COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INQUIRY INTO UNIVERSAL SERVICE AND FUNDING ISSUES	))	ADMINISTRATIVE CASE NO. 360

O R D E R

This Order addresses the cost model selection and input value issues in light of the recent Federal Communications Commission (FCC) decisions.

BACKGROUND

The FCC released its new federal forward-looking, high-cost support mechanism on November 2, 1999.[1] In that order, the FCC adjusted and finalized the model framework it adopted in the Seventh Report & Order.[2] Concurrently, the FCC reaffirmed its decision to base high-cost support calculations on forward-looking costs.[3] Also, the FCC has undertaken a thorough review of the high-cost model (synthesis model) and

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[1] Federal-State Joint Board on Universal Service, Ninth Report and Order and Eighteenth Order on Reconsideration, CC Docket No. 96-45, FCC 99-306, released November 2, 1999, (Methodology Order).

[2] Federal-State Joint Board on Universal Service, Access Charge Reform, CC Docket Nos. 96-45, 96-262, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262, and Further Notice of Proposed Rulemaking, FCC 99-119, released May 28, 1999. (Seventh Report and Order)

[3] Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs, CC Docket Nos. 96-45, 97-160, Report and Order, FCC 99-304, released November 2, 1999, (Inputs Order) at paragraph 22.

its input values, since its decision choosing the platform last fall.[4] There has been extensive coordination with the Joint Board and substantial input from interested parties. As a result of its efforts, the FCC is convinced that [its synthesis model] generates reasonably accurate estimates of forward-looking costs and that the model is the best basis for determining non-rural carriers high-cost support in a competitive environment. [5]

On May 22, 1998, this Commission adopted the HAI Model (release 5.0a) as the platform to establish the Kentucky intrastate high-cost USF. In addition, the model chosen was capable of estimating the costs of selected unbundled network elements. The Commission s choice of the HAI model and input values came only after an extensive process of information requests, testimony, cross-examination, and a lengthy hearing. Since the FCC has issued its Methodology Order and Inputs Order, the Commission s intrastate model now embodies assumptions, algorithms, input values, and data that are outdated. In addition, there are pending requests for rehearing on the issues of trenching cost inputs and appropriate access line count. These requests may be moot as a result of the recent decisions.

Going forward, the Commission is faced with two basic choices: (1) either update the HAI Model and cure input and data deficiencies or (2) adopt the FCC s updated and improved forward-looking model and attendant results. In the Methodology Order, the FCC found that the interstate USF would be implemented January 1, 2000. States receiving federal universal service high-cost support for non-rural carriers within their

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[4] Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs, Fifth Report and Order, CC Docket Nos. 96-45, 97-160, FCC 98-279, released October 28, 1998, (Platform Order).

[5] Inputs Order at paragraph 23 and paragraph 28.

territory are required to certify to the FCC that the support is used in a manner consistent with section 254(e). A new administrative case is established to review comments and make this certification to the FCC.[6]

DISCUSSION AND REQUEST FOR COMMENTS

The Commission herein tentatively proposes several decisions to conclude the establishment of an intrastate USF and requests comments from the parties.

A precise comparison of the results of the HAI Model adopted in the Commission s May 22, 1998 Order and the results of the FCC s synthesis model is not possible, even though there are many similarities. Differences between the two models are in their functional structures. Also, the study area for Contel of Ky. Inc. d/b/a GTE Kentucky has been classified by the FCC as a rural study area and has not been included in its non-rural carriers calculations.[7] The new synthesis model produces a total Kentucky USF requirement of $123 million as compared to $110 million (excluding $21 million for the Contel study area) when disaggregated at the wirecenter level and using a common revenue benchmark. Also there is a potential miscalculation by the synthesis model of Cincinnati Bell study area costs due to an imprecise line count for single line business customers.

The Commission finds that the new platform using default inputs produces reasonable results as an initial starting point for intrastate universal service purposes and reasonable UNE cost estimates. A benefit of adopting the FCC s synthesis model

[6] Administrative Case No. 381, A Certification of the Carriers Receiving Federal Universal Service High-Cost Support.

[7] Common Carrier Bureau Sends List of Rural Telephone Companies to the Universal Service Administrative Company for Purposes of Determining Federal Universal Service High Cost Support beginning July 1, 1999, CC Docket 96-45, DA 98-2642, released December 31, 1998.

is to remain in harmony with the federal methodologies. Using a platform different than that used by the FCC to calculate universal service cost could result in an unequal matching of state and federally designated high-cost wirecenters. Using the federal platform will assure that the state high-cost estimates have a similar methodological basis, though the use of state-specific input values could change a given wirecenter s high-cost estimate. Having similar sets of high-cost wirecenters will also simplify and speed up the process of certifying that federal and state universal service funds are being used in an appropriate manner. All parties are invited to comment upon this finding. Comments regarding this finding should be limited to the models structure and construction. Comments are also invited on the exclusion of data for the Contel study area, and the observed exclusion of single line business lines in the Cincinnati Bell study area.

The model comparison results stated above were based upon a common revenue benchmark. In its Seventh Report and Order, the FCC repudiated its decision to use a revenue benchmark and adopted a cost benchmark approach using national average costs. The Commission requests comments on the use of a national cost benchmark for the Kentucky USF or whether this Commission should develop some other benchmark.

In its Methodology Order and Inputs Order, the FCC stated that although many of its decisions were built around the use of national average state data and inputs, such data may not be appropriate for intrastate use. In a previous Order, this Commission rejected company-specific data and input values in the context of using company specific USF models for discrete company specific territory. The Commission reaffirms those conclusions. The Commission s goal to use a statewide model that will estimate the forward-looking incremental costs that an efficient firm would incur in providing basic local service remains unchanged. To that end, the Commission tentatively concludes that where appropriate, the synthesis model input values should be used. Some model input values must be necessarily geographically specific. However, because the time is limited, the Commission tentatively also concludes that the use of some national average data for input values provides an alternative that will suffice as an initial estimate of state universal service costs and of UNE costs.

All parties are invited to submit comments. Comments regarding these tentative conclusions should be limited to specific inputs and input values. Also, comments regarding specific classes or related groups of inputs should be organized similarly to the FCC s discussion of inputs and input values in Inputs Order. Parties arguing for specific intrastate input values other than default values should submit exact and detailed documentation for the calculation and source of input values, a disk containing the synthesis model with those specific values inserted so that the effect of the requested change can be seen, and specific directions to where in the model the input values were inserted.

Although the numbers are comparable, the Commission is concerned about the size of the Kentucky intrastate universal service fund and its impact on Kentucky ratepayers. Comments are requested on means to minimize the impact of the Kentucky USF on ratepayers. As discussed in the May 22, 1998 Order, final decisions have not been reached on the methodology for collecting the monies for the fund, i.e., flat-rated, usage based, or some combination thereof. The impact on certain classes of consumers of collecting a $123 million USF could be dramatic. For example, depending upon the ability to broaden the collection base, the impact of a simple flat-rated methodology would be approximately $4 to $5 per access line per month. The Commission previously has suggested an even split between methodologies. Another possibility is a percentage additive (usage based) to the consumer s bill. There could also be a flat-rated additive with an additional usage-based component. The Commission requests comment on each methodology, as well as suggestions for other proposals regarding ways to reduce the incidence of rate increases.

Decisions regarding the appropriate distribution of the funds and the restructuring of rates necessary to maintain revenue neutrality have not been finalized. The FCC has moved away from the traditional federal-state separations ratio to a new formula in which 76 percent of costs above the new cost benchmark (135 percent of the national average costs) will be federally supported. It is assumed that the $18 million of new federal funding that Kentucky is scheduled to receive plus the current funding of approximately $1 million must be deducted from current tariffed rates or invested in new facilities. Parties are invited to comment on the procedures that will be necessary to implement the distribution of the Kentucky USF and the changes necessary to maintain revenue neutrality. The Commission s principal priority may be the reduction of the residual non-traffic sensitive revenue requirement.

In the Methodology Order, the FCC ordered the implementation of intrastate high-cost universal service support for non-rural LECs and found that state commissions now can consider deaveraging in concert with the federal high-cost support to be available in the intrastate jurisdiction. States are required to establish different rates for interconnection and UNEs in at least three geographic areas pursuant to C.F.R. 51.507(f). Therefore, the Commission has established a new administrative proceeding for the purpose of developing deaveraged UNE prices.[8]

IT IS HEREBY ORDERED that:

1. By January 14, 2000, parties shall submit comments and suggestions on the tentative proposals herein and other proposals necessary to conclude the establishment of the Kentucky intrastate USF.

2. Implementation of the Kentucky intrastate USF is deferred pending a further Order of the Commission.

Done at Frankfort, Kentucky, this 10th day of December, 1999.

By the Commission

ATTEST:

Executive Director

[8] Administrative Case No. 382, An Inquiry into the Development of Deaverged Rates for Unbundled Network Elements.