Prepared by the North Dakota Legislative Council staff for the Regulatory Reform Review Commission
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# REGULATORY REFORM REVIEW COMMISSION - BACKGROUND MEMORANDUM

The Regulatory Reform Review Commission is established by North Dakota Century Code (NDCC) Section 49-21-22.2. The commission is established to review the operation and effect of North Dakota telecommunications law on an ongoing basis during the interims between the 1995 and 2002 legislative sessions. Also, the commission may review the effects of federal universal support mechanisms on telecommunications companies and consumers in this state as well as the preservation and advancement of universal service in this state.

## 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. This authority was removed in 1999 by Senate Bill No. 2420.

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, the 52nd Legislative Assembly (1991) enacted three bills that primarily affected NDCC 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. The 53rd Legislative Assembly (1993) enacted four bills that primarily affected NDCC 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 NDCC 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 federal 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 NDCC Title 49.

## 1997-98 Interim and 56th Legislative Assembly

The study of telecommunications law by the commission during the 1997-98 interim resulted in the recommendation of 1999 House Bill No. 1050, which was a request for further study. The commission was assigned one study, Senate Concurrent Resolution No. 4055. The study directed the Legislative Council to study the potential for expansion of extended area telecommunications service. 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. After studying extended area service and its alternatives, the commission made no recommendation.

In its review of this state's telecommunications law, the commission reviewed the federal Telecommunications Act of 1996 and its effect on universal service, access rates, competition, and this state's price cap. The 56th Legislative Assembly (1999) enacted seven bills that primarily affected NDCC Title 49.

**1999 House Bill No. 1050**

This bill extends the Regulatory Reform Review Commission through 2002 and encourages the study of universal service support mechanisms.

**1999 House Bill No. 1169**

This bill prohibited a change in telecommunications services without authorization from the customer, commonly referred to as "slamming" and "cramming." The bill stated that slamming and cramming are unlawful practices.

**1999 House Bill No. 1450**

This bill provided that a telecommunications company may not be an eligible telecommunications carrier unless the company offers all services supported by federal universal service mechanisms throughout the study area.

**1999 House Bill No. 1451**

The bill prohibited political subdivisions from imposing a fee on a telecommunications company for the use of the political subdivision's right of way other than a fee for management costs. This bill applies retroactively to January 1, 1999.

**1999 Senate Bill No. 2094**

This bill made technical changes in the law that requires a person who makes telephones available to the public or to transient users of that person's premises to provide operator services through access code numbers to the services desired by the consumer at a charge no greater than the charge for using the prescribed provider of operator services.

**1999 Senate Bill No. 2234**

This bill prohibited the Public Service Commission from setting aside any telecommunications price in effect on January 1, 1999, for intrastate switched access service provided by any rural telephone company upon complaint by an interexchange telecommunications company that the price is unreasonably high, except a price for intrastate switched access service in an exchange may be set aside to the extent it is unreasonably high as a consequence of recovery of costs of intrastate switched access service in that exchange from any explicit federal or state mechanisms to preserve and advance universal service; a sale, assignment, or other transfer of ownership or control of that exchange after January 1,

1999; or reduction of prices after January 1, 1999, for any other services provided in that exchange. This bill expires July 31, 2001.

**1999 Senate Bill No. 2420**

This bill allowed a telecommunications company with more than 50,000 subscribers to increase the monthly price of residential service up to $15.50 after July 31, 1999, and up to $18 after June 30, 2000. A telecommunications company increasing prices must submit a report to the Public Service Commission reasonably demonstrating that it reduced the prices of its intrastate intraLATA message toll service and intrastate switched access in an aggregate by an annual amount not less than the annual revenue increase resulting from the service price increases. The commission would have authority to investigate the increase prices and could set aside unfair or unreasonable price increases. An unfair or unreasonable price must be above the price in effect on January 1, 1999, and the average cost for providing residential service must exceed the price resulting from the increase using embedded or forward-looking economic cost methodologies. The bill provided that a local exchange carrier can set residential exchange service prices below the maximum price cap provided it also lowers its interconnection prices at the same time.

In addition, the bill deregulated private line transport service; specifically identified those provisions of the federal Telecommunications Act of 1996 that the commission is authorized to implement and granted the commission authority to adopt rules regarding the Act; attempted to clarify and removed some of the commission's jurisdiction over nonprofit, cooperative, or mutual telecommunications companies and telecommunications companies having fewer than 8,000 local exchange federal subscribers; and provided for several new definitions.

The bill changed the time period required for a company to notify the commission of a change in price of essential services from 60 to 25 days and eliminated the $50 filing fee required when a company files a price change. The bill allowed telecommunications companies to make certain promotional offerings, including special incentives, competitive discounts, and price waivers, and clarified that companies are allowed to recover fees from customers within a particular municipality which are imposed for providing services within that municipality. The bill provided that the commission may not adopt a rule or order regarding the quality of service provided by telecommunications companies unless the rule is applicable to all telecommunications companies providing similar service in the same market area. The bill provided that a telecommunications company may not be required to construct facilities at the request or for the use of another telecommunications company except to the extent required by the federal Act and clarified that if a telecommunications company is required to incur nonreoccurring costs in excess of the normal course of business and for the benefit of another company or a customer, the commission generally must allow the burdened company to recover the cost in advance. The bill prohibited a telecommunications company from discriminating against another company by refusing to provide or delaying access to the company's services or essential facilities, providing access on terms that are less favorable than those the company provides to itself, or by degrading the quality of access or service provided to another company. The bill identified those sections of law which competitive local exchange carriers are required to meet and established the commission's jurisdiction over those telecommunications companies regardless of size. The bill repealed the commission's authority to exempt a company, transaction, or service from complying with state public utility laws.

The bill required a local exchange carrier to provide 1+ dialing parity no later than January 1, 2000, and prohibited the state from requiring it earlier. However, this section of the bill has been superseded by a Federal Communications Commission ruling that 1+ dialing parity must be offered by July 22, 1999. This Federal Communications Commission ruling was in accordance with *AT&T Corp. v. Iowa Utilities Board*, 67 U.S.L.W. 4104 (U.S. 1999). This case held that the Federal Communications Commission has general jurisdiction to implement the federal acts local competition provisions.

## FEDERAL TELECOMMUNICATIONS ACT OF 1996 - EFFECTS ON TELECOMMUNICATIONS

### Competition With Regional Bell Operating Companies

The federal Telecommunications Act of 1996, enacted on February 8, 1996, represented the first major revision of federal telecommunications law in more than 60 years. The primary intent of the law was to open all telecommunications markets to competition by developing fair rules for all participants. 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 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.

One of the interesting ironies of the federal Telecommunications Act of 1996 is that it establishes cooperation as the essential prerequisite to competition. It requires federal and state regulators to cooperate in matters of policy. It requires incumbents to negotiate interconnection agreements, thereby cooperating with their competitors.

Much of the argument as to the agreements needed for competition involves cost. Cost is the basis for a fair price. There are different ways of looking at cost: embedded, incremental, and forward-looking and arguments center on the particular methodology for determining cost and the want of incumbents to recover stranded investment as part of their cost.

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.

During the 1997-98 interim, the Regulatory Reform Review Commission reviewed competition faced by U S West--the Bell operating company in this state. 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.

Until the passage of 1999 Senate Bill No. 2420, state law allowed the Public Service Commission to deregulate U S West or any competitive service, company, or transaction from state regulation. Presently, the Legislative Assembly would need to make legislative changes to deregulate U S West. It is argued if U S West were deregulated too early, it would be an unregulated monopoly in the local exchange market. 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, it would be extremely difficult for competition to come to the local exchange telecommunications industry. It is argued if U S West were deregulated and if U S West raises prices, competition would be better able to undercut the incumbent and enter the market. If overbuilding is the only way there may be effective competition, one way to encourage this competition would be to allow U S West to raise its rates. 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.

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. When competition was imposed on AT&T under the consent decree, there was a required discount of 55 percent. Under the federal 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.

It is assumed that competition will arrive in the telecommunications industry in three waves. 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.

It is argued that there needs to be a facilities-based competitor providing a substantial market share before there is true competition. However, 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.

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

There is an effort to provide competition by McLeod USA in certain markets in this state. McLeod USA uses U S West's lines to compete with U S West. McLeod USA is the largest customer of U S West. McLeod USA makes a profit by leasing lines from U S West at retail price and providing extra services through Centrex. McLeod USA purchases a common block of 20 lines from U S West and uses one Centrex line for five customers. The goal of McLeod USA is to become a facilities-based carrier in certain areas of the state as fast as possible.

Technology may provide competition from nontraditional sources. These sources include wireless, cable, and the Internet. Competition from these sources raises issues of regulatory and tax parity in developing a policy of fair competition.

## Rural Protections From Competition

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 unfeasible and is inconsistent with the public interest, convenience, and necessity.

Traditional competition may not work in rural cooperative areas. For there to be competition in rural cooperative areas, 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 normally requires some controls on price so that service is affordable.

## Universal Service

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.

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 universal service fund is an explicit subsidy meant to replace implicit subsidies. In creating a universal service fund, the implicit subsidies that are presently providing universal service would need to be removed. It is argued that local service is subsidized by universal service fund payments, rate averaging, higher business rates, access payments, and other federal programs. Implicit subsidies must be removed if there is going to be fair 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. As to the effects on the consumer, customers who do not use long distance very often will pay more under an explicit universal service fund than they did with high implicit subsidies access.

**Nonrural Companies**

During the 1997-98 interim, 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 was not made final. Under this decision, eligible telecommunications carriers in this state would have received 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 indicated an intrastate responsibility on this state's consumers of as much as $62 million.

The 75/25 percent split has been dropped in favor of a new mechanism that consists of a two-part methodology that considers both costs of providing support services and the state's ability to support those costs using their own resources. Specifically, the Federal Communications Commission completed development of the cost model that will be used to estimate the large telephone company's forward-looking cost of providing service. The federal cost model is for the purposes of determining federal universal service support and is not appropriate for other purposes, such as determining prices for unbundled network elements. In addition, the Federal Communications Commission adopted a methodology that uses the costs generated by the cost model to calculate the appropriate level of support for nonrural carriers serving high-cost areas. The new forward-looking mechanisms use a single national cost benchmark of 135 percent against which all carrier's forward-looking costs of providing supported services are compared to determine their need for support. If a carrier's forward-looking cost of providing service exceeds 135 percent of the national average cost per line, the new high-cost support mechanism will provide federal support for all intrastate costs that exceed this benchmark. The Federal Communications Commission also adopted a transitional hold harmless measure. During this period, no large telephone company will receive less support under the new high-cost support mechanism than it receives under the existing mechanism.

Cost is an issue in making a universal service fund in addition to being an issue in making interconnection agreements. Cost is used to compare companies and to determine the size needed for a fund. Generally, the difference between cost and an affordability benchmark is the need for a universal service fund. The Public Service Commission held a hearing to determine the price methodology for universal service for U S West and has said it will make no finding until the Federal Communications Commission acts. It appears if the state would have selected a model, the Federal Communications Commission would have required that the selected model must be used for the state universal service fund, if and when the fund is implemented.

This information is useful in pondering universal service for rural companies; however, nonrural carriers in North Dakota do not receive a subsidy nor will they receive a subsidy under the new rules. Thus, it appears these decisions and hearing have no direct effect on this state.

**Rural Companies**

Access charges are central to rural companies so that these companies can recover costs. The rural telephone cooperatives have recommended leaving intrastate access at present levels to accomplish a policy of universal service. The federal universal service support that exists for rural carriers will not be changed before 2001 and most likely not for a couple of years after that date. 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 Rural Task Force was formed by the Federal-State Joint Board on Universal Service to provide recommendations on appropriate high-cost universal service mechanisms and policies for areas served by the nation's more than 1,000 rural telephone carriers and those whose carriers serve in insular areas. Forty percent of the land area in the United States is served by independent rural telephone companies and cooperatives. Companies such as Western Wireless and McLeod USA are also expressing interest in providing competitive service in certain market segments served by rural telephone companies.

The Rural Task Force will deliver recommendations to the joint board in September 2000 which will provide an opinion on the most appropriate high-cost universal service mechanism for rural telephone companies which may include a proxy model similar to what has been adopted for nonrural companies or a modification of that model. The mechanism must provide efficient, predictable, and sufficient support to achieve the goals outlined by Section 254(b) of the

federal Telecommunications Act of 1996, which include quality services at just, reasonable, and affordable rates; access to advanced services; and access in rural areas to services reasonably comparable to those services offered in urban areas. The Rural Task Force will likely include recommendations that will ensure that universal service support provides adequate incentives for both competitors and incumbents to invest in high-cost areas served by rural telephone companies on a competitively neutral basis. In addition, the recommendations will most likely include a discussion of appropriate transition policies.

**Wireless Service Companies**

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. 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 Public Service Commission will determine whether to allow Western Wireless to become an eligible toll communications carrier. The Public Service Commission must consider whether the market can handle two competitors and if consumers will benefit from competition in making this decision. 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 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. No decision has been made by the Public Service Commission as to the eligible telecommunications carrier status of Western Wireless.

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 competitors 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 a measured service but is offered at a flat rate. There is access to the Internet and facsimile transmissions. 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. There is an expanded local calling area.

**State Funds**

The need for a high-cost fund is supported by three assumptions. First, it is assumed that penetration decreases when the cost of dial tone increases. Second, competition will cause rates to move toward costs. As a result, there will be rate restructuring in which more revenue is received from residential customers. In addition, there will be more revenue from rural areas due to geographic deaveraging. Third, it is assumed that federal support for rural services will not be adequate.

There are four reasons why a high-cost fund may not be needed. First, the elasticity of demand for telephone service may not be great. In other words, people may keep their telephones even if prices rise significantly. Second, other programs may be adequate, including Life Line and Link-Up. Third, rate restructuring and deaveraging may not happen. Finally, technology may provide a more cost-effective way to keep a customer connected within a level of affordability.

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 Florida, Idaho, Maine, Minnesota, Montana, Nebraska, Oklahoma, Utah, and Washington.

The issues in creating a state universal service fund include:

1. Funding level and formula.
2. Funding source.
3. Administration.
4. Covered services and companies.
5. Rulemaking and oversight authority.

The states that have a universal service fund mainly differ in how specific their law is in giving the state public utilities commission the power to create and administer the state universal service fund. Some states have given great authority to the state public utilities commission to create a fund that is directly compatible with the federal fund.

A state universal service fund would have to be administered by some entity. 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 service 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.

## CONCLUSION

The commission has a broad directive--to study the operation and effect of North Dakota telecommunications laws. In addition, the enabling statute for the commission requests the study of universal service. The area of telecommunications law is an area that is undergoing tremendous change. Major changes have occurred at the federal level. In the past, the commission has followed federal law changes throughout the interim. This role seems to be as important this interim as it has been in the past, especially considering the Federal Communications Commission's rulemaking as a result of the federal Telecommunications Act of 1996.

The commission may also wish to remain abreast of the level of competition present in this state. The move from monopolies to a free market system is based on having enough competition to keep prices low and technological service current. In the past, the commission has received testimony from representatives of the telecommunications industry on these issues.