REGULATORY REFORM REVIEW COMMISSION

The Regulatory Reform Review Commission is established by North Dakota Century Code (NDCC) Section 49-21-22.1. The commission is established to review the operation and effect of North Dakota telecommunications law on an ongoing basis during the interims between 1995 and 1999. Also, the commission may review the effect of taxation laws on North Dakota telecommunications law during the same time period.

The Regulatory Reform Review Commission was assigned one study, Senate Concurrent Resolution No. 4055 directs the Legislative Council to study the potential for expansion of extended area telecommunications service.

Under NDCC Section 49-21-22.1, the commission consists of one member of the Public Service Commission who has responsibility for telecommunications regulation, two members of the Senate appointed by the President of the Senate, and two members of the House of Representatives appointed by the Speaker of the House. Commission members during the 1997-98 interim were Representatives Mick Grosz (Chairman) and Eliot Glassheim; Senators John M. Andrist and Joel C. Heitkamp; and Public Service Commissioner Bruce Hagen.

The commission submitted this report to the Legislative Council at the biennial meeting of the Council in November 1998. The Council accepted the report for submission to the 56th Legislative Assembly.

NORTH DAKOTA TELECOMMUNICATIONS LAW

Before 1983 telecommunications companies in North Dakota were regulated by the Public Service Commission as traditional public utilities. In 1983 cooperatives and small telephone companies were removed from the ratemaking jurisdiction of the commission. In 1985 the Legislative Assembly revised this exemption to remove local service of cooperatives and small companies from the commission's ratemaking jurisdiction. In 1985 the commission was given authority to deregulate telecommunications services. The commission was required to find that the service, company, or transaction was of limited scope or was subject to effective competition to be deregulated.

There have been several amendments to the telecommunications law since 1989, when major deregulation of the telecommunications industry began.

1989 Senate Bill No. 2320

The Regulatory Reform Review Commission was created in 1989 to review the deregulation of the telecommunications industry resulting from enactment of 1989 Senate Bill No. 2320. The commission originally consisted of the three Public Service Commissioners, two members of the Senate, and two members of the House of Representatives.

Senate Bill No. 2320 exempted telecommunications companies and services from rate or rate of return regulation by the Public Service Commission unless a telecommunications company notified the commission that it wanted to be regulated in this manner. For telecommunications companies with over 50,000 end users, the election not to be exempt from rate or rate of return regulation was a one-time, irrevocable decision. Although the Legislative Assembly exempted essential telecommunications service and nonessential telecommunications service (service that is not included within the definition of essential telecommunications service) from rate or rate of return regulation by the commission, essential telecommunications service is still subject to a price cap based upon the essential telecommunications price factor. Essential telecommunications service includes service that is necessary for switched access to interexchange telecommunications companies and necessary for two-way switched communications for both residential and business service within a local exchange area.

1989-90 Interim and 52nd Legislative Assembly

During the 1989-90 interim, the commission reviewed the Public Service Commission's determination of the essential telecommunications price factor, Minnesota's incentive regulations, and recommendations of interested parties. Even though the commission did not recommend any legislation, in 1991 the Legislative Assembly enacted three main bills that primarily affected Title 49 (no changes were made to the substantive provisions of 1989 Senate Bill No. 2320).

1991 House Bill No. 1556

This bill required telecommunications companies and rural telephone cooperatives offering telephone call identification services to allow a caller to withhold display of the caller's telephone number from the person receiving the telephone call placed by the caller.

1991 House Bill No. 1095

This bill required a person who makes telephones available to the public for intrastate telephone calls on that person's premises to ensure that the telephones allow the consumer to use access code numbers ("800," "950," or "10XXX 0+") to obtain access to the provider of operator services desired by the consumer, at a charge no greater than that charged for calls placed using the presubscribed provider of operator services.

1991 House Bill No. 1557

This bill required mutual aid telecommunications cooperatives and telecommunications cooperative associations to have the approval of two-thirds of the membership of the cooperative or association to sell a physical plant if the value of the plant is more than five percent of the value of the cooperative or association. In addition, the enabling statute for the commission, NDCC Section 49-21-22, was amended to transfer responsibility for providing staff services for the commission from the Legislative Council to the Public Service Commission.

1991-92 Interim and 53rd Legislative Assembly

The study of telecommunications law by the commission during the 1991-92 interim resulted in two main recommendations incorporated into 1993 Senate Bill No. 2440. The first related to the banking of essential telecommunications price factor changes and the second related to uniform long-distance rates. These recommendations came after the commission reviewed the Public Service Commission's determination of the essential telecommunications price factor and the Public Service Commission's decision that ordered equal access (intraLATA) and unbundling for the purpose of offering service on an equal and open nondiscriminatory basis. In 1993 the Legislative Assembly enacted four bills that primarily affected Title 49.

1993 Senate Bill No. 2440

This bill changed the definition of "essential telecommunications price factor" for purposes of telecommunications regulation from the annual change in a company's input cost index reduced by 50 percent of that company's productivity incentive adjustment to a factor determined annually which is the lower of 41.6667 percent of the percentage change of the average annual gross national product price index or the percentage change of the average annual gross national product price index minus 2.75 percentage points for group I telecommunications companies or a factor determined annually which is the lower of 52.0834 percent of the percentage change of the average annual gross national product price index or the percentage change of the average annual gross national product price index minus 2.0625 percentage points for group II telecommunications companies. Group I telecommunications companies are those companies with over 50,000 subscribers and group II telecommunications companies are companies with 50,000 or fewer subscribers. The bill also revised the distinction between essential telecommunications services that are regulated or subject to the essential telecommunications price factor cap and nonessential services that are not subject to the essential telecommunications price factor cap. The bill also revised the definition of telecommunications services that are not subject to the telecommunications deregulation law, such as coinless or coin-operated public or semipublic telephone terminal equipment and the use of such equipment, inside wire and premise cable installation and maintenance, and directory services that are not essential, such as "yellow pages" advertising and boldface or color listings in "white pages."

1993 Senate Bill No. 2317

This bill exempted a public utility operated as a nonprofit, cooperative, or mutual telecommunications company or a

telecommunications company having fewer than 3,000 local exchange subscribers from regulation under NDCC Chapters 49-02 and 49-21. However, these public utilities were still subject to Sections 49-21-01.4, 49-21-08, 49-02-02(7), 49-21-01.2, 49-21-01.3, 49-21-06, 49-21-07, 49-21-09, and 49-21-10 regarding rates, terms, and conditions of access services or connection between facilities and transfer of telecommunications between two or more telecommunications companies.

1993 Senate Bill No. 2385

This bill, effective through July 31, 1999, provided that dialing parity on an intraLATA basis, otherwise known as 1+ intraLATA equal access, may not be required to be provided by any company providing local exchange service. This bill reversed a Public Service Commission ruling that forced U S West to open its "short haul" long-distance markets to other telephone companies.

1993 Senate Bill No. 2393

This bill reduced to one the number of Public Service Commissioners on the commission and required the Legislative Council to provide staff services rather than the Public Service Commission.

1993-94 Interim and 54th Legislative Assembly

The study of telecommunications law by the commission during the 1993-94 interim resulted in the recommendation of two bills Senate Bill Nos. 2078 and 2079. The commission made these recommendations after reviewing federal legislation and reviewing the North Dakota Supreme Court decision *MCI Telecommunications Corp. v. Heitkamp*, 523 N.W.2d 548 (1994). This case related to a challenge of 1993 Senate Bill No. 2385, which provided that dialing parity on an intraLATA basis may not be required to be provided by any company providing local exchange service. The statute withstood challenge on special law and unlawful delegation of legislative authority grounds. The 1995 Legislative Assembly enacted four bills that primarily affected Title 49.

1995 Senate Bill No. 2078

This bill included pay phones within regulation for the purpose of requiring access code numbers to the operator services desired by the consumer.

1995 Senate Bill No. 2079

This bill reestablished the commission until 1999.

1995 House Bill No. 1274

This bill required telecommunications companies to allow callers on a per line basis to withhold display of a caller's telephone number from the telephone instrument of the individual receiving the telephone call placed by the caller. The bill required telecommunications companies to provide this option without charge on a per call basis and without charge on a per line basis to residential customers and business customers with special needs.

1995 House Bill No. 1459

This bill increased the size of a telecommunications company not subject to regulation by the Public Service Commission from a company having fewer than 3,000 local exchange subscribers to a company having fewer than 8,000 local exchange subscribers. As a result of this bill, only the three largest telephone companies are subject to price regulation U S West, Souris River

Telecommunications in Minot, and the North Dakota Telephone Company in Devils Lake.

1995-96 Interim and 55th Legislative Assembly

The study of telecommunications law by the commission during the 1995-96 interim resulted in the recommendation of 1997 House Bill No. 1067. The commission made this recommendation after reviewing the Telecommunications Act of 1996, Public Law 104-104, 110 Stat. 56; and meeting with the Taxation Committee and reviewing the effect of taxation laws on North Dakota telecommunications law. The Act was the first major change to the federal telecommunications law since 1934 (the major change provided by the Act is the opening of local exchange markets to competition). House Bill No. 1067, which failed to pass, was meant to implement the federal Telecommunications Act of 1996. The 1997 Legislative Assembly did not enact any bill that primarily affected Title 49.

Federal Telecommunications Act of 1996

The commission received testimony on the federal Telecommunications Act of 1996. The basic concept behind the Act was to bring the benefits competition had brought to the long-distance market to the local exchange market. The Act allows competition in local exchange markets, and when there is competition, allows the regional Bell operating companies to enter into the interLATA long-distance market.

The Act provides for the development of competitive local exchange markets. There are three avenues for competition with the local exchange carrier: resale, lease or purchase of network elements, or overbuilding. The main rule is that each telecommunications carrier has the duty to allow interconnection. In addition, all local exchange carriers have the duty to offer resale. Each incumbent local exchange carrier has five main duties, which include the duty to negotiate, provide for interconnection at any technically feasible point and of at least equal quality, provide for unbundled access to network elements, provide for resale at wholesale rates, and provide for collocation for the physical location of equipment necessary for interconnection or access to unbundled network elements at the premises of the local exchange carrier. The Act allows states to authorize their public utilities commissions to establish access and interconnection obligations of local exchange carriers.

The Act allows for special protections for rural telephone companies. All local exchange carriers in this state are rural telephone companies, except U S West. The duties of an incumbent local exchange carrier do not apply to a rural telephone company until the company has received a bona fide request for interconnection, services, or network elements, and the state public utilities commission determines that the request is not unduly economically burdensome, is technically feasible, and is consistent with federal universal service. A rural telephone company may petition the state public utilities commission for a suspension or modification of the duties of a local exchange carrier or an incumbent local exchange carrier. The state public utilities commission must grant the petition if the commission determines it is necessary to avoid significant adverse economic impact on users of telecommunications services, to avoid imposing a requirement that is unduly economically burdensome, or to avoid imposing a requirement that is technically infeasible and is inconsistent with the public interest, convenience, and necessity.

The particulars of interconnection between an incumbent local exchange carrier and a competitor may be determined one of three ways: negotiation, mediation, or arbitration. Any interconnection agreement adopted by negotiation must be submitted for approval to the state public utilities commission.

The state commission may mediate or arbitrate an agreement. The Act provides for arbitration standards and procedures. The standard for arbitrating just and reasonable rates for interconnection and just and reasonable rates for network elements for unbundled access must be based upon the cost of providing the interconnection or network element and may include a reasonable profit.

The Act provides for a federal universal service fund. Universal service is the concept that every person should have a telephone. The Act creates a joint board that determines federal universal service support. Under the Act, only eligible telecommunications carriers may receive high-cost area federal universal service funds. An eligible telecommunications carrier is required to offer services that are supported by the federal universal service fund. In addition, the Act provides for discounts for educational providers and libraries.

Under the Act, the state public utilities commission is required to designate a common carrier as an eligible telecommunications carrier for a service area designated by the state commission. The state commission may in the case of an area served by a rural telephone company, and must in the case of all other areas, designate more than one common carrier as an eligible telecommunications carrier for a service area. Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the state public utilities commission is required to find that the designation is in the public

interest.

If no common carrier will provide the universal services, the state public utilities commission with respect to intrastate service must determine which common carrier or carriers are best able to provide the services and is required to order the carrier or carriers to provide the service. The state public utilities commission is required to permit an eligible telecommunications carrier to relinquish its designation if there is more than one eligible telecommunications carrier in the service area.

Under the Act, a Bell operating company may provide interLATA services if the company has filed an approved statement of generally available terms and has met a 14-point competitive checklist. A Bell operating company may file a statement of generally available terms with the state public utilities commission. The state commission may not approve the statement unless the statement complies with the pricing standards for interconnection and network element charges and the duties of interconnection. The Bell operating company may enter the interLATA market if the company is providing access and interconnection pursuant to an agreement with a facilities-based carrier and meets the 14-point competitive checklist.

The commission received testimony on the universal service fund discounts for schools and libraries. The original funding for schools and libraries was set at $2.5 billion. This amount was reduced to $625 million for a trial period of six months. The Federal Communications Commission created a nonprofit organization for the administration of the universal service fund for schools and libraries. The organization is called the Schools and Library Corporation. The federal funds for schools and libraries are distributed on a first-come, first-serve basis. A minimal amount will be reserved for distribution on a need basis. A portion of access charges will be used to pay for connecting schools, libraries, and hospitals with telecommunications technology. State universal service funds will not be required for these purposes. Interexchange carriers may add the extra cost on to customers' bills as a surcharge. The universal service funding for schools and libraries is a telephone tax.

Universal Service and Access

The federal Telecommunications Act of 1996 provides for the creation of a federal universal service fund to provide universal services to rural and high-cost areas. States may adopt their own state universal service fund. The Federal Communications Commission decided the percentage of universal service support provided by the federal mechanism was to be 25 percent of the cost for providing universal service to high-cost areas; however, this decision is not final. Eligible telecommunications carriers in this state will receive the 25 percent split for the portion of the local exchange which is used for interstate service from the federal universal service fund regardless of the formation of a state fund. This would leave 75 percent for the state to fund through a state universal service fund. According to one study, a state surcharge of an estimated 27 percent in addition to the federal surcharge of an estimated 2.7 percent would be required for a state universal service fund. One study indicates an intrastate responsibility on this state's consumers of as much as $62 million. The commission sent a letter to the Federal Communications Commission and the joint board on universal service which requested a higher federal share of universal service costs to be paid by the federal fund.

The Public Service Commission held a hearing to determine the price methodology for universal service, although it will make no finding until the Federal Communications Commission acts. The universal service fund cost hearings were for U S West. If the state selects a model, the Federal Communications Commission requires that the selected model must be used for the state universal service fund, if and when the fund is implemented. Rural carriers may have a different cost methodology applied than what is applied to U S West.

The universal service cost hearing was not for determining costs in the local exchange market. The benchmark is a mark of affordability for a new customer. The $31 benchmark set by the Federal Communications Commission does not deal with the issue of allocation. If the Federal Communications Commission determines that the split for universal service costs should be 75 percent for the state, this state may elect to be responsible for 75 percent of the amount of costs over $31.

The commission received testimony on a state universal service fund. The National Exchange Carrier Association administers seven state programs that are administered similarly to the federal program. The administrative charge for the administration of a universal fund depends on the complexity of the fund. The goal is to keep administrative charges less than one percent. No one has terminated the use of the National Exchange Carrier Association for the administration of a universal service fund after using the administrative services. Some states have developed a state universal service fund after the enactment of the federal Telecommunications Act of 1996 to fund high-cost areas. These states include Idaho, Minnesota, Montana, Nebraska, Oklahoma, Utah, and Washington. Idaho's and Washington's legislation requires a study and a report of recommended legislation. These states differ in how specific their law is in giving the public utilities commission the power to create and administer a state universal service fund. Some states have given great authority to the public utilities commission to create a fund that is directly compatible with the federal fund.

The commission discussed a state universal service fund. It would be difficult to create a state universal service fund without

knowing the portion the state must pay. Enabling legislation for the Public Service Commission to create a fund would give the commission, instead of the Legislative Assembly, power over a major issue. The Public Service Commission has the authority to do everything it needs to do to create a universal service fund, except it does not have the authority to tax.

The universal service fund is an explicit subsidy. In creating a universal service fund, implicit subsidies that are presently providing universal service would need to be removed. Implicit subsidies must be removed if there is going to be competition. If there is competition, a local exchange carrier with implicit subsidies in its prices may be targeted for competition. The competitor will be able to charge less than the incumbent. If the incumbent lowers its prices, it loses any implicit subsidies. The time for the removal of implicit subsidies must be at the same time as the addition of explicit subsidies or there will be a windfall. The universal service fund is meant to replace implicit subsidies with explicit subsidies. It is argued that local service is subsidized by universal service fund payments, rate averaging, higher business rates, access payments, and other federal programs.

Access fees are collected for the service provided by a local exchange provider to an interexchange carrier in connecting toll calls. There was debate as to whether there are any subsidies in access. It was argued that it costs more to begin and terminate a toll call in North Dakota. The commission was informed access fees should not be reduced. The commission was informed access should be based on cost.

After the creation of a universal service fund, there will be a surcharge that will remove the need for an implicit subsidy through access prices. Customers who did not use long distance very often will pay more under universal service than they did with high access.

The commission was informed access charges are central to rural companies so that these companies can recover costs. The commission was informed that the rural telephone cooperatives recommend leaving intrastate access at present levels to accomplish a policy of universal service. The federal universal service support that exists for rurals will not be changed before 2001. If access rates decrease, rural companies will need a supplemental income source. The state can implement programs to provide this through a state universal service fund.

The commission was informed residential rates appear low. This becomes more apparent when one assumes business rates are high and access rates are high. It is unknown whether U S West is charging a below-cost rate for local service because there has not been a recent cost study. It appears that there has been a dramatic reduction in the cost of providing telecommunications services in the last five years. There have not been any recent reductions in rates in U S West's territory.

U S West local service rates are based on a statewide average. If U S West were able to deaverage these rates, they could provide lower prices in the cities to meet competitive pressures. It is important to break down costs over a sufficiently small enough area because if the area is large, there will be substantial implicit subsidies in that area.

Competition

There are three avenues for competition: resale, lease or purchase of network elements, and overbuilding. The first wave of competition comes through resale. The second wave of competition comes through the unbundling of network elements. The third wave of competition comes through facilities-based competition.

Competition will come to a market if it is easy to compete. The commission was informed there needs to be a facilities-based competitor providing a substantial market share before there is true competition. Facilities-based competition requires a substantial investment. The deregulation of the trucking industry worked well because a person could get into the trucking business for $5,000, and a person could get out of the trucking business easily because trucks are easily marketable. These concepts do not apply to telephone companies. If a company builds a facility and it fails, that company cannot recoup its losses easily through selling its facilities.

Rurals

The commission was informed that competition may not work in rural cooperative areas. In rural cooperative areas, for there to be competition, the customers who own a cooperative would have to lease services to another company so that the other company could sell them back to the same customer.

Competition would most likely come from competitors taking large business accounts (cherry picking). If rural companies lost the top five percent of customers, they would lose 22 to 28 percent of revenues. If they lost the top 20 percent of customers, they would lose 80 percent of revenues. A natural monopoly may be the most efficient way to serve areas in which both companies

would fail if there were competition. A natural monopoly requires some controls on price so that service is affordable.

U S West

The commission received testimony on a report from Ostrander Consulting on the level of competition faced by U S West and on what would be sufficient competition for deregulation. The Ostrander report concluded that in this state resale is not competition. At the time of the report there were no facilities-based local exchange competitors in this state. The report concluded that competition must be evaluated on a facility-by-facility basis.

State law allows the Public Service Commission to deregulate U S West. If the Legislative Assembly does not make any legislative changes, the Public Service Commission could still function as to the deregulation of U S West. If U S West were deregulated too early, it would be an unregulated monopoly in the local exchange market. Prices could be increased and customers would have no recourse. There would be no check on pricing by competition or by the Public Service Commission. If prices are artificially low because of subsidies, prices would have to rise for there to be competition. If prices are artificially low, competition will never come to the local exchange telecommunications industry. If U S West is deregulated and if U S West raises prices, competition would be better able to undercut the incumbent and enter the market. AT&T lost one-half of the market share before being completely deregulated by the federal government. Until AT&T lost a sufficient amount of the market share, i.e., there was competition, the other companies offering long distance tracked the prices AT&T offered to the public. Competition was not present until other companies were strong enough to offer something better than AT&T.

The commission was informed other companies are building facilities in U S West territory and cherry picking large business customers. According to a representative of U S West, U S West should be allowed to reciprocate. The federal law does not protect U S West from cherry picking. There is protection in state law for U S West because they can increase rates to meet revenue needs through an application to the Public Service Commission.

New Entrants

The commission received testimony on competition from the wireless industry. The commission was informed it has been two and one-half years since the passage of the federal Telecommunications Act of 1996 and there is no competition in North Dakota. Wireless service could provide competition in rural portions of this state as an eligible telecommunications carrier. Western Wireless is capable of providing service throughout this state. Wireless service could reduce the subsidies needed for universal service because wireless service has a lower cost of service in some areas of the state. This assumes universal service subsidies are based on the most cost-effective provider. The lower cost service is based on a fixed wireless unit at the home of the consumer. The lower cost figures are based upon forward-looking costs. The use of a forward-looking cost model is only an issue if wire line companies have not recovered the cost of their facilities. The recovery for stranded investment is an important issue with the rural cooperatives.

The commission was informed that the Public Service Commission would determine whether to allow Western Wireless to become an eligible toll communications carrier. The Public Service Commission would take into account whether the market can handle two competitors and if consumers will benefit from competition in making this decision. The hearing for Western Wireless to become an eligible telecommunications carrier was on October 29, 1998, and may have been the first hearing of its kind in the nation.

For Western Wireless to become an eligible telecommunications carrier, a service area needs to be defined. The issue in designating a service area is whether the service area should mirror that of the competitor's or be competitively neutral. A wireless company would be required to serve existing dead spots in a service area if designated as a telecommunications carrier for that service area.

Western Wireless receives funding from a state rural improvement fund in Nevada. Western Wireless provides local exchange service in Nevada. The service provided in Nevada is not measured, but flat rate. There is access to the Internet and facsimile transmissions. There is an expanded local calling area.

The primary focus of wireless is on voice transmission. Security is an issue with analog wireless service, but not with digital service. In Nevada, in which wireless universal service is a reality, analog service is provided. The wireless industry is developing the capability to provide high-speed data service. Wireless can transmit data at 9.6 baud. Wireless may go as fast as 56 baud with proper equipment and design. Wireless is designed for mobile application, not high speed. High-speed data transmission would require a new system and spectrum would become an issue if there were heavy use. There is enough spectrum to provide data and voice transmission to every American. A digital voice channel does not need as much spectrum as analog.

Competition by the wireless industry would provide duplication of services and a loss of income for the incumbent rural provider. If there are two eligible telecommunications carriers in an area, both will receive subsidies, but only for their customers. The overall subsidy would remain the same.

The commission received testimony on competition from McLeodUSA. McLeodUSA makes a profit by providing extra services through Centrex. McLeodUSA combines many customers under one Centrex system. McLeodUSA purchases a common block of 20 lines from U S West and uses one Centrex line for five customers. McLeodUSA leases the lines from U S West at retail price. In addition to local service, McLeodUSA offers long-distance service and is working on enhanced services and cable television. McLeodUSA focuses on small businesses. McLeodUSA is the largest customer of U S West.

The commission was informed as to McLeodUSA's business in Bismarck. McLeodUSA will provide services to any residential or business customer in Bismarck. The goal of McLeodUSA is to become a facilities-based carrier in Bismarck as fast as possible. McLeodUSA will continue to build facilities as long as it continues to gain customers. Everyone pays the same basic rates for local service from McLeodUSA; however, a customer may receive other services for a fee.

The commission received testimony on competition from AT&T. The commission was informed AT&T has tried resale and although resale is successful in bringing in customers, AT&T lost money on local exchange resale. For resale to work, the wholesale price needs to be set low enough so there is a large enough profit margin. The commission was informed that even though the Public Service Commission is involved with the setting of the price for resale, the resale prices are not low enough to encourage competition. When competition was imposed on AT&T under the consent decree, there was a required discount of 55 percent. Under the Telecommunications Act of 1996, discounts for local exchange services have been as low as four to eight percent and average around 20 percent in U S West territory. Competition in the long-distance market took 14 years.

The commission was informed U S West has forced into arbitration and taken to court every interconnection agreement. These agreements will expire before they take effect. The regional Bell operating companies have not been penalized for delaying the implementation of the federal Telecommunications Act of 1996.

The commission was informed incremental costs are the correct measure of cost for access because the cost of the local loop is caused by a customer subscribing to a local exchange carrier for local service. The additional service to call outside the exchange area is incremental. The more common telephone call is a local call. If one believes incremental costs are the true costs, then any payment above incremental costs would be a subsidy. The cost for providing access for an intraLATA toll call under total long-run incremental cost determination is quite small. Local exchange carriers charge between 3 and 18 cents for local access. If the rate charge for access is 18 cents, almost 17.6 cents of the cost of local access would be above incremental cost. This number is based upon the incremental cost of access to the switch.

The commission was informed overbuilding requires a workable agreement with the incumbent local exchange company. All forms of competition require cooperation from the incumbent local exchange company. Overbuilding requires the least amount of cooperation; however, it requires the most time and money.

If overbuilding is the only way there may be competition, one way to encourage overbuilding competition would be to allow U S West to raise its rates. If U S West's access rates are above cost and U S West is allowed to raise its prices for local service, then U S West will have a windfall and be allowed to price gouge; however, price gouging by U S West may bring in competition. A viable competitor needs to be better or cheaper. High prices by U S West would allow competitors to be cheaper than U S West.

The commission received testimony on competition from Consolidated Communications Networks, Inc., which plans to provide facilities-based competition in Dickinson and Belfield. By the end of the year, Consolidated Communications Networks, Inc., expects to have approximately seven percent of the Dickinson market. Consolidated Communications Networks, Inc., is an Internet and personal communications service provider. Consolidated Communications Networks, Inc., does most of its business with businesses.

Price Cap

North Dakota is one of the first states to have a price cap instead of rate of return regulation. The price cap is used to regulate a monopoly. According to a representative from U S West, U S West needs to raise residential service rates and de-average pricing. This cannot be accomplished with the continuation of price caps.

In 1993, the price cap X factor was statutorily set at 2.5 percent. The X factor is a replacement for competition in figuring the price cap. According to a study by the Federal Communications Commission, it may need to be raised to approximately 6.5 percent. An error of 3.25 percent will cause an annual error of roughly $1 million per year in local service. The Federal Communications Commission recently performed a study that reported the productivity factor is approximately 6.5 percent

nationwide. To investigate the X factor properly, it would require an extensive review of U S West records.

A study would take approximately six months and cost approximately $50,000 to $70,000. The cost for a study would depend upon the type of study. To find numbers that are reasonably legitimate as they relate to nonregulated services in North Dakota, the Public Service Commission could bootstrap onto the Federal Communications Commission hearings.

Requests for Legislation

The commission received testimony on requests for legislation. McLeodUSA requested that the Legislative Assembly encourage overbuilding with fiber line. U S West requested computer- and data-related services be exempt from regulation; flexibility in raising prices to offset toll and switched access reductions; an extension of the 1+ dialing access law to the year 2000; regulatory parity; establishment of responsibilities of eligible telecommunications carriers; and repeal of certain statutes.

EXTENDED AREA SERVICE STUDY

Extended area service is a service by which a subscriber of one exchange may call a subscriber in another exchange without paying a toll fee or separate charge for the call. Usually the costs of extended area service are spread over the rates paid by all the subscribers in the involved exchange. In addition, once extended area service is implemented, it is typically mandated for all subscribers within an exchange. Alternatives to extended area service include:

1. A uniform calling area. This type of calling plan allows a customer to call within a predetermined mileage radius of the customer's local exchange on a mandatory participation, flat-rate basis.
2. A discounted toll calling plan. This type of calling plan allows a customer for a flat-rate fee to purchase various blocks of time at a certain percentage discount from regular rates for calling exchanges within a reasonable distance of the customer's home exchange.
3. A measured extension to flat-rate local service. This type of calling plan allows a customer to purchase measured service at a lower rate.

In many states, the process for determining extended area service is consumer driven. For example, in Indiana the process begins with a consumer who files a petition, after which a study is completed by the public utility agency to see if there is a sufficient community of interest, after which cost studies are completed by the local exchange carrier and the public utility agency. An election is held and upon approval by a majority of the customers an area of extended service is created.

In this state the process for determining extended area service is telephone company driven. Telephone companies may extend service on their own volition. The Public Service Commission does not have jurisdiction over a nonprofit, cooperative, or mutual telecommunications company or a telecommunications company having fewer than 8,000 local exchange subscribers so as to dictate extended area service. As for other telecommunications companies, the Public Service Commission has jurisdiction over complaints on the terms, conditions, and prices in these companies' price schedules. These companies are required to file a new price schedule before the creation of an extended area service that results in a price change.

In 1997 the Legislative Assembly considered, but did not pass, Senate Bill No. 2395. This bill would have given the Public Service Commission the power to create local calling areas that include Bismarck, Devils Lake, Dickinson, Fargo, Jamestown, Minot, or Williston. The Public Service Commission was to determine the boundaries of the calling areas after hearings in at least four different regions of this state and after considering the community of interest to be served.

The commission received testimony on extended area service. There are no Public Service Commission rules for extended area service. There are numerous extended area service routes in this state and there have been many proposals to expand extended area service. There are many issues that make expansion difficult. The development of extended area service has been a matter of public pressure. Historically, extended area service was adopted, after a poll of telecommunications customers, if that poll resulted in a two-thirds vote for extended area service. The development of the existing extended area service routes may have happened 30-50 years ago and may not match the current community of interest standards.

The newest extended area service route is between Minot and the Minot Air Force Base. A flat rate was offered to the Minot Air Force Base for calls made to Minot. This option was not popular because customers wanted to call "free." Extended area service to and from the Minot Air Force Base did not result in an increase in the number of telephone calls; however, the time per call has increased. The increased time has required some increase in capacity.

Under extended area service, a minority of customers make the majority of calls. Extended area service produces a change in the revenue stream, i.e., it shifts economic burdens. Extended area service would reduce access income for local exchange carriers. Extended area service affects interexchange carriers because they have less business. Extended area service also affects competition.

Measured service is an alternative to extended area service; however, measured service requires the addition of special computers to measure the cost and provide switching capability.

Conclusion

The commission makes no recommendation concerning extended area service.

Recommendation

The commission recommends House Bill No. 1050 to extend the duration of the Regulatory Reform Review Commission to the year 2003. Because of ongoing changes at the federal level, the commission will meet after the biennial meeting of the Legislative Council in November 1998 to consider a state universal service fund, if final decisions are made at the federal level.