Grandfathering" of Current TF/TTFE Recipients

The Smaller ILECs propose that the three companies currently receiving TF/TTFE disbursements--Crown Point Telephone Corporation, Newport Telephone Company, and Oneida County Rural Telephone Company--have disbursements at their respective funding levels continue from an SUSF pending submission of and action on a new rate case. They note that the Commission has already determined these companies' need for support. The companies should have a reasonable period of time after a Commission decision creating a fund issues and before existing support ends, they say, to digest and comply with requirements the Commission establishes for seeking SUSF moneys, file a new rate case, and complete the ensuing proceeding. Assuming four months for the companies to prepare their filings and six to eight months for the Commission to act, the Smaller ILECs suggest that funding at current levels should continue until the earlier of one year from a Commission order establishing an SUSF or the dates the Commission acts on their respective rate case and SUSF support filings.³⁵⁸ DCP agrees that prudent public policy should allow the existing support recipients a reasonable period to prepare filings after the Commission sets the requirements for seeking SUSF support.³⁵⁹

Staff, on the other hand, opposes grandfathering the existing recipients. It argues that, if time to make a decision on new SUSF funding runs out before TTFE support terminates, the best approach is to allow retroactive payments from an SUSF after final determinations on the companies' SUSF support do issue.³⁶⁰

³⁵⁸ Smaller ILECs IB, pp. 42-44.

³⁵⁹ DCP IB, 18, citing Ex. 89, Rebuttal, p. 14.

³⁶⁰ Staff RB, p. 9.

I agree with the Smaller ILECs and DCP that it is reasonable to preserve the *status quo* and continue funding the three recipients of TF/TTFE moneys at current levels pending preparation of and Commission action on rate case filings accompanied by any additional information the Commission determines necessary to support a request for SUSF disbursements. The companies cannot legitimately be expected to prepare the necessary materials until the Commission rules on what is required, and four months to prepare responsive filings does not seem excessive. Since the Commission, after Staff review, has already determined that the three companies have established need for their current funding levels, those levels of support, like current rates, should continue pending Commission review. Requiring the three companies to file new rate cases and SUSF support requests within four months will not unduly extend current funding, in my view.

Moreover, if that filing deadline is met, I find it would be reasonable to allow current funding to continue for the full time necessary for the Commission to act on the rate case and SUSF support request--which could conceivably take as much as the full 11-month statutory suspension period--rather than have support suddenly lapse in the middle of the proceeding to determine whether support should continue at some level. I find unreasonable Staff's proposal to let a current recipient languish and scurry to fill a revenue hole when TTFE support terminates, pending possible retroactive SUSF payments only after the Commission decides the company's first rate case with an SUSF support request.

If the Commission creates an SUSF, I therefore recommend that it also provide that the three companies now receiving TF/TTFE disbursements continue to receive funding from the SUSF at existing support levels for a period of four months

after the Commission order establishing the fund. I also recommend that, if one of those companies does file a new rate case with SUSF support request within that period of time, it continue to receive that level of funding until the Commission issues a decision on the new rate case and SUSF support request.

J. AT&T's Proposal

AT&T proposes that, rather than establish an SUSF at this time, the Commission just extend the Transition Fund for three years. AT&T does suggest some modifications to the current TF regime. It favors increasing the benchmark rate to \$28.75 per month and imposing a "soft cap" on the fund of 150 percent of the current fund amount in the first year, 175 percent in the second, and 200 percent in the third. It also maintains that expanding the set of contributors to include wireless and VoIP providers is desirable, but notes that there might be legal hurdles to overcome to implement that expansion. Under AT&T's proposal, after two years the Commission would begin a review proceeding on next steps to follow the Transition Fund.³⁶¹

AT&T grounds its TF extension proposal on its contention that the Commission should merely preserve the *status quo* pending completion of Phase III of this proceeding, which will consider reductions to intrastate switched access charges. It argues that the question of need for an SUSF is "inextricably linked" to the need for reforming access charges. It says the Commission must shift from the old system of implicit subsidies through access charges as a foundational step to creating a system of explicit subsidies through an SUSF. AT&T adds that by deferring SUSF consideration the Commission might also be able to benefit from any reforms the FCC develops in the federal

³⁶¹ AT&T IB, pp. 1-2, 11-17.

universal service and access charge reform rulemaking proceeding now under way.³⁶²

The Facility CLECs object that AT&T's proposal would only delay necessary decisions on important policy issues, while further institutionalizing subsidies from New York end-users to the NYSTA Smaller ILECs. Thus, the Facility CLECs argue, AT&T's proposed TF extension would give small rural ILECs no incentive to improve their business models, leaving them perpetually dependent on subsidies to meet their revenue requirements.³⁶³ Verizon adds that AT&T's proposal would just side-step complex factual and policy issues about an SUSF to accelerate consideration of access charge reductions.³⁶⁴

I do not recommend that the Commission adopt AT&T's proposal to extend the Transition Fund in order to accommodate a decision on access charge reform prior to deciding issues surrounding an SUSF. AT&T's proposal in essence attempts to reargue the priorities in this proceeding that the Commission established in the Phase I Order. There, the Commission concluded that the public interest would be better served by giving priority to SUSF-related issues over access charge issues in this proceeding.³⁶⁵ Among other things, the Commission noted that some of the issues implicit in considering whether to create an SUSF "would be useful before moving on to issues associated with access charge reform and might affect the approach to implementing access charge reform."³⁶⁶ The AT&T proposal seeks to reverse the Commission's prior decision *sub*

³⁶² *Id.*, pp. 6-8.

³⁶³ Facility CLECs IB, pp. 6-7.

³⁶⁴ Verizon RB, p. 5.

³⁶⁵ Phase I Order, pp. 31-34.

³⁶⁶ *Id.*

rosa, offering no justification whatsoever for doing so. I recommend that the Commission reject the attempt.

CONCLUSION

For the reasons set forth above, I recommend that the Commission establish a State Universal Service High Cost Fund, with the characteristics and features described in this recommended decision. Specifically, I recommend that the Commission:

1. Conclude that it possesses the implied statutory power to establish a State universal service high-cost fund.
2. Find that the number of residential locations in 31 smaller rural ILEC service territories (excluding Frontier and Windstream affiliates) without an available alternative to ILEC wireline service ranges from a minimum of 1,400 to as many as 50,000, with a mid-range estimate of 25,700.
3. Find that platforms alternative to ILEC wireline service are unavailable for a significant number of residential locations within those 31 service territories.
4. Find that directory listings and operator assistance services should no longer be included as elements of basic residential local exchange service.
5. Find that cable modem telephone service and wireless telephone service constitute economic substitutes for traditional wireline basic residential local exchange service.
6. Find that the small rural ILECs' financial circumstances have been deteriorating as a result of loss of access lines and associated revenues, threatening their viability and, in turn, their ability to continue to provide reliable, quality service throughout their service territories and ensure the universal availability of basic

residential local exchange service; and that these circumstances will be exacerbated with the impending reduction in Phase III of this proceeding of the intrastate access charges that have historically been priced above cost to subsidize local residential service.

7. Find that a State universal service high-cost fund is a reasonable means to ensure in the public interest achieving and maintaining the goal of universal service to residential telephone customers in New York.
8. Limit eligibility for State universal service high-cost fund disbursements to the 31 small rural incumbent local exchange carriers listed in Appendix A to this recommended decision.
9. Require an applicant for disbursements from a State universal service high-cost fund to file in connection with its request for disbursements from the fund: (a) a rate case; (b) a report on all the steps it has taken to reduce costs, including consideration of mergers and other restructuring possibilities; and (c) an impairment analysis.
10. Require parties to the first rate case requesting fund support to address in detail the issue of what information to include in an annual report and certification on need for and proper use of the funding, then decide the issue for that and subsequent cases involving requests for SUSF support.
11. Establish a benchmark rate cap for basic residential local exchange service of \$25.65, with:
 - a. the amount of distributions calculated by imputing to the requesting ILEC revenues from basic residential local exchange service at the benchmark level;

- b. the recipient ILEC allowed to move the rate actually charged for basic residential service to the benchmark level in steps of no less than \$3.50 each six months until the benchmark level is reached;
 - c. the recipient ILEC required to charge a rate for basic business local exchange service no lower than the rate for basic residential local exchange service; and
 - d. a requirement that annually, on the anniversary date of issuance of an order establishing the fund, the benchmark rate used to calculate fund disbursements increase in proportion with inflation for all new rate case requests for fund support filed over the ensuing year.
- 12. Not set a cap on fund size at this time, but consider the issues of impact on State universal service high-cost fund size and whether to impose a cap on the fund:
 - a. when it makes its decision on intrastate access charges in Phase III; and
 - b. if and when the FCC adopts any new federal universal service support regime significantly reducing payments that ILECs in New York are eligible to receive.
- 13. Require all providers of telephone service in New York to contribute to the State universal service high-cost fund, including ILECs, CLECs, intrastate interexchange carriers, wireless carriers, and fixed and nomadic VoIP providers; and
 - a. in order to facilitate that recommendation, before acting on this recommended decision, issue notice of and provide an opportunity for hearing, pursuant to PSL §5(6)(a), on the recommendation that it terminate the current suspension of the applicability of the Public Service Law to cellular mobile radio service

- carriers to the extent of requiring them to contribute to a State universal service high-cost fund;
 - b. find that there is no other legal barrier to assessing any of the designated providers to contribute to the fund and that the public interest favors assessing all; and
 - c. give contributors to the fund the option to pass the assessments for the fund on to end use customers through an explicit surcharge.
14. Require that contributions to a State universal service high-cost fund be calculated in proportion to telephone service providers' intrastate retail revenues, without netting of intercompany payments.
15. Appoint the New York State Intrastate Access Settlement Pool, Inc., as administrator of a State universal service high-cost fund.
16. Set a sunset date four years from the date of an order creating a State universal service high-cost fund, subject to:
- a. a review proceeding commencing three years from the date of the order creating the fund to consider whether to continue the fund;
 - b. continuation of the fund until completion of the review proceeding; and
 - c. reservation of the Commission's continuing ability to commence a proceeding at any time to consider, in light of changing circumstances, whether to terminate or make adjustments to the fund.
17. Provide that the three companies now receiving Transition Fund / Temporary Transition Fund Extension disbursements continue to receive funding from a State universal service high-cost fund at existing support levels:

- a. for a period of four months after a Commission order establishing the fund; and
 - b. if one of those companies files a new rate case with a State universal service high-cost fund support request within that period of time, it continue to receive that level of funding until the Commission issues a decision on the new rate case and fund support request.
18. Reject AT&T's proposal to extend the Transition Fund for an additional three years instead of creating a State universal service high-cost fund.

* * * * *

January 4, 2012

APPENDIX A

SMALLER ILECs MEMBERS

Armstrong Telephone Company--New York
Berkshire Telephone Corporation
Cassadaga Telephone Corporation
Champlain Telephone Company
Chautauqua & Erie Telephone Corporation
Chazy & Westport Telephone Corporation
Citizens Telephone Company of Hammond, NY, Inc.
Crown Point Telephone Corporation
Delhi Telephone Company
Dunkirk and Fredonia Telephone Company
Empire Telephone Corporation
Fishers Island Telephone Corporation
Germantown Telephone Company, Inc.
Hancock Telephone Company
Margaretville Telephone Company, Inc.
Middleburgh Telephone Company
Newport Telephone Company, Inc.
Nicholville Telephone Company
Oneida County Rural Telephone Company
Ontario Telephone Company, Inc.
Pattersonville Telephone Company
State Telephone Company, Inc.
Taconic Telephone Corporation
TDS Telecom - Deposit Telephone Company
TDS Telecom - Edwards Telephone Company
TDS Telecom - Oriskany Falls Telephone Company
TDS Telecom - Port Byron Telephone Company
TDS Telecom - Township Telephone Company
TDS Telecom - Vernon Telephone Company, Inc.
Trumansburg Telephone Company, Inc.
Warwick Valley Telephone Company

Appendix 1

Availability of Alternative Platforms
(Cellular Only – Gross)

ILECs	Total Households in Service Territory	Cable Modem Only	Cellular Only - Gross	None	Cellular Only or None	% Cellular Only or None
Armstrong Tel. Co. of NY	3,242		1,741	222	1,963	7 - 60%
Berkshire Tel. Co.	4,255		296		296	0 - 7%
Cassadaga Tel. Corp.	982		376		376	0 - 38%
Champlain Tel. Co.	4,198	4	533	7	540	<1 - 13%
Chatauqua & Erie Tel. Corp.	7,515	9	2,161	3	2,164	<1 - 29%
Chazy & Westport Tel. Corp.	2,210		449		449	0 - 20%
Citizens Tel. Co. of Hammond, NY, Inc.	969		969		969	0 - 100%
Crown Point Tel. Corp.	718	161	191	121	312	16 - 43%
Delhi Tel. Co.	2,286		1,052	60	1,112	3 - 49%
Deposit Tel. Co., Inc.	6,251		5,803	81	5,884	1 - 94%
Dunkirk & Fredonia Tel. Co.	5,686	2	791	1	792	<1 - 14%
Edwards Tel. Co., Inc.	1,905		1,262		1,262	0 - 66%
Empire Tel. Corp.	6,070	303	2,059	58	2,117	1 - 35%
Fishers Island Tel. Corp.	171		3		3	0 - 2%
Germantown Tel. Co., Inc.	1,789		1,598		1,598	0 - 89%
Hancock Tel. Co. NY	1,107		1,049	58	1,107	5 - 100%
Margaretville Tel. Co., Inc.	1,824	323	326	253	579	14 - 31%
Middleburgh Tel. Co.	4,265	5	1,857	487	2,344	11 - 55%
Newport Tel. Co., Inc.	2,650		1,586	36	1,622	1 - 61%
Nicholville Tel. Co., Inc.	2,008	3	817	13	830	1 - 41%
Oneida County Rural Tel. Co.	3,217		779		779	0 - 24%
Ontario Tel. Co., Inc.	3,590		740		740	0 - 21%
Oriskany Falls Tel. Co.	570		141		141	0 - 25%
Pattersonville Tel. Co.	914		205		205	0 - 22%
Port Byron Tel. Co.	3,119		1,721		1,721	0 - 55%
State Tel. Co	6,184		6,019		6,019	0 - 97%
Taconic Tel. Corp.	14,776		10,503	10	10,513	<1 - 71%
Township Tel. Co., Inc.	3,502	26	921	7	928	<1 - 26%
Trumansburg Tel. Co.	5,427		1,953		1,953	0 - 36%
Vernon Tel. Co., Inc.	2,358		734		734	0 - 31%
Warwick Valley Tel. Co.	9,826		27		27	0 - <1%
TOTAL	113,584	836	48,662	1,417	50,079	1 - 44%

Appendix 2

Availability of Alternative Platforms
(Cellular Only – 50% Available)

ILECs	Total Households in Service Territory	Cable Modem Only	Cellular Only - 50%	None	Cellular Only or None	% Cellular Only or None
Armstrong Tel. Co. of NY	3,242		870	222	1,092	7 - 34%
Berkshire Tel. Co.	4,255		148		148	0 - 3%
Cassadaga Tel. Corp.	982		188		188	0 - 19%
Champlain Tel. Co.	4,198	4	266	7	273	<1 - 6%
Chatauqua & Erie Tel. Corp.	7,515	9	1,080	3	1,083	<1 - 14 %
Chazy & Westport Tel. Corp.	2,210		224		224	0 - 11%
Citizens Tel. Co. of Hammond, NY, Inc.	969		484		484	0 - 50%
Crown Point Tel. Corp.	718	161	96	121	217	16 - 30%
Delhi Tel. Co.	2,286		526	60	586	3 - 26%
Deposit Tel. Co., Inc.	6,251		2,902	81	2,983	1 - 48%
Dunkirk & Fredonia Tel. Co.	5,686	2	396	1	397	<1 - 7%
Edwards Tel. Co., Inc.	1,905		631		631	0 - 33%
Empire Tel. Corp.	6,070	303	1,030	58	1,088	1 - 18%
Fishers Island Tel. Corp.	171					
Germantown Tel. Co., Inc.	1,789		799		799	0 - 45%
Hancock Tel. Co. NY	1,107		524	58	582	5 - 52%
Margaretville Tel. Co., Inc.	1,824	323	163	253	416	14 - 23%
Middleburgh Tel. Co.	4,265	5	928	487	1,415	11 - 33%
Newport Tel. Co., Inc.	2,650		793	36	829	1 - 31%
Nicholville Tel. Co., Inc.	2,008	3	408	13	421	1 - 21%
Oneida County Rural Tel. Co.	3,217		390		390	0 - 12%
Ontario Tel. Co., Inc.	3,590		370		370	0 - 10%
Oriskany Falls Tel. Co.	570		70		70	0 - 12%
Pattersonville Tel. Co.	914		102		102	0 - 11%
Port Byron Tel. Co.	3,119		860		860	0 - 28%
State Tel. Co	6,184		3,009		3,009	0 - 49%
Taconic Tel. Corp.	14,776		5,252	10	5,232	<1 - 35 %
Township Tel. Co., Inc.	3,502	26	460	7	467	<1 - 13%
Trumansburg Tel. Co.	5,427		976		976	0 - 18%
Vernon Tel. Co., Inc.	2,358		367		367	0 - 16%
Warwick Valley Tel. Co.	9,826		14		14	0 - <1%
TOTAL	113,584	836	24,326	1,417	25,713	1 - 23%